



GOVERNMENT OF THE REPUBLIC OF MACEDONIA

PRE-ACCESSION ECONOMIC PROGRAMME 2009-2011

Skopje, January 2009

TABLE OF CONTENTS

Introduction	4
1. Overall Policy Framework and Objectives	5
2. Economic Outlook	5
2.1. Recent economic developments.....	5
2.2 Republic of Macedonia and Maastricht Criteria	9
2.3 Total factor productivity	10
2.4. Medium-term macroeconomic scenario.....	11
2.4.1. Real Sector	11
2.4.2. Inflation	14
2.4.3. Monetary and Exchange Rate Policy	15
2.4.4. External sector	18
3. Public Finance	22
3.1. General Government Budget Balance and Debt	22
3.1.1. Policy Strategy and Medium-Term Objectives	22
3.1.2. Actual Balances and Medium-Term Perspectives	23
3.1.2 Structural Balance	34
3.1.4 Debt level and developments, analysis of below-the-line operations and stock-flow adjustments	36
3.1.5. Budget Implications of Main Structural Reforms	42
3.2. Sensitivity analysis	42
3.3. Quality of Public Finances	46
3.4. Sustainability of public finances	49
3.5. Institutional Features of Public Finances	50
4. Structural reforms	52
4.1. Enterprise sector.....	52
4.1.1. Industrial policy and strategy	52
4.1.2 Entrepreneurship and Small and Medium Enterprises.....	53
4.1.3 Tourism and catering industry.....	54
4.2. Financial Sector	57
4.2.1. Banking System	57
4.2.2. Non-Banking Sector.....	62
4.3. Development of Human Capital	65
4.3.1 Current Background on the Labor Market	65
4.3.2. Educational Reforms – Human Capital	67
4.3.3 Reforms for advancement of labor market functioning in the Republic of Macedonia	70
4.3.4 Labor law reform	72
4.3.5 Introducing the Concept of Gross Salary and Reform of the System for Financing of Social Contributions	73
4.4 Infrastructure	76
4.4.1. Energy market.....	76
4.4.2. Road transport	77
4.4.3. Rail transport	79
4.4.4. Air transport	80
4.4.5. Post	82
4.4.6. Electronic communications	83
4.5. Agriculture.....	85
4.5.1. Reforms in the area of agricultural land	87
4.5.2. Rural development	88
4.5.3. Phytosanitary policy.....	89

4.5.4. Seed and seedling materials and sanitary policy	90
4.5.5. Veterinary policy	90
4.5.6. Forestry	92
4.5.7. International cooperation	93
4.6. Administrative reforms	95
4.6.1. Institutional improvement of administrative structures and strengthening the administrative capacities	95
4.6.2. Improvement of transparency and accountability of the administration.....	96
4.7. Additional reform activities for business climate improvement	97
4.7.1. Market entry / exit	97
4.7.2. Judicial system reforms.....	97
4.7.3. Regulatory reform.....	100
4.7.4. Foreign Trade Facilitation.....	101
4.7.5. Property Rights Protection.....	102
4.7.6. Foreign Direct Investments.....	102
ANNEX: TABLES	124

Introduction

After the two exceptional years of strong growth and over performance of planned budget revenues, towards the end of 2008 (q4), the economy started to feel the effects of the global turmoil. Though the Macedonian financial sector was not directly hit by the global financial crisis, the real economy and production started to decline. The first industry that suffered from worsening global environment was the metal industry where both world prices of metals declined and world demand contained.

While by the end of 2007 and the first half of 2008 the main challenge for the economic policy was accelerated inflation, in the second half of 2008 the inflation rate began to decrease and the primary evocation became the global economic turmoil. Hence, the authorities reduced the initially projected real GDP growth of 6.7% in 2009 to 5.5% and respective revision to the planned budget revenues was made. However, we are all facing the uncertainty about the severance and duration of the crises meaning that additional revisions of the growth and planned revenues might happen.

The indirect impact of world crises on Macedonian economy can come from different channels. Lower world growth could worsen the current account deficit which widened in 2008 to about 12% of GDP, through lower export demand (60% of total exports are directed in the EU), falling world metal prices (metals constitute 40% of exports), or weaker private transfers (including remittances).

In addition, due to the financial crises and tighter international credit markets, FDIs which increased considerably in 2007 and 2008 and partly financed the current account deficit, would probably become more sensitive and volatile.

The Government has made a decision to fight possible growth reduction through more expansionary fiscal policy, i.e. counter-cyclical policy, while maintaining relatively prudent monetary policy. Hence, the planned budget deficit for 2009 is 2.8% of GDP, which is mainly due to the increased capital spending by 14% compared to 2008. In addition, the already planned reduction in the labour taxation will help firms accommodate to the declining world demand and possible reduction in private consumption.

In consultation with the private sector, the Government prepared an emergency package of 10 measures to fight against the reduction in the production. These include: four years grace period and possible writing-off compulsory healthcare contribution for companies, writing-off interest on personal income tax, profit tax, VAT, property tax and pension contribution under the condition that taxpayers pay their main debt, paying of tax debts in instalments, taxation of profit only if allocated in dividends, reduction of customs duties especially for raw materials, lower taxes for farmers, etc. In addition, the Government made a decision to convert the claims that the state has in terms of public duties into equity stake in 4 companies. The package is explained in details in section 2.2.1.

The fiscal effect of the package is estimated at maximum of 330 million euros, if all firms take advantage of all of the proposed measures which is not feasible in practice. This stimulus package is not incorporated in the 2009 Budget, because at the moment of promulgation, the Budget was already in parliamentary procedure and according to the Ministry of Finance assessment, in the first half on the 2009 proposed measures will have moderate effect on budget revenues. Hence, supplementary budget might be adopted towards the middle of the next year.

The major reform that started from January 1st 2009 is the introduction of the gross wage concept and changes in the social insurance system. This reform consists of several elements, that are:

- full harmonization of the basis for payment of the social contributions;
- reduction of social contributions' rates from current 32% to 27,9% in 2009 and further to 22% in 2011;
- introduction of a gross wage system: wages would be negotiated on a gross level, tax free allowances would be integrated into wage (broadening the tax base), liable person for the payment of PIT and social contributions would become the worker, instead of employer (as currently);
- integrated collection of the PIT and social insurance contributions in the Public Revenue Office.

1. Overall Policy Framework and Objectives

Government of the Republic of Macedonia in 2006 adopted an ambitious economic program for structural reforms, which is being intensively realised, and it was expanded and upgraded in 2008. The Programme actually is continuation and intensification of the reforms being constantly implemented by the Government in the recent years. Fundamental priority of the Government is to stimulate economic growth through development of the private sector, improvement of the investment climate, job creation and improvement of the living standard of the citizens. Activities resulting from the European Partnership are significantly intensified to the end of moving down the path to the EU membership.

Government programme is being realised through specific and intensive structural reforms, i.e. reforms in the business environment, so as to improve the entry in and exit from the market and creating free competition, strengthening the capacity of the institutions, judiciary reforms so as to accelerate court procedures, health system reforms, labour market reforms, education reforms as well as public finance management.

There is a general consensus among the political parties on the economic reforms in the Republic of Macedonia, and progress achieved in economy growth, implemented reforms and improved business environment have been acknowledged by renowned international institutions. Thus, in addition to the leading business portal Forbs, which ranked Macedonia at the 50th position in running business in its Best Countries for Business Report, being a leap by 32 places compared to 2007, the Doing Business Report of the World Bank confirmed the achieved progress, ranking our country at the 71st position, improving by eight places from 79th position in 2007. Fight against corruption and results achieved have been confirmed in the latest Transparency International's Global Corruption Report, ranking Macedonia at the 72nd position compared to the 84th position last year (a jump by 12 places).

Such economic programme has already yielded specific results confirmed with the preliminary data on the Macedonian economy for the first two quarters of 2008.

2. Economic Outlook

2.1. Recent economic developments

Macroeconomic trends in 2007 and the first half of 2008

In 2007, macroeconomic situation in the Republic of Macedonia was stable, reflected through intensified growth of GDP, prudent fiscal discipline, low inflation rate and downward trend of interest rates, which are solid basis for improved economic growth in the next period. Closer relations with the European Union are also strong impetus for the institutional capacity strengthening, acceleration of reforms and achievement of more dynamic economic growth.

In 2007, **gross domestic product** grew by 5.9%, being the highest growth rate since Macedonia gained its independence. Economic growth was confirmed by number of leading indicators, i.e. high export growth (28.3%), strong growth of credits to the private sector (40%), 8% growth of average salaries, exceptional growth, for a longer period, of investments in machines and equipment.

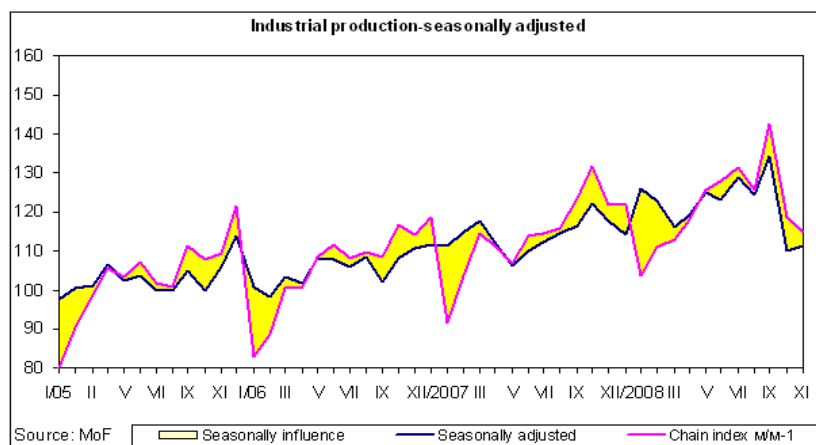
Table 1: Gross Domestic Product

	Growth rate		Contribution to growth	
	2006	2007	2006	2007
Agriculture	4.7	2.1	0.4	0.2
Industry	2.6	4.3	0.6	1.0
Construction	11.3	6.4	0.7	0.4
Services	6.7	7.9	3.3	4.0
GDP	4	5.9	4	5.9

Source: Calculations of the Ministry of Finance on the basis of data from the State Statistics Office.

Analysed from the aspect of the production side of the GDP, positive growth rates in 2007 were noted in almost all sectors, whereby especially high growth was registered in the following service sectors: trade, transport and communications, and hotels and restaurants. Still, achievements in the real sector were somewhat lower than the projected due to the low industry growth and the low growth in services. Thus, in 2007 industrial production grew by 4.3%, while the projected annual growth was 6%, and it should be pointed out that, in 2007, services contributed more to GDP growth compared to industry (Table 1). The biggest contribution within industrial production was by the sector for production of base metals (3.9 percentage points), the sector for production of metal products (1.5 percentage points), and the sector for production of food products (1.2 percentage points). Significant growth by 19.7% was also noted in the sector for capital products.

Chart 1: Industrial production and cycle



Regarding services, highest growth in 2007 was registered in the trade sector, while traffic and communications sector showed exceptionally high growth rate of 10.7% (entrance of the third mobile operator contributed significantly). High growth rates were registered in hotels and restaurants sector (6.8%, as a result of the increased number of domestic and foreign tourists, construction (5.7%) and processing industry (4.3%).

Analysis of the expenditure side of GDP shows that again, the biggest contribution to the GDP growth in 2007 was by the overall consumption with 6.8 percentage points, as well as gross investments with 3.2 percentage points. Within the total consumption, personal consumption grew in real terms by 8.1% (in accordance with higher net salaries by 7.9%) and contributed to total growth by 6.3 percentage points, while public expenditures grew in real terms by 3.2% and contributed with 0.6 percentage points in the total GDP growth. What was especially positive was that gross investments had significant share in GDP growth in 2007, whereby, taking into account the high import component of the investments in the Republic of Macedonia as a developing country, the negative contribution of the net import in 2007 grew and was -4.1 percentage points.

Economic growth in 2007 was accompanied by positive trends in **the fiscal area**. In fact, 2007 general government budget realised 0.6% surplus, being a strong support to the monetary policy, aimed at stable foreign exchange rate and further decrease of interest rates, both of the reference rate (interest rate of the Central Bank bills) and of the interest on debit balance of the commercial banks. At the same time, debt of the Republic of Macedonia in 2007 significantly declined, whereby the general government debt was 25.5% at the end of the year, being a decline by 7.4 percentage points.

