



Pre - accession Economic Programme 2014-2016

Macroeconomic Trends,
Public Finances
and Structural reforms

Ministry of finance of the Republic of Macedonia

Skopje, January, 2014



**The 2014 – 2016 Pre-accession Economic Programme has been adopted by the Government of the Republic of Macedonia, on its 182nd Session, held on 27th of January, 2014.*

***Social Partners and the business community have been consulted on the draft document (See Annex 2 for more details).*



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Abbreviations

| | |
|----------|--|
| CA | Customs Administration |
| CAF | Common Assessment Framework |
| CB bills | Central Bank bills |
| CDEPS | Processing of Customs Declarations and Excise Documents |
| CEB | Council of Europe Development Bank |
| CEEPUS | Central European Exchange Program for University Studies |
| CEFTA | Central European Free Trade Association |
| EARM | Employment Agency of the Republic of Macedonia |
| EBRD | European Bank for Reconstruction and Development |
| EC | European Commission |
| EFTA | European Free Trade Association |
| EGAF | European agricultural guarantee fund |
| EIB | European Investment Bank |
| EIOPA | European Insurance and Occupational Pensions Authority |
| ELEM | Macedonian Power Plants |
| ENER | Single electronic registry of regulations |
| ESA | European System of Accounts |
| ESARM | Employment Service Agency of the Republic of Macedonia |
| EU | European Union |
| FDI | Foreign Direct Investments |
| GDP | Gross Domestic Product |
| GFS | Government Finance Statistics |
| GWP | Gross Written Premium |
| HPP | Hydro Power Plants |
| IAIS | International Association of Insurance Supervisors |
| ICT | Information and communication technologies |
| IIP | International investment position |
| IMF | International Monetary Fund |
| IOPS | International Organization of Pension Supervisors |
| IOSCO | International Organization of Securities Commissions |
| IPA | The Instrument for Pre-Accession Assistance |
| IPARD | Instrument for Pre-Accession Assistance for Rural Development |
| IT | Information Technology |
| ISCO | International Standard Classification of Occupations |
| ISO | International Organization for Standardization |
| ISA | Insurance Supervision Agency |
| KfW | Kreditanstalt für Wiederaufbau (Reconstruction Credit Institute) |
| LGU | Local Government Units |
| MAFWE | Ministry of Agriculture, Forestry and Water Economy |
| MAPAS | Agency for Supervision of Fully Funded Pension Insurance |
| MBDP | Macedonian Bank for Development Promotion |
| MEPSO | Electricity Transmission System Operator of Macedonia |
| MISA | Ministry of Information Society and Administration |
| MW | Mega watt |
| NBRM | National Bank of the Republic of Macedonia |
| NCTS | New Computerized Transit System |
| NECC | National Entrepreneurship and Competitiveness Council |
| NGO | Non-governmental Organization |



| | |
|-------|--|
| NQF | National Qualification Framework |
| OECD | Organisation for Economic Co-operation and Development |
| PEP | Pre-accession Economic Programme |
| PSC | Point of single contact |
| p.p. | Percentage Point |
| REER | Real Effective Exchange Rate |
| RIA | Regulatory Impact Assessment |
| SAA | Stabilization and Association Agreement |
| SEC | Macedonian Securities and Exchange Commission |
| SEE | South -eastern Europe |
| SEETO | South East European Transport Observatory |
| SMEs | Small and Medium-Sized Enterprises |
| SSO | State statistical office |
| TAIB | Transition Assistance and Institution Building |
| TARIC | Tariff and Regulation of the Community |
| TARIM | Customs Tariff Database |
| TIDZ | Technological and Industrial Development Zones |
| TFP | Total Factor Productivity |
| USAID | United States Agency for International Development |
| VAT | Value Added Tax |
| VET | Vocational Education and Training |
| WBIF | Western Balkans Investment Framework |



Preface

Respectable,

It is my great honour and pleasure to present the new, eight in a row, Pre-Accession Economic Programme, covering the period 2014-2016. The Programme presents the priorities and economic policies for next year, medium-term macroeconomic and fiscal framework, as well as the agenda of structural reforms. Its goal is to present the activities of the Government of the Republic of Macedonia aimed at realizing the priorities arising from the Accession Partnership of the Republic of Macedonia with the EU, accelerating the economic growth of the country and improving the living standard of citizens.

Macedonian economy in 2013 experienced a strong recovery, being even better than the expectations. In the first 9 months gross domestic product increased by 3.2%. Main driving forces of economic growth in 2013 were certainly the capital investments funded from the Budget of Republic of Macedonia, i.e. the realisation of a large number of infrastructure projects, high level of foreign investments and export of companies operating in the free economic zones, which have already contributed with more than 20% to the export of goods from the Republic of Macedonia. On the basis of such starting position, i.e. the solid basis and the favourable circumstances of Macedonian economy in 2013, there is sound ground for forecasting even higher economic growth in the coming medium-term period. Projections of the Ministry of Finance are that in the period 2014-2016 economic growth will account for 3.8% in average, measured through the gross domestic product. This should be supplemented by the expectation that the realisation of several crucial projects will be started, which will be an additional impetus to the boosting of Macedonian economy, as well as the fact that European economy has finally exited recession.

Reflecting the current economic reality in the Republic of Macedonia, 2014 Budget was adopted, as well as the 2014-2016 Fiscal Strategy, clearly showing continuous fiscal consolidation and deficit reduction. 2014 Budget has been designed to end of providing higher, more intensified economic growth and retaining social stability. More intensified economic growth will be achieved through the planned infrastructure projects, in which the national construction, the industry and many other branches will be engaged and Macedonian economy and enterprises will be strongly supported throughout the year and thus we will together achieve higher economic growth.

By properly conducting the policies, as well as by implementing reforms in all areas, including the regulatory reform and improving the work of institutions, investments may be attracted, Macedonian economy may be boosted, and the technological gap between Macedonia and the European countries can be reduced. Companies investing in the free zones produce goods with high technological value, products already dominating in Macedonian export, such as catalysts and other equipment and other car spare parts for automotive industry. This will continue to be generator of economic growth in the coming medium-term period as well.

Key priority for the next medium-term period remains to be unemployment reduction (especially of youth unemployment) as the most burning problem of Macedonian economy. Although in the last several years there was certain reduction, however, unemployment rate is still high in European context. Thus, we will continue to implement a series of measures on the labour market and in the field of education to the end of enhancing human capital and enabling the unemployed persons to both acquire working experience and participate in different trainings, thus increasing their employability. In addition, further efforts are necessary so as to reduce grey economy and a number of activities in this area are also envisaged.



In the next medium-term period, structural reforms will continue for the purpose of improving business climate and competitiveness of the economy, attracting FDIs, providing favourable credit lines for small- and medium-sized enterprises, enhancing innovation capacity of enterprises and research companies, supporting entrepreneurship through different programmes, increasing productivity of agriculture, reducing the duration of bankruptcy procedures, increasing efficiency of the judiciary and the public administration as service to the citizens and increased support and promotion of export. In addition, economic policy is also aimed at implementing reforms for the purpose of enhancing the supervisory capacities of regulatory bodies in the financial system.

In the period 2014–2016, Government of the Republic of Macedonia will continue with its dedicated work so to create functional, competitive market economy, capable of dealing with the challenges on the road to the European Union, by minimising the adverse effects from the process of real convergence towards the European economy. Government of the Republic of Macedonia will be fully committed to unconditionally maintain both macroeconomic and fiscal stability in the country, to further intensify economic growth and reduce unemployment, as well as to further develop knowledge-based society.

Sincerely yours,
Zoran Stavreski MA
Deputy Prime Minister and
Minister of Finance



PART I General Macroeconomic Framework and Objectives

1.1. General Macroeconomic Framework and Objectives

2014–2016 Pre-Accession Economic Programme (PEP) is prepared in line with the 2011-2015 Programme on Government Operations of the Republic of Macedonia, as well as the other national strategic documents, such as the National Programme for Adoption of the Acquis Communautaire, the Stabilisation and Association Agreement and the national sectoral strategies. PEP is a coherent strategic document, presenting the national economic policy of the Republic of Macedonia. The Programme refers to the achieved economic trends, presenting the projections for the next three years and the key structural reforms, which will be implemented so as to strengthen the quality of the functional market economy, able to cope with the competitive forces following the accession to the EU. In addition, PEP presents the measures and activities the Government of the Republic of Macedonia undertakes for implementing the conclusions from the Ministerial Dialogue held on 9th July 2013 among the Ministers of Finance and Ministers of Economy of the EU member countries and the EU candidate countries.

In line with the priorities of the Government of the Republic of Macedonia, macroeconomic policy will be aimed at realising the strategic commitments to long-term and sustainable economic growth and development of the country, being in line with the EU Strategy for fast, sustainable and comprehensive economic development “Europe2020”, as well as the SEE– 2020 Strategy of the Council for Regional Cooperation, called “Jobs and Prosperity in a European Perspective”, which closely follows the vision of the “Europe 2020” Strategy. Macroeconomic policy, in the coming medium-term period, continues to be focused on retaining the financial and macroeconomic stability and increasing the competitiveness of Macedonian economy on permanent basis, increasing the employment, improving the living standard and quality of life of citizens, improving the business environment, conducting tax and customs policy to the end of supporting the development of economic entities, encouraging the investment activity and attracting Foreign Direct Investments (FDIs), as well as developing both the human capital and the economic infrastructure of the country.

Government of the Republic of Macedonia will continue to conduct prudent fiscal policy for the purpose of preserving macroeconomic stability and encouraging the economic activity, by achieving reasonable and non-distorsive budget deficit rates and low government debt, increasing the quality of public finances, mainly by increasing the capital expenditures for improving the infrastructure and the physical capital, thereby taking into account the government debt sustainability and preserving stable Denar exchange rate.

Monetary policy, as so far, will be aimed at preserving the price stability through the strategy of targeting the nominal Denar exchange rate to the Euro, to the end of achieving most favourable macroeconomic climate for sustainable economic development on the long run.

Government of the Republic of Macedonia in the period 2014-2016 as well remains dedicated to implementing the agenda of structural reforms in all areas of economic living, being a step forward in completing the processes of transition and accession to the EU, i.e. carrying out the model of economic growth, based upon competitive economy, providing for equal opportunities for all people. Such model, taking into account the particularities of the Macedonian economy, is based on the EU Strategy for fast, sustainable and inclusive economic growth, known as “Europe 2020” Strategy.

Taking into account the identified challenges to the economic policy, key areas in the structural reform agenda for the period 2014–2016 are the following: reduction of unemployment and improvement of the conditions on the labour market, continuous business climate



improvement, support to innovation, entrepreneurship and small-and medium-sized enterprises (SMEs), enhancement of human capital, as well as greater support and export promotion. In addition, economic policy is focused on implementing reforms in order to create effective and professional public administration, strengthening legal security and executing the contracts, strengthening supervisory capacities of regulatory bodies in the financial system, as well as increasing productivity in agriculture.

PEP 2014-2016 is comprised of four main parts. The first part analyses recent macroeconomic developments and presents medium-term macroeconomic scenario for the period 2014-2016, the second one presents policies for public finance management in the Republic of Macedonia, including analyses and medium-term projections of the Budget of the Republic of Macedonia and public debt management. This part also includes institutional features of public finances. The third part shows the reform agenda and the reform priorities for the next three years. The fourth part presents notification of the measures and activities undertaken for implementing the conclusions from the Ministerial Dialogue held on 9th July 2013 among the Ministers of Finance and Ministers of Economy of the EU member countries and the EU candidate countries.



Part II Macroeconomic trends

2.1. Economic overview

2.1.1. Recent macroeconomic trends

International economic environment. Last data on the trends of the growth rate of the global output show that it moves with slowed down pace, in conditions of further existence of the downward risks. Global growth rate is expected to account for 3.2% in 2013, being insignificant reduction compared to 2012, when it amounted to 3.3%. Growth rate for the developing economies remains to be higher compared to the developed countries, however, it is below the realised high growth rates in the past years in these countries, as a result of cyclical and structural reasons. As opposed to the trend in the past years, when the developing countries were the main driver of global growth, in the first three quarters of 2013, the contribution to growth of the developed economies is especially significant, experiencing upward trend.

Fiscal tightening and uncertainty related to the issue for the USA debt ceiling reflects in uncertainty for the future measures of the monetary policy of the USA. This causes instability of the international financial markets, increase of the capital price and lower outflows of capital to the growing markets, contributing to reduction of the prospects for intensified growth in the developing countries and the emerging economies.

Table 2.1. International economic environment – selected macroeconomic indicators (in %)*

| | 2011 | 2012 | 2013f | 2014f | 2015f |
|---|------|------|-------|-------|-------|
| GDP growth | | | | | |
| World | 4.8 | 3.3 | 3.2 | 3.9 | 4.3 |
| EU | 1.7 | -0.4 | 0.0 | 1.4 | 1.9 |
| Euro zone | 1.6 | -0.7 | -0.4 | 1.1 | 1.7 |
| USA | 1.8 | 2.8 | 1.6 | 2.6 | 3.1 |
| Developing countries and emerging economies | 6.2 | 4.9 | 4.5 | 5.0 | 5.3 |
| Unemployment rate | | | | | |
| EU | 9.7 | 10.5 | 11.1 | 11.0 | 10.7 |
| Euro zone | 10.1 | 11.4 | 12.2 | 12.2 | 11.8 |
| USA | 8.9 | 8.1 | 7.5 | 6.9 | 6.5 |
| Inflation | | | | | |
| EU | 3.1 | 2.6 | 1.7 | 1.6 | 1.6 |
| Euro zone | 2.7 | 2.5 | 1.5 | 1.5 | 1.4 |
| USA | 3.2 | 2.1 | 1.5 | 1.9 | 2.1 |
| Oil prices (EUR) | | | | | |
| | 79.7 | 87.0 | 82.0 | 78.0 | 73.4 |

Source: European Commission, European Economic Forecast, November 2013 *f- forecast

*EC Autumn Report does not include projections for 2016.

Following the recession registered in 2012, in 2013, first signs of recovery in the EU were observed, whereby in the second quarter, the EU countries experienced growth of 0.4% and 0.2% in the third quarter, being the first positive performance after a period of six subsequent quarters in which the EU experienced a GDP decline. In line with the last projections of the European Commission (EC), growth of GDP is expected to intensify in the next two years and to be driven by domestic demand. Foreign demand is expected to intensify in the next quarters, however, not with the same intensity which was previously envisaged, mainly because of the weakened prospects for growth of the fast-growing economies and the euro appreciation. Consequences from the crisis will continue to affect the growth, however, it is expected for this influence to gradually decline in the coming years. Thus, GDP growth rate for 2013 is expected to



amount to 0% in the EU, and in the Euro zone it will decrease by 0.4%. In 2014 and 2015 already, gradual acceleration of growth and achievement of positive growth rates is envisaged.

In 2013, continuation of the upward trend of inflation in the EU is projected mainly as a result of the reduced domestic demand. Under the assumption of slow decline of the prices of oil and unchanged exchange rate, during 2014 and 2015, it is also expected for the inflation rate to continue to decrease. Effect from the low economic activity in the past period is transferred on the labour market, thus the unemployment rate in the EU in 2013 is expected to increase to 11.1%. However, the projections are that the expected acceleration of the activity in the next period will be also reflected on the job creation, due to which, certain reduction of the unemployment rate to 10.7% in 2015 is expected.

Following the intensified efforts for fiscal consolidation in 2011 and 2012, the fiscal consolidation measures will slowly be reduced in the next period. Budget deficit at the level of the EU is expected to reduce by 0.4 p.p. to 3.5% in 2013, while in 2014 already, it is expected to account for 2.7%. Government debt is expected to continue to increase, reaching its peak in 2014, i.e. around 90% of GDP in the EU Member States and 96% in the Euro zone.

Recent Economic Trends in the Republic of Macedonia. Macedonian economy in 2012 started to experience gradual economic recovery, in particular in the second half of the year, when positive growth rate was realized. High growth rate of gross investments of 20% contributed to minimum GDP drop of 0.4% in 2012, at the same time creating basis for enhancing the competitiveness of the economy in the next period.

Table 2.2. GDP growth rates (production and expenditure methods)

| | 2012 | 2012 | | | | 2013 | | | |
|----------------------------------|------|-------|------|------|-------|-------|------|-------|---------|
| | | I | II | III | IV | I | II | III | Average |
| GDP | -0.4 | -1.1 | -1.5 | 0.8 | 0.0 | 2.6 | 3.5 | 3.3 | 3.2 |
| GDP by production method | | | | | | | | | |
| Agriculture | -6.2 | -7.1 | -7.0 | 0.0 | -10.1 | -3.1 | -0.4 | 1.1 | -0.5 |
| Industry | 2.8 | -5.0 | 2.6 | 5.6 | 7.8 | 9.1 | 7.0 | 1.7 | 5.8 |
| Construction | 4.8 | -11.7 | -5.7 | 16.5 | 11.3 | 37.3 | 33.7 | 30.5 | 33.0 |
| Services | -0.7 | 1.3 | -1.3 | -0.8 | -1.7 | 0.4 | 1.1 | 2.1 | 1.2 |
| GDP by expenditure method | | | | | | | | | |
| Final consumption | -2.7 | -2.4 | -3.1 | -3.3 | -1.9 | 5.1 | 4.9 | 0.4 | 3.4 |
| <i>Private</i> | -3.0 | -2.7 | -2.7 | -3.9 | -2.6 | 7.0 | 7.1 | 1.6 | 5.2 |
| <i>Public</i> | -1.4 | -1.1 | -4.7 | -0.6 | 0.8 | -2.2 | -4.3 | -4.4 | -3.6 |
| Gross capital formation | 20.0 | 4.8 | 39.1 | 28.0 | 12.7 | -23.2 | -6.5 | -16.4 | -14.9 |
| Export of goods and services | 0.0 | 0.2 | 0.7 | -1.3 | 0.6 | -3.0 | 2.5 | 8.8 | 2.9 |
| Import of goods and services | 4.2 | -0.3 | 9.5 | 3.9 | 3.8 | -4.9 | 1.6 | -4.7 | -2.6 |

Source: State Statistical Office and calculations of Ministry of Finance

Positive trends continued in 2013 with higher intensity, whereby GDP surged by 2.6% in the first quarter, while the increase was more intensified in the second quarter, accounting for 3.5%, while in the third quarter of 2013, growth of 3.3% was achieved. Average growth in the first three quarters of the year amounted to 3.2% (see Table 2.2), being the third best performance in relation to the countries in the region and the EU. Taking into account the performance in the first three quarters of 2013, as well as expectations for the fourth, it is expected for the GDP growth rate in 2013 to be 3.3% and exceed the first projection of 2% envisaged in the last year's PEP.

Analysed according to the expenditure side of GDP, in the first nine months of 2013, the growth was driven by the private consumption and the export of goods and services. In this period, private consumption experienced real growth rate of 5.2%. Increase in export in this period



accounted for around 3%, being partially a result of the recovery of European economy, as well as the increased export potential of the country. Import of goods and services, on the other hand, decreased by 2.6%. Gross investments in the analysed period dropped by 14.9%, while the decrease of public consumption accounted for 3.6%.

Analysed according to the GDP production side, in the first nine months of 2013, positive growth was observed in several sectors. Construction sector contributed the most to the total economic growth, where high activity growth of 33% was recorded, reflecting the significantly more favourable assessment for the economic situation of the business entities in line with the business tendencies in the construction. Industry also significantly contributed to the economic growth in this period, achieving 5.8% real growth rate. Industry growth was a result of the increased production of capital goods, energy and consumer goods. Thereby, growth in the processing industry, mainly the growth of the production of clothing, beverages, furniture, machines and devices, equipment and similar contributed to higher value added of industrial production. In the first three quarters in 2013, services sector experienced average growth of 1.2%, while agriculture registered low negative growth of 0.5%

External sector. In 2012, the developments in the balance of payments' current account were affected by the crisis, which reflected in reduced foreign demand, uncertainty and lower economic activity. In 2012, a deficit on the balance of payments' current account of 3% of GDP was registered. Analyzed by components, the higher deficit in trade of goods and income, as well as the lower surplus in the trade of services, were largely neutralized by higher net inflows from current transfers (by 1.8 p.p. of GDP), partly due to the uncertainty related to the crisis in the euro area, as well as to the positive effects of non-residents in the domestic economy, which reflected in increased supply of foreign currency on the currency exchange market. In 2012, net inflows of 4.2% of GDP were registered on the capital and financial account, of which the FDI amounted to 1% of GDP, and long-term loans 0.9% of GDP. The global uncertainty and risks related to the crisis in 2012 led to lower inflows of FDI compared to previous years, as well as capital outflows to foreign shareholders in form of intercompany debt. At the end of 2012, the gross foreign reserves totaled Euro 2,194 million, which is an increase of 6% compared to the end of 2011.

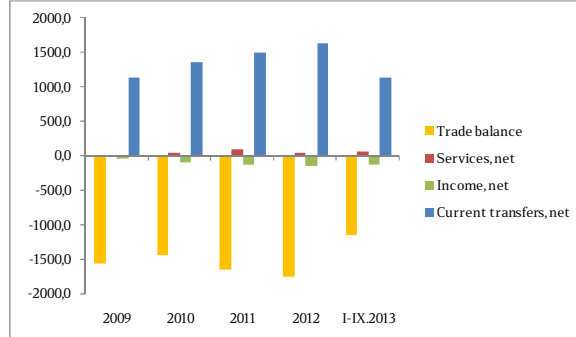
In January - September 2013, the cumulative deficit on the balance of payments' current account equals Euro 90.6 million, which is by 13.9% (by Euro 15 million) less compared to the same period of the previous year. However, both of the most significant current account components registered adverse movements compared to the previous year. Namely, the narrowing of the current account deficit is mainly conditioned by the smaller deficit in the trade of goods (by Euro 94 million), mainly as a result of the improved energy trade balance. The favorable developments with the trade balance and slightly higher surplus with services have neutralized the effects of the reduced net inflows from current transfers and the higher deficit with the income sub-balance. The lower net inflows based on current transfers primarily is a reflection of the reduced net inflows in cash within the net inflows from the currency exchange operations (by Euro 71 million), in conditions of higher comparison base, i.e. gradual exhaustion of the factors that caused their solid increase in the previous year.

In the first nine months of 2013, the largest contribution in the inflows on the capital and financial account came from the net inflows based on government borrowings abroad and FDI. Namely, within January - September 2013 period, the FDI amount to Euro 184 million, which is more than double higher than their level in entire 2012. Within the FDI, the share of the equity and the reinvested gain from one hand, and the intercompany debt from another, was almost equal. At the end of September 2013, the gross foreign reserves totaled Euro 2,065 million, which



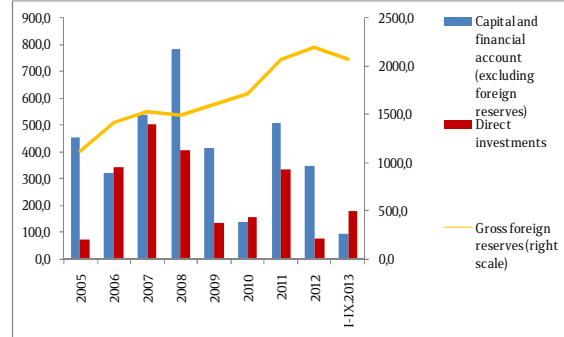
is a decrease of 5.9% in comparison with the end of 2012, mainly due to the price and value changes (especially with the gold). The foreign reserves are maintained at adequate level, ensuring average four-month coverage of the import of goods and services of the following year.

Chart 2.1. Current account components (Euro million)



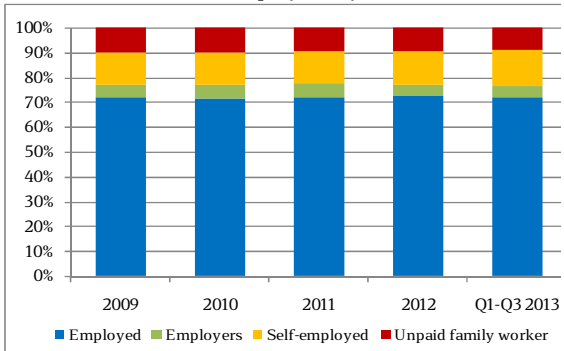
Source: NBRM

Chart 2.2. Capital inflows and foreign reserves (Euro million)



Labour market. Economic policy of the Government of the Republic of Macedonia and the continuous implementation of reforms focused mainly on improving the conditions on the labour market resulted in job creation and gradual increase of the number of employees in the past several years.¹ In 2012, positive trends were recorded on the labour market. According to the Labour Force Survey, number of employed persons in 2012 was higher by 0.8% compared to the previous year. Employment increase was accompanied by the decrease of the number of unemployed persons by 0.8%, while total labour force was higher by 0.3%. As a result of these positive trends on the labour market, employment rate increased to 39%, while unemployment rate reduced to 31%.

Chart 2.3 Structure of employees by economic status



Source: SSO

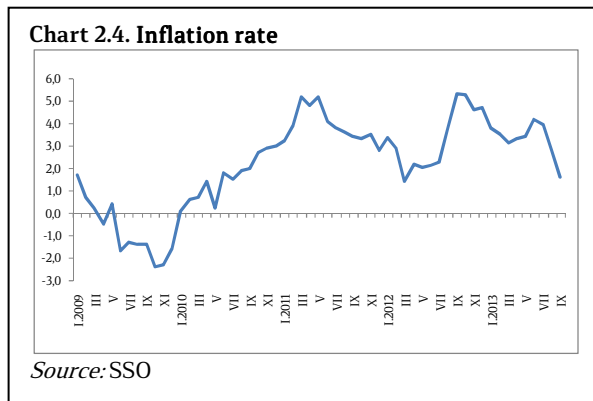
In 2013, the conditions on the labour market were positive. According to the Labour Force Survey, number of unemployed persons in the first three quarters in 2013 was lower by 5.2% on annual basis. These trends caused for the unemployment rate in Q3 2013 to reduce to 28.7%, i.e. by 1.9 p.p. compared to last year. Number of employed persons in the first three quarters of 2013 was higher by 4.4% compared to the same period last year, which contributed for the employment rate in Q3 2013 to account for 40.8%. Positive trends on the labour market corresponded to the accelerated economic activity in the same period, as well as to the measures and the activities the Government of the Republic of Macedonia continuously implements for reduction of unemployment, as well as the inflow of FDIs and the new capacities in the technological and industrial development zones (TIDZ), which absorbed new labour force.

In 2012, average net salary surged by 0.3% in nominal terms and dropped by 2.9% in real terms, while gross salary registered lower nominal, i.e. real growth rate of 0.2%, i.e. -3.0% respectively. In the first nine months of 2013, average net and gross salary grew by 1.3% in nominal terms, while as a result of the inflation in the analysed period, they realized negative real growth of 1.9%.

¹ This was recently acknowledged in the World Bank Report "Back to Work – Growing with Jobs in Europe and Central Asia" where it is indicated that in crisis situation, when the countries face unemployment increase, Republic of Macedonia is one of the few countries that manages to create jobs.



Inflation. The average annual inflation in 2012 equaled 3.3% (compared to 3.9% in 2011). In terms of components, the most significant contribution to the average inflation accounted to housing prices (contributing by 1.2 p.p.) due to the effect of increase in the prices of electricity and

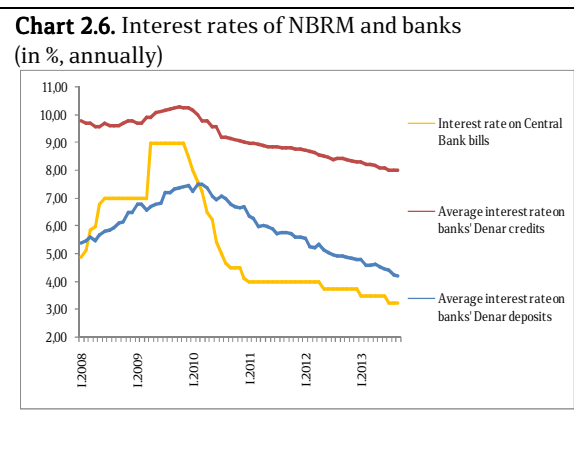
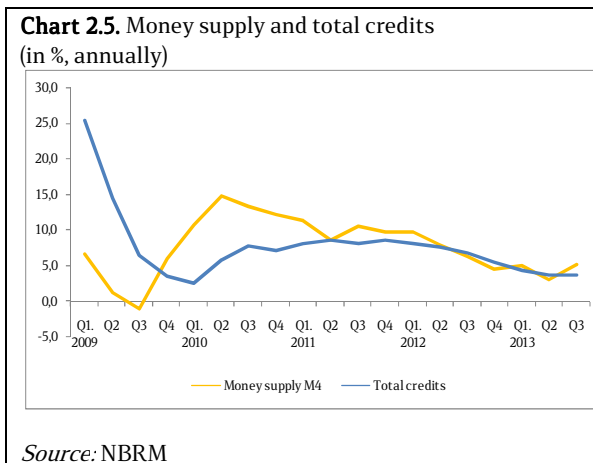


heating energy, and food prices (1 p.p.). Given the decelerated economic activity and deepened negative output gap, no pressures on the inflation through the demand channel were registered.

The average annual inflation in the January - September 2013 period equals 3.3%. The annual inflation rates in the first quarter of 2013 were downwards, in the second quarter of the year they accelerated moderately mainly influenced by the rising food prices, and in the

third quarter, they slowed again influenced by energy prices. Analyzed in terms of components, the food prices had the most significant contribution to the average inflation (contributing by 1.7 p.p.). Additional significant contributors are as follows: prices of clothing and footwear (0.5 p.p.), hygiene and health (0.4 p.p.) and housing prices (0.3 p.p.).

Monetary developments and exchange rate. The changes in the monetary policy in 2012 were towards its easing. In terms of slower economic activity, both the money supply and credits registered moderate increase. The annual growth in broad money M4 in December 2012 equaled 4.4%. At the end of 2012, the total deposits were higher by 4.9% on annual basis, given the increase in the Denar deposits (11.5%) and decrease in the foreign currency deposits (2.1%). In 2012, the bank loans registered moderate annual growth of 5.4%.



Generally, the environment for monetary policy implementation in the first three quarters of 2013 can be assessed as favorable, so accomodative monetary policy setup continued. The annual growth in broad money M4 accelerated and in September 2013 it equaled 5.1%. In September 2013, the total deposits of the domestic non-financial sector increased by 6.4%, annually, with faster growth in the Denar deposits (10.6%), compared to the slight rise in the foreign currency deposits (1.5%). The average share of the foreign currency deposits in the total deposits in the crisis period fell, and from about 55% in mid-2009 it reduced to about 44% in September 2013 (as it was in the pre - crisis period of late 2007). This change in the currency preferences of the entities is largely determined by the uncertainty regarding the crisis in the euro area, as well as the higher yields of the Denar instruments. By sectors, the total household deposits increased by 6.6%, while corporate deposits increased by 4.3%.

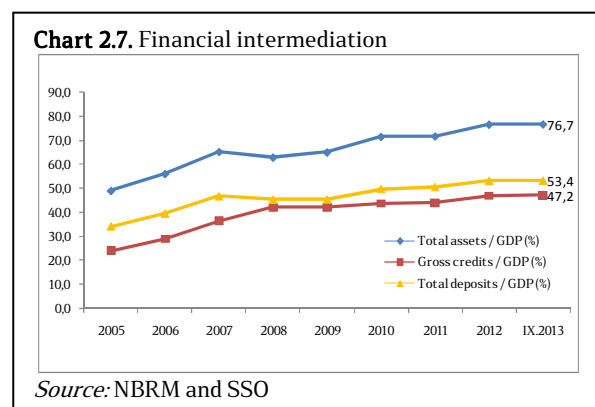


At the end of September 2013, the bank loans with the domestic non-financial sector registered moderate increase of 3.7%. However, their pace has been decelerating since the beginning of the year due to the banks' risk perceptions and the uncertain global environment, the moderate rise in the credit risk in the first half of the year, as well as the potential effects of the possible deleveraging process of the foreign parent banks. The credit-to-deposit ratio is maintained about 90%, on average, which indicates a room for a higher credit activity. Observed from currency aspect, the credit growth is fully due to the increase in the Denar loans (5.6%), while the foreign currency loans register a decrease (2%). Such developments in the loans' currency structure are due to the changes on the liabilities side which are led by the risen Denar deposits. From sectoral aspect, in the first nine months of 2013 the credits to the households have a dominant contribution of 86% to the growth of total credits to the private sector. The anticipated economic recovery and stabilized environment should stabilize the expectations of the banks and other financial entities, which together with the eased monetary setup would ensure larger financial support to the domestic economy through the banks.

The interest rates in the banking sector has followed the changes of the main policy rate and registered a moderate decrease. The interest rate on the total Denar loans has fallen from 8.3% in December 2012 to 8.0% in September 2013. At the same time, the average deposit interest rate fell from 4.8% in December 2012 to 4.2% in September 2013. Having in mind the larger decrease in the deposit interest rate, the interest rate spread increased to 3.8 p.p. In December 2012, the interest rates on foreign currency loans and foreign currency deposits amounted to 6.8% and 2.1%, and in September 2013 they decreased to 6.5% and 1.7%, respectively.

2.1.2 Latest developments in the financial sector

Banking system. The banks have a dominant role within the entire financial system, accounting for about 90% of the total assets. The banking system has maintained its stability and soundness, maintaining high and stable liquidity and solvency. As of September 2013, the banking system of the Republic of Macedonia is composed of 16 banks. In the ownership structure the foreign capital prevails, mostly from the EU countries. Thirteen banks are predominantly in foreign ownership, seven of which are subsidiaries of foreign banks. At the end of September 2013, the total assets registered annual growth of 7%, which represents a growth acceleration. In recent years, the share of the activities of the Macedonian banking system to GDP is mounting gradually.



The credit risk is still the most important risk for the banks in the Republic of Macedonia. However, in 2013, the growth of non-performing loans to non-financial entities slowed, with the annual growth rate at the end of September amounting to 12.9% (which is at the growth level in 2011). The slower growth of the non-performing loans allows lowering their share in the total loans compared to the previous two quarters, which at the end of September 2013 equals 11.8%. The changes in

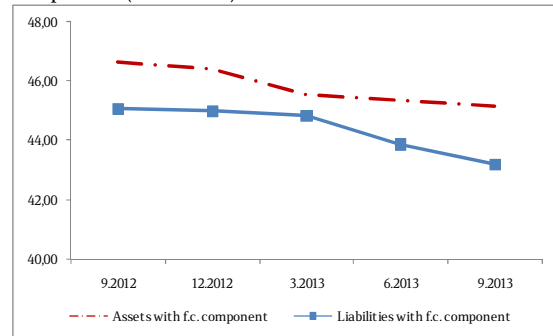
non-performing loans mainly derive from the corporate sector, and accordingly, their growth deceleration in the third quarter of the year came from the corporate sector, which can be explained by the positive developments in the domestic economy in recent quarters, and primarily the stronger growth of economic activity in the first and second quarter of 2013. The expectations that the economy will maintain in the zone of solid annual growth gives ground to



assume that further growth acceleration of the non-performing loans in the corporate sector is substantially exhausted, having in mind also the bank support to some borrowers in this sector, to facilitate the credit load, in accordance with their current difficult financial situation. The coverage of non-performing loans with the total impairment is high and is nearly 105%.

The total debt of the corporate sector at the end of 2012 accounted for 64% of GDP and registered annual growth of 7%. In terms of structure, more than half (55%) refers to debt to non-residents, about 43% are a debt to domestic banks and the remaining 2% are debt to leasing companies². However, as for the corporate external borrowings, their external claims mainly to the parent companies, should also be taken into consideration. In 2012, the liabilities of the companies to non-residents rose by 9.3%, but the net debt increased by 3.8%. The "households" sector is generally characterized by low level of indebtedness, which in 2012 accounted for 19.3% of GDP and registered an annual growth of 5.4%. The largest portion (94%) of the debt refers to the banking sector, and the remaining share relates to other domestic financial institutions. The banks' better perceptions of the risks in this sector resulted in improved credit conditions and lower credit growth deceleration, and over 2013 the quality of the credit portfolio to this sector is unchanged on an annual basis.

Chart 2.8. Assets and liabilities with foreign currency component (share in %)



Source: NBRM

Table 2.3. Basic bank risks indicators

| | | 2010Q4 | 2011Q4 | 2012Q4 | 2013Q3 |
|-----------------------------------|--|--------|--------|--------|--------|
| Capital adequacy | | | | | |
| | Capital adequacy ratio | 16.1 | 16.8 | 17.1 | 17.3 |
| Asset quality * | | | | | |
| | NPLs / gross loans | 9.3 | 9.9 | 10.5 | 11.8 |
| | Total provisions to Non-Performing Loans | 101.2 | 102.2 | 107.5 | 104.9 |
| Earnings and profitability | | | | | |
| | ROAA | 0.8 | 0.4 | 0.4 | 0.4 |
| | ROAE | 7.3 | 3.4 | 3.8 | 3.9 |
| | Interest margin/gross income | 61.8 | 60.0 | 60.7 | 63.3 |
| | Noninterest expenses/gross income | 68.2 | 69.7 | 65.3 | 62.1 |
| Liquidity ** | | | | | |
| | Liquid assets/total assets | 30.9 | 31.2 | 32.4 | 32.2 |
| | Liquid assets to total short-term liabilities (contractual maturity) | 46.9 | 48.9 | 53.0 | 55.9 |
| | Liquid assets to short-term liabilities (residual maturity) | 41.2 | 42.4 | 44.7 | 45.6 |
| Sensitivity to market risk | | | | | |
| | Net open foreign exchange position / own funds | 18.9 | 21.3 | 11.4 | 16.1 |

Source: NBRM

* Indicators for non-financial sector.

** NBRM methodology for liquid assets.

In the first nine months of 2013, the banking system showed profit almost twice higher than in the same period of the last year. At the end-September, 2013, the return on assets and equity amounted to 0.4% and 3.9%, respectively. The operational efficiency of the banking system improved, followed by reduction of the cost-to-income ratio, which equaled 59.8% at the end-September, 2013 and it is lower by 5.4 p.p. compared to the same period of 2012.

The banks maintain high liquidity, observed primarily through the volume of liquid assets, which covers much of the household deposits (or 61% at the end-September, 2013) and banks'

² Latest available data.



short-term liabilities (or 55.9% at the end-September, 2013). The stress tests show that the banking system is resistant to simulated liquidity shocks.

The solvency of the banking system is high and stable. The capital adequacy ratio at the end of September 2013 equals 17.3% and the Tier 1 ratio amounts to 14.6%. The recently adopted amendments to the regulations pertaining to the foreclosed assets based on uncollected claims and credit risk management, will further strengthen the banks capitalization, through the request the released impairment for the "collected" loans through foreclosure and eventually, the released impairment for credit risk due to regulatory changes, not to show as income (which can be paid as dividends), but to be used for amplifying the banks' capital, which in turn will create additional room for lending. The leverage ratio, calculated as the ratio between the sum of capital and reserves and the sum of the balance and off-balance sheet assets equals 9.8%. The banking system is resistant to shocks, which has been proven by the performed stress testing.

Capital market. During the period of January-September 2013, the Macedonian Securities and Exchange Commission (MSEC) issued 5 approvals for issuance of securities through private placement with total amount of Denar 111.4 million or around Euro 1.8 million. In the same period, MSEC approved 2 sells of own shares.

In the period of January-September 2013, the total turnover on the Macedonian Stock Exchange was Denar 2,174.3 million or around Euro 35.3 million.

Due to the amendments of the Law on Securities, which introduces mandatory listing of the companies that are not listed and that have basic capital of more than 1 million euro and more than 50 shareholders, the number of listed companies on the Macedonian Stock Exchange at the end of September 2013 was 115 and their total market capitalization on 30th of September 2013 was around Denar 105,901 million or around Euro 1.72 billion. Macedonian Stock Exchange Index MSEI-10 on 30th of September 2013 was 1,634.43 index points.

In this period, 4 investment funds management companies, managing 10 open-end investment funds operated on the capital market in the Republic of Macedonia. On 30th of September 2013, the net asset value of all 10 open-end investment funds was Denar 719 million or around Euro 11.7 million.

Insurance Sector. The insurance market in Republic of Macedonia is characterised by a small share in the financial system. In 2012, the assets of the insurance companies represented 3.3% of the total assets of the financial sector. The data concerning the insurance penetration rate in 2012 shows that the total gross written premium (GWP) in the country participates with 1.52% in the GDP, whereas the density rate is 3,401 denars per inhabitant, which is comparable to the countries in SEE countries.

As of September 2013, there are 15 insurance companies, 24 insurance brokerage companies, and 10 insurance agencies active on the insurance market. For the first time, one of the new insurance agencies is a commercial bank, which means promotion of bancassurance as new distribution channel in the country.