Growth of the economic activity in 2007 led to increase in the volume of the commodities trade, whereby in the analysed period, total cumulative export of goods, expressed in euros, increased by 28.3%, with a simultaneous increase of the import by around 27%. Despite the higher growth of export in relation to import, such trends resulted in an increase in the trade deficit with abroad compared to the one realised last year. Such situation was largely initiated by the increased trade deficit in relation to energy and equipment, whereby import of oil, machines and equipment and cars accounted for 32% of the total import or 22% of GDP.

Despite the significant inflow on the basis of private transfers (7% increase) and intensified export activity, due to trade deficit widening (20.3% of GDP) and slowdown on the increase of transfers, high **current account deficit** was realised in 2007, reaching 7.2% of GDP. Increased foreign currency inflows in the economy caused for foreign currency supply to exceed the demand, leading to pressure for appreciation of the Denar exchange rate. To the end of maintaining the stability of the nominal Denar exchange rate to the euro, in the observed period, via foreign exchange transactions, NBRM carried out net redemption of foreign currency, whereby the exchange rate remained unchained at the end of 2007 compared to 2006.

Level of foreign currency reserves continued to increase and, at the end of 2007, foreign currency reserves amounted to EUR 1.5 billion, which compared to end-2006 grew by 7.6% and were equal to 3.8-month import coverage.

With regard to the operational position of monetary policy, in 2007, NBRM also implemented de facto **fixed exchange rate** policy, whereby the fluctuations of Denar in relation to the euro were insignificant. Auctions of central bank bills, as well as of treasury bills issued for monetary purposes, remained to be the only instrument of the monetary policy, whereby, in 2007, "interest rate tender" was applied, meaning market-based interest rates of central bank bills, by bank offers. In conditions of relatively high level of liquidity and higher average demand than the offer of central bank bills, interest rates on central bank bills declined (interest rate on central bank bills at end-2007 was 4.8%, compared to 5.7% at end-2006).

Inflation, measured through the costs of living, amounted to 2.3% on average on annual level, and it declined in relation to 2006 (when it was 3,2%). Thus, Republic of Macedonia continues maintaining low inflation rate, necessary for conducive business environment and high-quality projections of economic trends.

CPI trends in 2007 were different by consumption groups. Growth was noted in the following groups: housing and restaurants and hotels (4.7%), food (3.9%), culture and leisure (2.4%), tobacco and beverages and clothes and footwear (1.8%), hygiene and health (0.3%), while means of transport and services dropped (-3.1%).

With regard to the performance in **the banking system**, total deposit potential of banks grew by 28.8% in 2007. Higher deposit base of banks, supplemented by more active placement of foreign currency deposit potential, contributed to annual growth rate of credits in the private sector by around 40% in 2007. Thereby, it was of great significance that long-term credits to enterprises, i.e. credits aimed at investment activity, realised high increase (44.5%).

Real sector performance and economic activity intensification had an adequate positive influence on **the social sector**, i.e. on the employment. In fact, in 2007, employment (according to the Labour Force Survey) grew by 3.5% compared to 2006, which was in accordance with the data from the Employment Agency, according to which almost 191,472 persons got new job, or 27% more compared to last year. Unemployment rate (ILO definition) was 34.9% at the end of 2007, being a decline by 1.1 percentage point compared to the 2006.

In 2008, Macedonian economy continued showing significant economic achievements, despite the slowdown of the global economic activity, including the countries in the region. Positive trends were recorded in almost all sectors of the economy. Accelerated growth was realised in conditions of higher coordination between fiscal and monetary policy, supported by disciplined fiscal policy and consistent and more restrictive monetary policy. In fact, **GDP growth rate** in the first half in 2008 was 6%, whereby is it important that the growth realised was diversified, i.e. all sectors in the economy realised growth. Most significant growth was registered in the construction sector (23.2%), industry (12.4%) and retail and whole sale (6.2%). High growth of value added at services led to further changes and approximation of the production structure of GDP to the one in the developed countries.

In 2008, industrial production grew by 6.4% in the first quarter, 12.4% in the second quarter and 13% in the third one, while cumulative growth of industry in the first three quarters reached even 10.4%. Contribution of growth was the highest in industry for production of metal products, industry for production of furniture and industry for production of electrical machines.

Relatively high growth of the general price level in the second half of 2007 continued in the first half of 2008 as well, and it started stabilizing and dropping on monthly level by the middle of the year. Thus, inflation rate in the first eleven months in 2008, compared to end-2007, was 3.2%, and 5.2% on annual level. With respect to the causes of inflation, it should be pointed out that they were mostly external. In fact, main reason for inflation pressure were the increasing prices of food, oil and raw materials in general on the global market, causing, to a certain extent, subsequent increase in the prices of some other products as well. Confirmation for the connection between national inflation and world prices of food and oil is the fact that their stabilisation and gradual decline lead to gradual decline of the national inflation rate. Contribution of food and fuels in the total increase of prices in the period January-November 2008 was even 79.3%.

Regarding the external sector, in euro terms, export growth in the first nine months in 2008 was 13.8%, while import grew by 35.2%, causing widening of the trade deficit by 84.2% compared to the same period last year. Increased deficit in the analysed period was mainly due to the increased import of oil and oil products and electricity. Despite the fact that imported quantities of these products increased by only 18.1%, i.e. 72.9%, increase of their prices on the world stock exchanges caused for increase of the euro-value of the import by 76.2% with respect to oil, and by even 150.5% with respect to electricity.

Positive economic developments that continued from 2007 into 2008 undoubtedly had their reflection in the **social sphere**. Recent statistical data on the labour market (Labour Force Survey¹) showed increase in the number of employed persons in the second quarter in 2008 by around 18,000 in relation to the same quarter previous year, or 3% surge of total employment. Thus, employment rate climbed by 1.1 percentage point (p.p.), amounting to 41.8%.

Employment rate amounted to 34% in the second quarter in 2008 which, compared to the same quarter the previous year, was a drop by 1.2 p.p. In general, downward trend of the unemployment rate, recorded in the last three years, continued, mainly as a result of the intensified economic activity and active labour market policies. Number of unemployed persons registered in the Employment Agency, which dropped for the first time after ten years and was kept at below 350,000, amounted to 343,692 at the end of September, with a possibility for further decline. It is important to point out that 271,727 persons out of them actively sought job, while the remaining 71,965 persons registered only for the **purpose of** exercising the right to health insurance, and according to the definition on unemployment in the **literature**, they should not be covered by this category.

At the same time, in the period January-August, average net salaries grew in nominal terms by 10.4% and in real terms by 1%, mainly due to the higher costs of living in this period.

In 2008, **monetary policy** was relatively more restrictive in relation to the previous years, however the results from the tightened policy measures started to be felt even after several months of their introduction, mainly as a result of time lag in their transmission. In fact, despite the increase of interest rates on central bank bills to 7% and passing from interest rate tender to amount tender, average weighted lending rates of the commercial banks dropped by 0.3 p.p. in October 2008 in relation to the same month previous year, increasing from 9.6% on monthly level in September to 9.7% in October.

With regard to the performance in the **banking sector**, total deposit potential of banks grew by 18.9% in October 2008 compared to the same period previous year. Higher deposit potential, coupled by the greater competition in the banking sector (entry of Steiermarkische Bank und Sparkassen AG, HYPO Investmentbank, Société General) led to increase of credits to the private sector by 39.6%. However, there was a slowdown in the high growth of credits in the last several months (being 44.1% at end-April 2008) as a result of the measures undertaken by NBRM, as well as due to the effects of the global financial crisis, which led to tightening of credit requirements of the domestic banks.

What is of special importance for the economic activity in future is the high growth of long-term credits to enterprises, mainly used for investments, by 26.7% in October, compared to end-2007, or high increase by 37% annually, which was an impetus and a signal for further intensive growth for the economy.

Regarding **public finance**, disciplined and prudent fiscal policy was conducted, as so far, in the first nine months in 2008. Despite the significant fiscal reforms undertaken (reduction of flat tax from 12% to

¹ Population at the age of 15 -64.

10%, reduction of VAT for certain products, etc.), tax revenues in the first nine months in 2008 underperformed by only 1.5% in relation to the projected ones, while profit tax revenues dropped by 5% in relation to the revised revenue plan, under which projected revenues were increased by even 12.4% in relation to the initially planned.

Previous analyses can lead to the conclusion that expectations for keeping high growth of GDP and employment in 2009-2011 are quite justified. However, global financial crisis that led to slowdown of growth in the countries in Western Europe and in the USA will have adverse effects on the Macedonian economy as well, expressed through declined external demand of Macedonian products (declined export) and possible drop in investments and domestic consumption (if credit activity of banks slows down and the population refrains from larger consumption).

2.2 Republic of Macedonia and Maastricht Criteria

Confirmation for the performance and macroeconomic stability is the analysis of the fulfillment of the criteria for accepting the euro as part of the European Economic and Monetary Union.

Maastricht Criteria on monetary integration with the Eurozone require the following:

- sustainable price stability, in terms of its average annual inflation rate not exceeding 1.5 percentage points above the average rate of the three countries with the lowest inflation;
- sustainable fiscal position, in terms of:
 - planned or current fiscal deficit not exceeding 3% of GDP; and
 - public debt not exceeding 60% of GDP.
- exchange rate stability (secured via membership in ERM II) in a period of at least 2 years before the membership into EMU, without devaluation pressures on the domestic currency in relation to the euro or any other currency of a Member State;
- converging long-term interest rates, as a result of the membership in the ERM II, defined as average nominal interest rate on 5 or 10-year government or corporate bond, not exceeding 2 percentage points of the rate of the three EMU members with the lowest inflation.

Analysis of their fulfillment by the Republic of Macedonia shows the following:

Table 2 - Republic of Macedonia and Maastricht Criteria

Criterion	Fulfillment
1. Price stability - three countries with the lowest inflation in 2006 Malta 0.7 France 1.6 <u>the Netherlands 1.6</u> average 1.3 + 1.5 p.p. = 2,8 - inflation rate in Macedonia in 2007 – 2.3%	√
2. Fiscal position - fiscal surplus/GDP = 0.6% - public debt/GDP = 25.5%	√
3. Exchange rate - pegged to the Euro (Deutsch Mark) since October 1995	√
4. Long-term interest rate - long-term government bond (10 years) – average rate of the three countries with the lowest inflation 4.3% + 2 p.p. =6,3% - long-term government bond (3 years) ² – Republic of Macedonia - 8%	X

² Bond with longest maturity issued in 2007 was the one with 3-year maturity. Thus, comparability is relatively low.

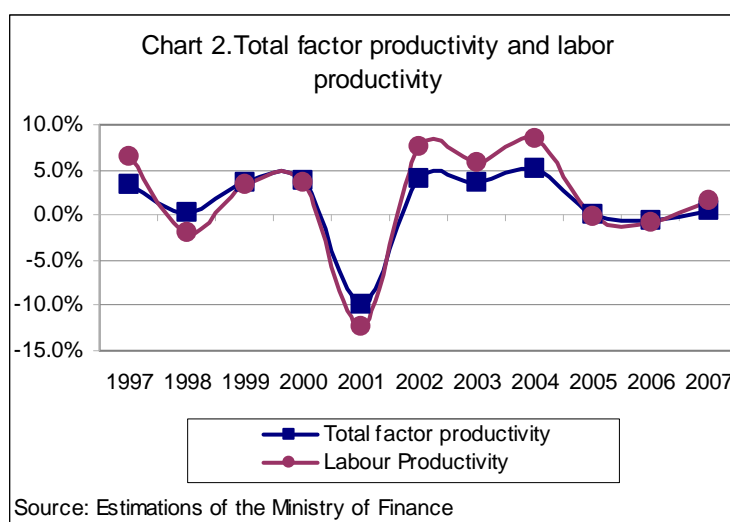
2.3 Total factor productivity

The analysis of economic growth in a country is of special importance for the creation and implementation of economic policies. According to the theory of economic growth, it depends on three factors:

- capital growth in the economy (i.e., the accumulated capital in the economy plus investments in the current year, minus depreciation according to weighted rate);
- labour force growth (number of employed persons in the economy); and
- growth of the total factor productivity (TFP), which is a total level of efficiency by which production factors – capital and labour - are utilised.

To calculate the total factor productivity in Macedonia, we assume that the capital stock depreciated by a weighted depreciation rate of 10%, and we used the LFS data for the number of employed persons. In the calculation, we used the assumption that for the period 1998-2007, the portion of the revenues from capital is 0,41, and the remaining (0,59) is revenues from labour.