There is moderate market concentration among the insurance companies, even though this trend is continuously declining. As of the third quarter of 2013, 2 insurance companies had market share over 10%, whereas the first five companies have a market share of 56.11%. Fourteen insurance companies are predominantly owned by foreign investors, owning 88% of the total equity, and only one insurance company is fully owned by domestic shareholders. Eleven insurance companies have been established by international insurance groups with head offices in the EU, which represents an additional advantage for the implementation of EU good practices in the operations of the insurance companies.



As per the most recent available data, as of the third quarter of 2013, the insurance companies in the Republic of Macedonia realized gross written premium in the total amount of Denar 5.52 billion, of which 8.45% were from life insurance, whereas 91.55% from non-life insurance. Compared to the same period in 2012, the GWP has increased in both insurance segments. There is 2.59% growth in the non-life insurance segment, and much higher GWP growth of 26.27% in life insurance segment. The GWP growth in both insurance segments was 4.25%. Analysed by insurance classes, motor vehicle insurance policies are predominant in the non-life insurance segment. The highest contribution comes from the compulsory MTPL insurance which has increased by 2.96%. The voluntary motor vehicle insurance (Casco) has decreased by 2.60%, property insurance has dropped by 0.37%, whereas the accident insurance has increased by 6.29%. Most noticeable is the situation of life insurance with 26.27% growth.

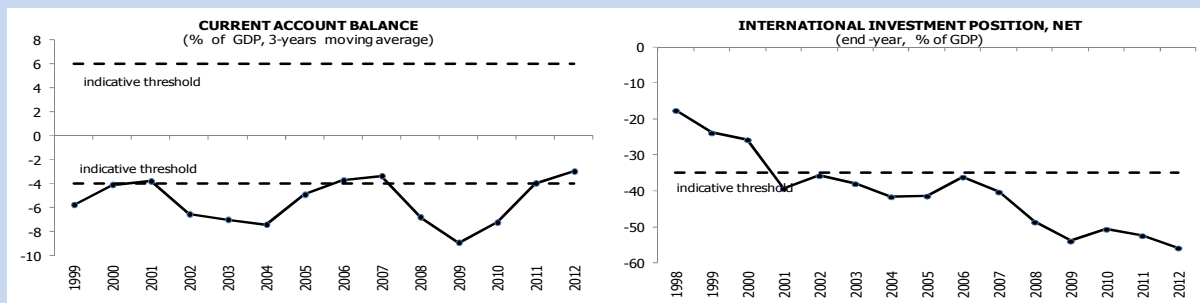
Fully - funded pension insurance. As of September 30, 2013 the number of second pillar members is 342,658, out of which 20% are voluntary members and 80% are mandatory members. Also, the value of the net assets in the second pillar is around Denar 25 billion which is 26% increase of the assets compared to September 2012.

As of September 30, 2013 the number of third pillar members is 17,876, out of which 27% are individual members and around 73% are members in occupational pension schemes. The assets of voluntary pension funds as of September 30, 2013 amounted to around Denar 267 million which is 60% increase of the assets compared to September 2012.

Leasing. On 30th September 2013, the funds of the leasing sector amounted to Denar 6,514 million, decreasing by 6.3% compared to 31st December 2012. After 4 years of negative developments, on 30th September 2013, leasing companies realised total operating profit in the amount of Denar 50 million. Number and value of newly concluded leasing contracts continued to decline during 2013 as well. Number of new contracts concluded in the first nine months of 2013 decreased by 40.3% compared to the end of 2012, while the value of concluded contracts decreased by 42.6% compared to 31st December 2012. Legal entities retained the main position in the structure of newly concluded contracts, accounting for 76.1%.

Box 2.1. Indicators of the Macedonian economy for 2012 pursuant to Macroeconomic Imbalance Procedure of the European Commission

The Macroeconomic Imbalances Procedures³ (MIP) is new approach of the European Commission (EC) which is implemented within the European Union for monitoring, prevention and correction of the macroeconomic imbalance through list of scoreboard indicators with set indicative thresholds. The basic indicators for the macroeconomic imbalance within this approach for the Macedonian economy in 2012, according to the thresholds set by EC, are given below.



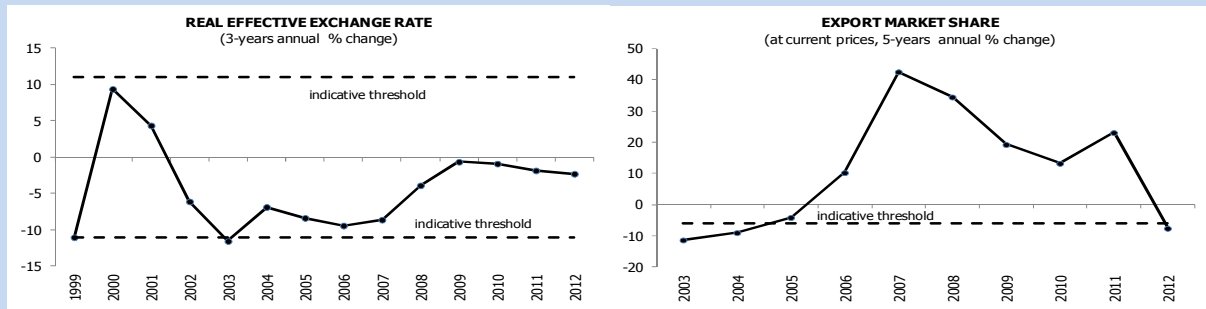
The deficit on the current account of the Republic of Macedonia, as a three-year moving average, is constantly ranging at the level or below the lower threshold of vulnerability, which in the years of rapid economic growth represented a zone of vulnerability of the economy. In 2012, this indicator slightly

³ Alert Mechanism Report, European Commission, February, 2012.

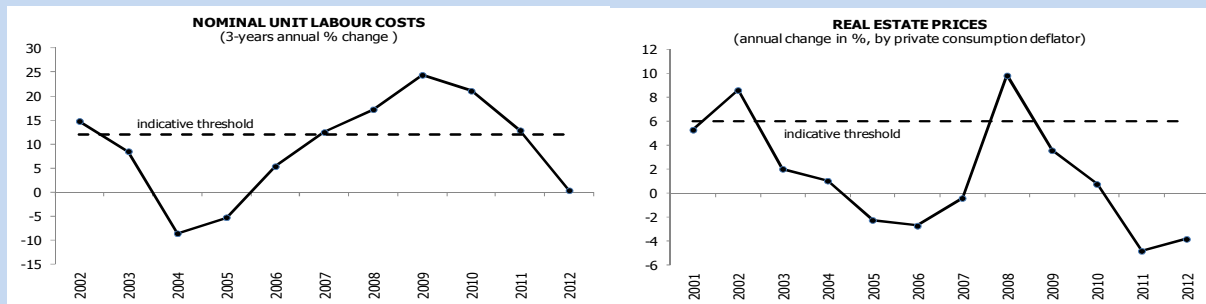


narrowed, and is below the specified lower vulnerability threshold (-4% of GDP), therefore within the allowed interval.

The net international investment position of the country, since 2007, has a deepening trend, with certain improvement in 2010 and re-expansion in the next two years, and in 2012 it reached 55.8% of GDP, which is far above the vulnerability threshold (35% of GDP). However, it should be taken into consideration that the net international position on the liabilities side includes FDI, which comprises nearly half of the increase in the total foreign liabilities in the last 3 years. In this context, when analyzing the converging countries, due to the effect of FDI exactly, it is suggested to consider also other indicators, such as the net external debt, which includes the debt instruments only, on a net basis. At the end of 2012, the net external debt of the Republic of Macedonia equals 17.4% of GDP.

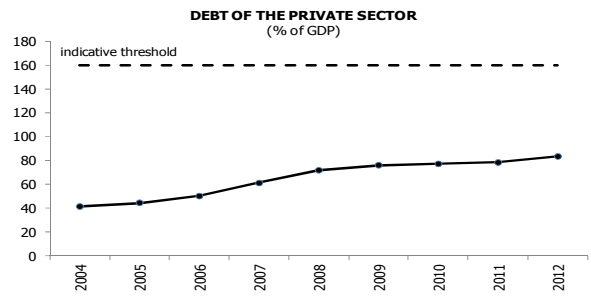
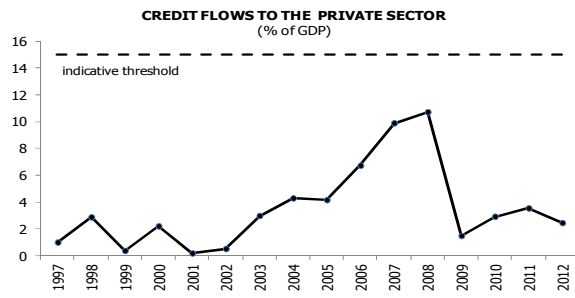


The real effective exchange rate is mainly in the area of depreciation or unchanged, which contributes to the competitiveness of the economy. In 2011 and 2012, the three-year change in REER indicates a moderate depreciation of about 2%. The export market share of the economy in the world exports as a five-year change, has been outside the zone of vulnerability since 2005. After the growth deceleration at the start of the global crisis, in 2011 the export market share registered a growth acceleration, but in 2012, it fell beyond the bottom threshold (-6%). These developments reflect the slight decline in the Macedonian exports amid a rise in world exports. It could be expected that the unfavorable change with the export market share will be corrected with the expected recovery of the Macedonian economy in the future.

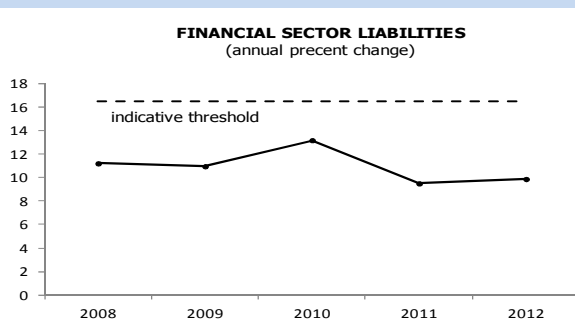
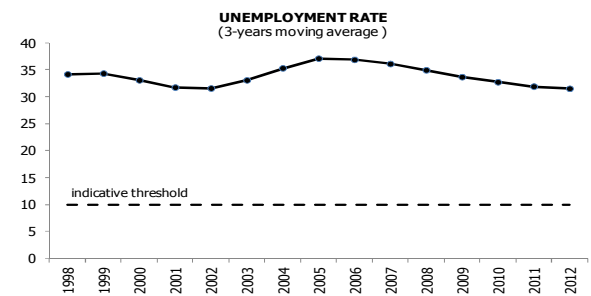
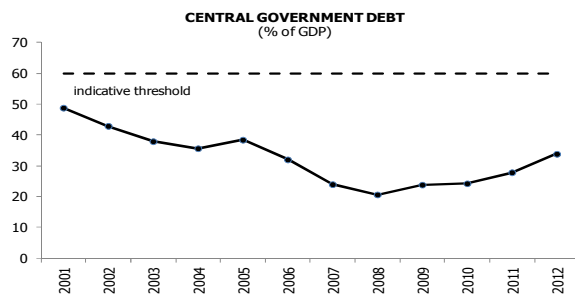


The nominal unit labor costs observed as a three-year change since 2007 were in the zone of vulnerability, with a downward trajectory since 2009, while in 2011 they came to the threshold, and in 2012 further slowed down and entered the safe zone. In general, within the indicators of possible external imbalances, the need for greater vigilance in the area of external debt is needed, although there are arguments to alleviate the problem.

In the area of internal imbalances, the annual changes in the bank loans to the private sector are constantly below the threshold of vulnerability, with even the highest annual change in loans of about 11% of GDP in 2008 being below the threshold of 15% of GDP. In 2012 the change in loans slowed to 2.4% of GDP and it is significantly lower than the threshold. At the same time, the liabilities of the financial sector in 2011 and 2012 show steady annual growth rates of around 10%, which is below the threshold (16.5%).



The changes in the property prices after their peak in the period of economic expansion in 2008 when they were in the zone of vulnerability, have downward dynamics outside the zone of vulnerability, and in 2011 and 2012, they recorded a negative annual change. The total internal and external debt of the private sector (domestic and external borrowings) is also consistently below the threshold of vulnerability. In 2012 it equals 83.3% of GDP, which is half of the threshold set at 160% of GDP, but on the other hand, it should be noted that in recent years it registers a steady growth trend. The government debt, is also at the level that is almost twice lower than the threshold (60% of GDP), but with moderate increasing pace in recent years.



The unemployment is the biggest problem of the Macedonian economy, which is verified by this approach, as well. The unemployment rate, as a three-year moving average, although reducing in the recent years, is, however, persistently above the threshold (10%). Hence, in the scope of internal imbalances, the Macedonian economy shows an exceptional vulnerability in terms of unemployment. Therefore, the top priority of the Government of the Republic of Macedonia, according to its Program, is to increase the economic growth and employment as a prerequisite for higher standard of living and better life of the citizens. Thus, the envisaged measures and reforms (part IV) are aiming at this priority.

2.2. Medium-term macroeconomic scenario

Macroeconomic policy in the period 2014-2016 provides conditions for increased economic activity through sustainable fiscal policy, which, in coordination with the monetary policy, will contribute to achieving sustainability of the external position of the country and maintaining macroeconomic stability in the economy.

In line with the basic macroeconomic scenario, in the analysed period, it is expected for the global economic growth to be intensified and for the confidence and optimism of consumers and investors to be gradually restored. In the EU, as the most significant partner, following the



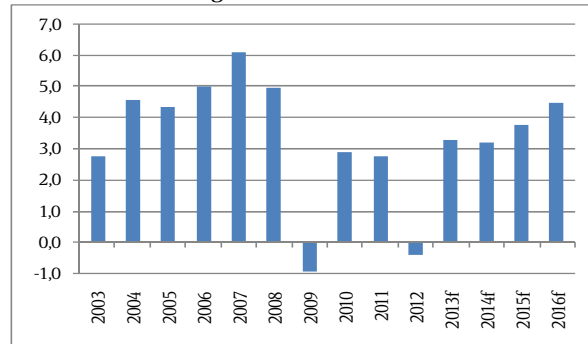
expectations for stagnation of the economic activity in 2013, in the next medium-term period, positive growth rates with prospects for certain growth acceleration (Table 2.1) are expected. Taking into account such expectations for the foreign surrounding, as well as the active fiscal policy of the Government of the Republic of Macedonia, by increasing the capital expenditures and developing the economic infrastructure of the country, structural reforms for enhancing competitiveness of the country and realising the envisaged FDIs, in the coming medium-term period, certain intensification of the economic growth of the Republic of Macedonia is expected.

Gross domestic product. On the basis of the above-mentioned assumptions, in the period 2014-2016, growth of economic activity in the Republic of Macedonia is expected to account for 3.8% in average, with prospects for certain growth intensification. Thus, economic growth is expected to amount to 3.2% in 2014, 3.8% in 2015 (which would be the same level compared to the expectations from the last year's Programme), while in 2016 growth rate of 4.5% is expected.

Following the recovery of industry in 2013, in the next medium-term period, moderate intensification of the industrial production growth is envisaged, mainly as a result of the expected dynamics for growth of foreign demand. Thus, in the period 2014-2016, the industry growth is expected to range between 3.8% and 5%. Growth of construction activity in the analysed period is projected at 7% in average, mainly as a result of the planned infrastructure projects and investments in TIDZ and the industrial zones. Services sector, accounting for the most in GDP creation, is expected to register average real growth rate of 3.4% in the analysed period. Real growth rates by years and sectors are shown in Table 1f, Attachment 1. Within the services sector, sectors trade and hotels and restaurants is expected to realize higher growth rates of the value added in the analysed period. Projection of real growth of the value added in the agriculture sector is 3% in average in the analysed period, encouraged by subsidies for support of agriculture, including the funds from the Budget of the Republic of Macedonia and IPA funds for agriculture and rural development.

Analysed according to the expenditure side of GDP (Chart 2.10), domestic demand is expected to contribute positively to economic growth. Projection for growth of gross investments in the analysed period amounts to 8.2% in average in real terms. Envisaged growth of gross investments is based upon the expectations for gradual growth of private investments (driven mainly by FDIs) and the policy of continuous growth of capital budget expenditures. In fact, within the public investments, realisation of major investment projects is planned, pertaining to improvement of the transport network in the country, improvement of the energy and utility infrastructure, investments for improving the

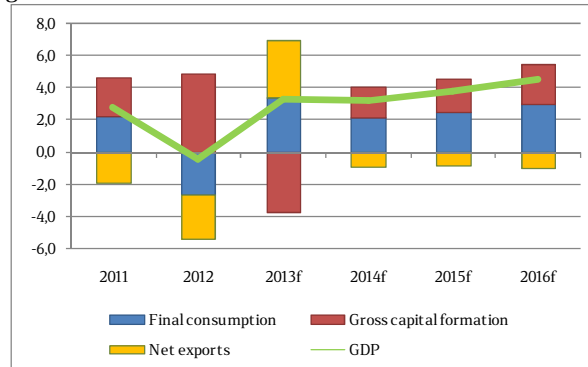
Chart 2.9. Real GDP growth



Source: SSO and calculations of MoF

f - forecast

Chart 2.10. GDP by expenditure method, contribution to growth



Source: SSO and calculations of MoF

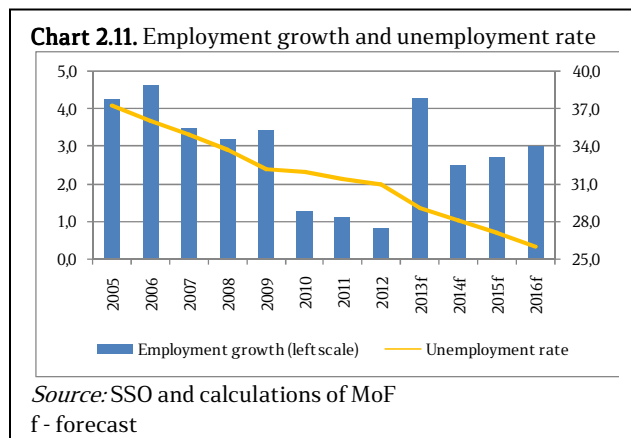
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conditions in the educational, social and health system, which will contribute to enhancing competitiveness of the country, being of key importance for increasing the production and the economy productivity. In the period 2014-2016, personal consumption is expected to grow by 3.1% in average in real terms, while public consumption is anticipated to surge by 1% in average.

Envisaged growth of foreign demand, in line with the expectations for strengthening the economic activity of the EU is basis for intensifying the growth of export activity of domestic companies. In addition, significant factor for growth of export will also be the increase of total export potential of the country as a result of the new export capacities in TIDZ and the industrial zones, which is expected to contribute to improving the structure of the country's export as well. Export of goods and services is expected to realise average growth of 8.2% in real terms. Anticipated increase of domestic demand and export activity will also provide for increase of import which, in this period, is expected to be 7.3% in average.

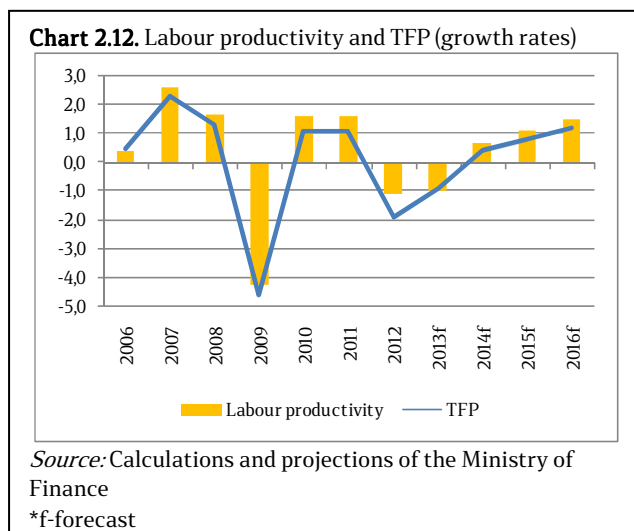
Labour market. Envisaged economic growth in the period 2014-2016 is expected to have positive effects on labour market trends. According to the projections, average annual increase



in the number of employees of 2.7% is expected. This will, on other hand, result in decline in the number of unemployed persons by 2.3% in average in the analysed period. Job creation is also expected from the increase in labour force, projected to surge by 1.3% in average. Such trends imply for employment rate to increase to 43.2% in 2016, while unemployment rate is projected to reduce to 26%. Active population in 2016 is expected to reach 58.4% of the working-able population. Labour market indicators by years are shown in Table 1c, Attachment

1. Nominal growth of average gross salary is expected to amount to around 3%.

Sources of growth. Chart 2.12. shows growth of both labour productivity and total factor productivity (TFP)⁴ in the period 2006-2016. Taking into account the projected growth rates of investments in fixed assets and the number of employees, TFP in 2013 is envisaged to drop by 0.9%. In 2014, as shown on the chart, productivity of production factors is expected to transfer into positive zone. TFP contribution to economic growth in the period 2014-2016 has an average share of 21.1%. Labour is expected to contribute to economic growth with 57.0%. Physical capital, according to the projections on investment growth, in the analysed period, is expected, in average, to grow by 4.2%, contributing by 21.9% to total economic growth.



⁴ TFP is a residual of growth of other factors of economic growth, labour and capital.



Potential growth. Calculation of potential output is basis for assessing the cyclical position of economy. Hodrick Prescott filter was used for calculating the potential output. This method belongs to the group of statistical approaches and, according to it, potential GDP growth is estimated at 3.4%⁵. Still, estimated rate of potential growth should be interpreted with caution, taking into account that the method applied is based solely on GDP historical data⁶. Production gap, as percentage of the potential output for the period 2012 – 2016 is shown in Chart 5 in Attachment 1. In 2013, in conditions of recovery of the economy, the cyclical component of the output is in the negative zone. In line with the projections on production growth in the coming medium-term period and the assessment for the trend movements, in 2015, closure of the gap is envisaged, while in 2016, production gap is expected to transfer into the positive zone.

Inflation. The global inflation factors, on a medium run, mainly indicate deceleration in the domestic inflation. The forecast of the foreign effective inflation⁷ for 2013 indicates increase in the level of foreign prices of 2.3%. In 2014 it is envisaged that the foreign inflation will slow down to 2%. In 2015 similar inflation trends are expected, with foreign inflation during the year being relatively stable and equaling 2.2%, on average. Regarding the price of crude oil annually, in 2013 it is expected that the oil price will fall to around 3%, amid the decrease in the first half of the year. In terms of dynamics, the price of oil per barrel continued to follow a downward path over the next two years (by about 5% per year). In 2013, it is projected that the prices of wheat and corn will fall. The decline in the prices is expected, given that the forecasts for a record high crop yields this season have materialized. There are similar assessments for the conditions on the supply side also for 2014, although expecting moderate growth in the price of wheat and decrease in the price of corn. Given the expectations for increased production of cereals, the differences in the direction of the annual price changes are due to the estimations for positive change in the stocks of corn and negative changes in the stocks of wheat. However, the current forecast indicates a general rise in the prices of basic food in 2015. The main risk of these projections remains associated with the uncertainty of weather conditions in the future period.

The average annual inflation rate in the Macedonian economy in the last quarter of 2013 is expected to continue decelerating. Consequently, the rate of inflation in 2013 is expected to be around 2.8%. The main risks to the inflation trend by the end of 2013 are both the world and the domestic food and energy prices and their possible pass-through effect on other prices in the economy. In terms of the assessment of negative output gap, no inflationary pressures by the demand side are expected. Compared to last year's scenario in PEP, when inflation of about 3.5% was expected, in this scenario, the inflation in 2013 is estimated at a lower level, which is mainly due to the moderate changes in food and energy prices than expected in the first quarter of the year, as well as the reduction of electricity prices in the third quarter, in contrast to the expected increase in these prices.

In 2014, the inflation rate is expected to amount 2.3%. The price developments in 2014 mirror the transmitted effect of the previous year, as well as the anticipated movements of part of the import prices and gradual recovery of the domestic demand. The inflation deceleration is

⁵ Due to the non-economic developments, 2001 is excluded from the calculations.

⁶ Trend value is assessed by minimising the gap between the real production and the trend and the variability thereof for the whole sample.

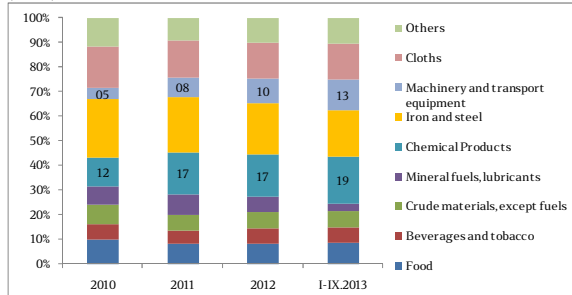
⁷ The calculation of foreign effective inflation is derived from the weighted sum of the consumer price indices of countries that are major exporters of consumption goods to the Republic of Macedonia. The weighted structure is based on normalized shares of nominal imports from each country in the total nominal imports in the period 2010-2012. The calculation of this indicator includes: Bulgaria, Germany, Greece, France, Italy, Austria, Slovenia, Croatia and Serbia.



expected to continue also in 2015 and 2016, when it is expected to get closer to the historical average and be around 2%.

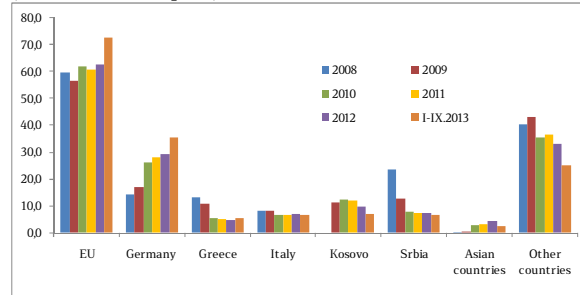
External sector and its medium term sustainability. The developments in the balance of payments' current account of the Republic of Macedonia in 2013 are in line with the gradual recovery of the economy, given the enhanced positive effects of the new production facilities on the total exports, in conditions of still relatively weak import demand and solid inflows of private transfers. According to the developments made and the assessments by the end of the year, the current account deficit in 2013 was estimated at 3% of GDP, which would be unchanged level compared to the previous year. The estimated deficit is lower than expected in the scenario in the previous PEP (3.8% of GDP), mainly due to the lower trade deficit, given the improved the energy balance due to the reduced import of oil and oil derivatives and electricity (increased hydro potential).

Chart 2.13. Structure of the export of goods (in %)



Source: SSO

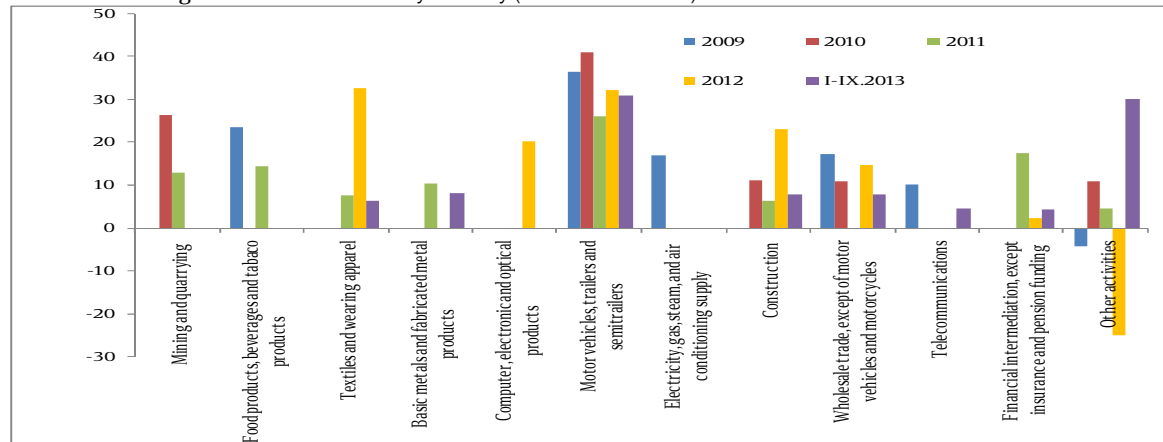
Chart 2.14. Geographical distribution of the export (% of the total export)



Source: SSO

In the January - September 2013 period, the trade deficit⁸ is lower by 7.3% relative to the same period of the previous year, in conditions of increased export (by 1.7%) and identical decrease in the imports (of 1.7%). The larger exports are mainly due to higher exports of chemical products and machinery and transport equipment, which primarily reflects the impact of new manufacturing facilities in the free economic zones. The decrease in the imports is mainly due to lower imports of mineral fuels, electricity and metal ores. The highest deficits in trade of goods in the January-September 2013 period are registered with the Great Britain and Greece, while significant surpluses were recorded in the trade with Germany and Kosovo.

Chart. 2.15. Foreign direct investments by activity (% of the total FDI)

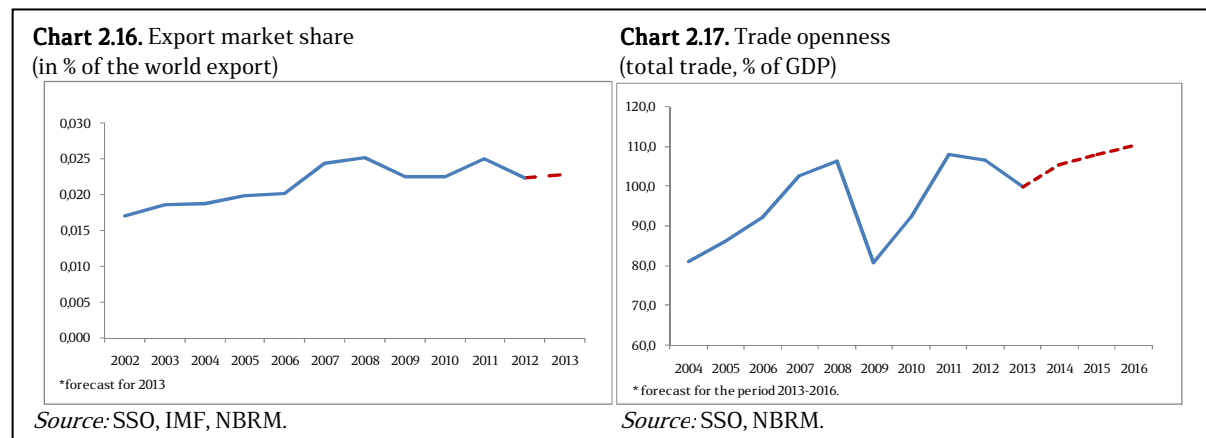


Source: NBRM

⁸ According to the foreign trade statistics, where the import is presented at c.i.f. basis.



Analyzed by structure, as a result of new capacities in the economy, significant improvement in the export structure has been registered. It is based on the larger share of products with higher value added on the exports side, mainly chemical products and machinery and transport equipment. These changes correspond to the foreign direct investments, which in recent years, were mainly concentrated in these areas. In the 2009-2012 period, on average about 60% of the new foreign capital have been invested in the tradable goods sector, therefore their further contribution to larger export diversification can be expected. The analysis of the geographic distribution of Macedonian exports proves the EU dominance as the major export destination, where in January-September 2013 period nearly 73% of the Macedonian exports have been directed to, with the share of exports to Germany registering an increase. The total trade of the Republic of Macedonia to the EU in the January-September 2013 period increased by 9.3% on an annual basis, constituting 66% of the total trade of the Republic of Macedonia. Moreover, in trade with the EU, narrowing the deficit by 26.5% on an annual basis was registered. The gradual increase in the share of emerging Asian economies on the exports side in recent years is worth to note, which proves the ability of the exporters for entering new markets during the crisis.



Within January - September 2013 period, the real effective exchange rate (REER)⁹ of the Denar deflated by the consumer prices appreciated slightly by 0.6%, annually, given the identical appreciation also of the real effective Denar exchange rate by the prices of the industrial producers. In conditions of favorable price ratio, i.e. faster increase in the foreign than domestic prices with both indices, such a change is a reflection of the appreciation of the nominal effective exchange rate of the Denar relative to the currencies in some of the countries which are the most important trading partners. The nominal unit labour costs in the first three quarters of 2013 register moderate increase of 2.4%.

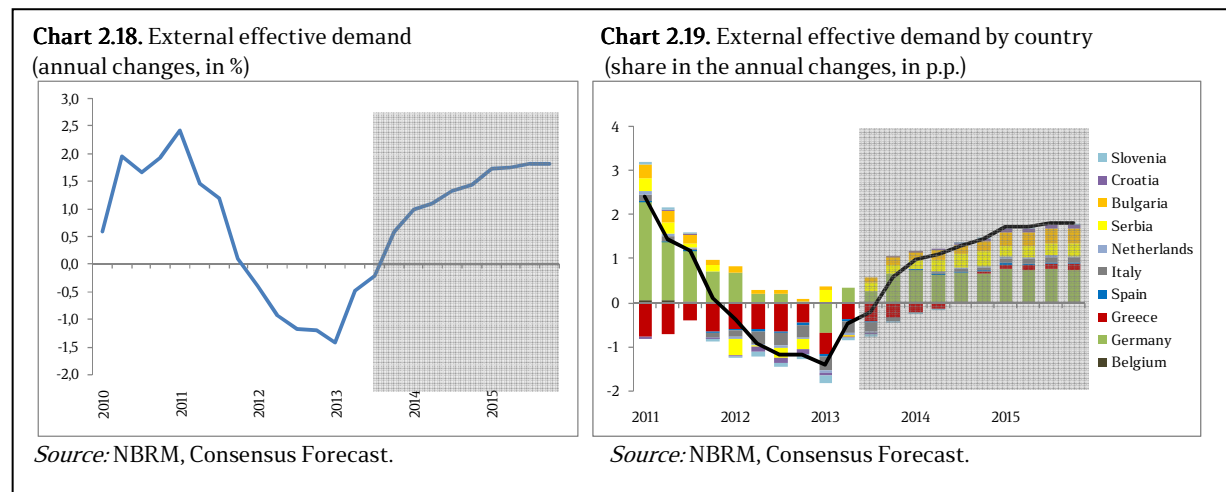
The export market share in the world export, after the slowdown of the beginning of the global crisis, increased in 2011, but in 2012, it decelerated again. These developments reflect a slight decline in realized Macedonian exports amid a rise in world exports. However, this adverse change in the export market share is expected to be corrected in 2013 already, having in mind the estimated export growth in 2013, which is in line with the recovery of the Macedonian economy. The degree of trade openness of the Macedonian economy is generally high and in recent years, it has been about 100, with a slightly slowed tendency in 2012 and 2013, reflecting the reduced trade with the second wave of crisis. In the next period gradual increase in the degree of trade openness of the economy is expected.

⁹ Within the REER, the calculation of the nominal effective exchange rate and relative prices includes 12 major trade partners of the Republic of Macedonia according to their share in the foreign trade in 2006 and a base period of 2006.



Assumptions for the external environment. The global economic recovery, which began in 2013, is expected to continue in the following years by registering positive global growth. The main impetus is expected by the advanced economies, given the growth deceleration in both emerging and advancing economies.

The external effective demand for Macedonian products¹⁰ in 2013 is expected to fall by 0.4% on annual level, having in mind the reduced economic activity in most of our trading partners this year. The current forecast for the external demand in 2014 assumes that it will re-enter the positive zone, with an expected growth of 1.2%. The economic activity in trading partners is expected to intensify more in 2015, when the growth of the external demand is expected to reach 1.8%. Observed by the contributions of individual countries, the most significant positive contribution is expected by the German economy, followed by the Serbian and Bulgarian economy.



The metals prices in 2013 generally show unfavorable trends, reflecting the greater supply on the metals market, high inventories compared to historical average and weaker global demand. With respect to certain types of metals, the price of nickel recorded the largest drop, with high falling rates being also expected in the copper prices. The adverse movements in the metals prices are reflected by reduced production and export of Macedonian manufacturing facilities in this industry. In 2014, small decline in the copper price and a moderate decline in the nickel price are expected. It is expected that the situation on the metal market will stabilize in 2015, when prices of most metals will register positive growth rates. However, the price risks are downwards and generally depend on the growth dynamics of the Chinese economy as a major global consumer of metals.

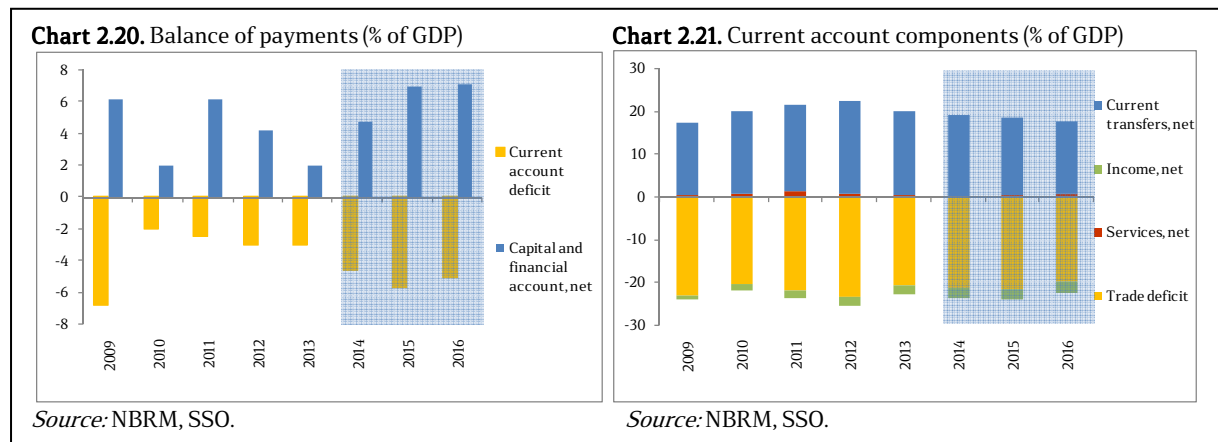
Balance of payments forecast. The latest estimates of the external sector indicate a moderate current account deficit, as well as possibility for growth in the foreign reserves in the next three-year period and their maintenance on adequate level. Namely, the larger domestic demand in the economy in the upcoming period is expected to create import pressures, but they would be relatively moderate. Additionally, it is assessed that the larger exploitation of the new facilities potential with foreign capital will mitigate, to some extent, the effects that the export growth, rising investments and private consumption have on imports. The sources for covering the needs for external financing are expected to be created through borrowing and direct investments also in the following three-year period, to the extent that is sufficient for further

¹⁰ The calculation of the external demand takes into account the growth rates of GDP (Consensus Forecast) of the ten most important trading partners, according to their participation in the Macedonian exports in 2010-2012.



accumulation of foreign reserves. Therefore, it is expected that the capital inflows will enable maintenance of an adequate level of foreign reserves.

The export activity of the Macedonian economy in 2013 was mainly marked by the expansion of manufacturing potential of some export-oriented companies in the country. In the following three years, it is estimated that the continuing investments in export-oriented production, as well as the gradual recovery of foreign demand, will result in faster growth rates of the exports. The intensification of the export demand, coupled with the expectations for further acceleration of the investment activity and household consumption, is expected to lead to some acceleration in imports, too.



According to achievements and the evaluations for the last quarter of the year, the nominal growth of export of goods and services in 2013 is expected to be moderate (1.3%), and to accelerate and reach a double-digit growth rate (12.8%) already in 2014. The export of goods and services in the following two years is expected to grow with a similar growth rate of about 11% per year. On the side of import of goods and services, in 2013 slight decline (0.6%) is expected, largely due to lower energy imports. In 2014, the import is expected to register an increase (about 12.7%), driven by growth in imports for the needs of the export-oriented production, as well as the imports caused by increased investment and private consumption. Thus, a part of the new FDI inflows during the period when the capacities are in process of establishing, reflects adequately on the import of machinery and equipment. From 2014, part of the envisaged investments, especially the medium-term infrastructure works, is expected to influence towards larger increase in import of services. In 2015 and 2016, with the gradual reduction of import needs of the new facilities, the import growth is expected to slow down (9% and 7%, respectively). In 2013, in terms of lower import pressures and increased exports, the trade deficit in goods and services is expected to narrow to 20.5% of GDP (from 22.9% of GDP in 2012). More dynamic movement of the imports will lead to the re-expansion of the deficit in the trade of goods and services to 21.5% of GDP in 2014. In 2015, given the expected slowdown in imports and maintaining the growth rates of exports as a result of the contribution of the new facilities, slight narrowing of the deficit on goods and services of 21.2% is expected, while in 2016, its level would reduce to about 20% of GDP.

A significant portion of this deficit will continue to be financed by private transfers, which in 2013 are expected to remain relatively high, but lower in comparison with the previous year, having in mind the gradual exhaustion of the effects present at the end of 2011 and in 2012. In fact, this balance of payment category is approximated through the net purchase on the currency exchange market, and in the previous year, the foreign currency was substantially being converted into the domestic currency, as a result of the impact of the crisis and the



uncertainty in the euro area. The diminution of the relative importance of transfers is expected to continue in the following three years, although more moderately. Thus, the private transfers in 2013 are estimated at nearly 19% of GDP, while in 2016 they are expected to reduce to 16.4% of GDP. The deficit in the current account "income" category for 2013 is estimated at 2% of GDP, while in the next three years, it is expected to register gradual growth up to 3% of GDP in 2016.