Total factor productivity in the Republic of Macedonia is given in the following chart which sets the labour productivity for the same period so as to compare it with TFP.



The chart shows that in 2007 TFP is positive, 0.4% and records a positive propulsion compared to 2006. Hence, the share of the TFP in the total economic growth is significant, 8.6%. This suggests relative improvement of the efficiency of utilization of both labour and fixed assets in 2007. Still, relatively low growth of TFP (0.4%) can be attributed to the high capital growth (6.4%) and labour growth (3.5%) in 2007.

Even more, this number should be taken with reserve due to the possible underestimation of the capital stock in the Republic of Macedonia, as well as due to the significant share of employment in the informal sector, excluded from the TFP calculation.

Cumulatively, for the period 1997-2007, the contribution and share of the production factors and the total factor productivity to growth are shown in the following table:

Table 3: Contribution and share of the factors and the factor productivity to growth in Macedonia (1997-2007)

Growth of GDP	Capital	Labour	TFP
2.7%	0.9%	0.6%	1.3%
	(32.9%)	(20.9%)	(46.1%)

Source: Ministry of Finance calculations

The table points to the conclusion that in a longer term (11-year average), contribution of total factor productivity to growth is around 46.1%, which is a significant indicator of the efficiency in using labour and capital. Although in 2007 the growth of TFP is low, it shows a positive trend in relation to the previous years and this figure is expected to improve in the next period. Such a statement is based on the fact that expected FDI growth in the next period will strongly affect the total factor productivity, as a result of improved corporate governance, standardisation and more efficient utilisation of the labour force. In the long run, reforms in the education and health sector will positively affect the TFP.

2.4. Medium-term macroeconomic scenario

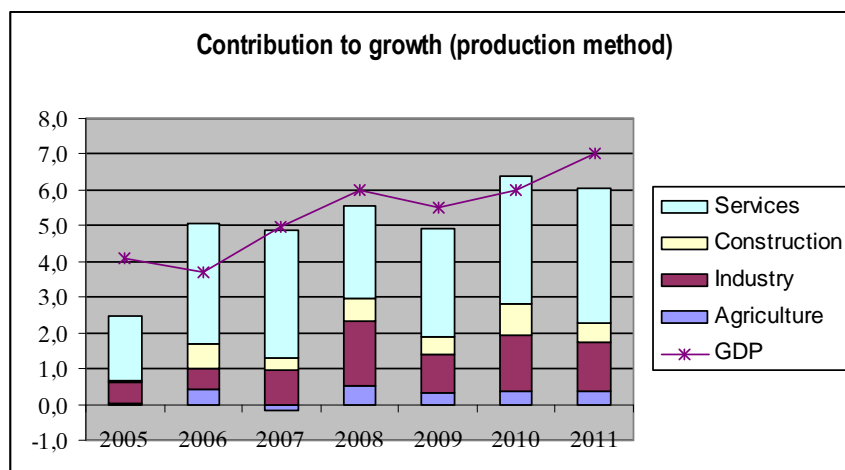
2.4.1. Real Sector

Transition period in the Republic of Macedonia was characterised with relatively high macroeconomic stability, but low economic growth rates. During this period, Republic of Macedonia did not manage to join the other countries which quickly restructured their economies and started realising high growth rates. Such negative trend was interrupted in 2007, when the country, for the first time since its independence, realised GDP growth rate of 5.9%. Following this turning point, economy started to recover fast and to take advantage of all its potentials for high growth, and there are strong arguments that 6% projected rate will be achieved in 2008.

Main objective of the Government of the Republic of Macedonia, in line with its economic programme, remains to be keeping and accelerating the high economic growth, whereby it is necessary to realise high growth rates several years in a row so as for the citizens to feel more significant increase of the available income and improvement of their living standard. Accordingly, in the period 2009-2011, average GDP growth rate is projected to be high, ranging between 5.5% and 7%, depending on the further success in attracting FDIs, as well as realising the planned capital investments.

Regarding the expenditure side of GDP, driving force of the economic growth will be personal consumption and investments. With respect to investments, FDIs are expected to contribute significantly, and capital investments will be no less important, which, according to the plan of the Government, will increase significantly and account for large share in the referred period. From the point of view of production method for calculation of GDP, services account the most in its creation, as the main drivers of growth. However, high growth is also expected at industrial production, as a result of continuation of restructuring of domestic capacities, as well as the increased FDIs.

Chart 3: Contribution to the GDP growth, production method



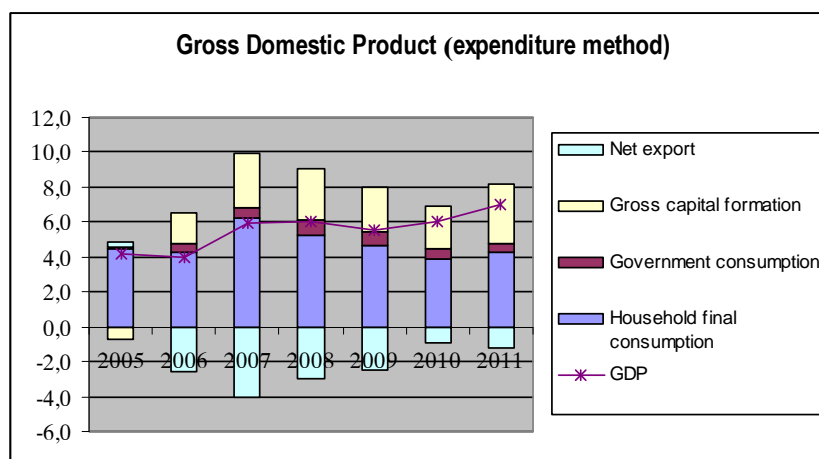
Source: State Statistics Office and Ministry of Finance

Contribution of personal consumption to GDP is expected to be between 4.5 and 5 percentage points in the period 2009-2011. Such assumption is based on the following:

- projected 4% employment increase;
- projected average growth of salaries by 8% in the analysed period, as a result of the growth of salaries in the public sector by 10% and the growth of salaries in the private sector that would follow the productivity growth;
- growth of credits to the citizens by 40% p.a.;
- expected stable level of private transfers.

Contribution of increased personal consumption to GDP is expected to be between 0.7 and 1 percentage point in the period 2009-2011, in conditions of general government budget deficit up to 3% of GDP, above all due to the expected increased capital investments. Intensification of reform activities by the Government of the Republic of Macedonia, especially in the tax area, business climate improvement, as well as the expected integration of the Republic of Macedonia into the Euro-Atlantic structures, are expected to enhance the investment activity in the country. Thus, in the period 2009-2011, gross investments are expected to grow between 19% and 20%, and to contribute to the growth by 3 to 4.5 percentage points. Expected future high inflow of FDIs, taking into account the large import component they have (Johnson Matthey, Montipe, Aqua pour, etc.), as well as the expected expansion of personal consumption, are anticipated to cause for the net export to be negative on the medium term. However, on long term, since over 80% of the FDI production will be export oriented, net export will have more neutral effects on GDP growth.

Chart 4: Contribution to GDP growth, expenditure method



Source: State Statistics Office and Ministry of Finance

Improvement of overall economic climate, especially the increased economic activity of small- and medium-size enterprises, i.e. the realisation of more dynamic economic growth rates (5.5-7% on medium term), will contribute to growth of employment by around 4% on annual level in the analysed period, with a simultaneous reduction of the unemployment rate. In addition, high economic growth would provide for further fiscal and structural reforms so as to improve the business environment, infrastructure, public institutions' capacity.

Appendix: Influence of global crisis over the real economy

Against a background of global financial and economic crisis, due to the low participation of the domestic banking system in the international financial markets and its relative isolation, the negative consequences, not being felt until October 2008, were dominantly transferred in the real sector of the Macedonian economy.

Thus, metal processing industry was the first to feel the adverse effect and the textile industry was also affected by the crisis. High decrease of the prices of metals put the companies of this industry in an invidious position. In fact, in September 2008, the price of nickel, zinc and lead decreased by 40% compared to the same month last year, and the copper price decreased by 9% on the world stock

markets. Reduced prices of the mentioned products on the global markets, as well as the dropped external demand for domestic products already led to a decline of the industrial production and hence strengthened the expectations for decrease of the activity in the coming period. After the particularly favourable period of high growth in the first half of 2008, serious decrease of the industrial production by 9.9% on annual basis was observed in October in the same year, amounting to 2.9% in November. However, despite the growth at the mine sector in November, in the mean time, certain mines were closed or they reduced the production leading to firing the workers or forcing them to take unpaid vacation. Other two sectors, processing industry and the energy sector decreased by 3% and 0.7%, respectively.

In the third quarter of 2008, due to the unfavourable economic conditions, the Gross Domestic Product slowly decreased by 5.5% (contrary to 6.3% in the second quarter), thus the projections were not realized. In 2009, GDP growth will be subject to numerous challenges. Thus, in addition to the difficulties of industry as one of the most significant sectors in the economy (participation of 22% in GDP), a decline of personal consumption and increase of active interest rates is also possible due to certain restraint from consumption and sharpening of the terms for crediting (including both credit cards and allowed overdraft).

However, positive development for keeping the economic growth in the country is the expectation for recovery of the European economy in the second half of 2009, as well as the favourable expected economic trends at other trade partners of the Republic of Macedonia, such as Kosovo, which experiences upward investment cycle, thus offsetting the effect from the declined external demand in EU. Government anti-cyclical fiscal policy, aimed at expansion of capital investments, is one more useful tool in avoiding the crisis, which exposed even the economically most developed countries to temptation. Following the steps of a number of developed countries, the Government of Republic of Macedonia adopted a stimulus plan in order to cope with the financial turmoil, comprising several measures:

1. Moratorium of the liabilities on basis of health insurance contributions in the next four years, and if they are regularly serviced they will be fully written off.
2. Writing-off the interests on the basis of all unpaid liabilities on the basis of taxes and contributions, and if they are paid in the first quarter in the next year the interest will be fully written off (100%), and 75%, i.e. 50% for the next quarters.
3. Reprogramming the tax liabilities of the firms having difficulties in the operations for the purpose of repaying the tax debt in instalments up to 36 at the most, by providing bank guarantee in the amount of 100 percents of the debt or mortgage in the amount of 250 percents of the debt.
4. Giving possibilities to the companies for payment with cession being particularly important for the enterprises with blocked accounts.
5. Conversion of the debt of 4-year state companies OHIS, EMO, Tutunski kombinat Prilep and Evrokompoziti into permanent state debt to the end of increasing the competitiveness of these firms and their attractiveness for sale.
6. Amendments to the Law on Reinvested Profit enabling profit tax exemption only for the amount of the redistributed profit in investment.
7. Reducing the customs tariffs referring to the raw materials for trade, economy, Informatics Society, meaning that our companies will have the possibility to become more competitive by importing raw materials without customs tariffs or with reduced customs tariffs.
8. Two-year postponement of payment of tax on interest on saving deposits.
9. Lower taxation of farmers, meaning fundamentally that those who have profit of EUR 5,000 will be fully exempted from tax, and those with profit of up to EUR 20,000 will only pay EUR 400 income tax.

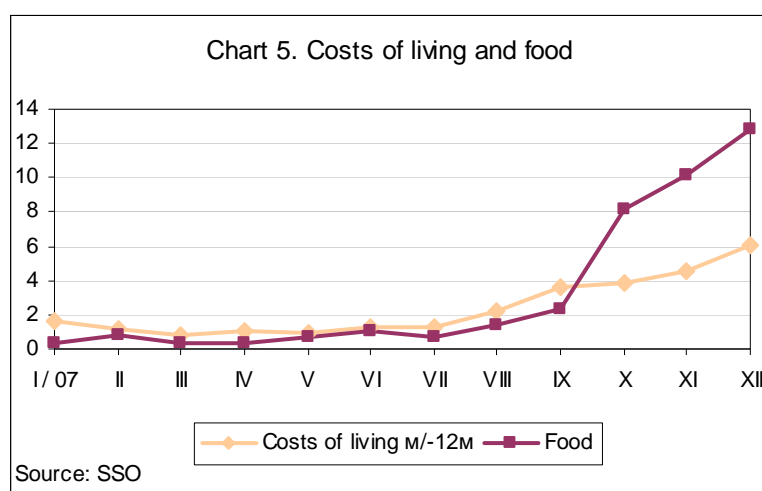
On the basis of the initial calculations, it is expected for these measures to contribute to improvement of the conditions in the real sector of the Republic of Macedonia. Thereby, the introduction of the Estonian model of profit tax, taxing the profit tax only is the most significant measure. This measure is expected to contribute for further increase in both investments and economic growth.