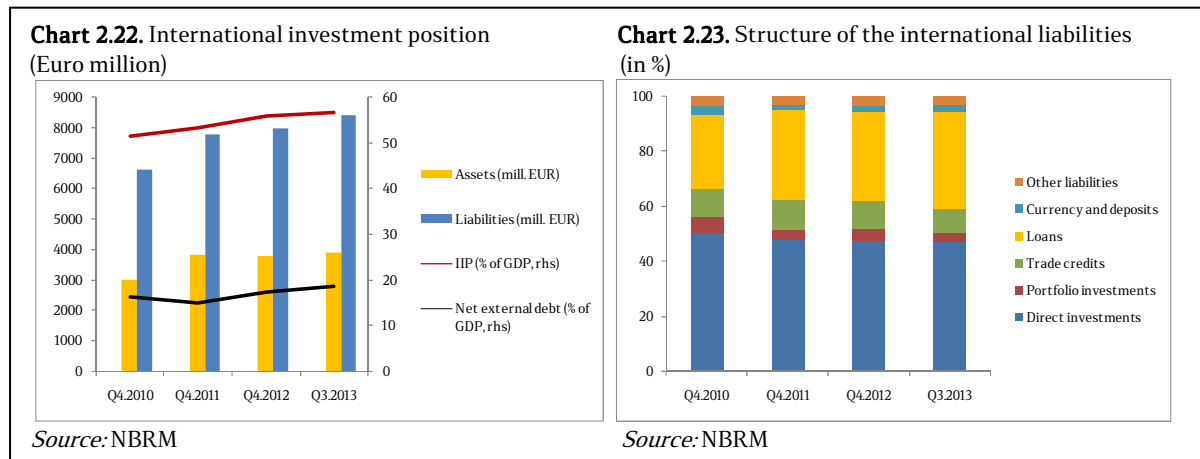
Having such current account items projected, despite the narrowing of the trade deficit of goods and services, in 2013 it is expected that the current account deficit will maintain 3% of GDP, while in 2014 it is expected to deepen to 4.6% of GDP. This trend is expected to continue in 2015, when the negative current account balance is expected to reach 5.7% of GDP, which in conditions of estimations for small narrowing in the trade of goods and services will come from the more intense decrease in the inflows from private transfers. However, in 2016, the current account deficit would slowdown to 5.1% of GDP, given that the expected significant narrowing of the trade deficit exceeds the effect of the anticipated slowdown in private transfers. This forecast of the current account balance mainly reflects the expected long-term effects of the inflow of FDI in recent years in the tradable sector, which has already led to changes in the structure of the economy, greater export diversification and on the long run, in conditions of expected favorable external environment and intensification of their export capacity, is expected to contribute to a narrowing of the trade deficit.

The capital inflows in 2013 and the following year will mainly arise from the expected FDI, the planned Government external borrowing and expected borrowings of the private sector. The boost of the domestic economy, the improvement of the global environment and the stabilization of global financial markets are expected to contribute towards more positive perceptions among investors. Consequently, FDI in 2013 and 2014 will gradually increase and will reach 2.7% and 4% of GDP, respectively. The gradual stabilization of the external environment and the global financial flows are factors that influence towards further moderate increase in the private financial flows. Consequently, FDI are expected to increase gradually over the next two years, and reach 5% of GDP in 2016. The total net inflows on the capital and financial account from 2% of GDP in 2013 are expected to increase to 4.8% of GDP in 2014, and to maintain about 7% of GDP over the next two years. The projected developments in the current and capital and financial account are estimated to provide an additional accumulation of foreign reserves in the following three years and further maintenance of relatively stable and satisfactory coverage of the average imports of each following year.

International investment position and external debt. In the first three quarters of 2013, the negative international investment position (IIP) increased by 7.4% compared to the end of 2012, amid faster growth in liabilities to abroad (5.3%) compared to the growth in the foreign assets (3%). Thus IIP in September equals -56.6% of GDP. The banks register a slight narrowing of the negative net IIP (of 0.6%), while the "other sectors" register an increase in the negative net IIP by 4% (or 54% contribution), but mainly as a reflection of the increased liabilities based on FDI. The monetary authority registers a decrease in the net positive position to abroad of 5% (34% contribution), in conditions of decrease in the foreign reserves, mainly due to currency and price changes, especially in gold. The Government sector accounted for 14% of the total increase of IIP, with increased negative net IIP by 2.7%.



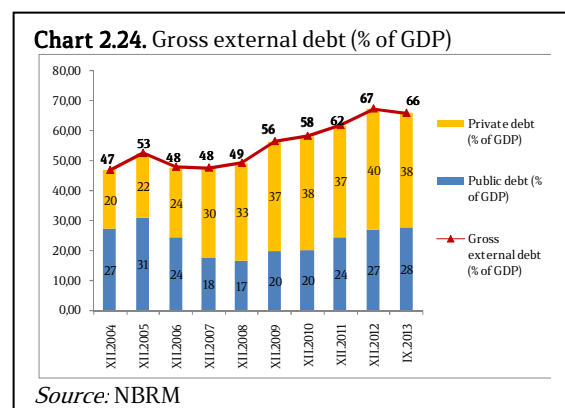
Having in mind the significant share of the FDI on liabilities side (about 50% in the last several years) within the net international position, which is characteristic for the converging economies, when analyze the external position, it is desirable to consider other indicators, as well, such as the net external debt, which encompasses the debt instruments only, on a net basis. At the end of the third quarter of 2013, the net external debt of the Republic of Macedonia amounted to 18.7% of GDP, which is an acceleration of 1.3 percentage points of GDP. The increase in net debt is mainly due to the higher net debt of the government, the banks and the loans between the connected entities.



At the end of the third quarter of 2013, the gross external debt amounted to Euro 5,221 million (excluding repo transactions of the NBRM, which appear in almost the same amount on both, the liabilities and the claims to non-residents, as well). The gross debt equals 65.8% of GDP and compared to the end of 2012 it is lower by 1.4 percentage points of GDP. This decrease is due to lower debt to the private sector (by 2.1 percentage points of GDP), while the external debt of the public sector increased (by 0.7 p.p. of GDP). The growth of public sector debt reflects the net borrowings of the public sector based on loans. The long-term debt continues to dominate the debt structure, with a share of nearly 70%.

The analysis of the external indebtedness of the Republic of Macedonia is based on the solvency indicators and the indicators for the liquidity in the payments abroad. The solvency indicators¹¹ point to the following:

- At the end of September, 2013, the gross external debt amounted to 68.5% of the three-year average of GDP. Thus, this indicator is almost at the level of the end of 2012;
- By the remaining three indicators (gross external debt/exports: 121%, debt servicing/exports: 16% and interest repayment/exports: 1.8%), the Republic of Macedonia is low indebted country. Compared to the end of 2012, the indicator for the gross external debt



¹¹ It is a three-year moving averages of GDP and exports of goods and services, as denominators in the calculation of the indicators. The methodology of the World Bank defines also the indebtedness criteria as orientation (reference) values for the degree of indebtedness.



compared to the exports and the indicator for the interest relative to the export improved, while the debt repayment relative to the exports increased.

The analysis of the liquidity indicators, calculated by the current annual values of variables, suggests the following changes:

- The indicator of the coverage of the short-term debt by the foreign exchange reserves equals 1.3, which is a solid coverage. At the same time, the indicator of the coverage of the short-term debt by residual maturity with the foreign reserves equals 0.95;
- The indicator of the share of the short-term in the total gross external debt equaled 30.4% of the total external debt and since the beginning of the year it has fallen by 1 percentage point. According to this indicator, the dependence on short-term external financing is low because only one third of the external borrowings has short repayment periods.

The forecast regarding the capital and financial account of the balance of payments for the 2014-2016 period, suggests moderate increase in total external debt. However, the debt indicators (gross external debt and debt repayment relative to exports) are expected to improve moderately, given the expected acceleration of export activity. In terms of maturity structure, the long-term debt is expected to remain dominant.

Monetary developments and exchange rate. The changes in the monetary policy in 2012 were towards relaxation, which mainly took place in the first half of the year, when the risks in the external sector remained low, given further maintenance of stable expectations for inflation and exchange rate. In such conditions, at the beginning of April 2012, the NBRM made changes in the operational framework of monetary policy, which were aimed at developing and supporting financial markets, active liquidity and investment portfolio management by the banks. These changes included reduction of the frequency of the CB bills auctions to once within a reserve requirement period (from once a week to once a month). Furthermore, the NBRM introduced regular weekly repo operations for providing liquidity in the banking sector, the deposits facility (overnight and seven days) and reduced the interest rate on available overnight loans. In early May, according to the macroeconomic forecast for the next period, the NBRM reduced its main interest rate by 25 basis points, reducing it to 3.75%. The purpose of the monetary relaxation was to ensure higher credit growth and thus support domestic economic activity.

In general, the environment for monetary policy implementation in the first three quarters of 2013 can be assessed as favorable, given the relatively stable inflation and a solid level of foreign reserves. In terms of deceleration of the inflation in late 2012 and the favorable movements on foreign exchange market, in early January 2013, the NBRM reduced the maximum interest rate by 25 basis points, bringing it down to 3.5%. Additional relaxation was made through the change in the reserve requirement instrument, which came into force on January 1, 2013, thus reducing the reserve requirement basis of the banks by the amount of newly granted loans to sectors the growth of which reduces the external vulnerability of the economy (net exporters and energy sector). It is a nonstandard measure, which will apply as of end-2014, when the need of its further application will be examined. A significant portion of the total loans approved during 2013 is related to these sectors.

In conditions of a controlled rate of inflation and a favorable balance of payments position, at the beginning of July 2013 the NBRM took additional measures intended to support the credit growth and the economy as a whole. Namely, the reserve requirement on the banks' Denar liabilities was reduced from 10% to 8%, given the simultaneous increase in the rate of foreign exchange liabilities from 13% to 15%, and introducing also 0% reserve requirement on liabilities to nonresidents. These changes are aimed at supporting de-euroization process, releasing the



liquid assets of the banks and larger inflows of funds from non-residents, especially from foreign financial institutions. At the same time, the main policy rate of NBRM decreased from 3.5% to 3.25%, which is the historical minimum.

The monetary policy remains oriented to price stability also in the following three-year period, by maintaining stable Denar exchange rate relative to the Euro. The results of the models for estimating the equilibrium real effective exchange rate¹² of the Denar as of the last quarter of 2012, do not indicate larger misalignment from the equilibrium level and in the 2003 - 2012 period they are within acceptable range of +/-4%, and in 2012 they indicate that the exchange rate has slightly been underestimated¹³.

In the past period of turbulent external environment, the monetary policy confirmed its flexibility and acted through appropriate accommodation of the monetary policy instruments, in order to encourage credit growth, while simultaneously achieving primary and intermediary monetary objectives. According to the forecast of the other segments of the economy, in the following three-year period, we can expect moderate inflation developments and generally favorable movements on the foreign exchange market, although accompanied by risks. The fiscal policy and especially the manner of financing the budget deficit in the future remains a significant factor in terms of the environment in which the monetary policy is implemented, which also emphasizes the importance of monetary - fiscal coordination. The monetary authority remains willing to take appropriate measures¹², if necessary, to maintain price and financial stability in the economy.

Intensification of economic activity and stabilization of risk perceptions are expected to contribute to increased lending by banks during the next period. Thus it is estimated that the expected annual credit growth of 5.2% in 2013 will accelerate to 6.4% in 2014 and 8.5% in 2015. These movements are due to the gradual depletion of the negative effects of perceptions of banks' credit risk and conservative strategies of major banking groups. The measures that the NBRM have taken are expected to have stimulating effect in the future, too. Also, positive impulse is expected from the stabilization of the global financial markets and the expected growth of the domestic economy, with positive effects on improving the creditworthiness of economic agents. The growth of private consumption and corporate investments will have an additional positive contribution by increasing the demand for loans. However, the basic forecast for bank lending is associated with downward risks related to possible further restraint from lending as part of the strategy of foreign parent banks. In terms of deposits, deposit growth of 4.8% in 2013 is expected. Furthermore, the strengthening of domestic economic activity, driven by growth in employment, wages and investments are expected to result in a significant recovery of the deposit base, which is expected to grow at a rate of about 9% annually in 2014 and 2015, respectively.

2.3. Risks and alternative scenario

Risks. Risks as regards the projected economic growth rates are generally related to the global economic trends, mainly with the recovery dynamics of the EU economy. On the short run, low economic growth in the Euro zone is probably the most serious potential risk for the growth of the developing countries such as the Republic of Macedonia. Realisation of risks for worse economic performance in the EU and other trade partners to the country can worsen the

¹² According to BEER approach (behavioral equilibrium exchange rate) for estimating the equilibrium exchange rate of the Denar, which is based on narrow definition of real effective exchange rate and it is created based on the five largest EU trading partners of the Republic of Macedonia. The models include the following as independent variables: productivity differential, the trade openness and the public consumption.

¹³ The IMF analyses also prove that there is no significant misalignment of the real effective exchange rate (IMF Staff Report for 2013 Article IV Consultation and first post program monitoring discussions, June 2013, p.17).



prospects for growth of economic activity in the Republic of Macedonia. On the other hand, faster progress related to structural reforms in the Euro zone as regards the expectations and increase of the confidence of investors, are positive risks, the materialisation of which can contribute to higher growth of export of Macedonian export and industrial production and bigger inflow of capital to the country. In addition, effect of planned FDIs, being in the phase of realisation or being announced, can be expected to fully materialize in the next several years. As for the presented external sector scenario, within still present uncertainty about the global recovery, risks may spill over through several points. Main risks as regards the external position of the economy in this period continue to arise from the dynamics of global and hence domestic economic recovery and their reflection on the perceptions of investors. Possible weak external demand can adversely affect the presence of domestic exporters on the foreign markets. In addition, trends of global prices are accompanied by uncertainty. At the same time, risks from lower capital inflows of non-debt financing or possible capital outflows aimed at financing the parent companies are not excluded.

The assessment and the scope of the effects of the new export entities in the economy are crucial for the forecast of the trade balance. The fact is that the number of export entities in the economy is gradually growing, which on the medium run should result in further diversification of exports and improvement of the export performance. The positive changes in the export structure realized in recent years are also in favor of this expectation. It is expected to contribute to strengthen the resilience of the economy to external shocks. Given the growing number of new production entities in the economy, and the expected improvement of the global environment, the expectations in this regard are justified. At the same time, the forecast of the private transfers, which assumes a gradual slowdown in the share of private transfers to GDP, can generally be assessed as conservative, which reduces the downward risks regarding this category.

The risks regarding the inflation forecast is mainly conditioned by the assumptions of the developments in the prices of primary goods, changes to regulated prices and their possible pass-through effect on other prices in the economy. Thus the projected inflation rate of 2.3% in 2014 does not include the effect of a possible increase in electricity prices. With the predicted increase in electricity prices in mid-2014 of 10%, the average inflation rate would be 2.7%. The risks to the projected path of inflation on a medium run are assessed as balanced, amid risk for greater downward effect of the future changes of the world prices over domestic inflation and greater upward pressure from the domestic demand.

The expectations in terms of credit growth of the banks are mainly associated with downward risks, which in terms of significant relaxation of the monetary conditions and a gradual stabilization of the risk perceptions, are mainly related to the conservative strategies of foreign banking groups present in the country. The risks of the business strategies of foreign parent banks are mainly related to potential deleveraging at the group level, with effects on their subsidiaries in the country.

The aforementioned risks associated with the macroeconomic scenario for the following three-year period indicate a need for continuous monitoring of possible changes in the external and domestic economic environment in the following period and taking appropriate and timely measures by the policy makers.

Alternative scenario. The alternative macroeconomic scenario is based on the assumption for lower economic growth in the EU economy and other trade partners of the country during the analyzed period. Under this scenario, the projection for real GDP growth is 2.1% in 2014, 2.7% in 2015 and 3.3% in 2016.



This scenario implies weaker external demand and adverse effects on domestic exporters i.e. lower growth of exports of goods and industrial production in the country. This is expected to have an impact on the perception of investors, which will affect the flow of capital into the country in the form of direct investments, implying slower growth of gross investments in the medium term.

Under this scenario, real export growth is expected to be 4.4% in 2014, 5.5% in 2015 and 5.8% in 2016. The forecast for growth of gross investments is 5.2% on average in the analyzed period. Lower growth of gross investments compared to the baseline scenario is mainly due to slower growth of private investments, and to some extent, to the growth of public investments. Public consumption is also expected to have lower growth, which is projected to be 0,8% on average for the analyzed period. Under the alternative scenario, the projected real growth of domestic consumption is 2.4% on average. The lower growths in exports, as well as domestic consumption, imply slower growth of import of goods, which is expected to increase by 4.6% on average in the analyzed period.

Regarding the labour market, lower economic growth implies slower growth of the number of employed and a slower pace of reduction of the unemployment rate compared to the baseline scenario. Thus, according to the alternative scenario, the average annual growth of the number of employed is expected to amount to 1.9%, resulting in a reduction of the number of unemployed by 1.6% on average in the analyzed period. Assuming that the projected rates of reduction of the inactive population and the growth of the working age population have not changed compared to the baseline scenario, the unemployment rate at the end of 2016, according to the alternative scenario is expected to be around 27%, while the employment rate will reach 42.5%. Active population in 2016 will amount to 58.1 % of the working population.

Regarding the inflation rate, it is assumed that the movements of commodity prices have not changed compared to the baseline scenario, i.e. we assume similar assessments of conditions on the supply side and the level of foreign prices. Slower growth of economic activity according to the alternative scenario implies that inflationary pressures from the demand side are not expected, given that the negative output gap is estimated to close in 2016. Hence, unlike the baseline scenario, an upward pressure from domestic demand on the inflation rate is not expected in 2016, so the projected inflation rate is around 2% (see Table 1b for comparison).

The effects of alternative scenario on the budget deficit are presented in section 3.2. Sensitivity analysis.



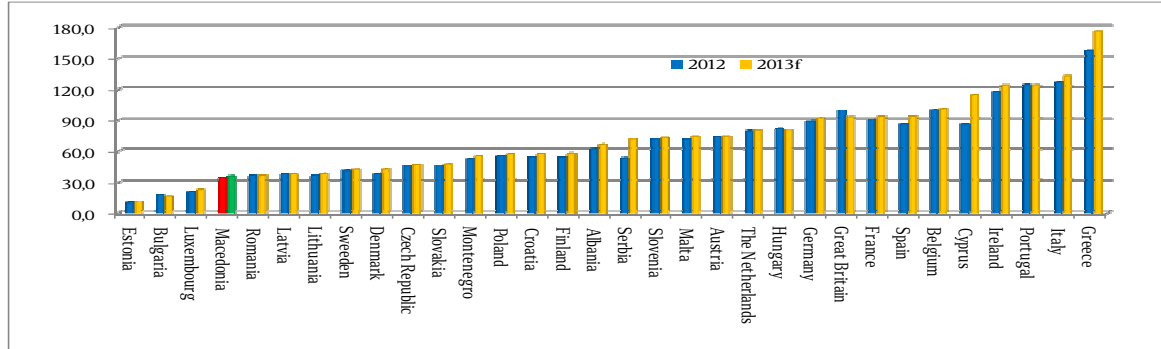
PART III Public Finances

Fiscal policy, as in the past period, will continue to be designed to the end of preserving macroeconomic stability and encouraging economic growth as main conditions for job creation and improvement of the living standard.

Fiscal policy in coordination with the monetary policy provided for macroeconomic stability to be preserved with average annual inflation of around 2.5%, supporting at the same time the economic activity by maintaining higher level of capital investments. Increase of capital investments in the Budget is a direct support to the business sector.

As a result of prudent and carefully conducted fiscal policy in the past years, Republic of Macedonia remains to be low-indebted country with government debt being far lower than the EU average (86.8% of GDP in the second quarter of 2013).

Chart 3.1. Government debt of EU Member States and candidate countries (% of GDP)*



Source: IMF, October 2013 and Ministry of Finance, November 2013

* f- forecast

Successful management of public finances by the country was acknowledged by many relevant financial institutions. Thus, renowned Fitch Credit Rating Agency in its report¹⁴ indicated that thanks to the strong fiscal position of the Republic of Macedonia before the financial crisis, the public debt level remains to be moderate, while Republic of Macedonia is relatively low-indebted country, the indebtedness of which is below the level of indebtedness of countries, being at the same or similar level according to the credit rating. In addition, Standard and Poor's Report¹⁵ indicate that the Republic of Macedonia remains to be relatively low indebted country, being one of the factors due to which the stable outlook of the country is confirmed.

Furthermore, in the programme document related to the World Bank policy based guarantee from December 2012¹⁶, the bank indicates that the results of their "Debt Sustainability Analysis of the Republic of Macedonia" show that the debt of the country is sustainable and remains at relatively moderate level in line with the international standards. These observations are based upon moderate budget deficit, relatively low public debt, low level of inflation, as well as well-capitalised banking sector. In addition, the same is based upon sound economic policies, as well as the inflow of foreign investments, being potential for economic growth. Taking into account the current challenges in the external surrounding, Republic of Macedonia has fiscal room for borrowing, and for the purpose of increasing the support to the economy, without thereby putting into question the ability for debt repayment.

¹⁴ Fitch Ratings, Republic of Macedonia Full Rating Report, October 2013.

¹⁵ Standard and Poor's Research Update, May 24, 2013.

¹⁶ Document of The World Bank (Report No. 72845-MK): Programme document for a proposed public expenditure policy based guarantee in the amount of Euro 155 million.



In the period 2014-2016, fiscal policy will continue to feature further improvement of quality of public finances and disciplined budget funds management, to result in maintenance of low fiscal deficit and public debt at sustainable level. By more efficient usage of budget funds in development programmes and infrastructure investments, fiscal policy will be aimed at preserving macroeconomic stability and reviving economic activity. Fiscal policy in the next medium-term period will continue to be balanced between realisation of the following two objectives:

- on the short run, to respond to the need for mitigating the fluctuations of the business cycle;
- on the long run, fiscal position to be driven by the need to establish sustainable level of public debt, by maintaining moderate level of budget deficit, which would not lead to increase in the level of public debt above the long-term sustainable level.

3.1. General Government Budget Balance and Debt Stock

3.1.1 Actual State-of-Play and Medium-Term Expectations

Actual State-of-Play in 2012. Total budget revenues were realised in the amount of Denar 138,115 million, i.e. 92.4% compared to the projected ones under the 2012 Budget. They were higher by 0.7% compared to the performance in 2011. Within total revenues, 85% were performed on the basis of tax revenues and social contributions. Tax revenues accounted for the most in the structure of total revenues with 55%, followed by contributions with 30%, non-tax revenues with 9%, while capital revenues and other revenues accounted for 3%, i.e. 3%. Tax revenues in 2012 were realised in the amount of 93% in relation to the annual projections, while revenues collected on the basis of value added tax (VAT) accounted for the most, with 51%.

Total expenditures of the Budget of the Republic of Macedonia in 2012 amounted to Denar 155,840 million or 96.4% of the annual projections. Realisation in 2012 was higher by 4.8% compared to 2011. In 2012, total of Denar 22,714 million was paid for salaries and allowances or 1.9% less compared to 2011. Expenditures related to goods and services were higher by 5% compared to 2011, amounting to Denar 14,652 million, while social transfers were higher by 3.7%, accounting for Denar 69,676 million. Capital expenditures in 2012 were realised in the amount of Denar 18,757 million, being higher by 5.9% compared to 2011.

The 2012 Budget of the Republic of Macedonia realised deficit in the amount of Denar 17,725 million, accounting for 3.9% of GDP. Structure of fiscal balance of the Budget of the Republic of Macedonia shows biggest share of the core budget or 89% of the total consolidated budget deficit. Financing of the 2012 deficit was provided through domestic and foreign borrowing.

Total revenues in the general government budget (Budget of the Republic of Macedonia and the budgets of local government units) amounted to Denar 149,620 million in 2012, while total expenditures reached the amount of Denar 167,816 million. Thereby, deficit of consolidated general government budget was realised in the amount of Denar 18,196 million or 4% of GDP.

Actual State-of-Play in 2013. Under the 2013 Budget of the Republic of Macedonia, total revenues are projected at Denar 147,958 billion, total expenditures at Denar 165,653 billion, i.e. deficit of Denar 17,695 billion (3.6% of GDP) was projected, core budget deficit out of which amounts to Denar 15,758 billion (3.2% of GDP), deficit on the own revenue accounts is Denar 1,842 billion (0.38% of GDP), deficit of Pension and Disability Insurance Fund is projected to amount to Denar 95 million (0.02% of GDP) and balanced budgets of Health Insurance Fund and Employment Agency.

In the period January-September 2013, total realised revenues of the Budget of the Republic of Macedonia amounted to Denar 103,012 million or 69.6% of the annual projections. Within the



total revenues, Denar 88,215 million was realised on the basis of tax revenues and social contributions, i.e. 85.6% of total realised revenues. Tax revenues accounted for the most in the structure of total revenues with 56%, followed by contributions with 30%, non-tax revenues with 9%, while capital revenues and other revenues accounted for 3%, i.e. 2%.

Tax revenues during this period were realised in the amount of Denar 57,389 million. VAT revenues accounted for the most in the structure of realised tax revenues with 50%, excises participated with 21%, personal income tax with 13%, profit tax with 6%, import duties with 6% and other tax revenues participated with 4%.

Table 3.1. Budget of the Republic of Macedonia (Denar million)

| <i>(Denar million)</i> | Budget 2013 | Realisation in the period January-September 2013 |
|---|--------------------|---|
| 1. Total revenues | 147,958 | 103,012 |
| 1.1. Tax revenues and contributions | 125,555 | 88,215 |
| 1.1.1 Tax revenues | 82,713 | 57,389 |
| 1.1.2 Contributions | 42,842 | 30,826 |
| 1.2. Non-tax revenues | 13,836 | 9,215 |
| 1.3. Capital revenues | 4,432 | 3,053 |
| 1.4. Donations | 4,135 | 2,529 |
| 2. Total expenditures | 165,653 | 118,802 |
| 2.1. Current expenditures | 146,941 | 106,817 |
| 2.1.1 Salaries and allowances | 23,132 | 16,901 |
| 2.1.2 Goods and services | 17,441 | 10,796 |
| 2.1.3 Transfers | 102,254 | 75,947 |
| 2.1.4 Interest | 4,114 | 3,173 |
| 2.2. Capital expenditures | 18,712 | 11,985 |
| 3. Deficit | -17,695 | -15,790 |
| 4. Deficit financing | 17,695 | 15,790 |
| 4.1 Inflow | 33,464 | 30,246 |
| 4.1.3 External sources | 17,758 | 18,779 |
| 4.1.3 Domestic sources | 3,598 | 10,556 |
| 4.1.4 Deposits/Additional sources | 12,022 | 658 |
| 4.1.5 Revenues on the basis of sale of shares | 95 | 253 |
| 4.2 Outflow | 15,769 | 14,456 |
| 4.2.1 Repayment upon foreign borrowing | 13,896 | 12,729 |
| 4.2.2 Repayment upon domestic borrowing | 1,873 | 1,727 |

Source: Ministry of Finance

In the period January-September 2013, total expenditures of the Budget of the Republic of Macedonia were realised in the amount of Denar 118,802 billion or 71.7% of the projected expenditures under the 2013 Budget. As for the structure of realised expenditures, Denar 106,817 billion was spent for current expenditures or 90%, while the capital expenditures amounted to Denar 11,985 billion.

Expenditures related to salaries and allowances amounted to Denar 16,901 million, while expenditures related to goods and services accounted for Denar 10,796 million. Transfers accounted for the most in total budget expenditures with 64% (Denar 75,947 billion), which, in addition to social transfers in the total amount of Denar 55,265 billion (on the basis of pensions, health protection, employment and social welfare benefits) also include the transfers to the municipalities on the basis of VAT and block and earmarked grants in the amount of Denar 11,347 billion for financing the transferred competences at local level. Category transfers also include the expenditures on the basis of agricultural subsidies paid by the Agency for Financial Support in Agriculture and Rural Development.



In the analysed period, the repayment of principal in relation to the total debt amounted to Denar 14,456 million, while interest-related payments amounted to Denar 3,173 million. Out of the total outflows on the basis of repayment of credits, outflow for repayment of principal to domestic creditors amounted to Denar 1,727 billion, while Denar 12,729 billion were outflows for repayment of principal to non-resident creditors.

In the period January-September 2013, deficit was realised in the amount of Denar 15,790 billion, as a result of the realised revenues in the amount of Denar 103,012 billion and the realised expenditures in the amount of Denar 118,802 billion.

Medium-Term Expectations. Public finance projection for the next medium-term period is based upon the real expectations in 2012 and in the first nine months of 2013, projected macroeconomic indicators for the next period, average recovery of the EU economy and realisation of positive growth rates, as well as the effects of the planned structural reforms and the expected inflow of FDI.

Projected revenues of the consolidated government budget in the next three-year period decline relatively, as a share of GDP, from 32.6% of GDP in 2014 to 31.3% in 2016. As a result of continuity in implementing disciplined budget policy and strengthened consolidation of public spending, in the period 2014-2016, total expenditures will also decline from 36.0% in 2014 to 33.9% in 2016.

Set basic postulates of the fiscal policy in the coming period provide for gradual reduction of the deficit level and its positioning at optimal level of around 2.6% of the projected GDP in 2016.

Table 3.2. Consolidated general government budget (Denar million)

| | 2014 | 2015 | 2016 |
|---|---------|---------|---------|
| Consolidated general government budget - Revenues | 171,941 | 180,713 | 190,002 |
| % of GDP | 32.6 | 32.0 | 31.3 |
| Consolidated general government budget - Expenditures | 190,212 | 198,569 | 205,835 |
| % of GDP | 36.0 | 35.2 | 33.9 |
| Consolidated general government budget - Deficit | -18,271 | -17,856 | -15,833 |
| % of GDP | -3.5 | -3.2 | -2.6 |
| Central Budget - Revenues | 95,430 | 100,308 | 106,641 |
| % of GDP | 18.1 | 17.8 | 17.6 |
| Central Budget - Expenditures | 113,601 | 118,164 | 122,474 |
| % of GDP | 21.5 | 20.9 | 20.2 |
| Central Budget - Deficit | -18,171 | -17,856 | -15,833 |
| % of GDP | -3.5 | -3.2 | -2.6 |
| Budget Funds - Revenues | 46,631 | 49,504 | 52,318 |
| % of GDP | 8.8 | 8.8 | 8.6 |
| Budget Funds - Expenditures | 46,731 | 49,504 | 52,318 |
| % of GDP | 8.9 | 8.8 | 8.6 |
| Budget Funds - Deficit | -100 | 0 | 0 |
| % of GDP | 0.0 | 0.0 | 0.0 |
| Local Government Budget - Revenues | 29,880 | 30,901 | 31,043 |
| % of GDP | 5.7 | 5.5 | 5.1 |
| Local Government Budget - Expenditures | 29,880 | 30,901 | 31,043 |
| % of GDP | 5.7 | 5.5 | 5.1 |
| Local Government Budget - Deficit | 0 | 0 | 0 |
| % of GDP | 0.0 | 0.0 | 0.0 |

Source: Ministry of Finance



Box 3.1. Activities for improving the management of public finances

The Ministry of Finance undertakes a large number of activities for improvement of public finances management. As part of the activities for further enhancement of the financial management in the public sector and future prevention of accumulation of new arrears, in the first half of 2013, procedure for procurement for upgrading the existing software solution of the Treasury Information System (TRIS) started, for the purpose of introducing new module, including data on the multiannual liabilities of budget users, in line with the Annual Plan for Public Procurement of the Ministry of Finance in 2013. In the first half of November, the contractor started the installation of the designed application software, i.e. solution for reporting the multi-annual liabilities in the existing software solution for TRIS. From the second half of November until the end of December, trainings for budget users were conducted, as well as pilot interaction with the new module, for the purpose of enabling it to be fully functional as of 1st January 2014, i.e. it will enable total recording and planning of the multi-annual liabilities, which will result in efficient planning of the liquidity and improvement of the public finance management. This Project will provide data on the liabilities the budget users assume, being basis for medium-term planning. At the same time, it will provide for improving the control and insight by the management of budget users into the assumed liabilities, as well as in both the current and years to come.

In cooperation with the EC, a twinning project for strengthening of the capacity for medium term macroeconomic and budgetary planning is ongoing. At the beginning of 2014, together with the World Bank, Public Finance Review will be done, aiming to improve public finances management and providing fiscal sustainability. In the period 2014-2016, together with the EC, a twinning project named Building up the capacity within the department dealing with central government budget and strengthening medium term policy making capacity, will be implemented, which will enable developing of medium term budget planning.

3.1.2. Medium term outlook

Projected Revenues in the Budget of the Republic of Macedonia. Total genuine revenues of the Budget of the Republic of Macedonia (central government¹⁷) for the period 2014-2016, are projected at around 30% of GDP, whereby expressed as percentage of GDP they reduce by years in conditions of unchanged tax policy, i.e. retaining of low tax rates and low tax burden of the business sector. Tax revenues account for around 56% in the projected revenue structure, followed by revenues on the basis of social contributions with around 28%, non-tax revenues and capital revenues with around 12%, while the rest of the revenues are expected to be realised from IPA Funds and other donations. With respect to tax revenues, most revenues will be realised on the basis of VAT, personal income tax and excises.

Projections for social contributions, which are genuine revenues of the Pension and Disability Insurance Fund, Health Insurance Fund and the Employment Agency, in the next medium-term period are based on the expected positive economic trends, which will appropriately reflect on the growth rates of employment and salaries. Non-tax revenues in the next medium-term period account for around 9% in the overall revenues, and the most significant is the share of revenues on the basis of administrative fees, concessions from mineral raw materials and other non-tax revenues the budget users realize to their own accounts.

Projection on the revenues with respect to foreign donations in the coming period include the donations the budget users would realise for specific projects, as well as disbursements from the EU pre-accession funds.

Projected Expenditures in the Budget of the Republic of Macedonia. The expenditure side of the Budget of the Republic of Macedonia in the next medium-term period is planned for the

¹⁷ Central government budget includes the central budget and the Funds budget

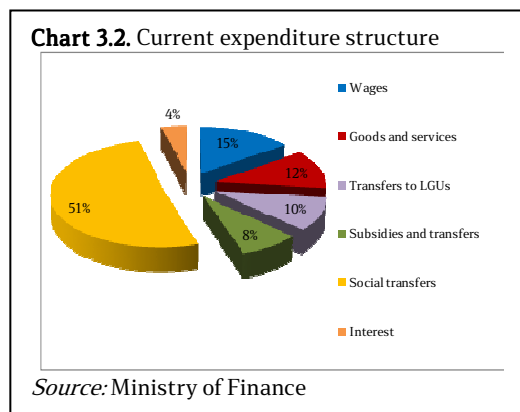


purpose of supporting the economic activity in the country and full recovery of Macedonian economy through increased investments in infrastructure projects, as well as improvement of the economic situation of citizens, with special attention to targeted groups of the population (pensioners and beneficiaries of social benefits). Thereby, disciplined budget spending will continue to be implemented, with an emphasis to restrictiveness and rigorous control over less productive costs, on one hand, and increase of investments in capital projects on the other. Average share of expenditures in the Budget of the Republic of Macedonia in the period 2014-2016 is around 33% of GDP.

When projecting the current expenditures for the next period, the following assumptions were taken into account:

- Continuation of strict control over new employments and gradual increase of government wages;

- Full and on-time payment of increased pensions and social benefits, for the purpose of ensuring the well being of the beneficiaries of these rights. Expenditures for pensions are planned to the end of ensuring further protection of this category of citizens, and during their projection, the expected increase in the number of pensioners and legal pension indexation calculated according to the projected increase of both salaries and costs of living, were taken into consideration. In addition, what is planned is increase of social benefits for socially most vulnerable families and regular servicing of



liabilities on the basis of child allowance, allowances on the basis of rights of disabled persons, invalids of war and civilian invalids and asylum seekers. Planned reforms in the social sphere, by simplifying the procedures for exercising these rights, as well as the effects from the integration of social centers in unique information system, will provide certain savings at the same time extending the scope and properly targeting these allowances towards the most vulnerable categories. To the end of improving the social policy, Conditional Cash Transfer Project is realised, financed by the World Bank, aimed at supporting the Government of the Republic of Macedonia in the efforts to poverty reduction at vulnerable groups by conditioning the existing pecuniary benefits;

- Payment of increased subsidies in the field of agriculture, aiming at strengthening and supporting this sector. Envisaged reforms in the agricultural sector will create conditions for establishing an efficient and competitive agricultural sector and its successful integration in the EU. The reforms will be successfully realised through increased financial support to farmers, for which, EUR 140 million is planned in 2014 and EUR 150 million in 2015, as well as usage of funds under the IPARD Programme.

- Improvement of the quality of university education, improvement of vocational education, as well as public financial support for stimulating the innovations in Macedonian companies. For this purpose, during 2014, realisation of the Skills Development and Innovation Support Project will start, to be financed by the World Bank, through which reforms will be implemented in the field of university education and the strengthening of institutional capacities of universities, to contribute to quality and efficient university education that will correspond to the needs of the private sector and the society as a whole. At the same time, quality of vocational education will be strengthened, to the end of adjusting it to labour market needs.



For the purpose of achieving and maintaining positive economic growth rates, in the next three years, significant portion of the Budget will be intended for public investments, taking into account that they present the development component of fiscal policy. In the past few years, capital projects financed from the Budget were fully justifiable, having great influence in coping with the negative effects from the economic crisis. Thus, 2014 Budget envisaged Denar 22,377 million for capital investments, being by 11% higher compared to 2013.

Regarding the budget funds for capital expenditures, in the coming medium-term period, significant investments are envisaged in completion of the construction of Corridor X highway and railway infrastructure, energy and utilities infrastructures, as well as capital investments in improving the conditions in the educational, social and health system, agriculture, environment protection and judiciary.

In the next period, the construction of new modern highway section Demir Kapija – Smokvica along Corridor X, being 28.18 km long, will be intensified, thus completing the main axis of Corridor X passing through the Republic of Macedonia. Construction of this section is financed with loans from EBRD and EIB, IPA grants and Budget funds.

Regarding the railway infrastructure, it is envisaged to continue the implementation of the Rail Corridor X Project, financed with EBRD loan, by which several sections along Corridor X, the total length of which is around 53 km, will be repaired. Main purpose of the Project is improvement of the railway line, reduction of its maintenance costs and ensuring safe traffic on the above-mentioned sections.

In the field of railway transport, the Project for Completion of Rail Corridor VIII will be implemented. Construction of the eastern part of Railway Corridor VIII, i.e. the part towards Bulgaria, will be carried out in 3 phases and it will be financed with loans from EBRD and EIB, as well as IPA funds. Reconstruction of the first section Kumanovo-Beljakovce with EBRD loan will start in the first half of 2014. For the purpose of preparing and realising this Project, technical assistance was provided from the EU through the Western Balkans Investment Framework (WBIF) and other donors.

As for energy infrastructure, construction of National Gasification System was envisaged, which will supply the business sector, public sector and households with cheap and environmentally friendly energy, at the same time reducing the emission of harmful gases in the atmosphere. Financial plan of the Project is completed with the funds from the liabilities of the former USSR towards the Republic of Macedonia, as well as with loans from EBRD and EIB. The route that will be financed with loans from EIB and EBRD will be built in two phases. First phase, with a total length of 294 km, is planned to be financed with EBRD loan, which is expected to be approved in 2014, while the second phase, with a total length of 454 km, will be financed with loans from EBRD and EIB, as well as funds from IPA 2.

To the end of improving the quality of life, above all in the field of rural areas, by supplying clean drinking water, Water Supply and Waste Water Collection Project, financed with EIB loan, will continue to be implemented. Project is aimed at supporting equal regional development and the development of rural areas is expected to be stimulated through investments in the utility infrastructure. Water and Sewerage Programme Macedonia, Phase I financed from the German Credit Bank for Reconstruction - KfW provides for sustainable supply of potable water to the population in the Municipalities of Bitola, Gevgelija, Gostivar, Kavadarci, Kocani, Negotino, Radovis and Tetovo. This purpose is achieved by improving their water supply systems, performing smaller investment operations within the systems themselves, as well as minor construction works. Second project stage is also envisaged to be realised, including more investments (reconstruction of water supply and sewerage networks) in the municipalities.