Of course, the measures proposed by the Government will also contribute to easier overcoming of the financial crisis in particular at those enterprises facing operational problems.

2.4.2. Inflation

After several years of an exceptionally low inflation rate in the Republic of Macedonia (in the period of 1996-2006 the inflation rate did not go beyond 5%) in the second half of 2007 (starting in October) inflationary pressures intensified significantly. In a small and open economy such as the Republic of Macedonia, with a de facto fixed exchange rate, price changes on the global markets reflect in the domestic market. Having in mind that the exchange rate conduit is fast and direct, the Republic of Macedonia in 2007 was not immune to the price trends on the global stock markets .

In the first half of 2007, the inflation rate was low at 0.9%. The low inflation rate in the first half of the year was a result of the reduction of the prices of oil and oil derivatives at the beginning of 2007, an unrealized planned increase of the electricity price, reduction of the price of the central heating, as well as the unchanged price of tobacco products despite the harmonisation of the excise for domestic and foreign cigarettes. In the third quarter, the inflation rate was 2.4% and the highest inflation rate was observed in the fourth quarter of 2007 when it reached the level of 4.8%.



In addition to different trends by months, the **average annual inflation rate in 2007 was low at 2.3%**. In the Eurozone the average inflation rate was similar at 2.1%.

Within the **CPI** (according to COICOP)³ in 2007 in the Republic of Macedonia, *food accounted for 34.3%*, meaning that an average Macedonian family spends 34% of all expenditures on food, which is significantly higher compared to the EU countries, where this percent is 15%. The share of food in the inflation rate, (2.3%) is 1.3 percentage points. The share of food in the total consumer basket in other countries in transition is similar as in the Republic of Macedonia, which explains the higher level of inflation in these countries compared to the developed countries. The CPI trend in 2007 was different by consumption groups. Growth was noted in the following groups: housing and hotels and restaurants (4.7%), food (3.9%), culture and entertainment (4.2%), tobacco and beverages and clothing and footwear by 1.8% and other services elsewhere unmentioned by 8.6%.

In the first half of 2008, the CPI inflation rate amounted 9,7% and it was significantly higher than projected one. This divergence generally is a result of the drastic increase of oil and food prices at the beginning of 2008. The growth trend of inflation rate has stopped in July, along with the stabilization of food and energy prices on the world markets.

The expectations for 2009 point to further deceleration of the inflation rate to the level of approximately 2-3% and its maintenance on a stable level of about 3% in the next two years. Such projections are based on the anticipations for improvement of the external conditions and decreasing of their influence on the domestic inflation, given simultaneous price pressures reduction originating from the domestic factors. Namely, in the following period the developed economies are expected to progress with slower dynamic, while the price of oil and external inflation registers moderate decline. From the aspect of the domestic factors, the expectations for decrease in the personal consumption (in line with the

³ Classification of personal consumption by purpose, by groups and subgroups of products and services

expectations for gradual households' crediting reduction and the uncertain dynamics of the private sectors), as well as the lower pressures arising from external demand in terms of decrease in the global growth, is considered to have effect on the reduced pressures arising from the aggregate demand. Additional deflation influence in the last period is expected from the movements on the side of supply, in accordance with the perceived decline in the pressures of the import prices on the domestic ones (drop in the price of oil and stabilization in the prices of food). In 2008, in conditions of significant intensification of the economic activity, it considered that the economy has faced with positive production gap, observed from the aspect of the inflation pressures, while in 2009, in line with the expected decrease in the external demand, movements towards negative production gap are possible, as additional argument for the anticipated decrease and stabilization of the inflation.

Until the end of the year, the slowing down of the deposit base growth, as well as the monetary measures undertaken so far, are expected to contribute to further hindering of the credits' growth dynamics, with the credit growth rate stabilizing on sustainable level on a middle-term basis, which will support economic growth, without generating risks for the macroeconomic stability. Regarding the money supply, by stabilizing the influences leading to slower monetary growth in 2008, stabilization of the money supply growth can be anticipated.

The uncertainty related to the future movement of food and oil prices and the risks of rapid widening of the current account deficit are the main challenges for the monetary policy on a middle-term basis, as well as for the macroeconomic policy, in general. Having in mind that the enlarged macroeconomic imbalances can jeopardize the sustainability of enhanced economic growth, the consistent macroeconomic policy conduct is of key importance for the following period. The NBRM contributes to preserve the macroeconomic stability by remaining focused on the maintenance of stable inflation and sound inflation expectations and continuation of the policy of stable Denar exchange rate relative the Euro, with adequate level of foreign reserves having on its disposal.

2.4.3. Monetary and Exchange Rate Policy

The monetary policy, as an integral component of the macroeconomic policy, created an environment for sustainable economic development through maintaining low and stable inflation rate. For the purpose of price stability maintenance, as core and legally defined objective of the monetary policy of the National Bank of the Republic of Macedonia (NBRM), the strategy of targeting the nominal foreign exchange rate of the Denar against the Euro is still applied. Thus the foreign exchange rate acts as nominal anchor, contributing to price stability maintenance and stable inflation expectations.

Starting from the end of 2007 and in the first three quarter of 2008, in conditions of inflation growth and increased current account deficit (primarily due to the deepening of the trade deficit and reduced net inflows based on private transfers), the monetary policy challenges were concentrated towards stabilization of the inflation expectations and maintenance of the stability of the national currency. In that direction, within the first half of 2008 the NBRM changed the monetary instruments layout and increased the reference interest rate three times, thus contributing for calming the inflation expectations down and stabilizing the movements on the foreign exchange market. The uncertain economic environment, augmented inflation and inflation expectations, as well as the reduced foreign currency inflows on the basis of private transfers, had appropriate reflection on the monetary aggregates dynamics, resulting in deceleration of the growth intensity of the broadest money supply. However, the growing pressure by the competitors, as well as the more active utilization of the additional sources of funds by the banks, enabled maintenance of high growth rates of the private sector crediting (with gradual hindering in the second and the third quarter of 2008).

The developments on the international market, related to the increase in the prices of food and oil, as well as the reduced domestic supply of agricultural products, were the main factors for the inflation movements in the Macedonian economy. The inflation rate was intensifying since August 2007, and it reached 6.1%, annually, in December 2007 (with the average inflation rate in 2007 being equal to 2.3%). The inflation pressures, which continued also in the first quarter of 2008, commenced reducing since the second quarter, which can be explained by higher domestic supply, the common seasonal decrease in the prices of food, effects resulting from the undertaken monetary measures, gradual exhaustion of the low comparison base effect, as well as the decrease in the price of oil on the

international market. Thus the annual growth rate of 10.2% in March, was reduced to 7.1% in September. Cumulatively, in the first nine months of 2008, average annual inflation rate of 9.3% was registered, with the contribution of the prices of food and energy being equal to 86%. The average core inflation rate (without food and energy) for the January - September 2008 period equals 2.7% (compared to 0.7%, on average, in 2007), pointing to possible effects of the increased demand and indirect effect of the rise in the prices of energy and other inputs on the inflation (in September, the annual core inflation is reduced to 1.9%). Until the end of the year, the largest portion of the factors is expected to act towards inflation deceleration (anticipated withholding of the downward trend of the international prices of food and oil and rise in the domestic supply of food), according to which the annual inflation rate would be equal to 6% in December 2008, with the largest risk remaining to be the possible increment of the domestic prices of electricity.

Despite the worsen external position, the undertaken monetary measures, which acted towards calming down the inflation expectations, together with the rise in the capital inflows in the economy, resulted in relatively stable movements on the foreign exchange market, with net purchase of foreign exchange of approximately 2% of the estimated GDP being registered in the first three quarters of 2008 (compared to 6.3% of GDP during entire 2007). Such performances enabled further growth of the gross foreign reserves.

The CB bills with 28-day maturity are the basic instrument in the NBRM operational framework. In 2007, during the CB bills auctioning according to "interest rate tender" principle, additional liquidity of 3.4% of the GDP, through monetary instruments (CB bills and Treasury bills for monetary purposes⁴), was sterilized. On the CB bills auctions held during the year, the demand mainly exceeded the supply, contributing to further decrease in the interest rate, which in November 2007 reduced to the historically lowest level of 4.66% (compared to 5.74% in December 2006). The downward trend of the interest rate on the CB bills ceased in December 2007, when initial measures for monetary policy tightening were undertaken (through gradual increase in the supply of CB bills), which continued more apparently in 2008 after the intensification of the inflation rate, without additional measures being undertaken. Namely, although the enhanced inflation pressures in this period were mainly due to the factors on the side of the supply, the intensification of the core inflation, the risks from the secondary effects of the prices of food on both short and middle-term basis, as well as the growing pressures on the foreign exchange market, imposed need of changes in the monetary instruments layout. Thus in February 2008, the NBRM replaced the "interest rate tender" of CB bills auctions with "volume tender" (unrestricted amount of fixed interest rate), increasing the interest rate on CB bills from 5.08% (as it equaled on the last auction before the replacement of the tender) to 5.25%. The additional adjustment of the interest rate was made in March and May, when it went up by 6%, i.e. 7%, and in June additional measure intended to impede the rise in the credits to households⁵ and restriction of the possible increment in the demand through this channel was undertaken. The registered movements acted towards calming down of the inflation expectations of the economic agents (with certain time delay), which can be perceived through the registered developments on the foreign exchange market and the holdup of the negative trend with the private transfers in the third quarter.

The banks' interest rates showed relatively poor responsiveness to the changes in the reference interest rate, thus proving the thesis that the changes in the banks' interest rate policy are mostly triggered by the growing competitiveness and the banks insisting to ensure larger market share. Namely, the trend of lending interest rate reduction, which can be explained by increased competitiveness, strong growth of the deposit base, the stable macroeconomic environment, as well as the improved efficiency of the

⁴ Since March 2008, in cooperation with the Ministry of Finance, the NBRM commenced issuing Treasury bills for monetary purposes with maturity of up to three months, intended for sterilization of the structural excess liquidity on a longer-term basis. In 2008, gradual decrease in the supply of these securities started, and their use as monetary instrument ceased.

⁵ On June 12, 2008, the NBRM adopted a Decision on the compulsory deposit thus obliging the banks and savings houses to allocate compulsory deposit with the NBRM, if their growth in the households loans exceeds the anticipated growth rate, which in the Decision are given for each day on cumulative basis compared to the stock of the households' loans on May 31, 2008. In line with this Decision, the prescribed growth rate of the households' loans in December 2008 equals 40%, with the NBRM paying interest on the compulsory deposit of 1%, annually.

banking sector have been characteristic for the last several years. On the other hand, the deposit interest rates register permanent rise, reflecting the banks' policy for providing larger market share. Despite the increase in the reference interest rate of the NBRM in 2008, the average interest rate on extended Denar loans of 9.9% in December 2007 (10.7% in December 2006), reduced to 9.6% in August 2008. Simultaneously, the average interest rate on Denar deposits registered increase to the level of 6% in August 2008 (compared to 5.3% in December 2007 and 4.4% in December 2006), which regarding the growing inflation pressures in this period, reflects the banks' insisting for maintenance of favorable real interest rates for the purpose of attracting additional deposit potential. However, the analysis of the interest rate dynamics on the newly extended loans within the same period, shows changes towards rise in the price of certain credit categories (the largest increase in the interest rate was registered by the short-term households' currency indexed loans), thus suggesting that despite the limited transitional effect from the reference interest rates to the banks' interest, it still influence on the formulation of the banks' interest rate policy.

The banks' total deposit potential, as primary source of financing of their activities, registered dynamic growth in 2007, which was supported by the stable macroeconomic environment, high foreign exchange inflows from abroad, attractive interest rates on savings instruments, as well as the strengthen confidence in the banking sector. In 2007, the share of the total deposits (with transaction deposits) in the GDP went up by 7.6 percentage points, annually and it equaled 45.8%. The rise in the deposit base continued also in the first nine months of 2008, although with slower dynamics, with the annual growth rate of the private sector's total deposits (with transaction deposits) in September 2008 being equal to 24.6% (32.1% in December 2007). The slower growth of the deposit base can be explained by the enhanced inflation pressures in this period, the downward trend of the current transfers from abroad, as essential factor in the creation of new deposit base, outflows from the enterprises' deposits for payment of dividends, as well as by the developments on the financial markets, especially on the stock exchange, where the change in the investors segment resulted in outflow of portfolio investments. On the other hand, the high nominal rise in the wages and generally, the increase in the economic activity, enabled continuous maintenance of relatively high growth rates of the deposit potential, and thus money supply.