Second phase will be realised with EIB support and it will include irrigation, as well as the third phase, which covers electricity generation through the Zletovica Water Basin Utilisation Improvement Project. Technical assistance was allocated to this Project through WBIF instrument, for the purpose of carrying out detailed assessments for the activities that should be realised within this multipurpose project. Main objective of the second stage is provision of irrigation for 4,570 ha net area in the region of Probistip and Kratovo municipalities. Realisation of the third stage, which includes construction of small hydro power plants along the flow of Zletovica River, will provide for reducing electricity shortage, safe, secure and quality supply of energy for the consumers, increasing energy efficiency, as well as possibilities for job creation in the region. Second phase of the Project Irrigation Programme Southern Vardar Valley II is financed with KfW loan and it covers rehabilitation and modernisation of the systems for irrigation of land area covering 3.904 hectares. Successful realisation of this Programme will contribute to higher productivity and sustainable development of agricultural production in the Southeastern region.

The realisation of the first phase of the Project for Rehabilitation of Health Provider Institutions continues in 2014, financed from the Council of Europe Development Bank (CEB). Main objective of the Project is to improve health infrastructure, operational services for delivery of respective health services, as well as to introduce new and modern equipment and technology to replace most of the existing obsolete equipment. This phase includes reconstruction or rehabilitation of 20 public health institutions Health Provider Institutions (HPIs) being in worst condition. With grant provided from EU through WBIF instrument, investments in the Institute for respiratory diseases in children – Kozle are financed.

In addition, Report on feasibility of the second phase of this Project is prepared with technical assistance from the EU through WBIF instrument and technical assistance from CEB. Second phase of the Project will include larger investments and installation of medical equipment in the Clinical Center "Mother Theresa" - Skopje and the Regional Clinical Hospital in Stip. It is expected for CEB loan to be approved in the first quarter of 2014, after which the realisation of this Project will start.

Project for Building Physical Education Facilities in Secondary Schools, financed with CEB loan and contribution of the Republic of Macedonia will continue to be realised. This Project will cover construction or reconstruction of 30 physical education facilities for the purpose of improving the conditions of the physical education. In addition, under WBIF instrument, grants were approved, being intended for rehabilitation of physical education facilities in secondary schools, procurement of equipment and renovation of several secondary schools.

In addition, realisation of the Project for Building Physical Education Facilities in Primary Schools and Rehabilitation of Primary and Secondary Schools in the Republic of Macedonia will continue, financed with loan from CEB and contribution of the Republic of Macedonia, being aimed at improving physical education, as well as improving the overall learning conditions of pupils in primary and secondary schools. In addition, under WBIF instrument, grants were approved, being intended for financing several primary schools and existing physical education facilities, as well as equipment of existing physical education facilities.

One of the important elements of the policy for social development is improvement of quality of life of persons with low incomes and vulnerable groups by providing their adequate housing. Therefore, in 2014, realisation of the Project for Housing of Socially Vulnerable Groups with CEB loan and contribution of the Republic of Macedonia.

To the end of ensuring, exercising and improving human rights as regards conditions for accommodation, hygiene, health protection and leisure time of the convicted and detained



persons, Project for Reconstruction of Penitentiary Institutions, financed with CEB loan, will start to be implemented in 2014. Under this Project, the reconstruction of four correctional facilities will be completed, and standards in line with the European prison rules will be implemented.

In 2014, the activities related to upgrading of the already commenced reform in the Real Estate Cadastre continue to be realised, supported with additional financing of the World Bank funded Real Estate Cadastre and Registration Project. Project realisation will provide for improving delivery of public services in the real estate cadastre sector and registration of rights, having direct impact on the economic development through the real estate market. Project also supports the Property and Legal Affairs Office by improving the working conditions in the regional offices, as well through automatisisation of business processes and digitalisation of the existing records to the end of creating digital archives.

Although not being part of the central government budget, it is still important to point out the investments in the energy sector, aimed at increasing the generation of electricity from renewable energy sources up to 20% in line with the guidelines presented in the Europe 2020” Strategy and the 2020 Strategy for Renewable Energy Sources of the Republic of Macedonia. Hence, in the coming medium term, rehabilitation of six hydro power plants, financed with a loan from KfW, will continue. “Wind Farm Bogdanci” Project, financed with a loan from KfW, is being implemented, the realisation of which will contribute to increasing the installed capacity of AD ELEM by around 30-40 MW. In addition, in the next period, construction of Lukovo Pole Dam and intake of Korab Waters is expected to start, which will be financed with a loan from the World Bank, and the construction of Boskov Most Hydro Power Plant will continue, which it will be financed with EBRD loan. At the same time, realisation and modernisation of Thermal Power Plant Bitola continues with financial support from Deutsche Bank, to the end of reducing the emissions of nitric oxides – Nox, in line with the EU directives. In addition, in the course of 2014, with World Bank loans, construction of 110 kV transmission line, Bitola 3 electricity transformation station to Bitola 4 electricity transformation station will continue, as well as revitalization of 110 kV transmission line Skopje 1 - Tetovo 1 and construction of 400 kV transmission line Stip (Republic of Macedonia) - Nis (Republic of Serbia). Construction of 400 kV transmission line Bitola (Republic of Macedonia) – Elbasan (Republic of Albania) is expected to start with EBRD loan. In addition, in 2014, AD MEPSO with EBRD loan, without sovereign guarantee, will start to improve the energy transmission network, thus increasing the quality of delivery and safety when supplying electricity, at the same time, revitalizing the 110 kV transmission lines, being older than 40 years. In the period to come, it is also expected for AD ELEM to start the implementation of Up-rate of HPP Spilje, Project District Heating of Bitola, Mogila and Novaci – first stage, as well as procurement of adequate mine equipment for excavation site Podinska coal series in Suvodol, for the purpose of exploiting coal from the excavation site so as to enable smooth production of the three blocks in TPP Bitola, as well as the project “Coal excavation site Zivojno”. Modernization of TPP Oslomej and opening of the mine Popovjani are also envisaged.

Although they are not part of the Central budget of the Republic of Macedonia, it is important to mention other investments in the transport sector:

In 2014, the realisation of two major infrastructure projects is envisaged, such as the construction of highway section Miladinovci - Stip and highway section Kicevo - Ohrid with a loan from Export-Import Bank of China. Construction of these sections will contribute to the overall development of the country, higher growth rates of the economy, higher living standard and better living conditions for the citizens. Realisation of the projects will provide for



improvement and development of road infrastructure in this part of the Republic of Macedonia, ensuring fast, secure and safe road traffic.

With the project for construction and installation of an electronic system for collecting tolls along Corridor X, financed by a loan from the EBRD, electronic toll collection will be implemented on existing toll stations and four new toll stations on Corridor X will be built and equipped.

In the next period the realization of the "Macedonian Railways Fleet Renewal Project" will continue, financed by loan secured from EBRD. The purpose of the Project is purchase of 4 three-car diesel passenger multiple units, purchase of 2 three-car electric passenger multiple units, rehabilitation of 8 electric locomotives and provision of 150 new cargo wagons from different types. Additionally, for realisation of this project, EBRD provided grant funds for consulting services.

In the next period, the implementation of the Project for upgrading of the Macedonian air navigation system - second stage without sovereign guarantee will continue, which is expected to increase the capacity of flights per year, as well as improved monitoring and control of air traffic in real time.

Budget Implications from the Envisaged Structural Reforms¹⁸. Projected expenditures of the Budget of Republic of Macedonia also include the expenditures for the key structural reforms shown in Part IV of PEP. Table 3.3 shows the net-budget impact¹⁹ of the envisaged measures in the separate areas. Net budget impact was the biggest in the field of labour market, mainly as a result of the purpose of the Government to reduce unemployment, being identified in Part II (Box 2.1.) as a serious internal imbalance.

Table 3.3. Net budget impact from the key planned reformatory measures (Denar million)

| | 2013 | 2014 | 2015 | 2016 |
|--|----------------|----------------|----------------|----------------|
| Business environment | -165.6 | -386.4 | -438.7 | -16.7 |
| Labour market | 2.304.1 | 2.220.7 | 2.286.8 | 2.349.2 |
| Enterprise sector | -5.0 | -69.4 | -57.5 | 8.5 |
| Financial system | - | -38.4 | -28.5 | - |
| Agriculture | 61.2 | 998.5 | 878.6 | 991.3 |
| Rule of law | 158.1 | 168.4 | -54.7 | 6.3 |
| Administrative reforms | - | -44.9 | -2.0 | 38.1 |
| Customs system | -52.2 | -114.9 | -38.0 | -28.9 |
| Energy | -7.0 | -31.4 | -17.5 | 10.0 |
| Transport | -102.6 | -169.6 | -43.1 | - |
| Total impact on the Budget | 2,191.1 | 2,523.5 | 2,485.5 | 3,357.8 |
| Total impact on the Budget (% of GDP) | 0.44 | 0.48 | 0.44 | 0.55 |

Source: Ministry of Finance

Projected Deficit and its Financing. In line with 2014 Budget revenue and expenditure projections, the deficit was projected at 3.5%, while on the medium run, budget deficit was projected at 3.2% in 2015 and at optimal level of 2.6% of GDP in 2016.

Financing of the planned deficit will be provided from foreign sources (favourable credits from international financial institutions intended for financing certain projects, loan for development polices from the World Bank intended for budget support and other foreign sources of financing the budget deficit) and domestic sources (issues of government securities). Despite the great caution of foreign investors on the international capital market due to the present downward

¹⁸ For more details see Part IV.

¹⁹ Net budget impact from certain measure is difference between the funds from the Budget of the Republic of Macedonia for certain area and the revenues from IPA, as well as other revenues in the form of donations.



risks in the scenario for economic recovery of the EU, Government of the Republic of Macedonia, at the beginning of 2013, managed to provide financial resources in the amount of EUR 250 million through the new World Bank Policy Based Guarantee, under very favourable conditions.

In the next period, the developments on the international capital market will continue to be monitored. Foreign borrowing as source of financing will be used by budget users for realisation of specific projects.

As for the borrowing on the domestic market, Ministry of Finance will continue to issue government securities in the next period as well. The purpose is, by regular presence of government securities, to provide for more efficient financing of budget needs on the short and long run, reduction of financing costs, as well as encouragement of the further development of domestic financial market. Thus, in the period to come, special emphasis will be put on regular presence of longer-term securities and continuation of the maturity of the permanent portfolio of government securities by issuing longer-term securities, i.e. by issuing 2-, 3-, 5-, 7- and 10-year government bonds. Special interest in investing in longer-term securities issued by the Republic of Macedonia is expected from the pension companies, as well as from commercial banks and insurance companies.

Table 3.4. Projected deficit and sources of its financing (Denar million)

| | 2014 | 2015 | 2016 |
|-----------------------------------|---------|---------|---------|
| Budget balance | -18,271 | -17,856 | -15,833 |
| Deficit financing | 18,271 | 17,856 | 15,833 |
| Inflows | 29,131 | 45,081 | 35,833 |
| External sources | 5,276 | 34,772 | 25,194 |
| Domestic sources | 9,940 | 10,148 | 10,455 |
| Deposits | 13,915 | 161 | 184 |
| Outflows | 10,860 | 27,225 | 20,000 |
| Repayment upon foreign borrowing | 9,133 | 20,372 | 13,718 |
| Repayment upon domestic borrowing | 1,727 | 6,853 | 6,282 |

Source: Ministry of Finance

Furthermore, to the end of improving the liquidity of domestic market, in the coming period, series of measures and activities are planned to be undertaken, which will refer to gradual reduction of the participation of government securities with foreign exchange clause, targeting of positive annual net borrowing and re-opening of the already held auctions of government securities.

In addition, Ministry of Finance will continue the activities pertaining to expansion of the investor base by considering the possibility to introduce new financial instruments adequate to the needs of the market participants, carrying out marketing campaign aimed at different target groups of investors and maintaining regular dialogue with all participants on the government securities market.

Local Government Budget. In the course of 2014, as well as on the medium run, it is expected for the municipalities to continue the trend of improved collection of own revenues, strengthening the capacities for development of financing policies and enhancing the capacities for financial management.

In the period 2005 – 2012, collection of own revenues (local taxes) experienced more than two-fold increase, while share of local taxes in GDP of 1% in 2005 surged to 1.6% in 2012, showing that capacity of LGUs was continuously strengthened.



Increase of the amount transferred to the municipalities on the basis of VAT grants (general grant), accounting for 4.5% of the collected VAT in the previous year, provided for additional stable revenues for the municipalities.

LGUs' own revenues are expected to continue the upward trend in the coming medium-term period, in particular revenues on the basis of real estate taxes, fully including the tax base of natural persons and legal entities and re-assessing the value of real estate. Increase is also expected by applying the improved elements for calculation in the Methodology for Determining Real Estate Market Value, adopted pursuant to the Law on Assessment and Determination of Tax Base for Tax on Sales of Unconstructed Land in Public Auction Procedure. Commencing the application of the legal provisions as regards professionalisation in determining the value of the real estate for the needs of taxation on the basis of property taxes is expected to provide for better quality and more objective assessment of the value of real estate, thus providing the municipalities the possibility to employ an expert – an evaluator or to use the services of licensed evaluators.

Additional increase of own revenues of the municipalities is expected to be realised from the fee collected by issuing concession for usage of water resources for electricity generation (50% for the central government budget and 50% for the local authorities), depending on which area the concession activity is performed as of 2016, and, in the meantime, revenues will be distributed in the following proportion: 75%:25%.

In the coming medium term, LGUs will continue with more intensive execution of the transferred competences for management of construction land and treatment of illegally built facilities and agricultural land, for which respective sources of revenues in LGUs budget are determined.

Strengthening of management at local level is supported under the Municipal Services Improvement Project, financed by the World Bank. The Project provides for favourable loans to the municipalities which, pursuant to the legal regulations, can borrow for the purpose of financing infrastructure investments in line with the LGUs priorities. Implementation of the second phase of this Project continues in 2014. Capital municipal projects will be financed under the Project in the field of water supply, sewerage and wastewater collection, energy efficiency, local road infrastructure, utility services and other priority municipal projects.

So far, 45 municipalities have shown interest in using this credit line. Ministry of Finance has concluded on-lending agreements with 30 municipalities in the total amount of EUR 20 million, while the remaining 15 municipalities, which are expected to conclude on-lending agreements in the course of 2014, have submitted projects in the total amount of EUR 15.4 million. Undisbursed funds under this loan amount to EUR 12.6 million and they will be distributed in the period 2014-2016, depending on the interests of the municipalities.

For the purpose of improving the living conditions and the quality of life, in particular in the rural areas in the Republic of Macedonia, by providing potable water, implementation of the Water Supply and Waste Water Collection Project commenced. This Project is financed by EIB, whereby the loan funds are awarded to 84 municipalities and the municipalities in the City of Skopje in the form of grants.

At the same time, pursuant to the legal regulations, LGUs fulfilling the legal criteria to borrow, will be able, in the coming period, to finance their projects by borrowing on the basis of concluding loan agreements at domestic or foreign creditors or on the basis of issuing municipal bonds. Hence, conditions will be created for a more dynamic local development, higher employment rate and better living standard and better quality life in the municipalities.



3.1.3. Structural Deficit

Economic activity over time tends to grow, but moving towards the trend line, it usually fluctuates above and below the long-term trend. Such cyclical developments in the economy are reflected in the fiscal developments as well, through automatic stabilisers. In order to exclude the effects from the fluctuations of the economic activity on the fiscal indicators and to assess the basic fiscal position of the country, we calculate and analyse the cyclically adjusted budget deficit. Cyclically adjusted budget balance is obtained by adjusting the budget revenues and the budget expenditures by the effect of deviation of the potential from the actual GDP, and the adjustment is made on aggregate level.

Table 3.5. Aggregate fiscal indicators and production gap

| | 2012 | 2013 | 2014 | 2015 | 2016 |
|--|-------------|-------------|-------------|-------------|-------------|
| Total budget balance | -3.9 | -3.9 | -3.5 | -3.2 | -2.6 |
| Primary budget balance | -3.0 | -3.1 | -2.6 | -2.2 | -1.5 |
| Production gap | -2.4 | -1.8 | -1.2 | -0.1 | 1.8 |
| Cyclical component of the budget | -0.8 | -0.6 | -0.4 | 0.0 | 0.6 |
| Cyclically adjusted total budget balance | -3.2 | -3.3 | -3.1 | -3.2 | -3.2 |
| Cyclically adjusted primary budget balance | -2.2 | -2.5 | -2.2 | -2.2 | -2.1 |

Source: Calculations of the Ministry of Finance

Note: Data on production gap and cyclically adjusted total/primary budget balance are expressed in relation to the potential GDP.

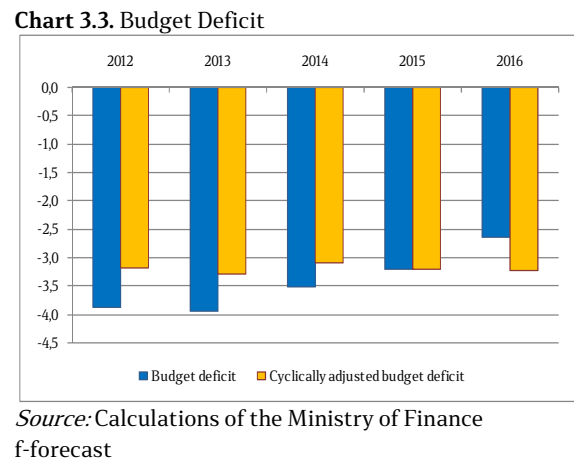
Calculations point out that cyclically adjusted budget deficit accounted for 3.3% in 2013, and it was lower than the projected budget deficit in 2013, taking into account that cyclical component of the budget has a negative value, as a result of the assessed negative production gap.

In 2014, cyclical component of the budget is negative, taking into account that projected GDP is expected to remain below the potential GDP and the assessment of the cyclically adjusted budget deficit accounts for 3.1%. In 2015, by closing the gap between the projected and the potential GDP, value of the cyclically adjusted budget deficit is leveled with the projected budget deficit, i.e. it accounts for 3.2%. In 2016, in conditions of positive production gap, cyclically adjusted budget deficit is projected at 3.2%. During the analysed period, cyclically adjusted primary budget deficit accounts for 2.2% (see Table 3.5).

3.1.4. Public Debt Management

Medium-Term Fiscal Strategy is the framework determining the public debt management policy in the Republic of Macedonia. Government of the Republic of Macedonia has adopted 2014-2016 Fiscal Strategy.

On the basis of the commitments to finance the state needs with the lowest possible costs on the medium and the long run, sustainable level of risk and low level of government debt, as well as realisation of the planned infrastructure investments, government debt trend is planned to remain within the projections, i.e. moderate increase is envisaged, which will not jeopardise the





sustainability of public finances. Hence, government debt is not expected to exceed the level of 37.0% of GDP by the end of 2016.

In order to reduce the exchange rate risk, hence the interest rate risk, optimal currency structure of government debt portfolio in foreign currency is determined, whereby share of euro-denominated debt in the structure of foreign currency debt portfolio should not be below the level of 70%. In addition, level of government debt with fixed interest rate in 2014 is projected to account for at least 50%.

Government debt of the Republic of Macedonia²⁰ at the end of the third quarter in 2013 amounted to EUR 2,708.1 million, i.e. 33.7% of GDP, being significantly lower than the average at EU level. Total public debt of the Republic of Macedonia amounted to EUR 3,225.8 million at the end of the third quarter, accounting for 40.2% of GDP.

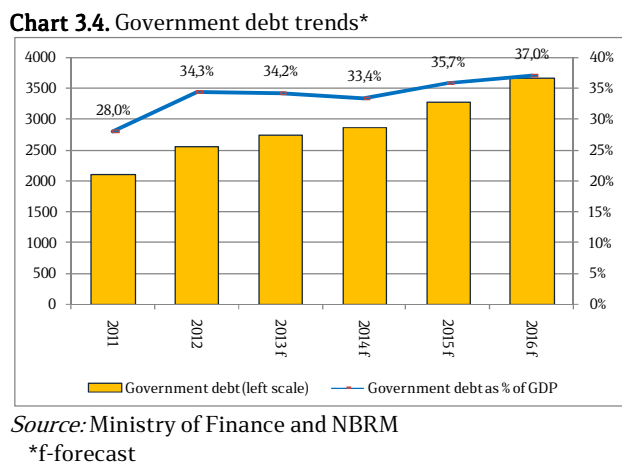
Table 3.6. Public debt stock* (EUR million)

| | 2009 | 2010 | 2011 | 2012 | 30.09.2013 |
|---|----------------|----------------|----------------|----------------|----------------|
| External Public Debt | 1,302.1 | 1,407.9 | 1,866.4 | 1,952.7 | 2,094.2 |
| Government debt | 1,105.3 | 1,173.8 | 1,582.1 | 1,615.9 | 1,612.0 |
| Public enterprises | 196.8 | 234.1 | 284.3 | 336.8 | 482.2 |
| Domestic Public Debt | 494.7 | 551.3 | 534.9 | 967.9 | 1,131.6 |
| Government debt | 492.0 | 537.0 | 510.8 | 938.6 | 1,096.1 |
| Public enterprises | 2.7 | 14.3 | 24.1 | 29.3 | 35.5 |
| Total public debt according to GFS Methodology and pursuant to Public Debt Law | 1,796.7 | 1,959.2 | 2,401.3 | 2,920.6 | 3,225.8 |
| Total public debt as % of GDP | 26.8 | 27.8 | 32.1 | 39.2 | 40.2 |
| Government debt | 1,597.2 | 1,710.8 | 2,092.9 | 2,554.5 | 2,708.1 |
| Government debt as % of GDP | 23.8 | 24.2 | 28.0 | 34.3 | 33.7 |

Source: Ministry of Finance and National Bank of the Republic of Macedonia

*NBRM debt is not included in the calculations for the total public debt, pursuant to paragraph 4, Article 7 of the Public Debt Law.

During the analysed period, domestic public debt accounted for 35.1% in the total public debt, while the external public debt accounted for 64.9%. Share of domestic public debt increased by 1.9 p.p. compared to the share of the external public debt. In the period January - September 2013, changes to the total public debt were observed in terms of the interest structure. Hence, decrease of variable interest rate debt by 2.8 p.p. was noticed compared to end-2012, and ratio between fixed interest rate debt and variable interest rate debt was 53.3% to 46.7% respectively. Increase of fixed interest rate debt was a result of the increased



²⁰Government debt comprises financial liabilities incurred on the basis of borrowing by the Republic of Macedonia, including the debt of public institutions established by the Republic of Macedonia and the municipalities, the municipalities within the City of Skopje and the City of Skopje.



level of issued bonds in the government securities portfolio, as well as of the PBG 2 loan, having fixed interest. From currency point of view, share of euro-denominated debt in the foreign currency debt portfolio accounted for 79% and, compared to end-2012, it increased by 5 p.p.

Moderate growth of investment activity is projected in the course of 2014, by using credit support from abroad. In addition, in the period 2014 - 2016, new investments in the field of energy, road and railway infrastructure, water supply and sewerage network, sports facilities, construction of social flats, as well as investments in the field of education, aimed at boosting productivity, i.e. strengthening competitiveness of the economy on the long run, are expected. In the coming medium term, larger volume of investments is expected in the energy sector, which would be realised through borrowing by the public enterprises in the energy sector. However, in the coming medium-term period, the government debt was projected at 37.0% of GDP, with firm commitment not to jeopardise the long-term sustainability of the level of country indebtedness.

In the period 2014-2016, guaranteed debt in relation to GDP is expected to experience a moderate increase, as a result of the new planned projects in the area of road infrastructure, energy sector, projects for financing SMSs for which the Government will issue guarantees (sovereign guarantees). Issued sovereign guarantees amount to Euro 500.97 million as of 30th September 2013 inclusive, accounting for 6.2% of GDP.

Primary Government Securities Market. According to the Calendar for Issuance of Government Securities on the Domestic Market, in the course of 2013, Ministry of Finance issued 3-, 6- and 12-month treasury bills on regular basis, as well as 2-, 3- and 5-year government bonds. In the period January – September 2013, total of 77 auctions of government securities were carried out, i.e. 52 auctions of treasury bills and 25 auctions of government bonds. Total amount offered for sale at the auctions was Denar 77,679.42 million, demand amounted to Denar 89,441.37 million, and the amount realised was Denar 74,395.42 million.

As of September 2013 inclusive, stock of outstanding government securities (short-term and long-term) amounted to Denar 60,528.58 million, Denar 39,879.23 million out of which as treasury bills and Denar 20,649.35 million as government bonds.

In the period January-September 2013, interest rates on government securities experienced multiple reduction. Hence, depending on interest rate maturity, interest rates on treasury bills dropped and such reduction ranged from 0.30 p.p. to 1.15 p.p., whereby interest rates on 3-month treasury bills without and with foreign exchange clause dropped by 0.35 p.p. and 0.30 p.p. respectively, accounting for 3.65% and 3.60% respectively at the end of March; interest rates on 6-month treasury bills without and with foreign exchange clause dropped by 0.95 p.p. and 0.90 p.p. respectively, accounting for 3.15% and 3.10% respectively at the end of September; interest rates on 12-month treasury bills without and with foreign exchange clause dropped by 1.15 p.p. and 1.10 p.p. respectively, accounting for 3.60% and 3.40% respectively at the end of September. During the same period, interest rates on long-term securities dropped and such reduction ranged from 0.90 p.p. to 1.00 p.p., whereby interest rates on 2-year government bonds without and with foreign exchange clause accounted for 4.00% and 3.80% respectively at the end of September; interest rates on 3-year government bonds without and with foreign exchange clause dropped by 0.95 p.p. and 1.00 p.p. respectively, accounting for 4.35% and 4.10% respectively at the end of September; and interest rates on 5-year government bonds without and with foreign exchange clause dropped by 0.90 p.p., accounting for 4.80% and 4.60% respectively at the end of September.

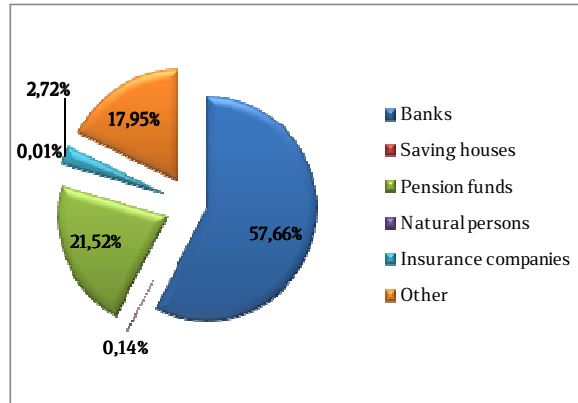
Despite the reduced share of banks in the ownership structure of outstanding government securities, the trend of their dominant share in ownership structure of government securities



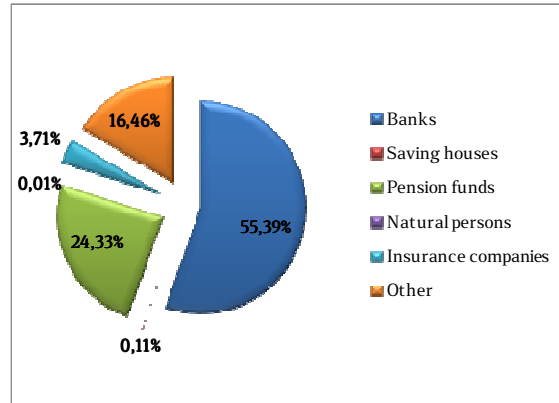
continued in the course of 2013 as well (Chart 3.5). In the period January - September 2013, except for the pension funds and the insurance companies, all other categories of market participants experienced decrease of their share in the ownership structure. During the analysed period, share of banks dropped by 2.27 p.p. in relation to the share of other market participants. As of September 2013 inclusive, ratio between banks and other market entities was 55.39% to 44.61% respectively.

Chart 3.5. Ownership structure of outstanding government securities

As of 31.12.2012



As of 31.12.2012



Source: Ministry of Finance

Secondary Government Securities Market. Legal regulations on secondary trading in the Republic of Macedonia provide for trading in all structural government securities on the Macedonian Stock Exchange AD, as well as trading in continuous government securities on the OTC market.

In the period January - September 2013, Macedonian Stock Exchange registered trading only in government denationalisation bonds, whereby total of 1,604 transactions were realised. Total volume of trading during this period amounted to Denar 667.33 million, which is a reduction by 30.65% compared to the same period previous year.

During the same period, total of twenty transactions with government securities were realised on the OTC market, fifteen transactions out of which pertained to treasury bills, while five transactions pertained to government bonds, and total nominal value of the trading amounted to Denar 1,963.83 million. Compared to the trading in the same period in 2012, it can be concluded that larger number of transactions with government securities were realised in 2013 and total nominal amount of trading was higher by Denar 955.83 million.

International Capital Market. In January 2013, Ministry of Finance fully repaid the Eurobond issued in 2009. Total amount paid on the basis of principal and coupon interest amounted to EUR 183.64 million. To that end, by timely servicing of liabilities on regular basis, a clear signal was sent on the ability and solvency of the Republic of Macedonia to timely settle its liabilities, thus additionally enhancing the reputation of the country on the international capital market and increasing the confidence at the foreign investors.

In the course of 2013, the Eurobond, issued by the Republic of Macedonia in 2005, continued to be traded on international capital market. Purchase price of the 2005 Eurobond, falling due in 2015, ranged from 95.5% to 99%, while yield to maturity ranged from 5.02% to 5.25%.

Credit Rating of the Republic of Macedonia. Each year, Republic of Macedonia obtains new revised credit rating by the international credit rating agencies "Fitch" and "Standard&Poor's".

On 15th October 2013, "Fitch" Credit Rating Agency announced that it affirmed the previously awarded credit rating for foreign and domestic currency of the Republic of Macedonia BB+, as



well as the stable outlook of the country. This credit rating was awarded to the Republic of Macedonia in 2010, and since then onwards, it has been affirmed each year. Affirmation of the credit rating of the Republic of Macedonia awarded by “Fitch” is based upon the low level of inflation, moderate budget deficit, relatively low public debt, as well as well-capitalised banking sector. In addition, credit rating affirmation is also based upon sound economic policies, as well as upon inflow of foreign investments, being potential for economic growth, and their increase in future may also have positive influence on the improvement of the credit rating grade of the country. Stable credit rating of the Republic of Macedonia is a strong signal to foreign investors and has positive impact on the interest rate at which the country borrows on the international capital market, as well as the overall economic and political image of the Republic of Macedonia. In addition, affirmation of the credit rating is a strong signal to the foreign investors that Republic of Macedonia is a country which they can have confidence in and could be assured of sound macroeconomic policies in future as well.

On 24th May 2013, “Standard&Poor’s” Credit Rating Agency reduced the previously awarded credit rating for foreign and domestic currency of the Republic of Macedonia from BB to BB-, at the same time affirming the stable outlook of the country. “Standard&Poor’s” Report indicated that, despite the reduction of the credit rating from “BB/stable” to “BB-/stable”, Republic of Macedonia remained to be a relatively low indebted country, which was one of the factors affirming the stable outlook of the country (BB-/stable).

3.2. Sensitivity Analysis

Sensitivity of Budget Deficit. Medium-term projections are always coupled with certain degree of uncertainty and risks, thus we present here a review of the results from the sensitivity analysis, examining budget deficit sensitivity under three pessimistic scenarios, the conditions being different than the ones taken as basis for medium-term projections.

Taking into account that medium-term fiscal scenario is based on macroeconomic assumptions, we believe they are a factor with potential effect on the fiscal trends. Thus, as a first scenario, we assume lower economic growth as presented in the alternative scenario elaborated in Section 2.3. Baseline scenario, which budget revenue and expenditure projections are based on, envisages real GDP growth of 3.2% in 2014, 3.8% in 2015 and 4.5% in 2016, while according to the alternative scenario the projection for real GDP growth is 2.1% in 2014, 2.7% in 2015 and 3.3% in 2016. As a result, budget deficit in 2014 is by 0.3 p.p. higher compared to the baseline scenario. In 2015 budget deficit is by 0.4 p.p. higher than the baseline scenario, while in 2016 it is higher by 0.6 p.p. Table 3.7. shows the budget deficit in the analysed period according to the baseline and the alternative scenarios.

Table 3.7. Sensitivity analysis of budget deficit

| | 2014 | 2015 | 2016 |
|--|------|------|------|
| GDP, real growth rate | 3.2 | 3.8 | 4.5 |
| Budget revenues, growth rate | 6.0 | 5.5 | 5.6 |
| Budget expenditures, growth rate | 4.7 | 4.7 | 3.9 |
| Budget deficit (% of GDP) | | | |
| Baseline Scenario | -3.5 | -3.2 | -2.6 |
| Scenario 1. Lower GDP growth rate in the analysed period according to the alternative scenario | -3.8 | -3.6 | -3.2 |
| Scenario 2. Lower growth rate of revenues by ¼ in 2014 and 2015 | -3.9 | -4.0 | -3.4 |
| Scenario 3. Higher growth rate of expenditures by ¼ in 2015 | -3.5 | -3.7 | -3.1 |

Source: Calculations of the Ministry of finance



As a second scenario, we assume for economic entities to refrain from spending, and the result thereof would be reduction of the annual growth rate of total budget revenues in 2014 and 2015 by 25% compared to the previously projected ones presented in Table 3.7. Under such assumptions, budget deficit in 2014 would amount to 3.9%, 4% in 2015 and 3.4% of GDP in 2016.

Under the third scenario, one-off shock is envisaged on the budget expenditure side in 2015, which generates 1/3 higher growth rate of budget expenditures in relation to the projection in the baseline scenario. As a result, budget deficit is higher by ½ p.p. in 2015 and 2016 then the level envisaged with the basic projections, reaching 3.7% of GDP in 2015 and 3.1% of GDP in 2016.

Government of the Republic of Macedonia is prepared, should any of the presented scenarios occur, to respond appropriately, by adjusting the expenditures to a level necessary to maintain the projected budget deficit. On the other hand, sound economic policies, macroeconomic stability and low level of government debt provide for the Republic of Macedonia to borrow favourable credits from international financial institutions, credits from commercial banks that would be guaranteed, above all, by the World Bank, as well as credit lines intended for financing certain projects.

Public Debt Risks. Uncertainty arising from the future trends of macroeconomic variables on the international capital market significantly affects the decision making for efficient management of debt portfolio of the country. In conditions of large oscillations of economic variables, need arises to actively manage risks to which public debt portfolio in the Republic of Macedonia is exposed.

The following appear as main risks identified at managing this portfolio: re-financing risk; market risk, including interest rate risk and exchange rate risk; risk of contingent liabilities and operational risk.

Sensitivity of Public Debt. To the end of analysing sensitivity of public debt portfolio in the Republic of Macedonia to exposure to market risk, i.e. interest rate risk and exchange rate risk, analysis was made of the effects of changes in the interest rate and the exchange rate on the external government debt. This sensitivity analysis of the trends on interest-related costs in the Budget of the Republic of Macedonia on the basis of external debt is based on the assumptions that by changing a single variable, all other variables remain the same, i.e. ceteris paribus; the assumption that in conditions of possible trends at other currencies in relation to the euro, Denar exchange rate in relation to the euro remains stable; and the assumption of lack of correlation between interest trends and exchange rate trends.

Analysis covers the period 2014-2016, and it is based upon scenarios for increase of interest rate by 1 p.p. and 2 p.p. compared to the baseline scenario, as well as appreciation and depreciation of the euro compared to the other currencies by 10%.

Table 3.8. Sensitivity analysis of servicing-related costs of the external government debt where there is change in both the interest rates and the foreign exchange rates

| | 2014 | 2015 | 2016 |
|--|--------------|--------------|--------------|
| Baseline scenario | 100.0 | 100.0 | 100.0 |
| Scenario 1: + 1 pp. interest rate | 112.8 | 111.8 | 107.3 |
| Scenario 2: + 2 pp. interest rate | 125.5 | 123.5 | 114.6 |
| Scenario 3: appreciation of other currencies of the portfolio in relation to the euro by 10% | 105.7 | 103.8 | 101.9 |
| Scenario 4: depreciation of other currencies of the portfolio in relation to the euro by 10% | 94.3 | 96.2 | 98.1 |

Source: Calculations of the Ministry of finance



Main conclusions under this analysis are the following:

- interest-related costs for servicing on the basis of external government debt are sensitive to the trends at interest rates. If the interest rates in the period 2014 – 2016 increase by 1 p.p., it would cause increase of the interest-related costs by 12.8% at the most, as a result of the exposure of the debt portfolio to the interest rate risk, being a result of the relatively high share of the debt with variable interest rates.
- In this period, possible unfavourable trends at exchange rates of other currencies, in relation to the euro, will not cause any more significant increases of the servicing-related costs, due to the fact that most of the external government debt is denominated in euros. Therefore, future euro appreciation, i.e. depreciation, in relation to the other currencies in the portfolio (US dollar, Japanese yen and special drawing rights) by 10% will cause an increase, i.e. decrease, of servicing-related costs at the most by 5.7% in 2014, 3.8% in 2015 and 1.9% in 2016. In addition, due to the de facto fixed Denar exchange rate in relation to the euro, this risk is minimised, i.e. sensitivity of public debt portfolio is at lower level.

3.3. Quality of Public Finances and Institutional Features

Sound public finances management is top priority for both the Government of the Republic of Macedonia and the Ministry of Finance, taking into account the economic, social and political significance of the Budget, especially in conditions of great uncertainty and evident challenges to the European and the global economy. In order to ensure sustainability of the national budget and the financial system, as well as stable and sustainable economic development, professional public finances management is required.

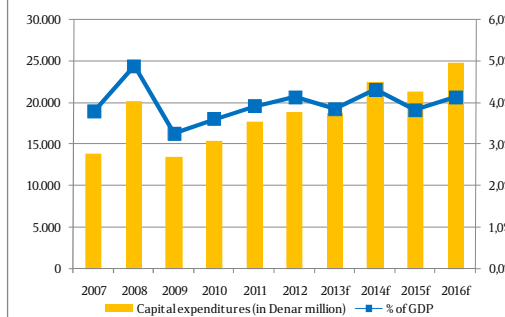
In the course of 2014, as well as in the coming medium-term period, policies will be aimed at improvement of public finances quality on both revenue and expenditure side.

Republic of Macedonia managed the consequences from the global economic crisis quite well, above all as a result of the adequate institutional and legal framework and the effects from the government anti-crisis measures. Hence, in the coming period, public expenditures will continue to be an important instrument to increase the potential development and to be used

as intervention instrument to increase both the production and the demand. At the same time, in the course of 2014, as well as in the coming medium-term period, structural improvement of the expenditure side of the Budget is expected, by significantly increasing the share of capital investments and maintenance of the social component and better controlled and more restrictive usage of less productive expenditures.

Thereby, in line with the priority sectoral policies, in the coming medium-term period, significant increase of capital investments for construction of road and railway infrastructure is envisaged, which will have positive effects on the revival of the economic activity and quality of life. In addition, by increasing the pension and social benefits, increasing agricultural subsidies, as well as credit lines for SMEs for starting new businesses with low interest rates, will provide for increase of the living standard, employment and economic development.

Chart 3.6. Capital expenditures



Source: Ministry of finance

f* - forecast



As regards the coming medium-term period, it is expected, through increased efficiency in using budget funds to ensure improvement of the services in the area of social protection, health, education and infrastructure.

Many activities will be undertaken in the coming medium-term period to improve the budget process, including full harmonisation of the legal regulations with the EU Acquis, strengthening the strategic planning and shifting the timeframe for the budget process. In addition, programmatic classification of expenditures will be applied, i.e. criteria and procedures on defining the budget programmes will be clearly defined, to the end of properly grouping the government activities and the public finances. Reporting on budget execution in line with GFS 2001 and ESA 2005 will be applied, and activities will be undertaken for medium-term planning with fixed limits on the expenditures, meaning improvement of the Fiscal Strategy document by mandatory determining of medium-term limits of expenditures, all to the end of protection against possible procyclical tendencies. Activities will be undertaken to introduce goals and performance indicators, i.e. gradual creation of a base for performance budgeting and respective support by sophisticated software solutions for integrated public finances management.

Reforms in this area will be underpinned by two projects to be realised in cooperation with the EU. Hence, project under IPA TAIB-2011 has already been approved, being generally aimed as strengthening the capacities for medium-term planning within the departments in charge of the budgets of the central and local government institutions, the implementation period of which is from 2014 to 2016.

Thereby, strengthening the medium-term planning capacity of the Ministry of Finance will contribute to improving the quality of spending public funds, as well as better allocation of the limited public expenditures. Activities will be undertaken, within this project, pertaining to defining the Medium-Term Expenditure Framework (MTEF).

New project financed under IPA-2 is planned as continuation of this project, which will include improvement of the capacities of the departments in charge of medium-term budget planning and execution.