The increase in the inflation and the inflation expectations and the uncertain economic environment caused moderate changes in the currency structure of the total deposits (without transaction deposits) in direction of augmented participation of the foreign currency deposits (from 53% in December 2007 to 55.6% in September 2008), thus indicating cautious behavior of the economic agents in order to avoid the potential risks. Observed from the maturity structure, the short-term saving still explains the largest share of the newly created deposit base (with a share of 73.6% in the cumulative increase in the total deposits for the January - September 2008 period), given the continuing rise in the share of the long-term deposits.

The intensive increase in the banks' credit activity, evident in the last several years, was characteristic also for 2007, and continued in the first nine months of 2008. Thus the share of the credits placed with the corporate sector in the GDP in 2007 equals 36.4%, i.e. it augmented by 7.5 percentage points, compared to the previous year. Although the financial deepening is inevitable process for a country in the process transition, however, if this process develops fast, it can result in imbalances in the economy, especially when a significant part of the extended bank credits are intended for financing the households' personal consumption. In the last several years, the rise in the available income and its influence on the creditworthiness of the sector households, the gradual relaxation of the crediting conditions in this segment, as well as the increased capacity of the banks for extending credits, enabled the households' credits to continually register high growth rates, increasing their share in the total credit portfolio. In terms when large part of the crediting of the sector households is due to the increase in the consumer loans, such financing of the personal consumption additionally stimulates the inflation pressures and contributes to worsening of the balance of payments' current account. Having in mind the enlarged presence of the macroeconomic risks from the beginning of 2008, in direction of their relaxation and maintenance of the monetary and financial stability in the country, in March 2008, the NBRM undertook certain prudent measures, and in June 2008 Decision on allocating compulsory deposit with the NBRM was adopted, if the households' credits exceeds the envisaged growth. In such conditions, since the beginning of 2008 continuing impediment of the annual growth rate of the total

households' credits is characteristic, and it equals 47.6% in September 2008 (compared to 56.4% in December 2007 and 58.9% in March 2008). Simultaneously, the annual growth rate of the total credits of the banks with the private sector, which reached 44.1% in April 2008, in September 2008 reduced to 38.4%.

The analysis of the currency structure of the placed credits shows dominant contribution of the Denar loans (including the foreign currency indexed loans) in the increase in the total loans (of 78.9% Denar loans for the January - September 2008), while from the aspect of the maturity structure, movements towards enhanced crediting on short-term basis are registered. Thus for the first nine months of 2008, the short-term credits explain 42.6% of the cumulative increase in the total loans (in 2007, 32.3% of the annual increase in the total credits was generated from the increase in the short-term credits), which is mainly due to the enhanced short-term financing of the corporate sector. However, the share of the long-term loans in the structure of the enterprises' loans maintained stable (55.1% in September 2008), thus signaling banks capacity to respond to the enhanced investment needs of the corporate sector, which will mean support also of the future perspectives for investment and development of the economy as a whole. In September 2008, the total enterprises' loans surged by 33%, annually. From the aspect of the sources of financing of the banks' credit activity, in conditions of weaker accumulation of deposits, as primary source, the banks are more relying on the additional sources of financing, which primarily include redirectioning of the foreign currency assets in function of credit activity finance, strengthening of the capital position, as well as occasional moderate foreign indebtedness.

With regard to the low integration level in the international financial flows, there is no direct effect of the financial crisis on the domestic banking system, with the consequences from the global crisis being likely to be transferred through the real sector of the economy. However, the significant liquidity contraction in global terms has secondary effects on the local banks, evident through increase in the costs of external financing. As a result of such movements, besides the increased cost for attracting additional deposit base on the domestic market, in terms of high competitive pressures, the banks are insisting more on enhancement of its deposit potential, as the most stable source of financing.

2.4.4. External sector

In 2007, deficit on the balance of payments' current account of 7.2% of the GDP was registered, which is worsening of 6.3 percentage points compared to 2006. The registered deficit is reflection of the negative gap significant broadening in the trade in the last quarter of 2007, opposite to the low deficits in the first three quarters of the year. Such a dynamics in the current account almost fully reflects the deterioration of the trade conditions, i.e. increase in the world prices of oil, given simultaneous drop of the prices of nickel on the international market, as well as the reduced inflows from private transfers as one of the basic surplus category. In environment of high import and energy dependence of the Macedonian economy, but given more favorable movements in the first half of the year, the foreign trade balance increased by 0.2 percentage points of the GDP and it equaled 20.3% of the GDP at the end of 2007. The foreign trade movements were supported by the movements of the real effective exchange rate, which calculated according to three types of deflators (consumer prices, index of the producers of industrial products and labor cost unit), registered annual depreciation of 2.3%, 3.3% and 13.9%, respectively, pointing to improved competitiveness of the Macedonian products on the international markets. The private transfers reached 17.1% of the GDP and enabled trade deficit coverage of 84.1%. However, their annual growth rate of 7.1% in 2007 (compared to the annual growth rates of 15.4% and 39.7% in 2006 and 2005, respectively), points to reduced growth, which is mainly due to the lower inflow based on private cash transfers through informal channel, estimated through the net cash from the currency exchange operations, which is canalized in the banking sector and dictates the dynamics of the total private transfers. Such impediment was characteristic for the fourth quarter of 2007, when negative annual rates for the first time since 2004 are registered, mainly due to the increased uncertainty conditioned by the political developments in the country and in the region. With respect to the income, among other current account components, higher net outflows were registered, corresponding to the higher foreign investments, in conditions of favorable movements with the services sub-balance.

The current account deficit in 2007 was financed from the net inflows on the balance of payments' capital and financial account, which mainly arises from the non-debit financing (foreign direct and portfolio investments), apart from the realized net outflows on the basis of early repayments of a significant part of the external public debt (full repayment of the debt to the World Bank, the repayments of the debt to the Paris Club of Creditors, repayments of the total debt to the International Monetary Fund and EIB). The inflows based on foreign direct investments reached Euro 506.9 million, and went up by approximately 4.2 times (if the effect of the ESM privatization in 2006 is excluded), thus reaching 8.8% of the GDP. The analysis of the foreign investors shows that the largest part of them originate from Hungary (14.4%), Slovenia (11.9%), Serbia (10.7%) and Greece (8.8%), while the most attractive investment sectors are the telecommunications (26.6%), financial intermediation (24%) and metal industry (17.8%). The inflows based on portfolio investments reached Euro 114.4 million (the share of which in the GDP equals 2%) and they are higher by 56.4%, annually, in conditions of enhanced interests of the foreign investors for purchasing domestic ownership securities (with exception to February and December, when net outflows with this category are registered). The augmented foreign exchange inflows in 2007, besides the early repayment of a significant part of the public debt, enabled increment of the gross foreign reserves of Euro 107.7 million, and on December 31, 2007 they reached Euro 1,524.4 million, thus providing 3.8-month coverage of the import of goods (fob) and services for the following year (according to the import projection from November 2007), opposite to 2006, when the coverage of the registered import in the following year equaled 4.1 months.

Starting from 2007, the NBRM commenced preparing and publishing data on the gross external debt, referring to 2004 - 2007 period. In conformity with the new methodology, the gross foreign reserves represent stock on certain date of all future liabilities of residents to nonresidents, which include liabilities based on principal, arrears based on principal and interest, as well as calculated late interest, regardless of the type of the instrument and the maturity. At the end of 2007, the gross external debt amounts to Euro 2,711.5 million, which is annual increase of 8.7%. Observed from the institutional aspect, such movement of the external debt is conditioned by the constant rise in the external debt primarily with "other sectors" category (nonbanking financial intermediations, nonfinancial trade companies, households and nonprofit institutions), the banking sector and intercompanies debt, which fully neutralizes the decrease in the gross external debt of the Government sector (early debt repayments to certain foreign creditors, stated afore) and the monetary authority.

In the first seven months of 2008⁶, in conditions of stagnation of the global economic activity, constant tensions on the international financial markets in combination with continuous inflation pressures and general high level of uncertainty, the Macedonian economy continued to grow intensively, led by strong domestic demand. The combined effect of the enhanced domestic demand, given intensified growth of the investment activity and unfavorable trade conditions (decrease in the prices of nickel on the international markets and rise in the world energy prices) reflected on the foreign trade, thus resulting in widening of the negative trade balance. Also, the continuous negative dynamics of the private transfers, initiated in the last quarter of 2007, stimulated by uncertain economic environment and growing inflation expectations, also contributed to negative movements on the current account. Namely, during the analyzed period, the private transfers plunged by 10.4% annually, which is due to the annual decline in the cash inflows through informal channel, in conditions of increase in the remittances and other transfers. The negative balance on the current account in the January - July 2008 totaled Euro 488 million, compared to the same period of the previous year when deficit in the amount of Denar 72 million was recorded.

According to the latest data pertaining to the foreign trade (SSO), in the January - August 2008 period, the foreign trade deficit dropped by 94.8% annually, in conditions of significantly slower increase in the export of goods (12.4%) compared to the more intensive annual rise in the import of goods (36.8%). On the side of the export of goods, oil derivatives were the basic driving forces of the registered growth (contribution in the total rise of 35.9%) as a result of the augmented price of oil on the international stock exchanges and enhanced foreign demand, as well as the higher import of ore and clothing and textile, with a contribution of 26.5% and 13%, respectively. On the other hand, the reduced export of metal industry, resulting from the decrease in the prices of nickel on the international stock exchanges and

⁶ Last available data on the balance of payments as of July 2008.

transportation problems, is indicated as the main factor for the slower dynamic of the increase in the total export of goods. The significant intensification of the import is a combination of rise in the prices of energy product, high dependence of some of the export industries on the imports, import of equipment and import determined by the increased domestic demand. Namely, the largest portion (38.6% of the total increase) refers to higher import of energy sources, thus verifying the dependence of the domestic economy on energy, while among the remaining part of the imported products, the most significant contribution to the total rise accounts for iron and steel with 14.4% and machines and transport vehicles with 21% (7.3% of which accounts for the import of vehicles). Such import pressures structure, in which remarkable part accounts for the import of machines and equipment, is expected for an economy in the process of convergence, with a decrease in those pressures being expected to reduce on a medium-term basis, given the simultaneous rise in the export capacities of the economy. High concentration of the export-oriented industries, the largest portion of which are completely exposed to changes in the international market prices, points to the need of more serious changes in the export structure, in direction of larger diversification, as a precondition for trade deficit reduction on a longer-term basis.

Analyzed from the aspect of the geographic distribution, the European Union (EU) remained to be the largest trade partner of the Republic of Macedonia with a share of 51.9% in the total foreign trade, which is annual drop of 5.6 percentage points. This decrease, however, is mainly due to the decline in the share of the Macedonian export in the EU (by 6.7 percentage points), while increasing export to the Western Balkan countries, as a result of the undertaken initiatives for interregional trade promotion (CEFTA 2006). The structural share of the import of EU products on the domestic markets, also decreases (by 3.7 percentage points), mostly because of the increased import from the EFTA countries (Switzerland).

Analyzing the real effective exchange rate (REER) dynamics, as an indicator for the competitiveness of the domestic products abroad in the previous years (2001 - 2007), it may be observed that it is characterized by a trend of depreciation which originates mostly from the low and stable inflation in the country. However, having in mind this connection, in the beginning of the year, following the growing inflation, the REER registered appreciation, which started to hinder with the reduction of the inflation pressures. Thus the index of the Denar REER deflated with the consumer price index on a cumulative basis in the January - August 2008 period appreciated by 0.8% (while the appreciation as of the preceding month equaled 1.1%), which is due primarily to the slower appreciation of NEER (of 0.9%), while the REER index of the Denar deflated by the price index of producers of industrial products on a cumulative basis, registered an appreciation (1.4%), which is due to the appreciation of NEER, given simultaneous faster rise of the domestic prices compared to the foreign ones. In the first quarter of 2008, the real effective exchange rate according to product unit labor cost registered depreciation of 8.1%, annually.