3.4. Long-Term Sustainability of Public Finances

Calculations for long-term sustainability of public finances²¹ are based upon the following assumptions:

- average economic growth in the analysed period by 3.8%,
- average labour productivity growth by 1.9%,
- increase of male participation rate from 76.3% in 2010 to 90.3% in 2060,
- more intensive increase of female participation rate (from 51.8% in 2010 to 76% in 2060), by which share of female population in the total active population is expected to reach 46% in 2060,
- reduction of unemployment rate with higher intensity in the first thirty years (from 32.2% in 2010 to 11% in 2040) and with lower intensity in the remaining 20 years, thus projected unemployment rate accounts for 5.3% in 2060,
- gradual increase of the share of population at the age above 65 years, reaching 11.4% in 2060.

In addition, it is assumed that non-tax budget revenues as percentage of GDP will not be changed. On the basis of the above-mentioned assumptions, as well as the employment growth projections, certain increase of the share of revenues on the basis of pension insurance

²¹ See Table 7 in Annex 1.



contributions is envisaged, from 6.2% of GDP in 2010 to 6.6% in 2030 and stabilisation at 6.5% in the remaining analysed period.

As for pension-related expenditures, it is worth mentioning that those of the Pension and Disability Insurance Fund are taken into account, while expenditures of the private pension insurance funds are not taken into account. Thus, share of pension-related expenditures in GDP in the period by 2030 is expected to amount to 9%, and in the next period, gradual reduction of this share is envisaged, if one takes into account that share of the pensioners whose pensions have been fully paid from the first pillar will reduce, while share of the pensioners who will receive part of their pensions from the second pillar will increase. Public expenditures for health protection as percentage of GDP are projected to gradually increase from 5% in 2010 to 5.5% in 2060. Such projected growth of expenditures was partially a result of the effects of population aging. Expenditures for education as percentage of GDP are envisaged to range from 5% to 6% during the analysed period. Increase of the share of expenditures for education is important for restructuring the labour market, reducing the unemployment rate and ensuring higher productivity and economic growth.

Interest-related costs in relation to GDP are expected to increase to 1.5% in 2030, while in 2060, it is expected for the share to reduce to 1%, in line with the projected trend of budget balance, i.e. government debt.

Public Internal Financial Control. Republic of Macedonia has continued to implement the reforms in the field of financial management and control and internal audit to the end of improving the public finances management and control systems. This is underpinned by the fact that separate Financial Affairs Units have been established at 87% of the first-line budget users and 51% of LGUs. In addition, 75 Internal Audit Units have been established at central-level authorities and in 64 municipalities and the City of Skopje, employing 137 internal auditors at central level and 62 internal auditors at local level.

In 2013, 75% of the first-line budget users and 38% of the LGUs established decentralised public finance management and accountability system. Pursuant to the amendments to the Budget Law, in effect from 1st January 2013, measures were undertaken for the first-line budget users to strengthen the planning approach during their operations. Most of the budget users prepared three-year strategic plans, which define the mission, the vision, the strategic objectives, the performance indicators and the manner of reporting to monitor the realisation of the objectives set. Strategic plans and budget request for 2014, submitted to the Ministry of Finance, are in compliance with the appropriations (limits) set by the Government for the coming three fiscal years.

In May 2013, Law on Financial Inspection in the Public Sector was adopted, pursuant to which, on 22nd August 2013, Act on Organisation and Operations of the Ministry of Finance was amended, on the basis of which Department for Financial Inspection in the Public Sector was established. In 2014, Department for Financial Inspection will be staffed, by employing 5 new persons with the adequate working experience.

In December 2013 the Law on Financial Discipline was adopted, which set up the legal framework to govern timely settlement of liabilities arising from business transactions realised between economic operators from the private sector and between public sector entities and economic operators from the private sector. The Law on Financial Discipline is prepared largely in accordance with the Directive 2011/7/EU on Combating late payment in commercial transactions.



In order to increase professionalism of the internal auditors, Law on Public Internal Financial Control was amended at the end of 2013, all to the end of precisely setting the requirements and the manner of carrying out training and taking the exam for chartered public sector internal auditor. By-laws prescribed by this Law will be adopted in 2014.

In 2014, development of the public internal financial control will be defined in the 2014 – 2016 Strategy on Development of Public Internal Financial Control, to be adopted at the end of May 2014. On the basis of this Strategy, Law on Modifications and Amendments to the Law on Public Internal Financial Control will be adopted by November 2014.

In 2014, Central Harmonisation Unit will continue the activities pertaining to international certification of internal auditors at central and local level within the “Training of Internal Auditors in the Public Sector” Project, which is financed by the USAID, the International Development Cooperation – Slovenia and the Center of Excellence in Finance (CEF). Within this Project, 65 internal auditors, 50 out of which at central level and 15 at local level are expected to acquire international certificate for chartered public sector internal auditor.

In 2014, Central Harmonisation Unit will also undertake the necessary measures for preparation of national certification of internal auditors, which is expected to commence in 2015.

New Law on Financial Police is expected to be adopted in the first half of 2014, while, in the course of 2014, the respective by-laws will be adopted. Pursuant to this Law, Financial Police will be included within the Judiciary Police, managed by the public prosecutor.

2014 – 2016 National Strategy for Prevention of Fraud and Protection of EU’s Financial Interests in the Republic of Macedonia will be adopted in 2014.

Budget Transparency. Since 2012, Republic of Macedonia has subscribed to the Special Data Dissemination Standard of the International Monetary Fund (SDDS). State Statistical Office, as coordinator, NBRM and Ministry of Finance, have successfully undergone the preparatory period for inclusion in the IMF’s Special Data Dissemination Standard and have provided for updated information on creation of National Summary Data Page. This standard serves to guide the member states, which have or would like to have access to the international capital market, to apply the basic principles on disseminating economic and financial statistical data.

National Summary Data Page is posted on the website of the State Statistical Office of the Republic of Macedonia and it includes macroeconomic indicators (data categories) pertaining to the four sectors of the national economy – real sector, fiscal sector, financial sector, external sector, as well as the population sector. National metadata is posted on the IMF’s Dissemination Standards Bulletin Board – DSBB website. The Advance Release Calendar (ARC) is included on the IMF’s website and comprises provisional information concerning the timing of the data releases for four months in advance.



PART IV Structural reforms

4.1. Obstacles to Economic Growth and Structural Reform Agenda

Being a developing economy, as well as a small and open country, the Republic of Macedonia is facing a series of challenges and obstacles to achieving higher rates of economic growth. Thus, the Republic of Macedonia is a small and limited internal market which makes hard to maintain very high growth rates only by itself. Given the geographical location of the Republic of Macedonia and the country's competitiveness, achieving higher rates of economic growth depends on strengthening the overall competitiveness and productivity of the country, increasing of the industrial production with higher value added and diversification and expansion of exports in order to strengthen the competitive position of the country and of the Macedonian companies in global terms.

Although the Macedonian economy shows improvement of the situation with unemployment, which dropped significantly in the past period, it is, however, still high in a European context. According to the analysis of indicators by the EC Macroeconomic Imbalance Procedure (Box 2.1.), the high rate of unemployment is the biggest obstacle for the Macedonian economy.

Access to capital for the private sector, especially for small and medium enterprises as the core drivers of economic growth, remains an obstacle to economic growth and structural reform agenda for the next medium term period. Therefore, in the next medium term period, the Government of the Republic of Macedonia will continue to support the private sector in terms of new projects, new employments, increased liquidity and increased exports. Also, the Republic of Macedonia is facing the need to improve and strengthen the quality of higher education and reform the current model, which will contribute to development of skills that are in line with the labor market needs.

The challenges of the global economic crisis and the debt crisis in the Euro zone further underlined a part of the remaining vulnerabilities that exist (such as the remaining administrative obstacles, the efficiency of the judicial system, the lengthy bankruptcy proceedings), that the government will remain focused and committed to solve in the next mid-term period.

4.2. Key Reform Areas

In order to mitigate the identified obstacles to economic growth, the Government will strive to implement policies that promote achieving higher rates of economic growth and improving the standard of living. The grounds on which Government policies are based on are: reducing the rate of unemployment (especially among youth), improving human capital, further maintaining low tax and social contributions rates, intensifying the major capital investment in transport infrastructure (see Section 3, Point 3.1. for more details), continuing with structural reforms for improving the business climate and competitiveness of the economy, attracting FDIs, providing favorable credit lines for small and medium enterprises, strengthening the innovation capacity of enterprises and research companies, support entrepreneurship, increasing agricultural productivity, reducing the duration of bankruptcy proceedings, increasing the efficiency of the judiciary system and the public administration as a service to citizens and increase the support and promotion of exports. The focus of economic policy is also on implementation of reforms aimed at strengthening the supervisory capacity of regulatory bodies in the financial system.

Reform programme reflected in this document comprises of interwoven elements and measures supporting each other, which need to be implemented with equal determination within a set time period. Realization of this agenda will mean a step forward in completing the process of



transition and accession to the EU, i.e. success in implementing a model of economic development that is promoted by the Government of the Republic of Macedonia, based on a competitive economy that provides equal opportunities for all. This model, taking into account the specificity of the Macedonian economy, is based on the EU Strategy for smart, sustainable and inclusive economic growth, known as Strategy “Europe 2020” and the Strategy “SEE 2020”.

4.2.1 Business environment

In the next medium-term period the implementation of the determined reform activities will continue, aimed at improvement of business climate and enhancement of competitiveness of Macedonian economy, establishment of high level of economic freedom and equal conditions for operations of the economic entities. Best experience of many European countries and recommendations of international institutions are incorporated in these measures and activities. Implementation of these projects is expected to directly contribute to increase of economic growth and reduction of unemployment as a structural problem of Macedonian economy.

Business climate. Government of the Republic of Macedonia will continue to implement measures and activities aimed at further improvement of the business climate in the country. Thus, through the Central Registry of the Republic of Macedonia, electronic registration of a company through a registration agent, with no costs and in a single step, is continuously promoted. In 2014, paper registration for the following types of companies: sole proprietorship, limited liability company and limited liability company founded by one person will be eliminated, so that registration of these types of companies will be done exclusively through the Single Window for online registration. Enhanced promotion of Electronic system for issuance of building permits will be carried out. The system is implemented by the Ministry of transport and communications and is expected to contribute for significant simplification of the procedure and shortening of time necessary for issuance of building permits by municipalities. Ministry of Economy and the Energy Regulatory Commission will implement measures to further facilitate the procedure, reduce costs and time needed for obtaining a connection to the electricity distribution system.

In order to further facilitate payment of taxes, the Public revenue office will continue activities to increase the number of users of the electronic system for payment of taxes, the use of which allows for saving time and reduced costs for companies.

In order to strengthen the protection of minority shareholders and improve the protection of investors in the next medium term period amendments to the relevant legislation will be prepared, i.e. the Law on trade companies and the Criminal Code. To enable faster market exit, introduction of electronic sale of the debtor’s assets in the bankruptcy proceeding is envisaged, which is done by upgrading of the e-bankruptcy system kept in the Central Registry of the Republic of Macedonia. Shortening certain stages of the procedure in small value proceedings is envisaged, to in order to enable faster conclusion of these procedures.

Access to credit. Recognizing the important role of SMEs in boosting economic growth and creating new jobs, facilitating access to finance for SMEs is of great importance for their operations, which is also a recommendation in the EC Progress Report for 2013. In this regard, the realization of the third stage of the Financial loan agreement between the EIB and the Macedonian Bank for Development Promotion (MBDP) continues, amounting to Euro 100 million, intended to support SMEs and other priority projects, with subsidized interest rate of 5.5%. As of December 2013 inclusive, approximately Euro 82.8 million have been withdrawn from the third phase of this credit line, while MBDP plans to withdraw the remaining amount during



February 2014. It is important to highlight that the first and the second phase of the project in the amount of Euro 150 million were fully realized.

Due to the great interest of SMEs for this type of credit line, the Government of the Republic of Macedonia determined the need for providing funds amounting to additional Euro 100 million and provided them in the form of a loan from EIB for implementation of the fourth phase of this project. The purpose of the new, fourth phase of the project is continuation of the support to the private sector by the Government of the Republic of Macedonia in terms of supporting new projects, new employment, increased liquidity in the economy and increased exports.

Borrower of this loan is MBDP while the Republic of Macedonia has issued sovereign guarantee which guarantees the settlement of obligations by MBDP. For this purpose, a Guarantee Agreement between the Republic of Macedonia and the EIB for the Project Financing of SMEs and other priority projects - IV phase and Financial loan agreement on this project in the amount of Euro 100 million between EIB and MBDP, were signed on 31.12.2013.

Regulatory Impact Assessment (RIA). To further build capacities in this area, the activities defined in the Action plan for improvement of the regulatory reform in Republic of Macedonia are continuously implemented. In that sense, in the first part of 2013 the Government adopted new RIA Methodology, new Form and Content of the RIA Report, Guidelines for the Ministries for conducting RIA and Methodology for ex post assessment of legislation. The Ministry of Information Society and Administration (MISA) will regularly inform the Government about the enforcement and application of these acts. Also, regular control is being taken on all draft legislation which is submitted in Government procedure, i.e. whether the legislation was published on ENER (Single Electronic Register of Regulations). There is a significant trend of increase on visits on this web portal. During 2014, improvement of the ENER portal and optimization of the process of public consultation will be carried out. Also, special attention is paid to the continuous capacity building of civil servants for implementation of RIA, assessment of implementation of regulation and smooth usage of ENER (apart many cycles of training of civil servants, training of trainers for RIA for civil servants within the ministries was conducted).

Innovation strategy. For about a year, the Government of the Republic of Macedonia continuously works on implementing the Innovation Strategy Action Plan 2013 - 2015, which aims to strengthen the propensity of the business sector to innovate, strengthen the human resources for innovation, create an adequate regulatory environment to support innovation and increase the flow of knowledge between innovation actors. The implementation of the Action Plan measures is expected to boost competitiveness and foster knowledge and innovation based economic development, which is the one of the three main objectives of the Strategy "Europe 2020". Simultaneously, the Innovation Strategy is expected to contribute to the creation of an effective innovation system based on the Triple Helix Model: encouraging the business community, the academic sector and the government agencies, to undertake joint activities to strengthen the capacity of the three innovation actors which will ultimately contribute to better utilization of Horizon 2020, as stated in the recommendations of the Report of the European Commission for 2013.

With the adoption of the Law on Innovation Activity a legislative framework is established in order to encourage innovations in the Republic of Macedonia. One of the most important measures of the innovation strategy is the establishment of a Fund for innovation and technological development, which is consistent with the strategic goal of the Government for supporting the private sector development. The fund will enable successful and efficient support for development of innovative creation, commercialization of research, connecting the business



sector with the academic sector and research centers by creating financial and material conditions for small and medium enterprises that are willing to increase their own innovation, competitiveness, or facilitate the introduction of new products or services to the market. The following financial instruments will be realized through the Fund:

- Instrument for cofinanced grants for start-up, spin-off companies and innovation,
- Instrument for cofinanced grants and conditional loans for commercialization of innovation,
- Support for the establishment of business and technology accelerators, and
- Cofinanced grants for technology transfer.

Participation in the regional project “Western Balkan Enterprise Development and Innovation Framework”. The project “Western Balkan Enterprise Development and Innovation Framework” started in 2013 under support of the EC, the EBRD and the European Investment Fund, where Republic of Macedonia is also participating. This platform aims to provide access to new sources of funding for companies from the SEE region countries. The project is consisted of four components: the Innovation Fund, Fund for expansion, Guarantee Fund and Fund for technical assistance.

Learning from the business community. In order to achieve broad consensus, creation of economic policies and strengthening the dialogue with business community, in accordance with the positive assessment of the European Commission in this year's report, in the next med-term period the Government will continue with the implementation of the project "Learning from the business community". According to the planned activities for the next phase of this project in September 2013 organizations and chambers of commerce in the country were contacted and a public call was announced for new companies to be visited in 2014.

Action plan for improving global competitiveness of the Republic of Macedonia. Review of the Action plan for improving global competitiveness and economic freedom will be made in the period 2014-2016. The review will incorporate additional measures driven by the Global Competitiveness Report 2013-2014 of the World Economic Forum. The Action plan is planned to be coordinated with the business community in a so called “Master Plan” for improving global competitiveness and economic freedom of the Republic of Macedonia.

National Entrepreneurship and Competitiveness Council activities (NECC) of Republic of Macedonia. NECC in the following period will continue with implementation of activities for developing and promoting sustainable tripartite dialog between business community, academia and the government in the process of creating and implementing polices. Under the NECC, permanent and temporary committees and working groups are established and functional, covering different sectors (SMEs, investment, automotive industry, textile industry, IT sector, craft, human resources etc.). The committees are working on identifying priority areas and creating National strategies for promotion of the competitiveness of Macedonian economy, improving conditions and decreasing costs for running a business, export promotion of higher valued added goods and services to developing markets, involvement of financial institutions in the development of a competitive economy, as well as increasing domestic and foreign investments, and analysis of the Global Competitiveness Report of the World Economic Forum.

Top Management. The second phase of this project was implemented in 2013, whereby 100 new managers passed through theoretical training. In the next med-term period, practical training will be conducted for the managers selected for the second phase of the project as well as for the managers selected in the first phase who have not completed the practical training. The practical training will last one month and will be conducted in a company from a developed country.



Activities of the National council for sustainable development (NCSD) of the Republic of Macedonia. The National council for sustainable development (NCSD) is formed according to the National strategy for sustainable development, which is a step forward in the process of implementation of the Strategy. The National council is advisory body of the Government, chaired by the Deputy Prime Minister of the Government of the Republic of Macedonia in charge of economic affairs and coordination of the economic sectors (DPM of economic affairs and coordination of the economic sectors) as a Chairman, and its consisted of senior government officials, experts in the field of economic and social issues and the environment, representatives of chambers of commerce, academia and NGOs.

This body will contribute towards establishment of policies that will provide economic growth and development, employment increase and protection, sustainable development and improvement of the environment in order to increase the living standard in Macedonia and to ensure a prosperous future for the future generations. In the forthcoming short-term period the Action plan for implementation of the Strategy will be prepared, for which the Government has received technical assistance from the World Bank through the Green growth Program for analytical and advisory support and USAID - Low emission development strategies - LEDS.

One stop shop for domestic and foreign investors. The establishment of this system will enable all licenses and permits for starting and running a business to be issued at one single point. Setting up the electronic system and using of electronic approach in issuing permits and licenses will be done in several phases. At the beginning the system will be implemented in the institutions which issue most of the permits and licenses, or that have greatest range in relation to the business community. Afterwards, the system will be replicated to other institutions.

| Description of policy | 2013 | 2014 | 2015 | 2016 |
|---|-------------|-------------|-------------|------------|
| <i>One stop shop for domestic and foreign investors (Registry)</i> | | | | |
| A. Implementation profile* | | | | x |
| B. Net direct budgetary impact (if any) | 0 | -- | 3,250,000 | 3,250,000 |
| B.1 Direct impact on budgetary revenues | 9,400,000 | -- | 27,700,000 | 27,700,000 |
| B.2 Direct impact on budgetary expenditures | 9,400,000 | -- | 30,950,000 | 30,950,000 |
| <i>Activities of the National Entrepreneurship and Competitiveness Council activities (NECC)</i> | | | | |
| A. Implementation profile* | | | | |
| B. Net direct budgetary impact (if any) | 600,000 | 1,200,000 | 1,200,000 | 1,200,000 |
| B.1 Direct impact on budgetary revenues | 12,000,000 | 12,000,000 | 5,400,000 | 2,400,000 |
| B.2 Direct impact on budgetary expenditures | 12,600,000 | 13,200,000 | 6,600,000 | 3,600,000 |
| <i>Fund for innovation and technological development</i> | | | | |
| A. Implementation profile* | x | | x | |
| B. Net direct budgetary impact (if any) | 18,390,000 | 18,390,000 | 18,450,000 | -- |
| B.1 Direct impact on budgetary revenues | 98,400,000 | 252,150,000 | 252,150,000 | -- |
| B.2 Direct impact on budgetary expenditures | 116,790,000 | 270,540,000 | 270,600,000 | -- |
| <i>Participation in the Enterprise Development and Innovation Framework</i> | | | | |
| A. Implementation profile* | x | | x | |
| B. Net direct budgetary impact (if any) | 3,075,000 | 0 | 0 | -- |
| B.1 Direct impact on budgetary revenues | 0 | 4,305,000 | 4,305,000 | -- |
| B.2 Direct impact on budgetary expenditures | 3,075,000 | 4,305,000 | 4,305,000 | -- |
| <i>Action plan for improving global competitiveness of the Republic of Macedonia</i> | | | | |
| A. Implementation profile* | x | | | |
| B. Net direct budgetary impact (if any) | 15,000,000 | 9,000,000 | 9,000,000 | 9,000,000 |
| B.1 Direct impact on budgetary revenues | 0 | 0 | 0 | 0 |
| B.2 Direct impact on budgetary expenditures | 15,000,000 | 9,000,000 | 9,000,000 | 9,000,000 |
| <i>Strategy for innovations</i> | | | | |



| | | | | |
|---|--------------------|--------------------|--------------------|-------------------|
| A. Implementation profile* | | | x | |
| B. Net direct budgetary impact (if any) | 8,625,000 | 5,227,500 | 5,227,500 | -- |
| B.1 Direct impact on budgetary revenues | 93,480,000 | 182,757,500 | 186,242,500 | -- |
| B.2 Direct impact on budgetary expenditures | 102,090,000 | 187,985,000 | 191,470,500 | -- |
| Project „Top management“ | | | | |
| A. Implementation profile* | | x | | |
| B. Net direct budgetary impact (if any) | 2,341,000 | 31,000,000 | -- | -- |
| B.1 Direct impact on budgetary revenues | 322,000 | 0 | -- | -- |
| B.2 Direct impact on budgetary expenditures | 2,663,000 | 31,000,000 | -- | -- |
| Total net budgetary impact | | | | |
| Total impact on budgetary revenues | 213,602,000 | 451,212,500 | 475,797,500 | 30,100,000 |
| Total impact on budgetary expenditures | 261,618,000 | 516,030,000 | 512,925,500 | 43,550,000 |

* Indicate start and, if needed, end with an “X” mark

Source: Cabinet of DPM of economic affairs and coordination of the economic sectors

4.2.2. Labour Market

Economic development is not sufficient if it is not followed by increased number of new job positions and improved living standard. In the same time, economic development and competitiveness of the economy depend on good quality and functional human capital engaged on productive work places. Taking into consideration that investment in human capital is equally important as investment in physical capital, the Government of the Republic of Macedonia continuously implements measures and activities for human capital development.

4.2.2.1. Education

Education and knowledge are fundamental for overcoming the obstacles related to low labor productivity. Economic development is closely linked with the synergy between the new knowledge and human capital.

Science and Research. Activities for implementation of the new National Programme for Higher Education and Research 2014-2017 will be developed in the forthcoming mid-term period. Capacity building for successful involvement in the new EU Programme Horizon 2020 will continue. The continuation of the multi-year capital projects “*Translation of 1.000 professional, scientific books and textbooks*” and “*Laboratories 2010/2020*” for purchasing 189 laboratories for public higher education institutions and scientific institutes will facilitate the integration of the Republic of Macedonia into the European Research Area and the Innovation Union and will contribute to quality of research. With the objective to support innovations in the private sector and to strengthen their innovative capacity, Fund for Innovations and Technological Development will be established (see page 59). Contribution in this direction will have the World Bank’s project “Skills development and innovation support” that will enable improvement of quality of the national education system to support the development of skills, as well as to improve the capacity of enterprises for innovation, by enabling easier access to skills, knowledge, finance and modern technology.

Higher Education. The implementation of the Bologna process will continue, in particular in the area of quality assurance in higher education, inter-disciplinarity of study programmes, development of doctoral studies, as well as increased student and staff mobility. State financial support to agreed quotas of II- and III- cycle students will continue. Study programmes in English language will be developed, practical and clinical work will be incorporated into the curricula, known managers from the real sector (mid- and high-management) will be involved in the education process, and efforts will be put for introducing external assessment in higher education and capacities for accommodation of students of the public higher education institutions will be improved. In accordance with the national policy for equal access to higher education, social cohesion and lifelong learning, the “*Project 35/45*” will continue. The



internationalization of higher education will continue supported by the new EU programme Erasmus+ and by the CEEPUS programme. The project *“Scholarships for studies abroad”* will continue providing opportunities for studies at prestigious foreign universities in the areas relevant for the socio-economic development of the country.

Primary and Secondary Education. Aiming at continuous improvement of the quality of primary and secondary education, the key policies in these areas will be related to: improvement of the legislative framework, development of contemporary study programmes encompassing implementation of up-to-date education methodologies and ICT, raising the quality of the educational process, providing equal conditions for education of pupils from all socio-economic categories, children with special educational needs and social inclusion.

In line with the priorities of the high level accession dialogue between the Republic of Macedonia and the European Union, a new contemporary curriculum for children 5-6 years old will be implemented, aiming to support their successful entry into primary education. The continuous implementation of the project *“Skilful and Competent”* will contribute to increased acquiring of applicable knowledge, skills and competences through introduction of entrepreneurship in the programs at all levels, improving the competency and effectiveness of the teaching staff, monitoring and improvement of the outcomes of the education process, as well as developing partnerships with the private sector. Special attention will be paid to the inclusion of pupils with special educational needs in secondary schools, reform of the arts education through improvement of the work conditions and through promotion of policies for early learning of foreign languages.

In line with the priorities of the Accession Partnership and with the objective to ensure equal access to all levels of education, the Government of the Republic of Macedonia will continue to support: free textbooks, transport, accommodation of pupils in primary and secondary education, scholarships to pupils in secondary education, pupils with special educational needs, pupils coming from families with lower socio-economic status, talented pupils and talented pupils – sportsmen.

In line with the recommendations of the Progress Report for the Republic of Macedonia in 2013, activities will continue for implementation of the Strategy for Integrated Education, with support from the Budget of the Republic of Macedonia and donors. The support to Roma pupils in primary and secondary education will continue with measures for increased participation in the education system, reduced percentage of early school leavers and increased quality of education, including provision of new 817 grants, as well as further implementation of the mentoring and tutoring system by awarding 120 grants for the school year 2013/14. In response to the recommendations of the Progress Report 2013, the improvement of educational infrastructure will continue in accordance with the rules for increased energy efficiency, adaptation to the needs of students with special needs, as well as reducing regional disparities in education with special emphasis on communities with mixed ethnic origin.

Vocational education and training (VET). The reforms in this area will continue in line with the Copenhagen-Bruges process. The realization of the Action Plan for implementation of the Strategy for Vocational Education and Training in a Lifelong Learning Context 2013-2020 will support actions for strengthening the social cohesion and social inclusion, increasing the attractiveness of vocational education and training, its quality and relevance as guarantee for competitiveness, as well as actions for increasing resources and capacities. In accordance with the EU flagship initiative *“New Skills for New Jobs”*, the implementation of the Protocol for Cooperation of the Social Partners and of the Memorandum for Understanding and Cooperation will continue, thus providing the basis for a lasting cooperation between the VET Centre, the



Government and the social partners. The newly established partnerships in accordance with the Memorandum of Understanding and Cooperation between the Chamber of Crafts of the Republic of Macedonia, the regional chambers of crafts and the VET schools will be strengthened. The implementation of the Strategy for Development of the VET Centre, the development of standards for vocations and study programmes in accordance with the labor market needs, including programmes for pupils with special educational needs, examination programmes and tests for external assessment of pupils' achievements will continue. The participation of the Republic of Macedonia in the regional project for entrepreneurial education in South Eastern Europe will continue. In accordance with the annual Operational plans for active programmes and measures for employment, the cooperation of the VET Centre with the Employment Service Agency will continue in the area of development of programmes and organization of training for vocations in need on the labour market, as well as in the implementation of the National Employment Strategy 2011-2015.

Adult education. Annual action plans will support the implementation of the Strategy for Adult Education. Regarding the system for non-formal adult education, the verification of providers and programmes of adult education will continue. Regular updating of the catalogue of verified programmes and providers for adult education will be ensured. Certain verified programmes will become a part of the Operational plans for active programmes and measures for employment. The increasing trend of participation of verified programmes and providers for adult education in the realization of the Operational plans is expected to continue. The realization of the Programme for completion of secondary vocational education by adults who have completed primary education will continue, so that the number of municipalities in which the Programme will be implemented will increase (so far it is implemented in four: Arachinovo, Prilep, Chair and Tearce). With the objective to develop a comprehensive system for education of adults, Concept for non-formal education and Concept for primary education of adults will be prepared.

National Qualifications Framework (NQF) and Entrepreneurial Strategy 2014-2020. In line with the recommendations of the EC Progress report for the Republic of Macedonia in 2013, the development of the NQF in accordance with the Baselines of the Macedonian Qualifications Framework and the Law on the National Qualifications Framework will continue. In 2014 these activities will be supported by the European Training Foundation. Preparations are in progress for starting an IPA project that will support the development of NQF. In the forthcoming mid-term period intensive activities will be developed for implementation of the Entrepreneurial Strategy 2020.

4.2.2.2. Labour market

Reduction of structural unemployment is top priority of the Government of the Republic of Macedonia in line with its Operational Programme. Hence, in the medium term, employment policies will be aimed at stimulating labour market demand, matching labour supply and demand with the labour market needs, improving labour supply, as well as reducing grey economy, which is in line with the recommendation in the 2013 Progress Report. In addition, policies and measures to be undertaken will rely on the basic principles and rights to work, promotion of gender equality and encouragement of social dialogue, which are essential for labour market development. Maintenance of flexible labour law will be realised by enhancing social dialogue at all levels and developing partnership with the real sector to the end of job creation. In this respect, contribution is expected by the already established local economic and social councils, as well as those planned to be established, where an active tripartite social dialogue at local level will assist on improving the situation of the labor market in line with these specific conditions and needs of municipalities.



For the purpose of realising the goals set in the 2015 National Employment Strategy and 2013 – 2015 Action Plan on Youth Employment, and taking into account the need for faster transition from school to work for the young people, programmes have been developed to increase youth employment, all to the end of helping them enter the labour market more prepared.

Labour market activity will be increased by expanding the scope of participants and the financial resources intended for the active employment programmes and measures, improvement of effectiveness, improvement of targeting the target groups and promotion of active employment programmes and measures for the unemployed and the employers, so as to apply them as possibilities for employment.

Ministry of Labour and Social Policy and the Employment Service Agency of the Republic of Macedonia will continue the activities for strengthening the capacities for efficient implementation of employment policies, their monitoring and performance evaluation, as well as the activities for development of a new approach to operating with new types of services by improving the functions, developing the IT system and developing the own human resources.

In addition, ESARM will continue the activities for full transformation of the Agency into a modern employment service in line with the EU standards, paying special attention to the following activities: introduction of quality management system in line with ISO standard 9001:2008, implementation of the Law on Modifications and Amendments to the Law on Employment and Unemployment Insurance so as to be aware of the real number of job seekers, determination of the structure of job seekers, creation of adequate active employment policies and measures adjusted to the needs of the job seekers and the possibilities on the labour market, development of employment services by expanding the scope of users and strengthening the individual approach in the operations with unemployed persons, in particular with the persons facing less possibilities on the labour market. Cooperation with employers will be strengthened through services and activities according to the identified needs of employers.

Development of activities to inform and promote the services of ESARM will be carried out, as well as continuous development of the information system through upgrading, improvement of the existing on line services for job seekers and employers, and by introduction of new types of services.

Further implementation of employment policies will be underpinned through IPA projects "Support to the Employment of Young People, Long-Term Unemployed and Women II" and "Support to ESARM for Implementation of Active Labour Market Measures and Services", "Capacity building for effective implementation of legislation in the area of free movement of workers", USAID's project "Youth Network for gaining skills for employment" and other.

Continuous activities are being implemented aimed at strengthening the capacities for planning and implementing projects financed with foreign assistance, quality improvement, efficient and effective service provided by the Employment Service Agency, as well as the capacities for monitoring, evaluation and long-term planning of the Ministry of Labour and Social Policy.

Employment Service Agency adopted new methodology on operations of the employment centers, based on an approach to encourage unemployed persons through support measures and job seeking measures, as well as promoting user-oriented approach by personalizing the services for the unemployed persons and the employers. By applying this methodology, better response to labour market supply and demand is expected in future.

In the coming period, Ministry of Labour and Social Policy and the Employment Service Agency will continue adopting Operational Plans on Active Employment Programmes and Measures and



implementing them, as well as implementing the Project on Self-Employment by Crediting and the Project on Crediting Legal Entities (micro and small-sized enterprises) for creation of new jobs.

| Description of policy | 2013 | 2014 | 2015 | 2016 |
|---|---------------|---------------|---------------|---------------|
| Programme for higher education and research, innovation, mobility and youth | | | | |
| A. Implementation profile* | x | | | x |
| B. Net direct budgetary impact (if any) | 132,306,670 | 94,810,930 | 240,653,430 | 325,093,430 |
| B.1 Direct impact on budgetary revenues | 207,047,906 | 333,188,367 | 339,787,500 | 369,000,000 |
| B.2 Direct impact on budgetary expenditures | 339,354,576 | 427,999,297 | 580,440,930 | 694,093,430 |
| Translation of 1000 professional, scientific books and textbooks | | | | |
| A. Implementation profile* | | x | | x |
| B. Net direct budgetary impact (if any) | -- | 150,000,000 | 190,000,000 | 156,500,000 |
| B.1 Direct impact on budgetary revenues | -- | 0 | 0 | 0 |
| B.2 Direct impact on budgetary expenditures | -- | 150,000,000 | 190,000,000 | 156,500,000 |
| "Laboratories 2010/2020" for public higher education institutions | | | | |
| A. Implementation profile* | | x | x | |
| B. Net direct budgetary impact (if any) | -- | 418,000,000 | 160,000,000 | -- |
| B.1 Direct impact on budgetary revenues | -- | 0 | 0 | -- |
| B.2 Direct impact on budgetary expenditures | -- | 418,000,000 | 160,000,000 | -- |
| Project "Skilful and Competent" | | | | |
| A. Implementation profile* | x | | | x |
| B. Net direct budgetary impact (if any) | 32,303,399 | 38,037,687 | 95,548,908 | 88,061,000 |
| B.1 Direct impact on budgetary revenues | 7,035,008 | 113,379,521 | 69,445,715 | 35,349,476 |
| B.2 Direct impact on budgetary expenditures | 39,338,407 | 151,417,207 | 164,994,623 | 123,410,476 |
| Strategy for vocational education and training in the context of lifelong learning 2013-2020 | | | | |
| A. Implementation profile* | x | | | x |
| B. Net direct budgetary impact (if any) | 30,715,595 | 35,480,123 | 107,590,749 | 92,320,500 |
| B.1 Direct impact on budgetary revenues | 57,285,729 | 35,487,826 | 18,044,075 | 0 |
| B.2 Direct impact on budgetary expenditures | 88,001,324 | 70,967,949 | 125,634,824 | 92,320,500 |
| Adult education in context of lifelong learning | | | | |
| A. Implementation profile* | x | | | x |
| B. Net direct budgetary impact (if any) | 13,608,000 | 15,889,000 | 16,139,000 | 16,139,000 |
| B.1 Direct impact on budgetary revenues | 990,887 | 1,000,000 | 1,000,000 | 1,000,000 |
| B.2 Direct impact on budgetary expenditures | 14,598,000 | 16,889,000 | 17,139,000 | 17,139,000 |
| Implementation of the Strategy for Integrated Education and Social Cohesion, Inclusion and Equality | | | | |
| A. Implementation profile* | x | | | x |
| B. Net direct budgetary impact (if any) | 2,081,280,120 | 1,876,836,869 | 1,864,715,219 | 1,869,682,819 |
| B.1 Direct impact on budgetary revenues | 241,303,605 | 146,079,151 | 56,985,545 | 27,912,222 |
| B.2 Direct impact on budgetary expenditures | 2,322,583,725 | 2,022,916,020 | 1,921,700,764 | 1,897,595,041 |
| IPA project "Strengthening lifelong learning through modernisation of the systems for vocational education and training and adult education" | | | | |
| A. Implementation profile* | | x | | x |
| B. Net direct budgetary impact (if any) | -- | 2,509,200 | 5,854,800 | 4,182,000 |
| B.1 Direct impact on budgetary revenues | -- | 14,218,800 | 33,177,159 | 23,698,041 |
| B.2 Direct impact on budgetary expenditures | -- | 16,728,000 | 39,031,959 | 27,880,041 |
| IPA project "Purchasing systems for monitoring and evaluation of the systems for vocational education and training and adult education" | | | | |



| | | | | |
|--|------------|------------|------------|------------|
| A. Implementation profile* | | | x | x |
| B. Net direct budgetary impact (if any) | -- | -- | 2,988,900 | 1,992,600 |
| B.1 Direct impact on budgetary revenues | -- | -- | 16,937,100 | 11,291,400 |
| B.2 Direct impact on budgetary expenditures | -- | -- | 19,926,000 | 13,284,000 |
| IPA project "Purchasing educational material and equipment for the needs of vocational education and training and adult education" | | | | |
| A. Implementation profile* | | | x | x |
| B. Net direct budgetary impact (if any) | -- | -- | 4,289,625 | 2,859,750 |
| B.1 Direct impact on budgetary revenues | -- | -- | 24,307,875 | 16,205,250 |
| B.2 Direct impact on budgetary expenditures | -- | -- | 28,597,500 | 19,065,000 |
| IPA project "Evaluation of the provided financial assistance for reforms in lifelong learning, especially VET and adult education with recommendations for future assistance and development" | | | | |
| A. Implementation profile* | x | x | | |
| B. Net direct budgetary impact (if any) | 830,250 | 553,500 | -- | -- |
| B.1 Direct impact on budgetary revenues | 4,704,750 | 3,136,500 | -- | -- |
| B.2 Direct impact on budgetary expenditures | 5,535,000 | 3,690,000 | -- | -- |
| IPA project "Evaluation of support in the area of equal access to quality education with recommendations for future assistance and development" | | | | |
| A. Implementation profile* | x | x | | |
| B. Net direct budgetary impact (if any) | 664,200 | 442,800 | -- | -- |
| B.1 Direct impact on budgetary revenues | 3,763,800 | 2,509,200 | -- | -- |
| B.2 Direct impact on budgetary expenditures | 4,428,000 | 2,952,000 | -- | -- |
| IPA project "Support the Operational structure in terms of IPA 4 Development of human resources for programming and implementation" | | | | |
| A. Implementation profile* | | x | x | |
| B. Net direct budgetary impact (if any) | -- | 1,734,300 | 433,575 | -- |
| B.1 Direct impact on budgetary revenues | -- | 9,827,700 | 2,456,925 | -- |
| B.2 Direct impact on budgetary expenditures | -- | 11,562,000 | 2,890,500 | -- |
| Support to the ESA in the implementation of active labour market measures and services | | | | |
| A. Implementation profile* | | x | | x |
| B. Net direct budgetary impact (if any) | -- | 4,449,600 | 5,562,000 | 1,112,400 |
| B.1 Direct impact on budgetary revenues | -- | 25,214,400 | 31,518,000 | 6,303,600 |
| B.2 Direct impact on budgetary expenditures | -- | 29,664,000 | 37,080,000 | 7,416,000 |
| Support to the ESA in the implementation of active labour market measures and services on the labour market (construction) | | | | |
| A. Implementation profile* | | x | | x |
| B. Net direct budgetary impact (if any) | -- | 5,778,300 | 8,404,800 | 1,575,900 |
| B.1 Direct impact on budgetary revenues | -- | 32,743,700 | 47,627,200 | 8,930,100 |
| B.2 Direct impact on budgetary expenditures | -- | 38,522,000 | 56,032,000 | 10,506,000 |
| Support to the ESA in the implementation of active labour market measures and services on the labour market (equipment) | | | | |
| A. Implementation profile* | | x | x | |
| B. Net direct budgetary impact (if any) | -- | 1,854,000 | 2,781,000 | -- |
| B.1 Direct impact on budgetary revenues | -- | 10,506,000 | 15,759,000 | -- |
| B.2 Direct impact on budgetary expenditures | -- | 12,360,000 | 18,540,000 | -- |
| Strengthening the fight against undeclared jobs | | | | |
| A. Implementation profile* | x | x | x | |
| B. Net direct budgetary impact (if any) | 3,615,300 | 7,230,600 | 1,205,100 | -- |
| B.1 Direct impact on budgetary revenues | 20,486,700 | 40,973,400 | 6,828,900 | -- |
| B.2 Direct impact on budgetary expenditures | 24,102,000 | 48,204,000 | 8,034,000 | -- |
| Strengthening the fight against undeclared jobs (procurement of equipment for State Labour Inspectorate) | | | | |
| A. Implementation profile* | | x | | |
| B. Net direct budgetary impact (if any) | -- | 2,781,000 | -- | -- |
| B.1 Direct impact on budgetary revenues | -- | 15,759,000 | -- | -- |
| B.2 Direct impact on budgetary expenditures | -- | 18,540,000 | -- | -- |
| Improving the employability of women from minority ethnic groups | | | | |