The negative balance on the current transactions was completely financed through the growing inflows in the capital and financial account (net inflows of Euro 545.7 million), the largest portion of which (61.4%) originate from sustainable and stable sources, i.e. direct investments, pointing to improved business environment and bigger interest of the foreign investors to investing in Macedonian economy. Relative to the direct investments structure, dominant share of 52.9% accounts for the loans and borrowings between mutually connected entities (in 2007, their share equaled 32.6%), followed by the capital and the reinvested profit (26.2% and 19.1%, respectively). However, the largest part of the direct investments pertaining to loans and borrowings among connected entities are within the sector of untradeable goods, mainly in energy and telecommunications, which can be observed from the aspect of investments in the infrastructure and to improve the economy productivity on a middle-term basis and additionally increase the attractiveness of the country for new investments. On the other hand, large part of the foreign capital poured into the financial system this year, which although directly not belonging to the group of tradable goods, represents better access to financing and implicitly point to larger export promotion. Simultaneously, part of the investments are allocated in the tradable goods sector, in sectors with high export potential, which also mean improvement of the Macedonian export structure.

Besides the net inflows originating from the non-debit financing, during the analyzed period (January - July 2008), net inflows were registered also in currencies and deposits and trade credits categories, as well as net foreign indebtedness on the basis of long-term credits and borrowings, arising from the lower

repayments compared to the same period of 2007, when high early repayments of the public debt were made. On the other hand, net outflows on the basis of portfolio investments (in the amount of Euro 16.3 million) were registered, in conditions of lower interest of the foreign investors to invest on the Macedonian stock exchange. The higher foreign investments contributed to increase in the supply of foreign currency on the foreign exchange market, enabling cumulative net purchase of foreign currency by the NBRM on the foreign exchange market and rise in the gross foreign reserves of Euro 157.6 million, and thus on September 30, 2008 they totaled Euro 1,689 million.

Having in mind the so far growth dynamics of the import and the expectations for further decrease in the world price of nickel (having direct impact on the largest exporters), additional widening of the negative trade balance is expected until the end of the year, which together with the reduced inflows from private transfers point to deterioration of the current account deficit, which is estimated to equal about 12% of the GDP at the end of 2008. From the aspect of current account financing, the dynamics of the direct investments is expected to continue and to finance the temporary high current deficit through long-term, stable capital flows, although the uncertainty relative to these inflows is enhanced due to the global economic crisis. According to these anticipated movements in the balance of payments, accumulation of foreign reserves is envisaged in 2008, thus enabling 3.1-month coverage of the import of goods and services for the following year.

The expectations for the slower growth of the EU countries in 2009, including the most significant trade partners of the Republic of Macedonia, would result in decrease in the external demand for Macedonian products, decline in the global demand and price reduction on the international market, with negative effects on the export of Macedonian products on the international markets. From the aspect of the trade deficit, the dependence of the domestic export on imported raw material should be taken into consideration, thus indicating that the effect of lower export will be partially neutralized with appropriate decline in the import of raw materials and energy. Also, having in mind that the so far intensification of the investment activity was accompanied with higher import of machines and equipment, given possible reduction of the domestic and foreign investments, would have suitable effect of lower import of these product categories.

In the following years, gradual improvement in the movements in the balance of payments is expected, in direction of stabilization of the trade conditions, through reduction and normalization of the level of the world prices of energy sources. Contemporaneously, it should be taken into consideration that although the enhanced import of equipment was conditioned by the direct investments in the initial stage, their positive effects on the side of the export with certain delay are expected. Also, regarding the capital and financial account, higher inflows based on the realized liberalization of the transactions with real assets can be expected. Consequently, reduction of the current account deficit on a medium term basis is anticipated.

3. Public Finance

3.1. General Government Budget Balance and Debt

3.1.1. Policy Strategy and Medium-Term Objectives

Defining the guidelines of medium-term economic and fiscal policy is the key in the overall complex project of budget planning, providing for real economic fiscal assumptions on which state budget for the next three years is prepared. Preparation of 2009-2011 Fiscal Strategy of the Republic of Macedonia is in line with both the practice and the methodology of the developed countries, and has proven, so far, as a necessary tool when determining the initial framework for conducting fiscal policy in the coming medium-term period.

Pursuant to the Budget Law, Government of the Republic of Macedonia adopted the Fiscal Strategy within the prescribed deadline and it was basis for preparation of the expenditure ceilings of the budget users within which budget requests were proposed, as well as for preparation of the 2009 Draft Budget of the Republic of Macedonia.

On-going turbulences in the global economy that emerged in the second half of 2008 were immediate aftermath of the global financial crisis, which, according to its features, has already been qualified as economic recession. Effects of the global crisis that commenced in the USA and spread over the countries in the Eurozone, started to be also felt in the Macedonian economy, especially in the real sector. Republic of Macedonia is small and open economy, which more the 60% of the trade realises with the European countries. We have already witnessed the slowed down economic growth, as a consequence of the declined demand, cancellation of export contracts, as well as laying off workers in the metal-processing industry, textile and leather industry.

Thereby, it should be noted that fiscal projects for the coming medium-term period (2010 and 2011) have been revised on these bases, and they incorporate the effects of the global economic crisis, as well as the fiscal effects of the undertaken measures aimed at protecting the Macedonian economy, while in the 2009 Budget the former is not included. Such set projections for the coming medium-term period are based on several main postulates:

- maintenance of macroeconomic stability and stimulation of sustainable growth rates of 5-6% of GDP;
- fiscal adjustment to lead to maintenance of high and controlled level of fiscal deficit and low level of public debt;
- projections on optimal level of revenues, incorporating the effects of the set of preventive measures to help the Macedonian economy and mitigate the consequences from the global crisis and recession;
- projections of expenditures to ensure rational and ear-marked spending and increased investments in road and railway infrastructure, as well as fiscal stimulation of the economic development.

Such defined fiscal projections are closely related to the defined strategic priorities of the Republic of Macedonia in the coming medium-term period, among which the most important are the following:

- intensification of economic activity and competition on permanent basis, with higher employment rates and improvement of the living standard;
- integration of the Republic of Macedonia into both NATO and EU;
- continuation of the fight against crime and corruption and efficient law enforcement;
- maintenance of good inter-ethnic relations and cohabitation on the principles of tolerance and mutual respect, and
- investments in education as basis for creation of increased values in the country.

3.1.2. Actual Balances and Medium-Term Perspectives

Fiscal Developments in 2007

Fiscal developments in 2007 showed conduction of prudent fiscal policy. Despite tax system reforms, revenues in the general government budget were by 15% higher compared to previous year, amounting to 35.3% of GDP. Expenditures in the general government budget increased by 11.1% compared to the previous year, amounting to 34.6% of GDP. General government budget surplus of 0.64% of GDP was realised in 2007. In 2007, projected revenues were overperformed by 11.1%, while projected expenditures were overperformed by 4.8%.

Total revenues in the central government budget amounted to Denar 76,158 million in 2007 or 22.7% of GDP. Compared to the previous year, these revenues surged by 21%, as a result of the improved economic activity of the entities, undertaken fiscal reforms and strengthened capacity of the Public Revenue Office (PRO).

Tax revenues reached the level of 20.7% of GDP. They participated with 90.4% in the total budget revenues in 2007.

Share of personal income tax in the structure of the realised tax revenues was 13.4%, while profit tax participated with 8.9%, value added tax (VAT) with 49.5%, excises with 18.9% and customs duties and the other import duties with 9.3%.

In 2007, revenues on the basis of personal income tax amounted to 2.7% of GDP, being by 5.7% higher compared to the previous year, despite the reduction and unification of the tax rate from 24%, 18% and 15% to 12%.

Such reform contributed to broadening of the tax base, which combined with the strengthened control by PRO, led to reduction of the informal economy and better collection of PIT and tax revenues in general. Positive economic developments, followed by job creation, increase of salaries, as well as reduction of the percentage of employees who did not received salary, contributed, to a certain extent, for better collection of PIT revenues.

In addition, there was a historic increase in the trading with shares on the capital market and higher stock exchange index in 2007, leading to increased capital gain revenues, which participated with PIT revenues with 5.6%. In fact, regarding the structure of these revenues, as usual most of them were realised on the basis of the payroll tax – 61.7%, as well as on the basis of income realised on the basis of contractual agreement (8.1%), tax on dividend income and other income realised on the basis of participation in the profit (4.7%), while the share of revenues on other basis was relatively lower.

Realised revenues on the basis of profit tax amounted to 1.8% of GDP in 2007, and they were higher by Denar 1,190 or by 25.3% when compared with the ones realised in 2006. Increase of these revenues in 2007 was due to the upward economic trend, resulting in increase of profitability of enterprises in 2006 by 30%, on the basis of which profit tax was paid for 2007. In addition, strengthened capacity of the PRO resulted in 33.6% better fiscalisation in the economy and more realistic presentation of the profit by the enterprises. Better fiscalisation and lower profit tax rate contributed to reduction of the grey economy and increase of revenues on the basis of profit tax.

Domestic taxes on goods and services (VAT and excises) participated the most in the structure of the total revenues with 66.2% (13.7% of VAT).

In September 2007, 18% general VAT tax rate was reduced to 5% reduced tax rate for the following products: pharmaceuticals and medical devices, computers and softwares, solar thermal systems and components, and transportation of persons and their accompanying luggage. Fiscal effects from this reform did not significantly influence the level of VAT revenues in 2007, however, they will have effects in future. VAT revenues in 2007 amounted to Denar 32,962 million (9.9% of GDP), and compared to the previous year, they increased by 21%. Such increase was mostly due to the increased final consumption by 8.3% (as a result of the achievements in the economy presented above). Thereby, collected VAT when importing goods in the country surged by 23%, as a result of the increased import of goods compared to the previous year. Increase in the import also reflected on the increase of import duties in 2007 by 14.4%, despite the reduced customs rates.

Excise revenues in 2007 participated with 3.8% in GDP, and they surged by 10.9% compared to 2006.

Such excise revenues were result, above all, of revenues from excise on oil derivatives, revenues from excise on tobacco products, sale of alcohol beverages and passenger vehicles.

Other tax revenues participated with 0.7% in GDP, or they increased by 48.9% on annual level. This increase was due to the inclusion of the fees, introduced pursuant to the Law on Environment Protection, Law on Tobacco and the Law on Health Care.

In 2007, non-tax revenues participated with 1.8% in GDP, and they increased twice in relation to 2006, mostly as a result of the payments on the basis of dividend from AD Macedonian Telecommunications for 2005.

Capital revenues participated with 0.4% in GDP in 2007, being an increase by 47.1% compared to 2006. Capital revenues performance was mainly due to the sale of construction land and flats.

In 2007, total central budget expenditures amounted to Denar 75,441 million (22.7% of GDP), i.e. they surged by 18.7% compared to the previous year. This increase was mainly due to the increase of almost all expenditure items. Regarding the structure of total expenditures, current expenditures participated with 85.7%, while capital expenditures accounted for 14.3%.

Current expenditures amounted to 19.5% of GDP, being an increase by 11.7% compared to the previous year.

Costs for wages and salaries and allowances amounted to 6.8% of GDP in 2007, being almost the same realisation, i.e. an increase by only 0.4% compared to 2006 despite the increased salaries in the public administration by 10% in September 2007. This performance was due to the fact that part of the funds for payment of wages and salaries in education and kindergartens were registered as transfers of grants to the local government (to 42 municipalities that moved to the second stage of decentralisation). Costs related to salaries, wages and allowances as percentage of total expenditures were lower by 5.4 percentage points compared to 2006.

Regarding goods and services, 2.9% of GDP was spent, i.e. 20.3% more compared to previous year.

Funds for transfers, which include subsidies, current transfers and social benefits, participated with 9.1% in GDP in 2007, being an increase by 23.7% compared to 2006. The increase in 2007 was mainly due to the increase of transfers to municipalities, grants to the Pension and Disability Insurance Fund (by 12.7% compared to the previous year) to cover the transitional deficit of the Fund regarding the second pillar of mandatory fully-funded pension insurance.

In 2007, 2.3% were spent for social programmes compared to 2006, while transfers for child allowance increased by 10.2%. Regarding *the reforms* in the Ministry of Defense, Denar 211 million was spent, being almost the same amount spent compared to 2006. Within the public administration reforms, Denar 361 million was spent in 2007, being a drop by 27.9% compared to 2006.

With respect to interest payments in 2007 (0.8% of GDP), there was 9.9% drop compared to 2006. This drop was mainly due to the decreased payments on the basis of interest on external debt by 17.3% compared to the previous year. Interest payments on the basis of domestic debt registered 2.7% decline.