| | | | | |
|---|------------|------------|-------------|------------|
| A. Implementation profile* | x | x | | |
| B. Net direct budgetary impact (if any) | 9,406,733 | 5,385,119 | -- | -- |
| B.1 Direct impact on budgetary revenues | 53,304,818 | 30,515,675 | -- | -- |
| B.2 Direct impact on budgetary expenditures | 62,711,550 | 35,900,794 | -- | -- |
| Strengthening the role of local partners in the field of preparation and implementation of projects of social inclusion | | | | |
| A. Implementation profile* | | x | | |
| B. Net direct budgetary impact (if any) | -- | 726,000 | -- | -- |
| B.1 Direct impact on budgetary revenues | -- | 4,117,000 | -- | -- |
| B.2 Direct impact on budgetary expenditures | -- | 4,853,000 | -- | -- |
| Social dialogue | | | | |
| A. Implementation profile* | | x | x | |
| B. Net direct budgetary impact (if any) | -- | 10,011,600 | 1,112,400 | -- |
| B.1 Direct impact on budgetary revenues | -- | 56,732,400 | 6,303,600 | -- |
| B.2 Direct impact on budgetary expenditures | -- | 66,744,000 | 7,416,000 | -- |
| Development of alternative services for childcare | | | | |
| A. Implementation profile* | | | x | x |
| B. Net direct budgetary impact (if any) | -- | -- | 5,562,000 | 4,171,500 |
| B.1 Direct impact on budgetary revenues | -- | -- | 31,518,000 | 23,638,500 |
| B.2 Direct impact on budgetary expenditures | -- | -- | 37,080,000 | 27,810,000 |
| Tackling youth unemployment, women and long-term unemployed II | | | | |
| A. Implementation profile* | | x | x | x |
| B. Net direct budgetary impact (if any) | -- | 12,051,000 | 9,640,800 | 2,410,200 |
| B.1 Direct impact on budgetary revenues | -- | 68,289,000 | 54,631,200 | 13,657,800 |
| B.2 Direct impact on budgetary expenditures | -- | 80,340,000 | 64,272,000 | 16,068,000 |
| Strengthening the role of local partners in the field of preparation and implementation of projects for social inclusion (phase 2) | | | | |
| A. Implementation profile* | x | x | -- | -- |
| B. Net direct budgetary impact (if any) | 998,373 | 665,582 | -- | -- |
| B.1 Direct impact on budgetary revenues | 5,657,449 | 3,771,633 | -- | -- |
| B.2 Direct impact on budgetary expenditures | 6,655,823 | 4,437,215 | -- | -- |
| Promoting Social Inclusion (programme for awarding grants) | | | | |
| A. Implementation profile* | | | x | x |
| B. Net direct budgetary impact (if any) | -- | -- | 16,356,104 | 13,084,883 |
| B.1 Direct impact on budgetary revenues | -- | -- | 92,684,589 | 74,147,671 |
| B.2 Direct impact on budgetary expenditures | -- | -- | 109,040,693 | 87,232,554 |
| Modernization and adaptation of the Centers for Social Work (construction) | | | | |
| A. Implementation profile* | | x | x | x |
| B. Net direct budgetary impact (if any) | -- | 4,758,600 | 6,921,600 | 1,297,800 |
| B.1 Direct impact on budgetary revenues | -- | 26,965,400 | 39,222,400 | 7,354,200 |
| B.2 Direct impact on budgetary expenditures | -- | 31,724,000 | 46,144,000 | 8,652,000 |
| Modernization and adaptation of the Centers for Social Work (equipment) | | | | |
| A. Implementation profile* | | x | x | |
| B. Net direct budgetary impact (if any) | -- | 3,263,040 | 4,894,560 | -- |
| B.1 Direct impact on budgetary revenues | -- | 18,490,560 | 27,735,840 | -- |
| B.2 Direct impact on budgetary expenditures | -- | 21,753,600 | 32,630,400 | -- |
| Development of vocational rehabilitation services and personal assistance | | | | |
| A. Implementation profile* | | | x | x |
| B. Net direct budgetary impact (if any) | -- | -- | 7,416,000 | 5,562,000 |
| B.1 Direct impact on budgetary revenues | -- | -- | 42,024,000 | 31,518,000 |
| B.2 Direct impact on budgetary expenditures | -- | -- | 49,440,000 | 37,080,000 |
| Support of employment policies | | | | |
| A. Implementation profile* | | | | x |
| B. Net direct budgetary impact (if any) | -- | -- | -- | 7,416,000 |
| B.1 Direct impact on budgetary revenues | -- | -- | -- | 42,024,000 |
| B.2 Direct impact on budgetary expenditures | -- | -- | -- | 49,440,000 |
| Development of human resources in the private sector | | | | |



| | | | | |
|---|----------------------|----------------------|----------------------|----------------------|
| A. Implementation profile* | | | x | x |
| B. Net direct budgetary impact (if any) | -- | -- | 2,781,000 | 6,489,000 |
| B.1 Direct impact on budgetary revenues | -- | -- | 15,759,000 | 36,771,000 |
| B.2 Direct impact on budgetary expenditures | -- | -- | 18,540,000 | 43,260,000 |
| Promoting social entrepreneurship | | | | |
| A. Implementation profile* | | | x | x |
| B. Net direct budgetary impact (if any) | -- | -- | 2,781,000 | 6,489,000 |
| B.1 Direct impact on budgetary revenues | -- | -- | 15,759,000 | 36,771,000 |
| B.2 Direct impact on budgetary expenditures | -- | -- | 18,540,000 | 43,260,000 |
| Support of health and work safety and fight against undeclared work | | | | |
| A. Implementation profile* | | | | x |
| B. Net direct budgetary impact (if any) | -- | -- | -- | 3,244,500 |
| B.1 Direct impact on budgetary revenues | -- | -- | -- | 18,385,500 |
| B.2 Direct impact on budgetary expenditures | -- | -- | -- | 21,630,000 |
| Social inclusion, support of Roma people and employment | | | | |
| A. Implementation profile* | | | | x |
| B. Net direct budgetary impact (if any) | -- | -- | -- | 18,540,000 |
| B.1 Direct impact on budgetary revenues | -- | -- | -- | 105,060,000 |
| B.2 Direct impact on budgetary expenditures | -- | -- | -- | 123,600,000 |
| Grant for self-employment | | | | |
| A. Implementation profile* | | x | x | |
| B. Net direct budgetary impact (if any) | -- | 20,857,500 | 20,857,500 | -- |
| B.1 Direct impact on budgetary revenues | -- | 118,192,500 | 118,192,500 | -- |
| B.2 Direct impact on budgetary expenditures | -- | 139,050,000 | 139,050,000 | -- |
| Programme for subsidization of unemployed persons, beneficiaries of social assistance | | | | |
| A. Implementation profile* | | x | | |
| B. Net direct budgetary impact (if any) | -- | 12,750,000 | -- | -- |
| B.1 Direct impact on budgetary revenues | -- | -- | -- | -- |
| B.2 Direct impact on budgetary expenditures | -- | 12,750,000 | -- | -- |
| Annual operational plans for active programmes and measures for employment, Project for self-employment with loans and Project for crediting of legal entities (micro and small enterprises) for opening new job positions | | | | |
| A. Implementation profile* | x | | | x |
| B. Net direct budgetary impact (if any) | 600,000,000 | 610,000,000 | 610,000,000 | 610,000,000 |
| B.1 Direct impact on budgetary revenues | -- | 5,088,240 | -- | -- |
| B.2 Direct impact on budgetary expenditures | 600,000,000 | 615,088,240 | 610,000,000 | 610,000,000 |
| Total net budgetary impact | | | | |
| Total impact on budgetary revenues | 601,579,765 | 1,116,185,973 | 1,107,705,123 | 889,017,760 |
| Total impact on budgetary expenditures | 3,507,308,405 | 4,453,052,322 | 4,502,195,193 | 4,127,242,042 |

* Indicate start and, if needed, end with an "X" mark

Source: Ministry of education and science and Ministry of labour and social policy

4.2.3. Enterprise sector

Small and medium enterprises. The importance of SME's is confirmed through their participation in total number of enterprises with 99.7%, as well as through absorption of 80.5% of total number of employees. Having in mind their importance for the increase of economic development and for the unemployment decrease, the Government in the following mid term period will continue the support of entrepreneurship and SME's, the improvement of business climate and competitiveness, alleviation of access to capital and other activities.

In 2014 the implementation of the Program for competitiveness, innovations and entrepreneurship will continue, through realization of activities for support of entrepreneurship and competitiveness of SME's, support of implementation of quality standards: ISSO, HACCP, HALAL, support of women entrepreneurship, craft promotion, support of authentic handy crafts, support of young entrepreneurs by selection of Best business plan and financial support of newly established enterprises, promotion of business angels etc.



In the period 2014-2016 activities will be directed to strengthen the institutional infrastructure for SME and craft support, improvement of business environment and competitiveness and innovation according to the Small Business Act principles and according to the Craft strategy 2012-2020.

Through the implementation of the SEE Strategy 2020 (project financed by EC, in organization of the Regional cooperation council from Sarajevo, Charter for investment) which is a document counterpart to EU 2020 Strategy and the Regional strategy for research, development and innovations, support of regional cooperation, improvement of competitiveness and realization of the common vision for EU integration is expected.

Great importance for the SME's sector will have the OECD project "Next Generation Competitiveness Initiative", financed through IPA. Within this project three sectors from the region will be identified and a detailed analysis of their conditions, perspectives, possibilities for value chain creation, identification of barriers for creation of these relations will be prepared. Also, a pilot project for each sector will be developed with activities towards elimination of certain barriers and for support of mutual cooperation in creation of a regional value chain.

Regulatory Guillotine for simplification of regulations and reducing the costs of craftsmen. In order to further facilitate conditions for doing business and in accordance with the program of the Government for the period 2011-2015, the project "Regulatory Guillotine for simplification of regulations and reducing the costs of craftsmen" will continue to be implemented. The project is aimed to identify the problems that craftsmen are facing at their work. In the next period, based on established findings, the regulation which concerns the craftsmen will be modified, in order to reduce costs and simplify the procedures for performing craft.

Industrial policy. Encouraging competitiveness as a basis of sustainable economic growth, will be realized through implementation of several strategic documents, action plans, programs and measures aimed at the implementation of industrial policy, encouraging and promoting investments, cluster development, export promotion and increased support for innovation.

In 2014, the implementation of the annual Program for competitiveness, innovation and entrepreneurship will continue, that will offer measures to support SMEs, industrial policy and clusters. The focus is on encouraging companies to introduce standards, increase their productivity, diversification of production by developing new or improving existing products, market development, encouraging innovation, various trainings related to technological development, innovation and export. Also, measures to support the activities of clusters and cluster associations will be provided. In the next mid-term period, the established practice of communication with businesses through conferences, visits and other forms of dialogue will continue.

Support for establishment and development of cluster associations is recognized as one of the drivers of competitiveness and represents a special area of operation of the industrial policy. World experience shows many positive effects of cluster mergers on regional economic growth and development of certain sectors, which are based on collaboration, knowledge exchange, building common strategies for development, export promotion etc. The Ministry of Economy prepares an annual Programme for support and development of the cluster association several years in a row, and since 2013 it has been integrated in the Program for competitiveness, innovation and entrepreneurship. The measures are aimed at supporting awareness for clustering, trainings for managers of clusters, supporting projects in clusters, encouraging innovation and export capacity of clusters, etc.



To enable improved transparency and awareness of the business community for all programs and measures that are designed to support companies, their continuous informing and education, the Ministry of Economy created a web portal www.konkurentnost.mk, where Government programs that are implemented by various ministries, European and donor projects and programs, many strategic documents, international reports and relevant publications etc. are presented at one place.

As part of the SEE Strategy 2020, a project will be implemented for creating a value chain in the region for several sectors: food processing, tourism and automotive industries, as well as several other projects related to SMEs development and access to finance, research and development, innovation and trade promotion.

In terms of sectoral export promotion, through donor projects, sector strategies for export promotion of ICT, agricultural products, food processing and other industries were developed. In order to attract FDI, the focus remains on attracting foreign companies in the technological industrial development zones and out of them, as well as active promotion through the network of promoters and road shows. Export promotion is realized through support for participation on trade fairs, B2B group meetings, trade missions, networking and education. In the period 2014-2016, the focus will be to strengthen the institutional capacity of the Agency for Foreign Investments and Export Promotion (InvestMacedonia) for enhanced trade and investment promotion, after care for investors, active engagement of promoters, functional web portal to promote exports, issuing various publications, surveys and brochures for export as educational materials in order to increase knowledge for export etc.

In the Republic of Macedonia special attention is paid to the corporate social responsibility of enterprises. The Ministry of Economy will continue to coordinate the activities related to the development of the concept of corporate social responsibility and development of CSR Strategy 2014-2020 with a two-year action plan. There is large contribution here by the National Coordination Body for Social Responsibility of Companies, as a permanent working body of the Economic and Social Council, with a mission to mobilize companies and all stakeholders to exercise social responsibility as a key strategy in operations. For six years, the Ministry of Economy in cooperation with the National Coordination Body for Social Responsibility of Companies continually awards the National Award for best corporate social responsibility practices of Macedonian enterprises and this event will continue to be organized in the future.

In the period 2014-2016, in order to strengthen the institutional capacity for implementation of proactive industrial policy, the IPA project - *"Strengthening the institutional capacity for implementation of industrial policy"* will be implemented, which is expected to begin during 2014. Significant effect is expected by the projects arising from the implementation of the Strategy for SEE 2020 and IPA 2014 – 2020, as well as various donor projects of the World Bank, USAID, GIZ, JICA and others.

Competition and state aid. The implementation of the twinning project of IPA TAIB 2009 "Assistance to the Commission for Protection of Competition for state aid control" will last until January 2014. At the end of 2013, the Regulation establishing conditions and procedure for granting horizontal aid was enacted, which transposes relevant EU regulation. The preparation of operational state aid database, preparation of methodology for drafting state aid annual reports and developing state aid schemes as well as methodologies and procedures to facilitate the decision making process are ongoing. During the period 2014-2016, the following activities are planned:

- Preliminary analyses of the competition on the market upon which draft measures and activities will be proposed for improvement of competitive environment, as well as



measures for systematic observation and improvement of enforcement of competition policy, according to the Strategy for Innovations of the Republic of Macedonia 2012-2020;

- Strengthening of the administrative capacity of the Commission for Protection of Competition through advanced trainings and enhancing the number of employees in antitrust and concentration;
- Efficient enforcement of the legislation for protection of competition in order to ensure free competition on the market in the Republic of Macedonia and further efficient enforcement of the legislation for state aid control and
- Improvement of the notification for granted state aid by the providers through raising awareness for due fulfillment of their obligations.

Consumer protection. The preparation of the final version of the ToR for the IPA project "Harmonization of legislation and capacity building in the field of consumer protection" is underway. The project is expected to start in September 2014 and will last for two years. The aim of the project is to strengthen consumers protection through strengthening of consumer's protection policy and upgrading the capacity of governmental and non-governmental institutions involved in this process.

The project consists of two components, whereby the first component includes further harmonization of consumer legislation and enhancing the capacity of government and non-governmental institutions to further successfully create and implement consumer protection policies. The second component includes direct financial support to NGOs in the field of consumer protection which is expected to contribute to the active participation of NGOs in the field of consumer education, information and counseling of consumers, increasing the capacity of NGOs for managing issues in the area of consumer rights, increase awareness of consumer rights, consumer policy implementation through well structured strategies for increasing consumer awareness, active participation in the establishment and provision of alternative dispute resolution procedures and establishment and development of a database for registering and resolving consumer complaints.

| Description of policy | 2013 | 2014 | 2015 | 2016 |
|---|-----------|------------|------------|------------|
| <i>Programme for Competitiveness, Innovation and Entrepreneurship</i> | | | | |
| A. Implementation profile* | | x | | x |
| B. Net direct budgetary impact (if any) | -- | 15,690,000 | 20,000,000 | 20,000,000 |
| B.1 Direct impact on budgetary revenues | -- | 0 | 0 | 0 |
| B.2 Direct impact on budgetary expenditures | -- | 15,690,000 | 20,000,000 | 20,000,000 |
| <i>IPA (2009) "Capacity building for the implementation of the industrial policy"</i> | | | | |
| A. Implementation profile* | | x | | x |
| B. Net direct budgetary impact (if any) | -- | 7,915,050 | 8,523,900 | 1,826,550 |
| B.1 Direct impact on budgetary revenues | -- | 71,235,450 | 76,715,100 | 16,438,950 |
| B.2 Direct impact on budgetary expenditures | -- | 79,150,500 | 85,239,000 | 18,265,500 |
| <i>IPA (2009) "Support of the Commission for Protection of Competition for state aid control"</i> | | | | |
| A. Implementation profile* | x | | | |
| B. Net direct budgetary impact (if any) | 307,500 | -- | -- | -- |
| B.1 Direct impact on budgetary revenues | 5,842,500 | -- | -- | -- |
| B.2 Direct impact on budgetary expenditures | 6,150,000 | -- | -- | -- |
| <i>IPA (2010) "Harmonization of legislation and capacity building in the field of consumer protection"</i> | | | | |
| A. Implementation profile* | | x | | x |
| B. Net direct budgetary impact (if any) | -- | 3,185,700 | 1,162,350 | 3,487,050 |
| B.1 Direct impact on budgetary revenues | -- | 28,671,300 | 10,461,150 | 387,450 |
| B.2 Direct impact on budgetary expenditures | -- | 31,857,000 | 11,623,500 | 3,874,500 |
| <i>Export promotion activities</i> | | | | |



| | | | | |
|---|------------------|--------------------|--------------------|-------------------|
| A. Implementation profile* | x | x | | |
| B. Net direct budgetary impact (if any) | 492,000 | 3,690,000 | -- | -- |
| B.1 Direct impact on budgetary revenues | 0 | 0 | -- | -- |
| B.2 Direct impact on budgetary expenditures | 492,000 | 3,690,000 | -- | -- |
| Total net budgetary impact | | | | |
| Total impact on budgetary revenues | 5,842,500 | 99,906,750 | 87,176,250 | 16,826,400 |
| Total impact on budgetary expenditures | 6,642,000 | 130,387,500 | 116,862,500 | 42,140,000 |

* Indicate start and, if needed, end with an "X" mark

Source: Ministry of Economy and Commission for Protection of Competition

4.2.4. Financial system

Banking and Non-Banking Sector. In the period 2014-2016, regulatory changes at international level and at EU level will be observed, in particular as regards measures to improve the conditions at banks and establish so-called bridge bank. After adopting the respective Directives, Republic of Macedonia will implement them.

To the end of strengthening the stability of the financial market in the Republic of Macedonia, modifications and amendments to the Law on Financial Undertakings are envisaged to be made in the course of 2014, so as to strengthen the supervisory role of the Ministry of Finance as regards the operations of the financial undertakings.

To the end of full harmonisation with the respective EU legislation, new Law on Payment Operations will be adopted in the coming medium-term period. Due to its complexity, a project is approved through IPA 2010, the realisation of which is expected to start in the third quarter of 2014. By transposing Directive 2007/64/EC in the national legislation, payment services will be liberalised, i.e. new entities, other than commercial banks, will be able to enter the payment services market. Adoption of the new Law on Payment Operations will contribute to intensifying the use and the application of new digital and computer devices for carrying out payment transactions, timely preparation of institutions in charge of regulating, licensing and supervising payment services providers and introducing new payment instruments for credit transfers and direct borrowing.

Infrastructure of the Financial Market. For the purpose of harmonisation with Directive (98/26/EC) on Settlement Finality, Law on Settlement Finality in Payment and Securities Settlement Systems will be adopted in the course of 2015. Adoption of this Law will provide for minimizing the systemic risks of the participants in the existing payment system and the existing securities settlement system and maintaining system stability.

Capital market. The main priority of the capital market in the period of 2014-2016 will be further harmonisation of the national legislation with the relevant one of the EU, in order to establish a modern, market oriented, stable and competitive financial sector and strengthening the role and capacities of the Securities and Exchange Commission as regulator of the securities market.

During the period of 2014-2015 adoption of a new Capital Market Law is planned, which will be fully in compliance with the EU legislation, especially to the Directive 2004/39/EU on markets in financial instruments (MiFID). This Law should provide a higher protection of minority shareholders in shareholding companies, larger transparency by the companies and introduction of new financial instruments. A special project through IPA 2010 is approved for preparing this new Law that should have started at the beginning of 2013 but due to unsuccessfulness of the first tender due to insufficient number of applied candidates, the start of the project was postponed. After the adoption of the new Law, the MSEC will prepare all necessary bylaws for its implementation.



In the following midterm period, adoption of the changes and amendments of the current Law on Investment Funds is planned, that will mean it's compliance with the relevant package of UCITS IV (introducing the feeder funds and master funds, fund mergers procedures applicable on both cross-border and domestic funds and providing higher level of investor's information through Key Investor Information Document – the simplified prospectus), as well as its compliance to the Alternative Investment Fund Managers Directive 2011/61/EC in the course of introducing the rules and procedures for licensing private fund management companies, to strengthen the interest protection of the investors in private investment funds and maintaining the stability of the Macedonian capital market.

The continuing process of harmonization of regulation with the relevant goals and principles of IOSCO Strategic Direction 2010-2015 will continue also in the next period, primarily by accepting the courses and recommendations for establishing mechanisms for cooperation among national regulators for more efficient conduction of the supervision and information exchange.

With financial assistance from EC, in the following period a Strategy for development of the capital market in the Republic of Macedonia for the period of 2013-2018 will be prepared, as well as an Action Plan for its implementation, in which main priorities of the MSEC in the course of further improvement of the national capital market will be defined. The Strategy will be created with the participation of all relevant regulatory institutions on the Macedonian securities market (Ministry of finance, NBRM, MAPAS, ISA and others).

In order to strengthen the supervisory function of the MSEC in the next period, the EBRD will financially support a project for creating a software solution for supervision of investment funds and fund management companies, which will represent an integrated system for monitoring the activities of the investment funds and fund management companies.

Insurance Sector. In order to implement the best practices from EU, but above all, to strengthen the stability of the insurance sector, adoption of a new Insurance Law in 2014 is envisaged, where the new EU Directive 2009/138/EC (Solvency II) will be transposed.

The Insurance Supervision Agency (ISA) continues with the activities related to the implementation of the Project on Catastrophe Risks Insurance SEEC CRIF. The insurance products will be promoted in the first quarter of 2014. ISA will actively participate in their promotion in order to inform the public on the importance of the catastrophe risks insurance.

As per the recommendations of the EC Progress Report on Republic of Macedonia with regards to the market liberalisation of the compulsory motor third-party liability insurance, ISA implemented a project with the World Bank, thus creating the basis for a regulatory framework and actuarial calculation of premium rates and technical reserves for motor third-party liability insurance that will be a guideline for the insurance companies in the upcoming period.

In collaboration with the International Finance Corporation, ISA is working on the Project on corporate governance of insurance companies. Deliverable of the Project will be Corporate Governance Code prescribing the obligation for the companies for annual reporting of their compliance with the Code or providing rationale for non-compliance. Hence, the ISA will be able to observe the Insurance Core Principle (ICP) 7 on corporate governance of the International Association of Insurance Supervisors (IAIS). ISA is planning to use the technical assistance and information exchange instrument (TAIEX) in order to prepare for the application of the provisions in the EU Directive 2009/138/EC (Solvency II), taking into account the announcements for amendment via Omnibus II, especially in regards to the application of tier 2 provisions. Also, ISA will continue its collaboration with De Nederlandsche Bank, carried out via



trainings on topics currently relevant for ISA, above all, related to the development of methodology for performing supervision and the introduction of risk based supervision.

One of the main priorities of ISA is development of consumer protection by improving financial literacy and by taking action on consumer complaints. In 2012 the number of submitted complaints has increased, hence ISA is planning to introduce and promote mediation in the upcoming period. Additionally, ISA will work on the creation of insurance ombudsman. ISA will continue its cooperation with the supervisory bodies of the EU Member States with whom it has signed memorandum of cooperation, mostly by performing joint supervisions with the regulators in the domicile countries of the parent companies and by participating in supervisory colleges upon invitations from the regulators in the domicile countries of the insurance companies operating on the Macedonian market. Particular challenge for the ISA is that Republic of Macedonia will become part of the programme commitments of EIOPA for the purpose of introducing equality for non-EU countries in the procedure for establishing and keeping professional secrecy in insurance supervision.

In the period 2014-2016, adoption of bylaws for the segment regulations and licensing is planned, especially in the areas of risk management, re-insurance, and better reporting to ISA. Also, it is planned to adopt internal acts in order to strengthen the methodology for conducting supervision. In 2014-2016, ISA will maintain the activities for continuous training of agents and brokers, thus contributing to increased efficiency of the insurance services market and increased trust for insurance services among insured. In the period 2014-2016, ISA will conduct a self-assessment on the extent of application and compliance with the Insurance Core Principles, or more specifically, ICP 23 on group supervision, and ICP 22 on prevention of money laundering and fight against terrorism financing.

Fully-funded pension insurance. Through promotion and further development of the multi-pillar pension system as a combined system of public, pay-as-you-go, and privately, fully funded pension insurance, the realization of the strategic objectives of the Government of the Republic of Macedonia for approximation to European standards and values and providing dignified life for all citizens will be enabled. MAPAS as a supervisor and regulator of Fully Funded Pension Insurance and as a member of IOPS (International Organization of Pension Supervisors), constantly strengthens its capacity and takes measures to protect the interests of pension funds. In 2014 MAPAS will continue to adopt the secondary regulation resulting from the introduction of risk-based supervision and will continue to work on regulations to comply with the Law for the payment of pensions and pension benefits in fully funded pension insurance.

In order to strengthen the supervisory capacity of MAPAS, during 2014 employees of MAPAS will participate in workshops organized by the IOPS for financial education and seminars in the area of risk-based supervision in order to receive certificates for risk management. In this respect, training of the employees will be conducted for development of IT processes and software for risk-based supervision, asset management, creation and analysis of a portfolio of pension funds, development of electronic quotation system of pensions and retirement benefits, as well as building institutional capacity and alignment with EU practices.

The EC approved a request of MAPAS for mission through TAIEX project for consultation in finalizing the secondary regulation of the Law for payment of pensions and pension benefits in fully funded pension insurance. Application and implementation of the mission is expected to be completed in the period 2013/2014. In the next med-term period, an employee of MAPAS participating in the two-year training for actuaries organized by ISA is expected to get a certificate for a certified actuary. MAPAS as supervisor of pension companies and pension funds is constantly revising and improving its approach for supervision. With the implementation of



risk-based supervision MAPAS provided a system of risk assessment with particular attention to the management of supervised entities and continued to improve surveillance for better risk assessment of the work of each supervised entity. In order to strengthen the supervisory capacity MAPAS reviewed certain processes associated with the system of quality management. In the next period in order to direct the resources of MAPAS to risk-based supervision over the activities of the Committee for Risk Assessment, MAPAS will regularly review all potential risks to the pension system and will propose possible control mechanisms.

MAPAS performs preparation of documentation and implementation of quality standards for the second certification for getting the standard ISO 9001 certification. Representatives of MAPAS are part of the working group for public education on issues of fully funded pension insurance, and together with representatives of Ministry of labor and social policy, Ministry of education and science and pension companies, will conduct presentations for purposes and principles of fully funded pension insurance in high schools and universities, chambers of commerce and associations of citizens. In the next period MAPAS will continue to participate in working meetings for financial education of the population, together with representatives from the financial supervisory and regulatory bodies in Republic of Macedonia. In this regard, MAPAS promotes the activity open days of the Agency, in order to inform members and potential members of Fully Funded Pension Insurance on issues of their interest.

| Description of policy | 2013 | 2014 | 2015 | 2016 |
|--|------|-------------------|-------------------|------|
| IPA (2010) "Harmonization with the EU legislation in the area of free movement of capital and financial services payment – Securities Market and investment services" | | | | |
| A. Implementation profile* | | x | x | |
| B. Net direct budgetary impact (if any) | -- | 4,797,000 | 3,198,000 | -- |
| B.1 Direct impact on budgetary revenues | -- | 43,173,000 | 28,782,000 | -- |
| B.2 Direct impact on budgetary expenditures | -- | 47,970,000 | 31,980,000 | -- |
| Total net budgetary impact | | | | |
| Total impact on budgetary revenues | -- | 43,173,000 | 28,782,000 | -- |
| Total impact on budgetary expenditures | -- | 47,970,000 | 31,980,000 | -- |

* Indicate start and, if needed, end with an "X" mark

Source: Ministry of Finance

4.2.5. Agriculture and Agricultural Policy

Land Policy. In terms of land policy, in the next medium term, the activities will continue to be implemented and aimed at the following:

- Distribution of free state-owned agricultural land to farmers, including pastures;
- Registration of the existing facilities for agricultural purposes built on agricultural land and enabling construction of farm buildings under the simplified procedure, without paying for utilities;
- Implementation of actions identified in the National Strategy for consolidation of agricultural land and providing project support for consolidation of agricultural land;
- Granting state-owned agricultural land for usufruct to socially non-provided categories of citizens, in order to engage them in economic activity as employees who earn livelihoods from agriculture.

In the next period, opportunities for selling of state-owned agricultural land pursuant to the Law on sale of agricultural land will be promoted, in order to mobilize the market of agricultural land and investments in agricultural business.

Direct Support Policy. Within the transition period of adjustment of the systems for direct support in accordance with the priorities of the Common Agricultural Policy and the



mechanisms for payment of direct support in accordance with the European Agricultural Guarantee Fund (EAGF), Republic of Macedonia will continue to implement the measures for direct support in the course of the following:

- Implementation of continuous and stable policy of direct support in agriculture, animal husbandry, fruit growing and gardening, farming, viticulture and tobacco, through direct payments per head and per hectare;
- Strengthening the system of efficiency of the measures for direct support through the use of indicators and results from the Farm Accounting Data Network in defining the amount of payments;
- Strengthening the system of payment of direct support measures and administrative control through the application of a fully built Integrated Administrative Control System (IACS) and complementary systems, particularly through the implementation of electronic connection logs for evidence of agricultural holdings (Single Farm Register) and implementation of the Land Parcels Identification System, the Wine Cadastre, and the Fruit and Olives Cadastre;
- Continuous institutional upgrading of the Agency for Financial Support in Agriculture and Rural Development for implementation of the functions of "Paying Agency" on the principles and mechanisms of direct support payments, pursuant to EAGF.

The direct support measures have been carried out on the base of the five-year National Program for Agriculture and Rural Development 2013-2017 in which annual budget funds for direct payments in agriculture have been projected, as well as the level and purpose of the financial support per hectare and per head. The available funds for institutional strengthening from the IPA Component – 1 shall be used for implementation of the direct support policy and alignment of the control systems for administrative review and site supervision over payments.

Organization of markets for agro-food products. In accordance with the recommendations of the Progress Report 2013, and in order to fully implement the provisions of the quality of agricultural products, which is in accordance with EU regulations on "Common Market Organization", the establishment of registries for higher standards for geographical indications, designations of origin and traditional specialty shall commence in the next mid-term period. Also, activities for informing the farmers on the market conveniences are planned for the next mid-term, for applying of higher standards for geographical indications, designations of origin and traditional specialty, especially for products that have the status of local specialties.

Within the next mid-term period 2014-2016, the programs for promotion of the national brands on new alternative markets and domestic marketing campaigns for products with low national consumption, providing continuous information on the trends, demand and prices on agricultural markets and prediction of trends in the future seasons through the Market Information System of MAFWE will continue to be supported.

A particular priority to the policies for agriculture and rural development in the period 2014-2016 will be given to the promotion of the benefits from joining, as well as implementation of the financial packages that include support for creation and operation of the new cooperatives and strengthening of their capacity for independent functioning, as well as establishing a system of continuous training for managers that are going to manage the agricultural cooperatives by improving of their marketing, organizational and managerial skills.

Rural development. In the rural development area, the policy priorities in the period 2014-2016 shall be the following:

- In accordance with the recommendations of the Progress Report 2013, the work on improving the existing procedures for implementation of the IPARD program in terms of



facilitating the process of applying, particularly through promoting the use of public advisory services, will continue;

- Structural adjustment of the agricultural sector through the financial support for the possibility for faster handing over of farms to young farmers from 18 to 40 years, by providing financial incentives for starting new agri-business and development of human resources in agriculture, by improving the qualifications and professional skills and knowledge in new technologies and modernization;
- Support for production which is based on agro - ecological approach to maintain of particular traditional landscapes, biodiversity and promotion of traditional varieties and types;
- Promoting the establishment and development of family businesses and achieving additional income from agricultural and non-agricultural activities, through co-financing of projects for diversification of activities in rural areas.

With an objective for development of the rural tourism and strengthening tourist offers in the next period, enhanced promotion of measures for support of investments in rural tourism according to the IPARD program and continuous implementation of the measures for support of municipalities to enrich the tourist offers through investments in public picnic areas, infrastructural linking of the cultural monuments of local importance, signposting of forest and hiking trails, establishment of bicycle paths and walkways etc., will be conducted.

In order to provide a system of public advisory services with high quality, according to the requirements of agricultural holdings, legal regulation in the area of agricultural advisory services and restructuring and strengthening of the Agency for the development of agriculture is planned in the next period.

The quality of life in rural areas remains a high priority for the future period, for which the investments in rural infrastructure through budgetary support to municipalities and use of the IPA and World Bank funds will be increased.

According to the National Program for Agriculture and Rural Development 2013-2017, activities for investments in infrastructure for agricultural development or rehabilitation and expansion of irrigation, as well as construction or reconstruction of the road network for access to arable land will be conducted.

Food safety. In this area, the focus in the next med-term will be on the following activities:

- Implementation of the strategy for food safety, internal control plan and the general plan for crisis management;
- Implementation of the multi-annual Strategy for improvement and monitoring of the quality of milk and establishing a system for monitoring the milk quality;
- Establishing a system for identification and registration of pigs and strengthening and updating the existing system for identification and registration of livestock;
- Implementation of programs for eradicating rabies through vaccination measures, education and other safeguarding measures;
- Establishment of a system for treatment, collection and processing of waste of animal origin, in accordance with the recommendations of the Progress Report 2013.

In the area of veterinary health activities, the actions in the next medium-term period shall be aimed at increasing the availability and quality of veterinary services.

Phytosanitary Policy. In terms of phytosanitary policy, activities in the period 2014-2016 will be in the direction of the law enforcement in the area of phytopharmacy, strengthening of the system of trade and using phytopharmaceutical resources, including the enhancement of the



level of control. Additionally, efforts in this area will be focused on enhancing the production and market of seeds and seedlings and protection materials through special measures for control of the production and trade with seeds, their labeling and quality control. Activities are planned in strengthening the legal framework in this area, as well as development and implementation of monitoring plans for export of agricultural products of plant origin.

| Description of policy | 2013 | 2014 | 2015 | 2016 |
|--|--------------------|----------------------|----------------------|--------------------|
| IPA (2009) "Capacity building for the implementation of policies in the field of agriculture and rural development" | | | | |
| A. Implementation profile* | x | | x | |
| B. Net direct budgetary impact (if any) | 4,358,931 | 8,738,417 | 292,125 | -- |
| B.1 Direct impact on budgetary revenues | 73,594,684 | 68,777,508 | 5,550,375 | -- |
| B.2 Direct impact on budgetary expenditures | 77,953,615 | 77,515,925 | 5,842,500 | -- |
| IPA (2009) "Strengthening the capacities of competent authorities for food safety, veterinary and phytosanitary policy" | | | | |
| A. Implementation profile* | | x | | x |
| B. Net direct budgetary impact (if any) | -- | 4,783,657 | 5,151,650 | 1,103,925 |
| B.1 Direct impact on budgetary revenues | -- | 43,783,675 | 46,364,850 | 9,935,325 |
| B.2 Direct impact on budgetary expenditures | -- | 48,567,332 | 51,516,500 | 11,039,250 |
| IPA (2010) "Procurement of vaccines against rabies" | | | | |
| A. Implementation profile* | x | | x | |
| B. Net direct budgetary impact (if any) | 0 | -- | 0 | -- |
| B.1 Direct impact on budgetary revenues | 43,542,000 | -- | 29,028,000 | -- |
| B.2 Direct impact on budgetary expenditures | 43,542,000 | -- | 29,028,000 | -- |
| Strategy for improving and monitoring the quality of milk | | | | |
| A. Implementation profile* | | x | | x |
| B. Net direct budgetary impact (if any) | -- | 915,200,000 | 911,000,000 | 911,100,000 |
| B.1 Direct impact on budgetary revenues | -- | 0 | 0 | 0 |
| B.2 Direct impact on budgetary expenditures | -- | 915,200,000 | 911,000,000 | 911,000,000 |
| Programmes for seeds and planting material | | | | |
| A. Implementation profile* | x | x | x | x |
| B. Net direct budgetary impact (if any) | 4,000,000 | 4,000,000 | 15,560,000 | 18,500,000 |
| B.1 Direct impact on budgetary revenues | 0 | 0 | 0 | 0 |
| B.2 Direct impact on budgetary expenditures | 4,000,000 | 4,000,000 | 15,560,000 | 18,500,000 |
| Programmes for the protection of plants | | | | |
| A. Implementation profile* | x | x | x | x |
| B. Net direct budgetary impact (if any) | 7,000,000 | 6,000,000 | 27,500,000 | 30,500,000 |
| B.1 Direct impact on budgetary revenues | 0 | 0 | 0 | 0 |
| B.2 Direct impact on budgetary expenditures | 7,000,000 | 6,000,000 | 27,500,000 | 30,500,000 |
| Programme on food safety and veterinary | | | | |
| A. Implementation profile* | x | x | | |
| B. Net direct budgetary impact (if any) | 163,000,000 | 172,312,000 | -- | -- |
| B.1 Direct impact on budgetary revenues | 0 | 0 | -- | -- |
| B.2 Direct impact on budgetary expenditures | 163,000,000 | 172,312,000 | -- | -- |
| Total net budgetary impact | | | | |
| Total impact on budgetary revenues | 117,136,684 | 112,561,183 | 80,943,225 | 9,935,325 |
| Total impact on budgetary expenditures | 295,495,615 | 1,223,595,257 | 1,040,447,000 | 971,039,250 |

* Indicate start and, if needed, end with an "X" mark

Source: Ministry of Agriculture, Forestry and Water Economy

4.2.6. Rule of law and contract enforcement

Taking into account the results from the implementation of existing legislation, and the realized activities defined within the Strategy for the reform of the judicial system of the Republic of Macedonia, the Government adopted the Framework for further implementation of the judicial reform for the period 2014-2017, which includes the priorities for future reforms in



the judicial system. Key segments that underpin the reform are further strengthening of the independence and increasing the efficiency of the judicial system, having legal guarantees for fair trial, firm legal framework and consistent institutions, as well as further fighting against the corruption.

The need for further improvement of the judicial system in the country through implementation of specific reforms and actions is in line with EC recommendations in the Progress report for the Republic of Macedonia for 2013. Further development of the judiciary is a priority covered by the Action Plan for beginning of accession negotiations between Macedonia and the EU, which arises from the High Level Accession Dialogue between the Republic of Macedonia and the EC from March 2012.

The most important activities in the field of justice that will be realized in the next mid-term period, representing follow up activities of previous reforms, which are expected to have significant positive impact on the implementation of the agreements and strengthening of the business climate are: completion of the process for electronic delivery and audio recording in courts, conducting initial training of judges and prosecutors at the Academy for Judges and Public Prosecutors, implementation of the new Law on Criminal Procedure, linking of ICT systems of public prosecution offices and courts and implementation of Methodology for Judicial Statistics through collection, processing and analysis of statistical data on operation of courts.

In the next period, special emphasis will be placed on the work of enforcement agents and notaries, after taking payment orders and old enforcement cases from courts. In areas of expertise and assessment, activities will be aimed at increasing the quality of the expert opinions and estimates which will be achieved by increasing the professionalism and accountability of the experts and appraisers. For realization of these objectives, the activities of exams for bailiffs, notaries, experts and appraisers will continue, as well as their licensing and establishment of required registers.

According to the Framework for further implementation of the judicial reform, aimed at strengthening the independence, impartiality and effectiveness of the judiciary, while taking into consideration the comments of the EC Progress Report for the Republic of Macedonia in 2013 concerning the responsibility of judges, promoting of the system for accountability of judges is provided, in accordance with international standards and practice of the European Court of Human rights, and in terms of the organization and jurisdiction of the judicial system under the Constitution. In order to increase the efficiency actions will be taken to improve the Court Case Management System and improve the capacity for conducting initial and continuous trainings of judges and public prosecutors.