Capital expenditures in 2007 participated with 3.3% in GDP. Projected capital expenditures in 2007 were fully met, being by 89.2% more compared to 2006. Major part of capital expenditures (66.1%) was related to costs for purchasing capital assets.

Trends in the fiscal sector in 2007 initiated low general government budget surplus of 0.6% of GDP.

Fiscal Developments in 2008

Fiscal policy in the course of 2008, reflected through the general government budget, was implemented within the initially planned policies, guidelines and projections, without any significant disorders. This provided for regular financing and performance of the functions of the state at both central and local level, timely financing of legal obligations, continuation and commencement of realization of capital projects and continuation of the policy on active public debt management in the Republic of Macedonia. Such performance in the fiscal policy ensured sound basis for further fiscal consolidation and continuation of the low-deficit policy.

Successful implementation and completion of the fiscal decentralization process provided for overall management, monitoring, control and better transparency of public finance.

Intensification of economic and investment activity, as well as realization of reforms in the tax sphere in the course of 2008, ensured sound collection of revenues, thus providing for continuous realization of the ambitious activities and policies of the Government of Republic of Macedonia.

Budget of Republic of Macedonia			
		in millions denars	
		Budget 2008	Realization 2008
TOTAL REVENUES		144.706	136.669
Taxes and contributions		118.803	115.386
	Tax revenues	81.049	76.854
	Contributions	37.754	38.532
Non Tax Revenues		22.278	18.372
Capital Revenues		1.299	1.393
Donations		2.326	1.518
TOTAL EXPENDITURES		150.371	139.922
Current Expenditures		123.409	119.979
	Wages and Allowances	22.979	20.827
	Goods and Services	21.493	18.833
	Transfers	76.225	77.708
	Interest	2.712	2.611
Capital Expenditures		26.962	19.943
BUDGET BALANCE		-5.665	-3.253
FINANCING		5.665	3.253
Inflow		12.919	10.205
	Privatisation Receipts	3.312	1.642
	Foreign Loans	5.463	2.669
	Domestic Borrowing	2.848	3.136
	Deposits/Additional sources	1.296	2.758
Outflow		7.254	6.952
	Repayment of foreign loans	1.974	1.854
	Repayment of domestic loans	5.280	5.098

In 2008 (period January-December), ***genuine revenues in the Budget of Republic of Macedonia*** were realized in the amount of Denar 136,669 million, Denar 115,386 million out of which were tax revenues and social contributions, i.e. around 85% of genuine revenues.

Good performance of tax revenues during 2008, amounting to 95% of the planned dynamics for the year, spoke in favour of the successful implementation of the tax reform composed of flat tax introduction, tax burden reduction and tax procedures simplification.

Regarding tax revenues, there is evident realization of *Personal income tax* revenues which amounted Denar 8,695 million, whereby regarding the structure of personal income tax, as usual most of the revenues were realized on the basis of the payroll tax of around 63,2%, tax on income realized on the basis of contractual agreement of around 8,3%, capital gain tax– sale of shares of around 3,1%, as well as tax on other earnings of employees in companies, public enterprises, proprietors and other legal entities and natural persons not being budget users and spending units, of around 5%.

Profit tax revenues in 2008 were realized in the amount of Denar 8,580 million, accounting for 95,3% of the annual planned amounts, whereby highest share of these revenues was on the basis of withholding tax from dividend paid to foreign legal entities.

VAT revenues were realized in the amount of Denar 36,173 million, i.e. around 94% of the total projected level. Better performance of VAT was mainly due to the increased VAT collection when importing goods in the country and increased VAT refund.

Excises revenues were realized in the amount of 99,4%, while *Customs revenues* were realized in amount of 84,6% in relation to the planned dynamics, mainly as a result of the increased level of liberalization, as well as the transition period for reduction of customs rates in line with the Free Trade Agreement.

Other tax revenues in 2008 increased, amounting to Denar 2,560 million, accounting for 111,3% in relation to the planned level, where fees paid by legal entities producing or importing tobacco products harmful to health participated the most, as well as the fees paid by legal entities producing or importing tobacco products intended for financing additional agricultural production.

Regarding the realization of total *social insurance contributions* in 2008, sound collection of social contributions was evident, amounting to Denar 38,532 million, being within the projected dynamics of 102%. Employment benefits accounted for 111%, while other contributions were realized in relation to the projected amounts, which was result of the positive influence of the implementation of new processes in contribution collection and carrying out controls at the taxpayers.

Good performance of personal income tax and social contributions in relation to the planned dynamics are indirect indicators of legalization of most of the informal employment.

During 2008, *non-tax revenues* were realized in the amount of Denar 18,372 million, mainly on own accounts of the budget users, while with respect to the core budget, dividend from AD Makedonski Telekom was realized in the amount of Denar 3,784 million, profit of the National Bank of the Republic of Macedonia in the amount of Denar 1,289 million, as well as revenues on the basis of collected road toll in the Agency for State Roads in the amount of Denar 1,943 million.

Capital revenues in 2008 were realized in significant amount of Denar 1,393 million, i.e. 107,3% in relation to the planned dynamics, mainly as a result of the increased revenues on the basis of sale of private and construction land, as well as continuation of the sale of socially-owned flats.

Budget users realized Denar 1,327 million in this period on the basis of donations for financing the envisaged projects.

In 2008, **expenditures of the Budget of Republic of Macedonia** reached Denar 139,922 million or 93% of the initially planned expenditures, including the ones the budget users finance from own sources, generally reflecting lower realization compared to plan due to the poor realization of capital expenditures and unsuccessful realization of tender procedures for several major capital projects, as well as due to restrictive unproductive budget spending.

Analyzed by structure, expenditure performance deviates from the projected dynamics for capital expenditures, reaching 77,6%, as well as expenditures for goods and services, reaching 89,3% in relation to the projected dynamics in the Budget.

Within *current expenditures*, being realized in amount of Denar 119,979 million, Denar 18,855 million was paid for wages and allowances in the public administration, including the effect of salary increase and the strengthened capacity of the public administration in line with the EU integration processes.

Disciplined budget spending was especially evident regarding the expenditures for goods and services, realized with slower dynamics, mainly due to the strictly controlled non-productive spending.

Social budget component, expressed through the social transfers, accounted the most in current expenditures. This included regular settlement of government liabilities in the field of guaranteed social protection of specific categories of people, accounting for Denar 3,959 million, i.e. 98% of the total projected expenditures, the most significant being intended for payment of allowances to socially vulnerable households. In fact, welfare was paid to around 10,000 most vulnerable households during the year in order to mitigate the consequences from price increase, and 29 soup kitchens were opened for providing hot meal for the poorest households.

Regarding regular payment of pensions, coupled with the effects of the last regular and additional increase, in the past year, Denar 33,389 million was allocated for payment of pensions to 273,281 beneficiaries, receiving average pension in the amount of Denar 9,541. Transfers to private pension funds, in line with the pension reform, accounted for Denar 2,491 million. According to the records of the

Agency for Supervision of Fully Funded Pension Insurance, 32,487 persons became members, thus the total number of persons joining the private pension funds reached 195,140. Denar 1,623 million was allocated, through the Employment Agency, for payment of unemployment benefits to 25,137 persons, 1,862 out of which were bankruptcy workers who, pursuant to the law, exercised this right.

Denar 18,638 million was spent for financing health services, and these funds were used within the adopted budgets of the public health institutions and the concluded contracts for financing health services. In this period, Health Insurance Fund regularly settled its outstanding liabilities related to pharmaceuticals and medical supplies it inherited in the public health institutions, i.e. arrears exceeding 60-day maturity were fully settled. Regarding the arrears of public health institutions, Government of the Republic of Macedonia, according to its Decision on Reallocation of Funds Among Budget Users, provided Denar 800 million, as well as Denar 400 million on the next-year budget, to settle these liabilities, contributing to their significant reduction.

Regarding other transfers from the Budget of the Republic of Macedonia, grants were transferred to local government units on regular basis, and Denar 990 million from VAT revenues was transferred to local level in 2008. The rest comprised block grants for financing the transferred competences (payment of salaries and allowances to the employees in local public institutions and operating costs) to 68 municipalities that moved to the second stage of decentralization, earmarked grants for financing operating costs of local public institutions, as well as earmarked grants for salaries and allowances of employees in fire fighting units of the municipalities. During the previous year, activities for awarding subsidies in agriculture were realized with success, whereby subsidies for tobacco purchase were fully realized, as well as the first payment of subsidies for purchase of plant and life stock production, and subsidies for purchase of dairy products and organic production products.

In 2008 Denar 2,611 million was allocated for interest payments according to the depreciation schedules on domestic and foreign borrowing, Denar 1,670 million out of which were interest on foreign borrowing.

Capital expenditures accounted for Denar 19,943 million, being 77,6% of the planned dynamics in the budget. The weaker performance of capital expenditures led to realization of lower deficit in amount of Denar 3,253 million or 0,85% of GDP, compared to the initially projected one of 1,5%. The realised deficit at lower level than initial projections in 2008 was mainly result of the good performance of all types of tax revenues and, in general, of the slowed down performance of capital expenditures, related to the time necessary to announce tenders, cancelled tender procedures and the time necessary for approval of credits by international financial organizations for financing certain projects.

In 2008, Agency for State Roads executed Denar 2,777 million for investment activities, Denar 2,378 million out of which was credits and Denar 397 million was from own funds, whereby Denar 2,015 million was allocated for completion of Skopje By-Pass – first and second stage, and the rest was allocated for the construction of the third lane on Prilep-Gradsko and Zirovnicki Most-Boskov Most section.

At the same time, envisaged capital projects in certain sectors were realized, as follows: construction of 17, out of the envisaged 50 football fields, to be fully complete next year, 9, out of the envisaged 35, new sports halls became operational, construction of sports hall "Boris Trajkovski" was completed, embassy buildings were purchased in Prague, Vienna and Moscow, construction of the embassy in Ankara commenced, procedure for signing contracts for purchase of the embassy in London is in progress, thus realizing significant savings on the long run. In the area of culture, construction of the Old Theatre is ongoing, as well as the construction of the museum complex Macedonian Struggle – VMRO Museum and Victims of Communism Museum, Memorial House of Mother Theresa, extension of NULM "St. Kliment Ohridski", as well as realisation of the projects on 120 volumes of Macedonian literature, translations of expert and scientific books and textbooks from renowned universities in the USA and England, and translations of literature works of Nobel Prize winners. Regarding education, the biggest investment project Computer for Every Child, continued to realise, providing around 18,000 PCs for all primary and secondary schools, covering 2/3 of the needs of schools, and there were investments in improvement of the educational infrastructure, rehabilitation of all sanitary knots, renovation of school inventories and student dormitories.

Realized inflow in amount of Denar 10,205 million was mainly from disbursements of foreign loans in the amount of Denar 2,669 million, revenues from concessions in amount of Denar 1,231 million (on the

basis of the single compensation from T-mobile and Cosmofon for 3G technology utilization), privatization revenues in amount of Denar 367 million, as well as deposit withdrawals from the National Bank of the Republic of Macedonia in the amount of Denar 2,758 million, thus ensuring regular repayment of principal of external and domestic debt of the Republic of Macedonia in amount of Denar 6,952 million.

Medium-Term Fiscal Framework

Process of successful implementation of the fiscal consolidation, which started in the previous period, will continue in the coming medium term, expressed through a slightly higher, but controlled fiscal deficit. However, fiscal consolidation, especially in 2009, when the consequences of the economic crisis will be the most evident, will certainly have to be realized in specific and risky conditions. In fact, measures undertaken, aimed at facilitating the Macedonian economy in the process of coping with the consequences of the crisis, will have fiscal effect on the revenue and expenditure projections in the coming medium-term period.

Fiscal framework for the coming period is defined on the basis of the effects from the undertaken measures and the guidelines for the Government activities and it creates real basis for designing the economic policies, having in mind the pending challenges posed by integration processes.