In order to improve the administrative law, in the future period, measures will be implemented for improvement of the system for misdemeanor, improving the system of administrative law and the establishment of functional interoperability between the Administrative Court and administrative bodies.

Furthermore, as part of reforms in the criminal law system measures will be implemented to overcome the shortcomings of the legal framework that regulates criminal procedures, arrangement of the structure, jurisdiction and functioning of Public Prosecution Office, monitoring and evaluating the work of prosecutors and promotion of the public prosecutor's service. In this direction, regulations will be made for equalization of penal policy for determining penalties.



In order to develop the civil justice system, the process of drafting of the Civil Code of the Republic of Macedonia will continue, where experience with other EU member states will be exchanged in order to harmonize national rules in this area with the EU legislation. Also, work will be done on improving the legal framework of procedures in the field of commercial and employment disputes.

In order to promote alternative dispute resolution (mediation) we will continuously improve the legal framework for mediation in civil cases and criminal matters in accordance with the European standards.

In terms of access to justice, in the period 2014 - 2016 projects will be implemented for improving of the system of free legal aid, promotion of an e-justice system and setting a web portal that will allow citizens access to all data of the litigation, as well as participants in the proceedings. Also, e-delivery for individuals will be promoted, by defining measures for its application, and models for providing pro bono service by lawyers will be established and promoted.

| Description of policy | 2013 | 2014 | 2015 | 2016 |
|--|-------------|-------------|------------|-----------|
| Initial training of fifth generation listeners for judges and public prosecutors | | | | |
| A. Implementation profile* | | x | | x |
| B. Net direct budgetary impact (if any) | -- | 10,800,000 | 11,000,000 | 8,000,000 |
| B.1 Direct impact on budgetary revenues | -- | 0 | 0 | 0 |
| B.2 Direct impact on budgetary expenditures | -- | 10,800,000 | 11,000,000 | 8,000,000 |
| Electronic delivery and recording of sound on trials | | | | |
| A. Implementation profile* | | | x | |
| B. Net direct budgetary impact (if any) | -- | -- | 0 | -- |
| B.1 Direct impact on budgetary revenues | -- | -- | 21,525,000 | -- |
| B.2 Direct impact on budgetary expenditures | -- | -- | 21,525,000 | -- |
| Connection of the IT systems between the judiciary and public prosecution | | | | |
| A. Implementation profile* | | | x | |
| B. Net direct budgetary impact (if any) | -- | -- | 0 | -- |
| B.1 Direct impact on budgetary revenues | -- | -- | 30,750,000 | -- |
| B.2 Direct impact on budgetary expenditures | -- | -- | 30,750,000 | -- |
| Implementation of the new Law on Criminal Procedure | | | | |
| A. Implementation profile* | x | | x | |
| B. Net direct budgetary impact (if any) | 61,957,000 | 112,698,000 | 0 | -- |
| B.1 Direct impact on budgetary revenues | 1,300,000 | 700,933 | 901,400 | -- |
| B.2 Direct impact on budgetary expenditures | 63,257,000 | 113,398,933 | 901,400 | -- |
| Implementation of the framework for further implementation of the judiciary reform | | | | |
| A. Implementation profile* | | | | x |
| B. Net direct budgetary impact (if any) | 135,327,000 | 95,000,000 | 0 | 0 |
| B.1 Direct impact on budgetary revenues | 0 | 0 | 1,400,596 | 1,703,306 |
| B.2 Direct impact on budgetary expenditures | 135,327,000 | 95,000,000 | 1,400,596 | 1,703,306 |
| Capacity building of the law enforcement agencies for appropriate treatment of detained and sentenced persons | | | | |
| A. Implementation profile* | x | | x | |
| B. Net direct budgetary impact (if any) | 4,735,382 | 6,170,617 | 1,394,000 | -- |
| B.1 Direct impact on budgetary revenues | 42,618,446 | 55,535,554 | 12,546,000 | -- |
| B.2 Direct impact on budgetary expenditures | 47,353,828 | 61,706,171 | 13,940,000 | -- |
| Total net budgetary impact | | | | |
| Total impact on budgetary revenues | 43,918,446 | 56,236,487 | 67,122,996 | 1,703,306 |
| Total impact on budgetary expenditures | 198,584,000 | 219,198,933 | 65,576,996 | 9,703,306 |

* Indicate start and, if needed, end with an "X" mark

Source: Ministry of Justice



4.2.7. Administrative reforms

Public administration reform. The key objective of the reform of public administration in the Republic of Macedonia is transformation of the country's administration in an efficient and transparent service for the citizens, companies and other entities that will ensure the realization and protection of citizens' rights and partnership with civil and business sector. The basic principles of the administration in exercising these rights are: equality of citizens, predictability of the work of the administration, participation of the citizens, economic entities and all stakeholders in creation of Government policies as one of the fundamental values of a democratic society.

In the following medium term period a new legal framework will be adopted and implemented, which will regulate the status of all employees in the public sector, where except administrative servants, providers of services in the health sector, education, culture, and other activities of public interest will be covered, with special emphasis on the administrative servants. The new legal framework will provide a unified regulative of the status of employees in the public sector, will establish a unified classification of job positions, will establish a single register of public sector employees, will guarantee the minimum rights and duties of employees, and will also establish a system for managing performance and guarantee equal access to jobs in the public sector, based on the principles of professionalism, competence, equal access and transparency.

Regarding administrative servants and their status, the new legislation will ensure improvement of the system for human resources management by fully regulating the responsibilities of the various institutions and introducing a system of competencies, will establish a single job positions classification, will fully elaborate the procedure for filling new job positions through employment, promotion and mobility, which will be based on the principles of professionalism, competence, equal access and transparency. It will also establish an entirely new system of professional training of administrative servants through generic and specialized trainings and mentoring. The new legal framework will establish for the first time a complete system of performance management, which should motivate administrative servants for improving their work through rewards and penalizing, as well as to improve the assessment process. Disciplinary responsibility and the manner of termination of employment will be further regulated.

Implementation of the Law on introduction of a system of quality management and a common framework for assessment of operation and provision of services in the public service will continue. According to the law, all authorities should introduce at least a basic standard ISO 9001, as well as the Common assessment framework CAF.

The Parliament of the Republic of Macedonia adopted the Law on obtaining and exchange of evidence and data ex officio. This law represents an obligation for institutions to exchange data and documents ex officio among each other, in order to enable mandatory offering of one-stop shop administrative services, without any responsibilities for the citizen.

In order to increase the rights of citizens in administrative procedures and facilitate the fulfillment of their obligations to the public institutions, which is a remark given by the EC and Sigma, a new Law on General Administrative Procedure will be prepared, adopted and implemented. In order to improve the quality of public administration an electronic learning management system will be implemented in the public administration. This system will be the foundation for continuous development of the knowledge of the administration and a mechanism for assessment of the qualifications needed for each job position.



In the period 2014 - 2016 the implementation of the already started projects for improvement of the performance of the public administration will continue, including:

- Continuous capacity building of the Ministry of Information Society and Administration and the State Administrative Inspectorate.
- The implementation of the project "Evaluate the administration" continues, which provides for citizens to directly express their satisfaction with the services received from the public institutions through a special device that is connected to a software system for calculation of salary, to the end of raising the responsibility of the civil servants
- The implementation of the project "No wrong door" continues, in order to ensure that the citizens are always served no matter whether they have addressed the right place and/or the right office.
- The implementation of the project "Civic Diary" continues, in order to strengthen public awareness of the benefits of this tool.
- The implementation of the system for permanent measurement of the satisfaction with the administrative services continues within the project "Barometer of quality".
- Activities for assessment of the work commitment and the level of satisfaction of the employees in the public administration will continue.
- Implementation of the system for interoperability of data exchange and electronic documents between institutions continues.

Improvement of the transparency and the accountability of the administration. Regarding the improvement of the transparency and accountability of the administration, in the next three years activities will be carried out for strengthening of the administrative capacity for strategic planning, which is in the same direction with the priorities arising from Pre-accession partnership. Implementation of the Strategy for cooperation with the civil sector for the period 2012-2017 will continue through encouraging and supporting of the participation of the civil society in the process of policy creation and strengthening of capacity for cooperation with the civil society, which is correlated with the Strategy "Europe 2020".

The focus in the next three-year period will be also on the continued development of civil society by encouraging development outside the City of Skopje and rural areas, which is in the same direction with the priorities arising from the Strategy "Europe 2020". The development of the local strategies for cooperation with civil society in eight pilot municipalities will be supported by the IPA project "Sustainable civil society". The cooperation with the Ombudsman will be highly promoted and developed in the next period as well.

| Description of policy | 2013 | 2014 | 2015 | 2016 |
|---|------|---------|------------|------------|
| Strengthening the capacity of MISA and the State Administrative Inspectorate | | | | |
| A. Implementation profile* | | x | | x |
| B. Net direct budgetary impact (if any) | -- | 20,000 | 30,000 | 35,000 |
| B.1 Direct impact on budgetary revenues | -- | 100,000 | 115,000 | 120,000 |
| B.2 Direct impact on budgetary expenditures | -- | 120,000 | 145,000 | 155,000 |
| Project "Rate this administration" | | | | |
| A. Implementation profile* | | x | | |
| B. Net direct budgetary impact (if any) | -- | 310,000 | 15,350,000 | 15,350,000 |
| B.1 Direct impact on budgetary revenues | -- | 0 | 0 | 0 |
| B.2 Direct impact on budgetary expenditures | -- | 310,000 | 15,350,000 | 15,350,000 |
| Improving the "Civic Diary" | | | | |



| | | | | |
|---|----------|-------------------|-------------------|-------------------|
| A. Implementation profile* | | x | | |
| B. Net direct budgetary impact (if any) | -- | 615,000 | 615,000 | 615,000 |
| B.1 Direct impact on budgetary revenues | -- | 0 | 0 | 0 |
| B.2 Direct impact on budgetary expenditures | -- | 615,000 | 615,000 | 615,000 |
| Quality Barometer | | | | |
| A. Implementation profile* | | x | | x |
| B. Net direct budgetary impact (if any) | -- | 1,230,000 | 1,230,000 | 1,230,000 |
| B.1 Direct impact on budgetary revenues | -- | 0 | 0 | 0 |
| B.2 Direct impact on budgetary expenditures | -- | 1,230,000 | 1,230,000 | 1,230,000 |
| Introduction of ISO and CAF standards in the public administration | | | | |
| A. Implementation profile* | | x | | |
| B. Net direct budgetary impact (if any) | -- | 6,150,000 | 18,000,000 | 20,000,000 |
| B.1 Direct impact on budgetary revenues | -- | 0 | 0 | 0 |
| B.2 Direct impact on budgetary expenditures | -- | 6,150,000 | 18,000,000 | 20,000,000 |
| Implementation of system for interoperability | | | | |
| A. Implementation profile* | | x | | |
| B. Net direct budgetary impact (if any) | -- | 1,000,000 | 1,000,000 | 1,000,000 |
| B.1 Direct impact on budgetary revenues | -- | 0 | 0 | 0 |
| B.2 Direct impact on budgetary expenditures | -- | 1,000,000 | 1,000,000 | 1,000,000 |
| IPA 2009 "Sustainable civil society" | | | | |
| A. Implementation profile* | | x | x | |
| B. Net direct budgetary impact (if any) | -- | 0 | 0 | -- |
| B.1 Direct impact on budgetary revenues | -- | 54,149,904 | 38,099,636 | -- |
| B.2 Direct impact on budgetary expenditures | -- | 54,149,904 | 38,099,636 | -- |
| Total net budgetary impact | | | | |
| Total impact on budgetary revenues | 0 | 54,249,904 | 38,214,636 | 120,000 |
| Total impact on budgetary expenditures | 0 | 63,574,904 | 74,439,636 | 38,350,000 |

* Indicate start and, if needed, end with an "X" mark

Source: Ministry of Information Society and Administration

4.2.8. Additional reform areas

4.2.8.1. External trade

Liberalization of market services within CEFTA. During 2012 and 2013, activities related to assessment of the potentials for launching negotiations for liberalization of trade in service sectors pursuant to Articles 27 and 29 of the CEFTA Agreement continued. CEFTA States have adopted a model for multilateral negotiations on CEFTA base. Protocol for trading in services is the model for regulating the level of openness of services sectors in the region. The project for CEFTA States envisages creating relevant data base of regulations and in the beginning will cover the area of professional services that includes: legal services, accounting services, architectural and engineering services. Analysis of the data in the service sector should be an advantage of liberalization in this sector compared to the regulatory framework of the CEFTA States via OECD and EU countries. At this stage CEFTA States agreed to analyze the level of its market openness in the following sectors: transport, construction and distribution services. In 2013 CEFTA States agreed on the draft text of the Protocol on Trade in Services. The negotiation process for liberalization of services will start in 2014, and after its conclusion the Protocol will be signed. The willingness for negotiations on liberalization of services is primarily for business services, tourism and transport services, construction and distribution services that are designated as priority sectors.

Trade with services. In line with the goals set in the "Europe 2020" Strategy, main priority for the services sector is to continue with the measures and activities for harmonization with the Services Directive. For this purpose the general principles of the directive were transposed in the Proposal of the Law on Services. In the following period adoption of the law is planned, which will ensure transparent and predictable legal framework for elimination of the remaining



barriers that impede access to and provision of services in the country. The Proposal of the Law on Services foresees establishment of “Point of Single Contact” (PSC) according to the Services Directive requirements. Ministry of Economy is responsible for establishment of the PSC. Within the Project “Further alignment with the EU Services Directive” which started in June 2013, a Feasibility study for establishing a “Point of Single Contact” in Macedonia will be developed. The study should outline the necessary activities for establishment of “PSC” as a step forward to efficient implementation of the Services Directive.

Protocol for enlargement within SSA with accession of Republic of Croatia in EU. Under Article 35 of the Stabilization and Association Agreement between the Republic of Macedonia and the EU, two rounds of negotiation were held in 2013 for revision of the existing Protocol, concerning the accession of Croatia in EU from 1 July 2013. The Protocol regulates the existing quotas for agricultural products, process agricultural products and fishery products and is revised according to concessions that the Republic of Macedonia and Croatia applied on bilateral basis within CEFTA. Signing of the Protocol by both sides is expected in the following period.

4.2.8.2. Attracting Foreign Direct Investments and Export Promotion

In the following three years, the Agency for Foreign Direct Investments and Export Promotion (Invest Macedonia) will continue its activities for attracting foreign investment through the marketing campaigns on international TV channels and printed media in order to strengthen the country's image as an attractive investment destination with excellent conditions for doing business. Additionally, the strong engagement of the whole network of economic promoters continues, currently numbering 31 person, who are committed to direct promotion of the investment possibilities and export potential of our country in front of foreign companies in the global economic centers such as the U.S.A, Canada, Brazil, Russia, Azerbaijan, Qatar, China, Malaysia, Japan, UK, France, Germany, Italy, Austria, Switzerland, Belgium, Netherlands, Sweden, Norway, Hungary, Bulgaria, Serbia, Albania, Kosovo and Turkey.

The promotion of the country is greatly assisted by the new website of Invest Macedonia, which includes an interactive portal for trade with relevant information about the foreign markets and relevant information and profiles of the Macedonian exporters. In the next period, Invest Macedonia will continue the activities via the Department for Export Promotion for organization of B2B events for Macedonian exporters, for support in participating on many trade shows, trade missions, etc.

Invest Macedonia in the period 2014-2016 will intensify all previous activities to attract investors by presenting the country in several international fairs, will continue to organize the so-called road shows headed by high government officials (including the Prime Minister and Deputy Prime Ministers and several Ministers) in targeted countries, through direct contact with investors and presentation of the reforms for development of the business climate in Macedonia and incentives offered in the Technological Industrial Development Zones.

The Agency is preparing an updated database of successful investment projects that will be implemented continuously in the period of 2014-2016. By achieving close cooperation with already present investors in the country, the Agency could identify the main challenges and problems they face in their everyday work and based on the these observations, Invest Macedonia will inform the relevant authorities to take measures in order to overcome the unnecessary obstacles for effective realisation of their business activities. For even more complete and higher quality service offered to potential foreign investors in all the investment phases, the Agency will develop a database of potential Macedonian vendors in the following period.



All these efforts resulted in increasing of the inflow of FDI, which reached a level of 2.3% of GDP in the first nine months of 2013, which is doubled compared to 2012. Unlike other countries in the region, almost all investment projects are export-oriented and most of the foreign investors have a long-term plan for investment in the country, for expanding their production through additional investments in building new plants and factories and, of course, creating new jobs. Table 4.1. shows the projected cumulative results of completed and planned FDI, the estimated output and planned employment during 2013 – 2014 by existing investors in TIDZ and two other foreign investors.

Table 4.1. Estimated FDIs, production and employment by selected investors in the Republic of Macedonia (in Euro million)

| | Investment | | Production / Export | | Projected employment | |
|--------------|------------|------|---------------------|---------|----------------------|-------|
| | 2013 | 2014 | 2013 | 2014 | 2013 | 2014 |
| Total | 76.4 | 40.5 | 788.85 | 1,219.7 | 5,119 | 9,265 |

Source: DTIDZ

Invest Macedonia is in the final stage of negotiations with several companies from the automotive industry, medical technology, IT, telecommunications and electronics industry, which are expected to be finalized during next year. The expected Greenfield FDIs (largely in the export-oriented industries) and investments from other sources (mostly from reinvested earnings) by the end of 2013 are expected to reach around 3.4% of GDP, and in 2014 these are expected to be 4.7% of the GDP. The expectations are that this trend will continue in the future, according to the agenda for structural reforms combined with aggressive marketing, as well as with the expansion of the total number of Technological industrial development zones to fifteen.

4.2.8.3. Customs System

Within the period 2014-2016, the process for amending of the Customs Law and the Implementing Regulation for the Customs Law shall continue in order to fulfill the priorities of the European partnership with the Republic of Macedonia and harmonization of the customs legislation with Acquis.

As part of the implementation of the Project for establishment of the New Computerized Transit System (NCTS), new regulatory framework was adopted, amendments to the relevant laws and regulations were prepared, and trainings have been conducted for customs officers and economic operators. Also, preparatory activities for installing and testing and further development of NCTS application have been established. New version of the application was installed, as well as two of its updates. In the area of transit, Customs Administration (CA) will implement all necessary requirements for accession of the Republic of Macedonia to the Convention on Common Transit Procedure between the Member States of the EU and EFTA and accession of the Republic Macedonia in the new NCTS system.

Harmonization of the Customs Tariff with the Combined Nomenclature of the EU will continue to be implemented in the upcoming mid-term period, so that the new amendments to the Combined Nomenclature of the EU shall be implemented in the national legislation.

CA shall continue to implement activities for further improvement of the institutional and administrative capacity through implementation of continuous training and development of human resources capacity. Fight against corruption will continue by taking preventive measures for its suppression, further improvement of the already established systems that allow control of corrupt and deviant behavior and their timely prevention, by constantly upgrading their institutional and administrative capacities.



In the period 2014-2016, CA shall continue with implementation of the new System for Processing of Customs Declarations and Excise Documents (CDEPS) - a solution to manage the excise and customs declarations documents under the customs and excise procedures.

The project for establishing an Integrated Tariff Environment will introduce an integrated customs and statistical nomenclature EU TARIC (TARIM), in order to increase the number of companies that use simplified procedures and improvement of surveillance mechanisms.

In the period 2014-2016, the Customs Administration will begin with implementation of two new twinning projects. The first refers to "Completion of procedure for accession to the Convention on Common Transit procedures and simplification of formalities in trade in goods " and is funded through IPA TAIB 2010. The aim of the project is further approximation of legislation and customs procedures to the Acquis, strengthening the administrative and operational capacity of CA to implement customs legislation, finalizing preparations for accession to the Convention on Common Transit Procedure and the Convention on the Simplification of Trade in goods. The second project refers to the "Harmonization of legislation in the field of excise duties with EU Acquis" and is funded through IPA TAIB 2010. The purpose of this project is to further harmonize legislation and procedures with the Acquis in the field of excise duties, further strengthening of the administrative and operational capacity of CA to meet EU standards in this area, effective implementation of the excise law, improvement of the organization and management of the CA operating capacity, trade facilitation and security of the international supply chain, supported by appropriate control mechanisms and IT systems.

| Description of policy | 2013 | 2014 | 2015 | 2016 |
|---|-------------------|--------------------|-------------------|-------------------|
| <i>Twinning projects Completion of procedure for accession to the Convention on Common Transit procedures and Convention on the Simplification of Trade in goods</i> | | | | |
| A. Implementation profile* | | x | | x |
| B. Net direct budgetary impact (if any) | -- | 1,000,000 | 1,000,000 | 913,132 |
| B.1 Direct impact on budgetary revenues | -- | 20,000,000 | 20,000,000 | 15,350,000 |
| B.2 Direct impact on budgetary expenditures | -- | 21,000,000 | 21,000,000 | 16,261,132 |
| <i>Twinning project "Harmonization of legislation in the field of excise duties with EU Acquis"</i> | | | | |
| A. Implementation profile* | | x | | x |
| B. Net direct budgetary impact (if any) | -- | 1,000,000 | 1,000,000 | 913,132 |
| B.1 Direct impact on budgetary revenues | -- | 20,000,000 | 20,000,000 | 15,350,000 |
| B.2 Direct impact on budgetary expenditures | -- | 21,000,000 | 21,000,000 | 16,261,132 |
| <i>Twinning project Strengthening the capacity of the Customs administration</i> | | | | |
| A. Implementation profile* | x | x | | |
| B. Net direct budgetary impact (if any) | 6,524,766 | 13,753,322 | -- | -- |
| B.1 Direct impact on budgetary revenues | 58,722,891 | 90,652,247 | -- | -- |
| B.2 Direct impact on budgetary expenditures | 65,247,657 | 104,378,569 | -- | -- |
| <i>Total net budgetary impact</i> | | | | |
| Total impact on budgetary revenues | 58,722,891 | 130,625,247 | 40,000,000 | 30,700,000 |
| Total impact on budgetary expenditures | 65,247,657 | 146,378,569 | 42,000,000 | 32,522,264 |

* Indicate start and, if needed, end with an "X" mark

Source: Customs administration

4.2.8.4. Energy

In accordance to the Progress report for Republic of Macedonia for 2013 in the first half of 2014 all conditions are expected to be fulfilled for opening of the electricity and natural gas markets for all consumers except households and in the period 2014-2015 activities for fully opening of the energy markets will continue. In accordance to the recommendations of the same report, the rest of the bylaws arising from the Energy Law will be prepared, as well as amendments to the law in compliance to the third internal energy market package of the EU in order to provide



functional electricity and natural gas market. Also, the government programme for subsidizing the bills for energy used by socially vulnerable consumers will continue to be implemented.

In the period 2014-2016 implementation of the Programme for realization of the energy development strategy will continue, while in 2014 preparation of the new Strategy for energy development for the next 20 years will start. In accordance to the activities of the Government of the Republic of Macedonia for reaching the targets in the Strategy "Europe 2020" activities for implementation of the Second national energy efficiency action plan will be undertaken, where measures and activities are set in order to reach 9% energy savings in 2018.

Having in mind the recommendations of EC and the Strategy "Europe 2020 for promotion of electricity generated from renewable energy sources, in the period of 2014-2016 Action plan for renewable energy sources will be implemented, as well as updating of Strategy for utilization of the renewable energy sources. In the next period, Programmes for subsidizing of part of the costs for purchased and installed solar collectors will continue to be adopted, having in mind their successful implementation so far. In accordance to the Progress report for 2013, in 2014 activities for full harmonization of the national legislation with the Directive 2009/28 are envisaged, by amendments to the Energy law and preparation of new Law on biofuels. Cooperation with international donors will continue for simplification of procedures for construction of power plants that use renewable energy sources. Also, activities will be undertaken for measurement of wind potential on five locations in order to investigate the possibility for usage of wind for electricity generation.

In the period 2014-2016 announcement for granting water concession for electricity generation will be published and construction of power plants that use renewable energy sources will continue. In the following mid-term period, construction of the interconnection line between Macedonia and Serbia is expected to finish and the technical documentation for the interconnection line with Albania to be prepared. In the same period, the construction of the main priority gas pipelines will start, as well as preparation of technical documentation for development of the distribution gas network.

| Description of policy | 2013 | 2014 | 2015 | 2016 |
|--|-----------|-----------|-----------|-----------|
| Implementation of the second Action Plan for Energy Efficiency of the Republic of Macedonia | | | | |
| A. Implementation profile* | | x | | x |
| B. Net direct budgetary impact (if any) | -- | 500,000 | 500,000 | 500,000 |
| B.1 Direct impact on budgetary revenues | -- | 0 | 0 | 0 |
| B.2 Direct impact on budgetary expenditures | -- | 500,000 | 500,000 | 500,000 |
| Implementation of the Strategy for Energy Development in the Republic of Macedonia 2013-2017 | | | | |
| A. Implementation profile* | x | | | x |
| B. Net direct budgetary impact (if any) | 2,000,000 | 500,000 | 500,000 | 500,000 |
| B.1 Direct impact on budgetary revenues | 0 | 0 | 0 | 0 |
| B.2 Direct impact on budgetary expenditures | 2,000,000 | 500,000 | 500,000 | 500,000 |
| Implementation of the Strategy for renewable energy sources in the Republic of Macedonia until 2020 | | | | |
| A. Implementation profile* | x | | | |
| B. Net direct budgetary impact (if any) | 6,000,000 | -- | -- | -- |
| B.1 Direct impact on budgetary revenues | 0 | -- | -- | -- |
| B.2 Direct impact on budgetary expenditures | 6,000,000 | -- | -- | -- |
| Implementation of the Action plan for renewable energy sources 2013 - 2023 | | | | |
| A. Implementation profile* | | | x | x |
| B. Net direct budgetary impact (if any) | -- | 6,000,000 | 9,000,000 | 9,000,000 |
| B.1 Direct impact on budgetary revenues | -- | 0 | 0 | 0 |
| B.2 Direct impact on budgetary expenditures | -- | 6,000,000 | 9,000,000 | 9,000,000 |
| Implementation of the First Energy efficiency action plan of the Republic of Macedonia | | | | |



| | | | | |
|--|-------------------|-------------------|-------------------|-------------------|
| A. Implementation profile* | x | | | |
| B. Net direct budgetary impact (if any) | 1,500,000 | -- | -- | -- |
| B.1 Direct impact on budgetary revenues | 0 | -- | -- | -- |
| B.2 Direct impact on budgetary expenditures | 1,500,000 | -- | -- | -- |
| IPA Project "Strengthening the Administrative Capacity of the Energy Department in the Ministry of Economy and the Energy Agency" | | | | |
| A. Implementation profile* | x | | x | |
| B. Net direct budgetary impact (if any) | 2,059,020 | 4,804,380 | 3,431,700 | -- |
| B.1 Direct impact on budgetary revenues | 18,531,180 | 43,239,420 | 30,885,300 | -- |
| B.2 Direct impact on budgetary expenditures | 20,590,200 | 48,043,800 | 34,317,000 | -- |
| Total net budgetary impact | | | | |
| Total impact on budgetary revenues | 18,531,180 | 43,239,420 | 30,885,300 | 0 |
| Total impact on budgetary expenditures | 30,090,200 | 55,043,800 | 44,317,000 | 10,000,000 |

* Indicate start and, if needed, end with an "X" mark

Source: Ministry of Economy

4.2.8.5. Transport

In accordance with the priorities of the Accession Partnership, the Republic of Macedonia continues with the implementation of the Memorandum of Understanding for the Southeast - European Core Regional Network and actively participates in the regional initiatives, with strong and substantial cooperation under the Southeast-European Transport Observatory (SEETO). Republic of Macedonia takes part in the development of a new five-year plan 2013-2017 and in the implementation of multi-annual plan priorities. In April 2014, it is planned that the Ministry of Transport and Communications will make the fifth updating of the National Transport Strategy 2007-2017, which will affect the promotion of economic growth by building, enhancing, managing and maintaining transport services, infrastructure and networks to obtain maximum efficiency.

Road transport. In the period 2014-2016, it is planned to continue with activities for concluding agreements on international transport of passengers and goods by road with those countries that the Government has not yet signed an agreement with, including: the Kingdom of Sweden, Republic of Portugal and the Republic of Ireland. Continuous activities are carried out on harmonization of laws in the field of road transport with the EU Acquis, in order to meet the second strategic priority of the Programme of the Government of the Republic of Macedonia 2011-2015, i.e. integration of the Republic of Macedonia into the EU and NATO, and the same will continue in the next period. In order to strengthen the administrative and operational capacity of the State Inspectorate for Transport to effectively implement the legislation in the road transport, realization of 18 month training programme is underway: "Conducting inspection controls in carrying out the road transport of passengers and goods, by the inspectors from the State Inspectorate for Transport". Concerning the area of road infrastructure, in the next mid-term period, a motorway connection shall be provided between Kichevo and Ohrid, with branch to Albania, construction of road route Skopje - Shtip and trunk road Ohrid – border crossing St. Naum.

Inland waterways navigation. In the next period, European legislation in the area of inland waterways navigation will be continuously monitored in order to comply the Law on inland waterways and the by-laws with EU legislation. Activities will also be implemented for regulating the manner, conditions and safety of inland waterways navigation, through completion of construction activities for performing rehabilitation work on the operational part of the ports in Ohrid and St. Naum.

Rail transport. In the field of railway infrastructure, in the next mid-term period, the focus will be on completion of the overhaul of Corridor 10, starting and ending with the construction of the



section from Kumanovo to Beljakovce, eastern part of Corridor 8, preparation of investment and technical documentation for the sections Beljakovce – Kriva Palanaka - Deve Bair border with Bulgaria, as well as preparation of the investment and technical documentation for the section of the western part of Corridor 8: Kichevo – Lyne, border with the Republic of Albania, Corridor that connects the Black Sea with the Adriatic Sea, making this a project of great strategic importance. There will also be activities implemented to renew the rail fleet by concluding contracts with selected companies which should produce new passenger rail cars and freight cars of various types, and there will be also continuation of activities related to compensation of losses in the carriage of passengers by providing and allocation of funds in the Budget of the Ministry of Transport and Communications.

Air transport. Following the concept “Single European Sky” the Government undertakes steps for reconstruction of the airspace based on the traffic flows, not according to national borders. According to the National aviation development strategy in the Republic of Macedonia for period 2013-2018, the most important activities which will be conducted in the following middle term period are: improving the safety of air transport, revising the existing and conclusion of new Bilateral Agreements for Air Service, revision of the bylaws which derive from the Aviation Act and their alignment with the EU Acquis, international standards and practices and ratified international agreements, attracting new and low-cost airlines and commencement of initial activities regarding the satellite navigation in transport sector.

Postal services. The level of compliance with the EU Acquis has significantly advanced since the adoption of the by-laws arising from the Law on Postal Services. Among other competences, the Postal Agency has competence to protect consumers, and keeping in mind the requirements of the standard MKS EN 14012:2010, in the course of 2014, the Postal Agency will amend the existing secondary legislation in order to develop an appropriate and consistent legal framework in the part of dealing with the complaints and protests from users of the universal service. By interventions in several rule books, including the rulebook on the general conditions for provision of universal service, the guarantees of rights of users contained in the Postal Service Act would be further governed and strengthened. Taking into account the EU directives, as well as meeting the needs of users in terms of quality of universal service, in the course of 2014, the Postal Agency shall carry out, through an independent company, measurement of transfer of single postal mails with the provider of the universal service AD Macedonian Post Skopje.

Gasification. In July 2013, the Ministry of Transport and Communications signed a Contract for preparation of feasibility study for development of distribution networks of natural gas in the country. The feasibility study should be used to evaluate possible options for building a network across regions or municipalities in the Republic of Macedonia in terms of reference and projected state of the gas system, and to determine the potential profitability of regional concessions or implementation of the project by public-private partnership system. Based on the project documentation, building of National gasification system will be accessed.

| Description of policy | 2013 | 2014 | 2015 | 2016 |
|---|-----------|-----------|-----------|------|
| <i>South East European Transport Observatory (SEETO)</i> | | | | |
| A. Implementation profile* | x | | x | |
| B. Net direct budgetary impact (if any) | 3,077,355 | 3,077,355 | 3,077,355 | -- |
| B.1 Direct impact on budgetary revenues | 0 | 0 | 0 | -- |
| B.2 Direct impact on budgetary expenditures | 3,077,355 | 3,077,355 | 3,077,355 | -- |
| <i>Financial support for Wizz Air</i> | | | | |



| | | | | |
|--|--------------------|--------------------|-------------------|----------|
| A. Implementation profile* | | | x | |
| B. Net direct budgetary impact (if any) | 86,000,000 | 135,000,000 | 40,000,000 | -- |
| B.1 Direct impact on budgetary revenues | 0 | 0 | 0 | -- |
| B.2 Direct impact on budgetary expenditures | 86,000,000 | 135,000,000 | 40,000,000 | -- |
| IPA 1 "Strengthening the administrative, operational and managerial capacity of the State Transport Inspectorate" | | | | |
| A. Implementation profile* | x | x | | |
| B. Net direct budgetary impact (if any) | 1,351,924 | 3,154,489 | -- | -- |
| B.1 Direct impact on budgetary revenues | 12,167,314 | 28,390,399 | -- | -- |
| B.2 Direct impact on budgetary expenditures | 13,519,238 | 31,544,888 | -- | -- |
| Total net budgetary impact | | | | |
| Total impact on budgetary revenues | 12,167,314 | 28,390,399 | 0 | 0 |
| Total impact on budgetary expenditures | 102,596,593 | 169,622,243 | 43,077,355 | 0 |

* Indicate start and, if needed, end with an "X" mark

Source: Ministry of Transport and Communications



Part V Implementation of Conclusions of the Ministerial Dialogue

1. At the Ministerial Dialogue held on 9th July 2013 attended by the Economics and Finance Ministers of the EU and the candidate countries, the Ministers welcomed the reform activities Republic of Macedonia implements, pertaining to improvement of labour market conditions, education and business environment that would address structural weaknesses and raise the country's growth potential. Furthermore, the Ministers encouraged the country to implement further measures to increase competitiveness, through enhancing innovation and further diversifying exports towards higher-value markets, to the end of reducing structural unemployment.

Top strategic priority of the Government of the Republic of Macedonia is increase of both economic growth and employment, being a precondition for improvement of the living standard of citizens. To that end, measures are continuously undertaken to strengthen competitiveness by improving the business climate and the working conditions for both domestic and foreign investors, strengthening and improving labour force quality, building of the infrastructure, facilitating the access to financial resources, supporting small- and medium-sized enterprises and encouraging innovations and new technologies, with the ultimate goal of creating new jobs and attaining higher economic growth rates.

The Government conducts strictly proactive economic policy aimed at growth and development of the private sector, since it has the biggest potential to create new jobs. To that end, significant reforms have been implemented, in particular in the field of: tax policy (low and flat taxes of 10% of personal income tax and profit tax, as well as tax exemption on retained profit), reduction of social contributions, simplification of the regulations through the regulatory guillotine and public administration reforms, establishment of one-stop-shop system in the customs and the tax administration, incentives in the free economic zones, financial sector reforms, modernisation of the education and the agriculture, as well as investments in infrastructure and energy.

Foreign direct investments are one of the key elements in realising higher economic growth of the country and increasing employment. To that end, in the past years, the Government has been especially active in its efforts to attract FDIs through intensified promotion of the country as a favourable business destination.

In order to strengthen the economic potential on the medium and the long run, it is of essential importance to develop competitiveness of the private sector by increasing the knowledge and the innovations at companies. The Government implements activities aimed at supporting the increase of knowledge and innovations at domestic companies, so as for them to improve and diversify their production and to respond to the demands on the markets with higher value added. Hence, comprehensive 2012-2020 Strategy on Innovation Development has been prepared, as well as Law on Innovation activity, pursuant to which Innovation and Technological Development Fund has been established recently. The Fund will offer funding instruments for encouraging the innovation activity in the forms of: co-financing grants for newly established start-up and spin-off companies, co-financing grants and conditional loans for commercialisation of innovations, equity and mezzanine investments, co-financed grants for transfer of technologies and technical assistance.

As regards specific measures and activities aimed at reduction of structural unemployment, Government of the Republic of Macedonia, in line with the Operational Programme, continuously works on mitigating and overcoming this issue. Hence, employment policies are



implemented, aimed at stimulating labour market demand, matching labour supply and demand with the labour market needs, improving labour supply, as well as reducing grey economy. To the end of creating new jobs, flexibility of labour regulations will be maintained and improved further. For the purpose of realising the goals set in the 2015 National Employment Strategy and 2013 - 2015 Action Plan on Youth Employment, programmes have been implemented and developed to increase youth employability, all to the end of helping them enter the labour market more prepared. For the purpose of increasing labour market activity, active employment programmes and measures will continue to be realised by increasing the scope of the participants and the financial resources, improving their effectiveness, improving the targeting of target groups and promoting active employment programmes and measures for the unemployed and the employers.

2. The Ministers welcomed the efforts of the efforts of the National Bank of the Republic of Macedonia to firmly manage the exchange rate, which has served the country well so far to anchor the inflation expectations, which, in turn, has allowed the monetary authorities to implement adequate combination of standard and non-standard measures aimed at supporting the economic growth. Anyhow, the Ministers pointed out that restoration of the banking loan channel and the concerns on banks' asset quality would remain a challenge and should be addressed.

National Bank of the Republic of Macedonia has continued its consistent application of strategy of targeting Denar exchange rate to the Euro, to the end of maintaining price stability in the economy. It has created conditions for further combination of standard and non-standard measures aimed at encouraging the crediting by the banks and subsequently supporting the economic growth. Measures of the monetary authorities, constant improvement of banking supervision, and in particular the gradual recovery of the economy, are expected to contribute to improvement of the quality of banks' credit portfolio, which, in crisis period, has been kept among the better ones in the region.

3. As regards the increase of the level of debt and deficit, the Ministers encouraged the authorities to implement a credible plan for restoring to a sustainable fiscal path. The Ministers pointed out that consistency of the fiscal framework was still lacking and called the authorities to continue strengthening the fiscal planning and management capacities.

Taking into account that public debt in the Republic of Macedonia is at a moderate level, dynamics of fiscal consolidation in the coming medium-term period is designed in line with the dynamics of real sector recovery and developments in the European economy. Hence, fiscal policy in the coming period provides for a gradual reduction of the level of deficit from 3.5% of GDP in 2014 by positioning it at an optimal level of around 2.6% of projected GDP in 2016.

Financing of the projected deficit will be ensured from foreign sources (favourable credits from international financial institutions, credit lines intended for financing certain projects, Eurobonds and other type of external borrowing) and domestic sources (issues of government securities).

Improvement of fiscal planning is a continuous process to which the Ministry of Finance is committed. Draft 2014 Budget of the Republic of Macedonia was prepared and submitted to the Parliament on time, accompanied by medium-term fiscal projections. The Budget was adopted on 20th December 2013. Amendments to the Budget Law have provided for improvement of the process of strategic planning of the budget users and the spending units in a way that the submitted strategic plans reflect, to a full extent, the policies, the activities and the necessary funds for their execution.



To the end of improving the budget process in the coming medium-term period, more activities will be undertaken aimed at improving the legal regulations to the end of full harmonisation with the Acquis, strengthening the strategic planning and extending the time framework of the budget process, introducing programme classification of expenditures, i.e. clearly defining the criteria and the procedures for defining the budget programmes, all to the end of properly grouping the government activities and the public finances and reporting on budget execution in line with GFS 2001 and ESA 2005. In addition, activities will be undertaken to introduce medium-term planning with fixed limits on the expenditures, meaning improvement of the Fiscal Strategy document by mandatory determining of medium-term limits on expenditures, to the end of protecting from the possible procyclic tendencies.

Activities will be also implemented to introduce goals and performance indicators, i.e. gradual creation of budgeting base on the basis of performances and respective support by sophisticated software solutions on integrated public finances management.

Reforms in this area will be underpinned by two projects to be realised in cooperation with the EU. Hence, project under IPA TAIB-2011 has already been approved, being generally aimed as strengthening the capacities for medium-term planning within the departments in charge of the budgets of the central and local government institutions, the implementation period of which is from 2014 to 2016. New project financed under IPA-2 is planned as continuation of this project, which will include improvement of the capacities of the departments in charge of medium-term budget planning and execution.

4. The Ministers encouraged the Republic of Macedonia to continue submitting fiscal reports and to ensure harmonisation with ESA 95 classification. Further on, the Ministers underlined that PEP would gain benefits from presenting specific measures for implementing fiscal and structural reforms, including their timeframe and expected effects.

State Statistical Office, Ministry of Finance and National Bank of the Republic of Macedonia were part of IPA 2007 Project – “Technical Assistance to the State Statistical Office”, which was implemented in the period February 2010 until March 2012. Main project coordinator and beneficiary was the State Statistical Office, while the Ministry of Finance participated in the section that pertains to statistics of the national accounts. The National Bank of the Republic of Macedonia was also a participant in the Project.

Project objective was to contribute to improvement of the overall system for production of quality statistical data of the State Statistical Office and further development of the National Statistical System towards fully sustainable and EU harmonised statistical system.

So-far joint work has contributed to better defining the obligations and the sets of data necessary to compile the annual non-financial sector accounts and generating pilot tables according to the Excessive deficit procedure, EDP notification table. National Bank of the Republic of Macedonia has undertaken the obligation to be the primary holder of the statistics of the financial accounts with a special annex to the Memorandum of Data Exchange.

Implementation of the Project “Support to the State Statistical Office for Capacity Building and Improving Compliance of Statistics with EU Standards” is in progress. The Project commenced in August 2012 and will be completed by August 2014, and it is supported under IPA 2009 National Programme. One of the priorities in this Project is implementation of National Classification of Activities, NACE Rev. 2 on the main aggregates of national accounts for the series of data before 2009. Within the Project, annual non-financial accounts are compiled, on an experimental basis, for all institutional sectors and pilot tables on the basis of the excessive



deficit procedure. Activities are being implemented for quality analysis of available data and transaction in and between sectoral accounts are balanced. The Project will also include continuation of the activities related to implementation of ESA 95, and issues related to ESA 2010 will also be considered. Issues related to ESA 2010 are subject to support through the IPA 2011 multi-beneficiary programme, which is expected to contribute to the implementation of the most important issues arising from the changes to ESA 2010. Cooperation between SSO, Ministry of Finance and NBRM is of special importance in the process of implementation of activities.

In the coming period, focus will be placed on improvement of statistics on budget data for the government accounts and generating pilot notification tables according to the excessive deficit procedure, which are expected to be prepared and submitted to Eurostat in 2014.

As regards the observations by the Ministers that Pre-Accession Economic Programme would gain benefits from presenting specific measures for implementing fiscal and structural reforms, including their timeframe and expected effects, we would like to point out that the Ministry of Finance continuously works on quality improvement of this document. Hence, recommendations and guidelines indicated in PEP outline are carefully observed and they are more extensively implemented when preparing this document. All relevant institutions participated in the preparation of the Pre-Accession Economic Programme by providing their input in the material, by presenting specific reforms and measures to be implemented in the coming medium-term period and the funds necessary for their implementation, as well as the expected effects arising therefrom.



Part VI Annexes

Annex 1. Summary data to the Pre - accession economic Programme for 2014 – 2016

Table 1a: Macroeconomic prospects

| | ESA Code | 2012 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|----------|----------------|----------------|-------|------|------|------|
| | | Level (bn EUR) | Rate of change | | | | |
| 1. Real GDP at market prices | B1*g | 5.86 | -0.4 | 3.3 | 3.2 | 3.8 | 4.5 |
| 2. GDP at market prices | B1*g | 7.45 | -0.3 | 7.7 | 6.8 | 6.9 | 7.6 |
| Components of real GDP | | | | | | | |
| 3. Private consumption expenditure | P3 | 4.49 | -3.0 | 5.1 | 2.7 | 3.0 | 3.7 |
| 4. Government consumption expenditure | P3 | 0.96 | -1.4 | -3.0 | 0.8 | 1.2 | 1.0 |
| 5. Gross fixed capital formation ²² | P51 | 1.74 | 20.0 | -12.5 | 7.5 | 8.0 | 9.0 |
| 6. Changes in inventories and net acquisition of valuables (% of GDP) | P52+P53 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| 7. Exports of goods and services | P6 | 2.76 | 0.0 | 4.3 | 7.2 | 8.6 | 8.8 |
| 8. Imports of goods and services | P7 | 4.08 | 4.2 | -2.2 | 6.6 | 7.4 | 7.8 |
| Contribution to real GDP growth | | | | | | | |
| 9. Final domestic demand | | 7.2 | 2.3 | -0.3 | 4.1 | 4.6 | 5.4 |
| 10. Change in inventories and net acquisition of valuables | P52+P53 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| 11. External balance of goods/services | B11 | -1.3 | -2.8 | 3.6 | -0.9 | -0.8 | -0.9 |

Source: SSO and calculations of the Ministry of finance

Table 1b: Price developments

| | | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|--------|------|------|------|------|------|
| 1. GDP deflator | %, yoy | 0.2 | 4.3 | 3.5 | 3.0 | 3.0 |
| 2. Private consumption deflator | %, yoy | 2.4 | 1.6 | 3.8 | 2.8 | 2.6 |
| 3. HICP | %, yoy | n.a. | n.a. | n.a. | n.a. | n.a. |
| 4. National CPI change | %, yoy | 3.3 | 2.8 | 3.3 | 2.7 | 2.5 |
| 5. Public consumption deflator | %, yoy | 2.1 | 3.5 | 3.2 | 2.3 | 3.0 |
| 6. Investment deflator | %, yoy | -6.7 | 18.6 | 2.3 | 3.2 | 3.0 |
| 7. Export price deflator (goods & services) | %, yoy | -2.5 | -1.5 | 3.0 | 2.6 | 2.2 |
| 8. Import price deflator (goods & services) | %, yoy | -2.0 | 2.2 | 3.0 | 2.6 | 2.2 |

Source: Calculations of the Ministry of Finance

Table 1c: Labor market developments²³

| | ESA | 2012 | 2012 | 2013 | 2014 | 2015 | 2016 |
|--|-----|-------|----------------|---------|---------|---------|---------|
| | | level | Rate of change | | | | |
| 1. Population (thousands) | | -- | 2,061.0 | 2,063.7 | 2,066.4 | 2,069.1 | 2,071.8 |
| 2. Population (growth rate in %) | | -- | 0.12 | 0.13 | 0.13 | 0.13 | 0.13 |
| 3. Working-age population (persons) | | -- | 1,670.0 | 1,672.4 | 1,679.9 | 1,690.3 | 1,703.5 |
| 4. Participation rate | | -- | 56.5 | 57.2 | 57.6 | 58.0 | 58.4 |
| 5. Employment, persons | | -- | 650.6 | 678.5 | 695.5 | 714.3 | 735.7 |
| 6. Employment, hours worked | | -- | n.a. | n.a. | n.a. | n.a. | n.a. |
| 7. Employment (growth rate in %) | | -- | 0.8 | 4.3 | 2.5 | 2.7 | 3.0 |
| 8. Public sector employment (persons) | | -- | n.a. | n.a. | n.a. | n.a. | n.a. |
| 9. Public sector employment (growth in %) | | -- | n.a. | n.a. | n.a. | n.a. | n.a. |
| 10. Unemployment rate | | -- | 31.0 | 29.1 | 28.1 | 27.1 | 26.0 |
| 11. Labour productivity, persons ²⁴ | | 554.6 | -1.3 | -1.0 | 0.7 | 1.1 | 1.5 |
| 12. Labour productivity, hours worked | | -- | n.a. | n.a. | n.a. | n.a. | n.a. |
| 13. Compensation of employees | D1 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |

Source: SSO and calculations of the Ministry of Finance

²² Data refers to gross capital formation.

²³ ILO definition (15+) is used for the labor market indicators.

²⁴ Real GDP per person employed.



Table 1d: Sectoral balance

| % of GDP | ESA code | 2012 | 2013 | 2014 | 2015 | 2016 |
|--|-----------------|-------|-------|-------|------|------|
| 1. Net lending/borrowing vis-à-vis the rest of the world ²⁵ | B.9 | 1.4 | -0.9 | 0.1 | -- | -- |
| of which: | | | | | -- | -- |
| - Balance of goods and services | | -22.9 | -20.4 | -21.5 | -- | -- |
| - Balance of primary incomes and transfers | | 19.8 | 17.4 | 16.9 | -- | -- |
| - Capital account ²⁶ | | 4.2 | 2.0 | 4.8 | -- | -- |
| 2. Net lending/borrowing of the private sector ²⁷ | B.9/ EDP B.9 | 0.6 | -4.3 | 0.8 | -- | -- |
| 3. Net lending/borrowing of general government ²⁸ | | 0.8 | 3.4 | -0.7 | -- | -- |
| 4. Statistical discrepancy | | 0.3 | 0.1 | -0.1 | -- | -- |

Source: National Bank of the Republic of Macedonia

Table 1e: GDP, investment and gross value added

| | ESA Code | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|----------|-------|-------|-------|-------|-------|
| GDP and investment | | | | | | |
| GDP level at current market prices (in Denars) | B1g | 458.6 | 494.1 | 527.8 | 564.3 | 607.3 |
| Investment ratio (% of GDP) | | 29.4 | 28.3 | 29.2 | 30.4 | 31.8 |
| Growth of Gross Value Added, percentage changes at constant prices | | | | | | |
| 1. Agriculture | | -6.2 | 0.4 | 3.0 | 3.0 | 3.0 |
| 2. Industry (excluding construction) | | 2.8 | 4.6 | 3.8 | 4.2 | 5.0 |
| 3. Construction | | 4.8 | 29.2 | 5.0 | 7.2 | 8.8 |
| 4. Services | | -0.7 | 1.8 | 2.8 | 3.3 | 4.0 |

Source: SSO and calculations of the Ministry of Finance

Table 1f. External sector developments

| Euro billion | 2012 | 2013 | 2014 | 2015 | 2016 |
|--|-------|-------|-------|-------|-------|
| 1. Current account balance (% of GDP) | -3.0 | -3.0 | -4.6 | -5.7 | -5.1 |
| 2. Export of goods | 3.11 | 3.13 | 3.56 | 3.93 | 4.39 |
| 3. Import of goods | 4.86 | 4.78 | 5.38 | 5.89 | 6.33 |
| 4. Trade balance | -1.75 | -1.65 | -1.82 | -1.96 | -1.94 |
| 5. Export of services | 0.82 | 0.79 | 0.41 | 0.56 | 0.57 |
| 6. Import of services | 0.77 | 0.76 | 0.41 | 0.53 | 0.52 |
| 7. Service balance | 0.05 | 0.03 | 0.00 | 0.03 | 0.05 |
| 8. Net interest payments from abroad | -- | -- | -- | -- | -- |
| 9. Other net factor income from abroad ²⁹ | -0.15 | -0.16 | -0.19 | -0.23 | -0.27 |
| 10. Current transfers | 1.63 | 1.55 | 1.62 | 1.64 | 1.66 |
| 11. Of which from EU | -- | -- | -- | -- | -- |
| 12. Current account balance | -0.22 | -0.23 | -0.39 | -0.52 | -0.50 |
| 13. Capital and Financial Account | 0.31 | -- | -- | -- | -- |
| 14. Foreign direct investment | 0.08 | 0.21 | 0.34 | 0.41 | 0.49 |
| 15. Foreign reserves ³⁰ | 2.19 | 2.06 | -- | -- | -- |
| 16. Foreign debt ³¹ | 5.01 | 5.23 | -- | -- | -- |
| 17. Of which: public | 2.00 | 2.19 | -- | -- | -- |
| 18. O/w: foreign currency denominated | -- | -- | -- | -- | -- |
| 19. O/w: repayments due | -- | -- | -- | -- | -- |

²⁵ Financing of the Balance of payments

²⁶ Capital and financial account without official foreign reserves

²⁷ Residual

²⁸ Central government debt, net

²⁹ Net income, total

³⁰ For 2013, as of September 2013.

³¹ Ibid.



| | | | | | |
|--|-------|-------|----|----|----|
| 20. Exchange rate vis-à-vis EUR (end-year) | 61.50 | 61.50 | -- | -- | -- |
| 21. Exchange rate vis-à-vis EUR (annual average) | 61.50 | 61.60 | -- | -- | -- |
| 22. Net foreign saving (lines 21-25: percentages of GDP) | -- | -- | -- | -- | -- |
| 23. Domestic private saving | -- | -- | -- | -- | -- |
| 24. Domestic private investment | -- | -- | -- | -- | -- |
| 25. Domestic public saving | -- | -- | -- | -- | -- |
| 26. Domestic public investment | -- | -- | -- | -- | -- |

Source: National Bank of the Republic of Macedonia

Table 1g: Sustainability indicators

| | Dimension | 2009 | 2010 | 2011 | 2012 | 2013 ³² |
|---|-----------|-------|-------|-------|-------|--------------------|
| 1. Current Account Balance | % of GDP | -6.8 | -2.0 | -2.5 | -3.0 | -2.9 |
| 2. Net International Investment Position | % of GDP | -53.9 | -51.4 | -53.1 | -56.1 | -56.0 |
| 3. Export market shares | % yoy | -10.0 | -2.2 | 13.9 | -12.2 | 4.5 |
| 4. Real Effective Exchange Rate (CPI based, 2006=100) | % yoy | 1.0 | -2.7 | -0.5 | 0.8 | 0.6 |
| 5. Nominal Unit Labour Costs | % yoy | 14.0 | -0.5 | -0.5 | 1.4 | 2.1 |
| 6. Private sector credit flow | % of GDP | 1.5 | 2.9 | 3.5 | 2.5 | 1.5 |
| 7. Private sector debt | % of GDP | 75.9 | 77.1 | 78.6 | 84.1 | 0.0 |
| 8. General Government Debt | % of GDP | 23.8 | 24.2 | 28.0 | 34.3 | 34.2 |

Source: National Bank of the Republic of Macedonia and Ministry of Finance

Table 2: General government budgetary prospects

| | ESA Code | 2012 | 2012 | 2013 ³³ | 2014 | 2015 | 2016 |
|--|----------|-------------------|----------|--------------------|------|------|------|
| | | Level (bn denars) | % of GDP | | | | |
| Net lending (B9) by sub-sectors | | | | | | | |
| 1. General government | S13 | -18.20 | -4.0 | -3.9 | -3.5 | -3.2 | -2.6 |
| 2. Central government | S1311 | -17.73 | -3.9 | -3.9 | -3.5 | -3.2 | -2.6 |
| 3. State government | S1312 | / | / | / | / | / | / |
| 4. Local government | S1313 | -0.46 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| 5. Social security funds | S1314 | -0.08 | 0.0 | -0.1 | 0.0 | 0.0 | 0.0 |
| General government (S13) | | | | | | | |
| 6. Total revenue | TR | 149.62 | 32.6 | 32.9 | 32.6 | 32.0 | 31.3 |
| 7. Total expenditure ³⁴ | TE | 167.82 | 36.6 | 36.8 | 36.0 | 35.2 | 33.9 |
| 8. Net borrowing/lending | EDP.B9 | -18.20 | -4.0 | -3.9 | -3.5 | -3.2 | -2.6 |
| 9. Interest expenditure | EDP.D41 | 4.24 | 0.9 | 0.8 | 0.8 | 1.0 | 1.1 |
| 10. Primary balance ³⁵ | | -13.95 | -3.0 | -3.1 | -2.6 | -2.2 | -1.5 |
| 11. One-off and other temporary measures ³⁶ | | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Components of revenues | | | | | | | |
| 12. Total taxes (11 = 11a+11b+11c) | | 83.34 | 18.2 | 18.8 | 18.7 | 18.5 | 18.2 |
| 12a. Taxes on production and imports | D2 | 67.71 | 14.8 | 15.0 | 15.0 | 14.9 | 14.7 |
| 12b. Current taxes on income and wealth | D5 | 13.32 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 |
| 12c. Capital taxes | D91 | 2.31 | 0.5 | 0.9 | 0.8 | 0.8 | 0.7 |
| 13. Social contributions | D61 | 40.77 | 8.9 | 8.6 | 8.6 | 8.5 | 8.3 |
| 14. Property income | D4 | 7.49 | 1.6 | 1.3 | 1.4 | 1.3 | 1.2 |
| 15. Other (15 = 16-(12+13+14)) ³⁷ | | 18.03 | 3.9 | 4.1 | 3.9 | 3.7 | 3.5 |
| 16 = 6. Total revenue | TR | 149.62 | 32.6 | 32.9 | 32.6 | 32.0 | 31.3 |
| p.m.: Tax burden (D2+D5+D61+D91-D995) ³⁸ | | 124.10 | 27.1 | 27.5 | 27.3 | 27.0 | 26.6 |
| Selected components of expenditures | | | | | | | |

³² For 2013, as of September 2013. Data for Export market share is estimation for 2013.

³³ Fiscal data for 2013 are from the 2013 supplementary Budget.

³⁴ Adjusted for the next flow of swap-related flows, so the TR-TE = EDP.B9.

³⁵ The primary balance is calculated as (EDP.B9, item 8) plus (EDP.D41 + FISIM recorded as intermediate consumption, item 9).

³⁶ A plus sign means deficit-reducing one-off measures

³⁷ P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)

³⁸ Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D995), if appropriate.



| | | | | | | | |
|---|-----------|--------|------|------|------|------|------|
| 17. Collective consumption | P32 | 57.92 | 12.6 | 12.3 | 11.9 | 11.5 | 10.7 |
| 18. Total social transfers | D62 + D63 | 69.68 | 15.2 | 15.2 | 14.9 | 14.9 | 14.3 |
| 18a. Social transfers in kind | P31 = D63 | / | / | / | / | / | / |
| 18b. Social transfers other than in kind | D62 | 69.68 | 15.2 | 15.2 | 14.9 | 14.9 | 14.3 |
| 19 = 9. Interest expenditure (incl. FISIM) | EDP.D41 | 4.24 | 0.9 | 0.8 | 0.8 | 1.0 | 1.1 |
| 20. Subsidies | D3 | 11.70 | 2.6 | 2.8 | 2.6 | 2.4 | 2.3 |
| 21. Gross fixed capital formation | P51 | 24.28 | 5.3 | 5.7 | 5.8 | 5.3 | 5.5 |
| 22. Other (23 = 23-(17+18+19+20+21) ³⁹ | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| 23. Total expenditures | TE | 167.82 | 36.6 | 36.8 | 36.0 | 35.2 | 33.9 |
| p.m. compensation of public sector employees | D1 | 36.05 | 7.9 | 7.4 | 7.1 | 7.0 | 6.6 |

Source: Ministry of Finance

Table 3: General government expenditure by function

| Percentage of GDP | COFOG code | 2012 | 2013 | 2014 | 2015 | 2016 |
|--|------------|------|------|------|------|------|
| 1. General public services | 1 | 3.7 | 4.1 | 4.2 | n.a. | n.a. |
| 2. Defence | 2 | 1.2 | 1.2 | 1.2 | n.a. | n.a. |
| 3. Public order and safety | 3 | 2.7 | 2.7 | 2.6 | n.a. | n.a. |
| 4. Economic affairs | 4 | 4.4 | 3.6 | 3.7 | n.a. | n.a. |
| 5. Environmental protection | 5 | 0.2 | 0.2 | 0.2 | n.a. | n.a. |
| 6. Housing and community amenities | 6 | 2.4 | 2.8 | 2.6 | n.a. | n.a. |
| 7. Health | 7 | 5.4 | 5.4 | 5.1 | n.a. | n.a. |
| 8. Recreation, culture and religion | 8 | 0.7 | 0.8 | 0.9 | n.a. | n.a. |
| 9. Education | 9 | 4.5 | 4.4 | 4.3 | n.a. | n.a. |
| 10. Social protection | 10 | 11.4 | 11.5 | 11.4 | n.a. | n.a. |
| 11. Total expenditure (item 7 = 23 in Table 2) | TE | 36.6 | 36.8 | 36.0 | n.a. | n.a. |

Source: Ministry of Finance

Table 4: General government debt developments

| Percentages of GDP | ESA code | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|----------|------|------|------|------|------|
| 1. Gross debt ⁴⁰ | | 34.3 | 34.2 | 33.4 | 35.7 | 37.0 |
| 2. Change in gross debt ratio | | 6.3 | -0.1 | -0.7 | 2.3 | 1.3 |
| Contributions to change in gross debt | | | | | | |
| 3. Primary balance ⁴¹ | | -3.0 | -3.1 | -2.6 | -2.2 | -1.5 |
| 4. Interest expenditure (incl. FISIM) ⁴² | | 0.9 | 0.8 | 0.8 | 1.0 | 1.1 |
| 5. Stock-flow adjustment | | 2.3 | -4.0 | -4.2 | -0.9 | -1.3 |
| of which: | | | | | | |
| - Differences between cash and accruals ⁴³ | | n.a. | n.a. | n.a. | n.a. | n.a. |
| - Net accumulation of financial assets ⁴⁴ | | n.a. | n.a. | n.a. | n.a. | n.a. |
| of which: | | | | | | |
| - Privatisation proceeds | | n.a. | n.a. | n.a. | n.a. | n.a. |
| - Valuation effects and other ⁴⁵ | | n.a. | n.a. | n.a. | n.a. | n.a. |
| p.m. implicit interest rate on debt ⁴⁶ | | 3.3 | 2.6 | 2.6 | 3.2 | 3.5 |
| Other relevant variables | | | | | | |
| 6. Liquid financial assets ⁴⁷ | | n.a. | n.a. | n.a. | n.a. | n.a. |
| 7. Net financial debt (7 = 1 - 6) | | n.a. | n.a. | n.a. | n.a. | n.a. |

Source: Ministry of Finance

³⁹ D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8

⁴⁰ As defined in Regulation 3605/93 (not an ESA concept).

⁴¹ Cf. item 10 in Table 2.

⁴² Cf. item 9 in Table 2.

⁴³ The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

⁴⁴ Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

⁴⁵ Changes due to exchange rate movement, and operation in secondary market could be distinguished when relevant.

⁴⁶ Proxied by interest expenditure divided by the debt level of the previous year.

⁴⁷ F1, AF2, AF3 (consolidated at market value, AF5 (if quoted in stock exchange; including mutual fund shares).



Table 5: Cyclical developments

| Percentage of GDP | ESA code | 2012 | 2013 | 2014 | 2015 | 2016 |
|--|----------|------|------|------|------|------|
| 1. Real GDP growth (%) | B1g | -0.4 | 3.3 | 3.2 | 3.8 | 4.5 |
| 2. Net lending of general government ⁴⁸ | EDP.B.9 | -4.0 | -3.9 | -3.5 | -3.2 | -2.6 |
| 3. Interest expenditure | EDP.D.41 | 0.9 | 0.8 | 0.8 | 1.0 | 1.1 |
| 4. One-off and other temporary measure ⁴⁹ | | n.a. | n.a. | n.a. | n.a. | n.a. |
| 5. Potential GDP growth (%) ⁵⁰ | | 3.4 | 3.4 | 3.4 | 3.4 | 3.4 |
| Contributions (percentage points): | | | | | | |
| - labor | | n.a. | n.a. | n.a. | n.a. | n.a. |
| - capital | | n.a. | n.a. | n.a. | n.a. | n.a. |
| - total factor productivity | | n.a. | n.a. | n.a. | n.a. | n.a. |
| 6. Output gap | | -2.4 | -1.8 | -1.2 | -0.1 | 1.8 |
| 7. Cyclical budgetary component | | -0.8 | -0.6 | -0.4 | 0.0 | 0.6 |
| 8. Cyclically-adjusted balance (2-7) | | -3.2 | -3.3 | -3.1 | -3.2 | -3.2 |
| 9. Cyclically-adjusted primary balance (8-3) | | -2.2 | -2.5 | -2.2 | -2.2 | -2.1 |
| 10. Structural balance (8-4) | | n.a. | n.a. | n.a. | n.a. | n.a. |

Source: Ministry of Finance

Table 6: Divergence from previous programme

| | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|------|------|------|------|------|
| 1. GDP growth (% points) | | | | | |
| Previous programme | 0.5 | 2.0 | 3.2 | 3.8 | -- |
| Latest programme | -0.4 | 3.3 | 3.2 | 3.8 | 4.5 |
| Difference | -0.9 | 1.3 | 0.0 | 0.0 | -- |
| 2. General government net lending (% of GDP) | | | | | |
| Previous programme | -2.7 | -3.6 | -3.3 | -2.8 | -- |
| Latest programme | -4.0 | -3.9 | -3.5 | -3.2 | -2.6 |
| Difference | -1.3 | -0.3 | -0.2 | -0.4 | -- |
| 3. General government gross debt (% of GDP) | | | | | |
| Previous programme | 31.9 | 30.5 | 32.2 | 33.5 | -- |
| Latest programme | 34.3 | 34.2 | 33.4 | 35.7 | 37.0 |
| Difference | 2.4 | 3.7 | 1.2 | 2.2 | -- |

Source: Calculations of the Ministry of Finance

Table 7: Long-term sustainability of public finances

| Percentage of GDP | 2007 | 2010 | 2020 | 2030 | 2040 | 2050 | 2060 |
|---|------|------|------|------|------|------|------|
| Total expenditure | 32.8 | 35.9 | 33.4 | 32.6 | 32.0 | 31.7 | 31.7 |
| of which: | | | | | | | |
| - Age-related expenditures | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| - Pension expenditure | 7.7 | 8.9 | 9.0 | 9.0 | 8.7 | 8.5 | 8.4 |
| - Social security pension | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| - Old-age and early pensions | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| - Other pensions (disability, survivors) | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| - Occupational pensions (if in general government) | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| - Health care | 4.4 | 4.5 | 5.0 | 5.0 | 5.2 | 5.4 | 5.5 |
| - Long-term care (this was earlier included in the health care) | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Education expenditure | n.a. | 4.6 | 5.2 | 5.4 | 5.5 | 5.5 | 5.7 |
| Other age-related expenditures | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Interest expenditure | 0.8 | 0.7 | 1.4 | 1.5 | 1.4 | 1.2 | 1.0 |
| Total revenues | 32.2 | 33.4 | 32.0 | 32.0 | 31.7 | 31.7 | 31.5 |

⁴⁸ Data refers to central government budget deficit

⁴⁹ A plus sign means deficit-reducing one-off measures.

⁵⁰ Until an agreement on the Production Function Method is reached, countries can use their own figures (SP).



| | | | | | | | |
|---|------|------|------|------|------|------|------|
| <i>of which: property income</i> | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| <i>of which: from pensions contributions (or social contributions, if appropriate)</i> | 6.0 | 6.2 | 6.4 | 6.6 | 6.5 | 6.5 | 6.5 |
| Pension reserve fund assets | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| <i>of which: consolidated public pension fund assets (assets other than government liabilities)</i> | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Assumptions | | | | | | | |
| Labour productivity growth | 2.5 | 1.8 | 1.5 | 1.9 | 2.2 | 1.9 | 2.0 |
| Real GDP growth | 6.1 | 2.9 | 4.0 | 4.2 | 4.0 | 3.5 | 3.5 |
| Participation rate males (aged 20-64)* | 74.8 | 76.3 | 81.0 | 84.5 | 87.2 | 89.2 | 90.3 |
| Participation rates females (aged 20-64)* | 50.4 | 51.8 | 57.4 | 62.5 | 67.2 | 71.5 | 76.0 |
| Total participation rates (20-64)* | 62.8 | 64.2 | 69.2 | 73.5 | 77.2 | 80.4 | 83.1 |
| Unemployment rate | 35.2 | 32.2 | 23.4 | 15.7 | 11.0 | 7.6 | 5.3 |
| Population aged 65+ over total population | 9.6 | 9.7 | 10.0 | 10.3 | 10.6 | 11.0 | 11.4 |

* Data refer to the age group 15-64

Source: Calculations of the Ministry of Finance

Table 7a: Contingent liabilities

| % of GDP | 2013 | 2014 |
|--|------|------|
| Public guarantees | 6.9 | 9.2 |
| Of which: linked to the financial sector | 2.3 | 2.5 |

Source: Ministry of Finance

Table 8: Basic assumptions on the external economic environment underlying the PEP framework

| | Dimension | 2012 | 2013 | 2014 | 2015 | 2016 |
|--|----------------|-------|-------|-------|------|------|
| Short-term interest rate | Annual average | -- | -- | -- | -- | -- |
| Long-term interest rate | Annual average | 0.1 | 0.9 | 0.9 | -- | -- |
| USD/EUR exchange | Annual average | 1.28 | 1.33 | 1.36 | 1.36 | -- |
| Nominal effective exchange rate | Annual average | -- | -- | -- | -- | -- |
| Exchange rate vis-à-vis the EUR | Annual average | 61.5 | 61.5 | 61.5 | 61.5 | 61.5 |
| Global GDP, excluding EU | Annual average | 4.0 | 3.5 | 4.1 | 4.4 | 4.1 |
| EU GDP growth | Annual average | -0.4 | 0.0 | 1.4 | 1.9 | 1.8 |
| Growth of relevant foreign markets ⁵¹ | Annual average | 1.4 | 2.3 | 2.7 | 3.3 | 3.5 |
| World import volumes, excluding EU (y-o-y) | Annual average | 3.2 | 4.1 | 5.9 | 6.3 | -- |
| Oil prices (Brent, USD/barrel) | Annual average | 111.8 | 108.8 | 105.8 | 99.7 | 94.1 |

Source: European Commission, European Economic Forecast, Autumn 2013; IMF, World economic outlook, October 2013

Table 9. Structural reform agenda and achievements

| Major measures foreseen in previous year's PEP | Adopted (Yes/No) | Date* | Comments |
|---|------------------|------------------------------|------------------------|
| Business environment | | | |
| Implementation of the project "Regulatory Guillotine for simplification of regulations and reducing the costs for craftsmen" | yes | August 2012 | |
| Preparation of new draft version of RIA Methodology, new form of RIA Report and criteria and list for examination of quality of RIA documents | yes | July 2013 | |
| Publication of Handbook for civil servants for conduction of RIA | yes | 2013 | |
| Organizing promotional and educational event for presenting the upgraded Single electronic registry of regulations (ENER) | yes | November 2012 -December 2013 | |
| Pilot project for issuing construction permits through Electronic one-stop-shop system | yes | June 2012 | |
| Establishment of Fund for innovation and technological development | yes | May 2013 | Realisation is ongoing |
| Participation in the regional project "Western Balkan Enterprise Development and Innovation Framework" | yes | May 2013 | Realisation is ongoing |
| Continuing the project "Learning from the business community" | yes | December 2012 | Realisation is ongoing |

⁵¹ Central East Europe (14 countries). Source: IMF, World Economic Outlook, Autumn 2013.



| | | | |
|---|-----|-----------------------------|--|
| Review of the Action plan for improving global competitiveness and economic freedom | yes | continuously | |
| Activities of the National Entrepreneurship and Competitiveness Council | yes | continuously | |
| Project "Top management" | yes | September 2013 | |
| Labour market | | | |
| Preparations for successful enrollment in the new EU programme - <i>Horizon 2020</i> | yes | continuously | |
| Project " <i>Translation of 1000 professional, scientific books and textbooks and Laboratories 2010/2020</i> | yes | continuously | |
| Project <i>35/45</i> | yes | continuously | |
| Internationalisation of higher education by participation in EU programmes for education and in the programmes Erasmus for all 2014-2020 and the programme CEEPUS | yes | continuously | |
| Project " <i>Scholarships for studies abroad</i> " | yes | continuously | |
| Project „Skilful and competent “ | yes | continuously from 2008 | |
| Implementation of the Strategy for integrated education, social cohesion, inclusion and equality | yes | continuously from 2010 | |
| Strategy for Vocational Education and Training in a Lifelong Learning Context 2013-2020 | yes | 2013 | |
| Project „ <i>Centers for education of adults</i> " | yes | 2012 | |
| Implementation of the twinning project „Support to the national employment policy“ | yes | 2011-2013 | |
| Implementation of the IPA project „ <i>Further modernization of the Employment service agency</i> " | yes | January 2012 - October 2013 | |
| Implementation of the IPA project „Support of the Employment service agency for implementation of active measures and employment services“ | yes | 2013 | The Twinning partner was chosen in 2013 |
| Implementation of the USAID project „ <i>Youth network for acquiring employment skills</i> “ | yes | continuously | |
| Enterprises sector | | | |
| Preparation and implementation of integrated Programme for competitiveness, innovations and entrepreneurship | yes | January 2013 | |
| Realisation of the third phase of the Project for financing SMEs and other priority projects valued Euro 100 million | yes | July 2012 | |
| Strengthening of the institutional capacity of the Agency for foreign investments and export promotion for extensive trade and export promotion | yes | continuously | |
| IPA project „ <i>Strengthening the institutional capacity for implementation of industrial policy</i> " | no | | The Project is expected to begin in 2014 |
| IPA project " <i>Support to the Commission for protection of competition for State Aid Control</i> " | yes | January 2014 | The Project ends in January 2014 |
| IPA project „ <i>Harmonisation of legislation and capacity building in the field of consumers protection</i> " | no | | The Project will begin in September 2014 |
| Financial sector | | | |
| New Law on Foreign Exchange Operations | no | / | With amendments to the Law on Foreign Exchange Operations, the need for adoption of new Law is surpassed |
| Law on Modifications and Amendments to Law on Credit Burro | no | Realization is ongoing | |
| New Law on Takeover of Joint Stock Companies | yes | 2013 | |
| Strategy for Development of Government Securities Market in 2013-2018 | no | 2014 | |
| Continuing the Project on Insurance Market Development against Catastrophe Risks Europe RE | yes | continuously | |



| | | | |
|---|--------------|---------------|--|
| Continuing the Self-assessment Project on Application and Compliance Level with the Insurance Core Principles of the International Association of Insurance Supervisors (IAIS) | yes | continuously | |
| Appointment of members of the Council of Experts of Agency for Supervision of Fully Funded Pension Insurance as well as change of internal acts | yes | February 2013 | |
| Preparation of documentation for implementation of quality standards for the first certification for ISO 9001:2008 | yes | 2012 | |
| Adoption of bylaws arising from the Law on Payment of Pensions and Pension Benefits from Fully Funded Pension Insurance | yes, ongoing | | |
| Agriculture | | | |
| Provision of state agricultural land to socially unprotected categories of citizens and their inclusion in the categories of employees who earn their livelihood from agriculture | yes | continuously | |
| Financial support of the process for faster transfer of agricultural holdings to young farmers at the age of 18 to 40, by providing financial incentives to start new agricultural businesses aimed at decreasing of unemployment rate among young people | yes | continuously | |
| Support of production which is based on agro-ecological approach for maintaining special traditional landscapes, bio-diversity and promotion of traditional varieties and species | yes | continuously | |
| Promotion of the possibility for establishment and development of family businesses for achieving additional incomes from agricultural and non-agricultural activities, through co-financing of projects for diversification of activities in rural areas | yes | continuously | |
| Implementation of a multi-annual Strategy for monitoring and improving of the quality of milk and establishing of a milk quality monitoring system in line with the recommendations in the 2012 EC Progress Report | yes | continuously | |
| Rule of law | | | |
| Initial training with the fifth-generation of listeners for judges and prosecutors within the Academy for Judges and Public Prosecutors | yes | 2013-2015 | |
| Implementation of the adopted Methodology for Judicial Statistics | yes | 2013-2016 | |
| Project for electronic delivery and tone recording of trials | yes | 2013-2014 | |
| Administrative reforms | | | |
| Strengthening capacities of the Ministry of information society and administration and the State Administrative Inspectorate, in line with the recommendations in the 2012 Progress Report | ongoing | | IPA TAIB 2009 Project for Technical support of MISA is ongoing |
| Continuous implementation of the project "Evaluate the Administration" | yes | continuously | |
| Continuous realization of the project "No Wrong Door" | yes | continuously | |
| Continuous upgrading of the project "Civil Journal" | yes | continuously | |
| Systematic implementation of the RIA, in line with the recommendations in the 2012 Progress Report | yes | 2013 | |
| Implementation of a system for permanent measurement of consumers' satisfaction with administrative services, within the "Barometer of Quality" project | yes | 2013 | |
| Continuous activities for introduction of the ISO and CAF standards for quality in public administration | yes | continuously | |
| Continuous implementation of the interoperability system for electronic data and document exchange between institutions | yes | continuously | |
| Other reform areas | | | |
| Continuing with marketing campaigns on global TV channels and newspaper networks in order to increase the country's image as an attractive location for investment with excellent conditions for doing business | yes | continuously | |
| New web site of 'Invest in Macedonia' which will allow for greater efficiency and easier visibility of its contents | yes | November 2012 | |



| | | | |
|--|-----|----------------|---|
| Preparation of a database of potential investment projects, database of suppliers and database on locations and already constructed facilities offered for sale, joint venture or lease | yes | September 2013 | Database on locations and already constructed facilities has been prepared, the preparation of database on investment projects and suppliers is ongoing |
| Continued harmonisation of the Customs Tariff and the EU Combined Nomenclature | yes | continuously | |
| Preparation of the Programme for realization of the Strategy for energy development | yes | March 2013 | |
| Adoption of the Programme for subsidizing of the part of the costs for purchased and installed solar collectors in the households | yes | January 2013 | |
| conclusion of the Agreement on international transport of passengers and goods with the countries with which the Government has not concluded an agreements yet i.e. the Kingdom of Sweden, Republic of Finland, Republic of Lithuania, Republic of Portugal and the Republic of Ireland | yes | December 2012 | Draft agreement is indorsed with Finland and Lithuania |



Annex 2. List of institutions and other organizations, from which opinion on the 2014- 2016 PEP was required:

- National Bank of the Republic of Macedonia;
- Cabinet of the Deputy Prime Minister in-charge of economic affairs, Mr. Vladimir Peshevski, MA;
- General Secretariat of the Government of the Republic of Macedonia;
- Secretariat for European Affairs;
- Ministry of Economy of the Republic of Macedonia;
- Ministry of Information Society and Administration of the Republic of Macedonia;
- Ministry of Agriculture, Forestry and Water Economy of the Republic of Macedonia;
- Ministry of Justice of the Republic of Macedonia;
- Ministry of Labour and Social Policy of the Republic of Macedonia;
- Ministry of Education and Science of the Republic of Macedonia;
- Ministry of Transport and Communication of the Republic of Macedonia;
- Customs Administration of the Republic of Macedonia;
- Securities and Exchange Commission of the Republic of Macedonia;
- Agency for Fully Funded Pension Insurance of the Republic of Macedonia;
- Commission for Protection of Competition of the Republic of Macedonia;
- Employment Service Agency of the Republic of Macedonia;
- Agency for Foreign Investment and Export Promotion;
- Directorate for Technological Industrial Development Zones;
- State Statistical Office of the Republic of Macedonia;
- Agency for Supervision of Insurance of the Republic of Macedonia;
- Macedonian Academy for Science and Arts;
- "Ss. Cyril and Methodius" University, Faculty of Economics – Skopje;
- "Ss. Cyril and Methodius" University, Faculty of Agricultural Sciences and Food – Skopje;
- "Ss. Cyril and Methodius" University, Faculty of law "Iustinianus I" – Skopje;
- University American College, Faculty of Business Economics and Organisational Sciences - Skopje;
- South -East European University, Faculty of Business and Economics - Tetovo;
- State University of Tetovo, Faculty of Economics – Tetovo;
- "Goce Delcev" University, Faculty of Economics – Stip;
- "Goce Delcev" University, Faculty of Agriculture – Stip;
- "St. Clement Ohridski" University, Faculty of Economics – Prilep;
- FON University, Faculty of Economics - Skopje;
- European University, Faculty of Economics – Skopje;
- "Ss. Cyril and Methodius" University, Economic Institute – Skopje;
- Association of Local Government Units;
- Federation of Trade Unions of the Republic of Macedonia;
- Independent Trade Union of Education, Science and Culture of the Republic of Macedonia;
- Union of Independent and Autonomous Trade Unions of the Republic of Macedonia;
- Association of Chambers of Commerce of the Republic of Macedonia;
- Chamber of Commerce of the Republic of Macedonia;
- American Chamber of Commerce in the Republic of Macedonia;
- Chamber of Commerce of the North-West Region in the Republic of Macedonia
- Federation of Farmers of the Republic of Macedonia;
- Centre for Research and Policy Making - Skopje;
- Institute for Democracy, Solidarity and Civil Society - Skopje;
- Centre for Economic Analyses – Skopje;
- CeProSARD Centre for promotion of sustainable agricultural policies and rural development– Skopje;
- and
- Macedonian Centre for International Cooperation – Skopje.



Institution in charge:

Ministry of Finance of the Republic of Macedonia

Macroeconomic Policy Department

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Participating institutions:

- Ministry of Finance;
- National Bank of the Republic of Macedonia;
- Cabinet of the Deputy Prime Minister in-charge of economic affairs, Mr. Vladimir Peshevski, MA;
- Ministry of Economy;
- Ministry of Agriculture, Forestry and Water Economy;
- Ministry of Justice;
- Ministry of Labour and Social Policy;
- Ministry of Education and Science;
- Ministry of Transport and Communication;
- Ministry of Information Society and Administration;
- Commission for Protection of Competition;
- Employment Service Agency;
- Agency for Foreign Investment and Export Promotion;
- State Statistical Office;
- Security Exchange Commission;
- Agency for Supervision of Insurance;
- Agency for Fully Funded Pension Insurance; and
- Customs Administration.

Skopje, January 2014