Realization of the planned medium-term fiscal policy is directly conditioned by the negative effects of the global economic crisis, the fiscal effects from the last set of measures of the Government of the Republic of Macedonia and the projected macroeconomic indicators, including the achievement of the following challenges and assumptions:

- successful coping with the negative repercussions from the global economic crisis, attaining long-term economic growth, mainly through further improvement of the working climate, the business environment, as well as ensuring special conditions for high level of realization of increased investments;
- successful implementation of tax reforms through further harmonization of the national legislation with the Acquis, especially in the field of indirect taxes and application of low tax rates, as well as introduction of favorable conditions and incentives for foreign investments, especially for investments in the economic zones, which will provide for increased investments in construction of new schools, roads, water supply, hospitals and IT equipment;
- successful implementation of the policy on reduced social contribution rates by 10 p.p. in the next three years (from current 32% to 22%), which together with the integrated collection of all contributions and personal income tax will provide for further reduction of the total costs of companies, improvement of their competitiveness, as well as unemployment and grey economy reduction;
- successful realization of the planned policies for the coming period in conditions of reduced revenues, as well as full realization of capital public investments to the end of fiscal impetus for the economic development;
- efficient utilization of credit funds earmarked for the cadastre reforms, reforms in the judiciary, social protection, health and education, municipal development, irrigation rehabilitation and improvement of business environment, as well as the available resources from EU pre-accession funds that will provide new job creation;
- measures of the Government of Republic of Macedonia for alleviation of consequences from the global financial crisis (starting from 2010).

Medium-Term Projections of the Budget of Republic of Macedonia

Regarding the coming medium term, projected revenues and expenditures in the Budget of Republic of Macedonia, including the central government budget and the budgets of the Funds, ensure controlled deficit level of 2,8% of the projected GDP. Attaining such deficit level, in conditions of full realization of capital investments, especially in the road and the railway infrastructure, will provide for an impetus to the economic growth, as solid basis in the integration processes.

CONSOLIDATED GENERAL GOVERNMENT BUDGET	2008	2009	2010	2011
(millions denars)				
Consolidated general government budget -Revenues	155.127	162.194	165.463	169.774
% of GDP	40,7	39,0	34,7	32,3
Consolidated general government budget - Expenditures	160.792	173.776	178.934	184.296
% of GDP	42,2	41,7	37,5	35,1
Consolidated general government budget- Deficit	-5.665	-11.582	-13.471	-14.522
% of GDP	-1,5	-2,8	-2,8	-2,8
Central Budget - Revenues	92.607	99.522	101.274	105.208
% of GDP	24,3	23,9	21,2	20,0
Central Budget - Expenditures	94.956	109.604	112.555	118.457
% of GDP	24,9	26,3	23,6	22,6
Central Budget - Deficit	-2.349	-10.082	-11.281	-13.249
% of GDP	-0,6	-2,4	-2,4	-2,5
Extra-budgetary Funds - Revenues	40.668	40.717	40.760	40.819
% of GDP	10,7	9,8	8,5	7,8
Extra-budgetary Funds - Expenditures	43.984	42.217	42.950	42.092
% of GDP	11,5	10,1	9,0	8,0
Extra-budgetary Funds - Deficit	-3.316	-1.500	-2.190	-1.273
% of GDP	-0,9	-0,4	-0,5	-0,2
Local Government Budget - Revenues	21.852	21.955	23.429	23.747
% of GDP	5,7	5,3	4,9	4,5
Local Government Budget - Expenditures	21.852	21.955	23.429	23.747
% of GDP	5,7	5,3	4,9	4,5
Local Government Budget - Deficit	0	0	0	0
% of GDP	0,0	0,0	0,0	0,0
Gross Domestic Product	381.190	416.230	477.501	525.232

Projected Revenues in the Budget of the Republic of Macedonia

Revenues of the **consolidate government budget** (including the central government budget and the local government budget) in the next three-year period decline relatively as a share of GDP, from 40,7% of GDP in 2008 to 32.3% in 2011. Projected decrease is mainly result of the reduction of the tax burden on the basis of reduced taxes and social contributions, as well as the effect from the measures undertaken to help the Macedonian economy in coping with the global crisis, which will provide for reduction of the total costs of the Macedonian enterprises, as well as space for freeing available resources and their focusing on increased investments and job creation that would directly accelerate the development of the national economy.

Projections of genuine revenues in the Budget of Republic of Macedonia in the coming medium-term period are mainly based on the realized and revised revenues in the current 2008, as well as on the need to revise the projected revenues with the effects from the measures for coping with the crisis, which will mostly reflect on the expected revenues from the profit tax and the VAT. Thereby, when projecting the revenues, effects from the previous and future envisaged reforms in the tax area are taken into account, as well as the effects from implementation of the policy on reduced social contributions, as follows:

- successful implementation of reforms in the tax area presented through simplification and shortening of tax procedures and the effects from the introduction of the flat tax, giving the initial results seen in the increased collection of revenues. At the same time, projections of tax revenues for the next period also take into account the effect from the legal changes related to the tax on profit, which will be taxed only if distributed as dividend, as well as the declined inflow of revenues on the basis of VAT in conditions of significant reduction of oil price;

- functioning of the Large Taxpayers Office within the Public Revenue Office and provision of electronic services for the large enterprises for submission of tax forms, as well as the envisaged expansion of the capacities of the existing portal – e-tax services for electronic submission of tax returns by small and medium taxpayers, largely contributing to simplification of procedures and having positive impact for their increased collection;

- continuation of the activities aimed at further harmonization of the legislation and strengthening the administrative capacity of the customs authorities in implementing the customs legislation and fight against cross-border crime. Full implementation of one-stop shop system will provide for shortening the procedures and reducing the number of document necessary when importing and exporting goods, while creation of possibility for electronic application for obtaining the necessary licenses and quotas will to a great extent reduce the time necessary for application processing. Projections for customs duties envisage the effect of the recent government measures for reducing customs duties on raw materials for the needs in the trade, the economy and the information society;

- implementation of government policy on reduced social contributions by 10 p.p., harmonization of minimum bases for payment of social contributions and integrated collection of all types of contributions and personal income tax by one of the competent institutions, will largely provide for reduction of the operating costs and simplification of the procedures and administration costs.

Having the above-mentioned in mind, total revenues for the period 2009-2011 are projected to around 33% of the projected GDP. Thereby, tax revenues still account for the most in the structure of projected revenues with around 60%, while social contributions dropped from 24,7% to 23,6%, as a result of the planned measures for their reduction to the end of increased investments and job creation.

Non-tax revenues in the next medium-term period account for around 11% in overall revenues, and the most significant is the share of revenues on the basis of administrative fees and fines and revenues from road tolls and registration of vehicles generated by the Agency for State Roads. As a result of the measures undertaken for more efficient collection of road tolls, share of the revenues of the Agency for State Roads is expected to grow in the next period.

Projection of the revenues of the Budget of the Republic of Macedonia, with regard to foreign donations in the coming period, include the donations that 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

Total expenditures in the period 2009-2011, in conditions of rational management of public finances at all government levels, according to the planned policies and low level of budget deficit, decline as a share of GDP from 42,2% in 2008 to 35,1% in 2011.

Expenditure side of the Budget of Republic of Macedonia in the next period is fully created in terms of achieving the strategic priorities of the Macedonian Government, i.e. expediting the economic growth and integration processes in EU and NATO.

Expenditure projections in the state budget for the next medium-term period are prepared on the basis of three key postulates:

- projections of total expenditures in the state budget provide for continuous fiscal consolidation and maintenance of controlled fiscal deficit;
- projected amounts of expenditures provide for smooth performance of all obligations of the state arising from legal regulations, realization of commenced reforms and increased capital investments in infrastructure projects, as well as budget co-financing as a necessary precondition for obtaining and using IPA funds, and
- better expenditure structure of public finances, with a distinguished development component, as compared to current expenditures.

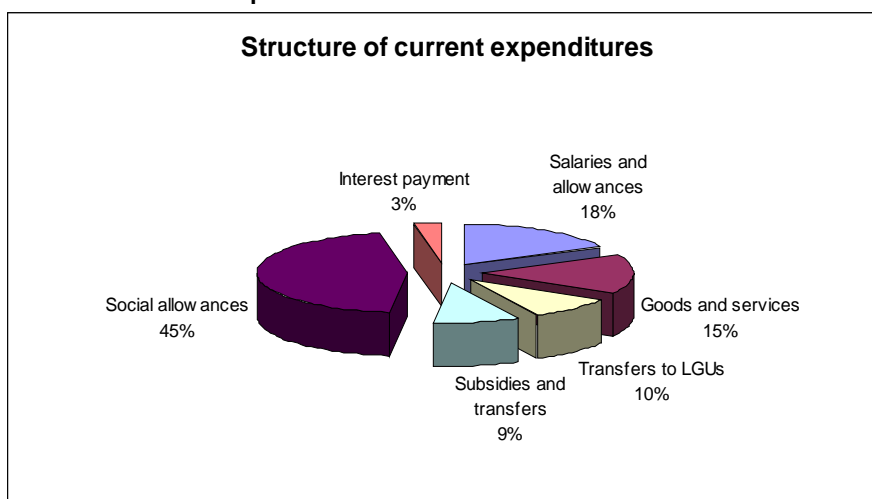
Average share of expenditures in the Budget of Republic of Macedonia in the coming medium-term period is around 35% of the projected GDP, whereby share of capital expenditures is envisaged to increase from 17.7% in 2009 to 18.5% in 2011 in relation to the total expenditures, and share of current expenditures will reduce (from 82.3% in 2009 to 81.5% in 2011). Such change in the structure of public expenditures is a result of the policy of the Government for increased investments in the public sector,

in particular in infrastructure projects, as well as the expected inflow of investments for financing capital projects from both domestic and foreign sources (IPA funds).

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

- expenditures for payment of wages and salaries and allowances include the effects of the gradual salary increase of the employees in state administration bodies by 10% in the coming year, the institutional strengthening of the public administration through new employments related to integration and reform processes, effects of the application of stimulative reward and career measures for the civil servant to the end of keeping well-trained employees in the state administration, as well as full implementation of the second stage of fiscal decentralization;
- within current expenditures, *social transfers* remain to be dominant, accounting for 46,4% in 2009, to increase by 1,1 p.p., mainly as a result of the indexation of pensions and introduction of new rights related to the active demographic policy. Such tendencies are result of reduced social contributions and thus increased transfers from the central budget, the expected reduction of the number of unemployed persons receiving benefits and funds for their financial support, as well as completion of certain reforms. Hence, increased expenditures for payment of pensions are expected, as a result of the undertaken measures for improving the standard of the pensioners, increased expenditures to cover transition costs of the pension reform in conditions of increased number of members in the fully funded pension funds and increased expenditures for health services.

Chart 6: Structure of current expenditures



Source: Ministry of Finance

Around 80% of the total expenditures of the Pension and Disability Insurance Fund refer to payments related to the rights arising from pension and disability insurance. Thereby, expenditures for pensions were projected on the basis of the estimated growth of the number of pension beneficiaries and the calculated pension indexation in accordance with the projected indicators of the growth of costs of living and the salaries in the next medium-term period, as well as the effect from the additional increase of pension.

Around 94% of the total expenditures of the Employment Agency in this period will be intended for payments on the basis of rights arising from unemployment, whereby, when doing the projections, what was taken into consideration was the expected reduction of the number of persons exercising these rights, the projected costs arising from the implementation of the structural reforms and the public administration reform.

In the next medium-term period, around 95% of the total expenditures of the Health Insurance Fund will be focused on services and allowances arising on the basis of health insurance of the population. Within these frameworks, the share of costs for hospital treatment and costs for primary healthcare prevail.

Within the medium-term projections of social transfers, funds were planned for regular coverage of obligations of the state towards the socially most vulnerable families in the form of social welfare, child allowance, allowances on the basis of the rights of disabled persons, invalids of war and civilian invalids and asylum seekers.

Planned reforms in the agriculture will create conditions for construction of an efficient and competitive agricultural sector and its successful integration in the EU. These reforms will be successfully realised only through increased financial support to farmers, provision of credit lines from the Agricultural Credit Discount Fund and development of the market for purchase of agricultural products by establishing new Points of purchase and distribution. Therefore, *subsidies to farmers* are envisaged in the amount of EUR 70 million in 2009, EUR 100 million in 2010 and EUR 115 million in 2011. With regard to *transfers*, increased funding is projected for implementation of the self-employment project, as well as awarding new and revolving credit funds with low interest for opening small businesses.

Improvement of the *decentralization* process will continue in the coming period through full inclusion of the municipalities in the second stage of fiscal decentralization, and accordingly transfers are projected through increased block and earmarked grants, necessary to cover municipal costs. Effect from increased revenues for financing the competences of the municipalities through the property taxes, concessions in utility fees and environmental fees will result in increase of the fiscal capacity of the municipalities and improvement of the quality and the quantity of the services in the public sector.

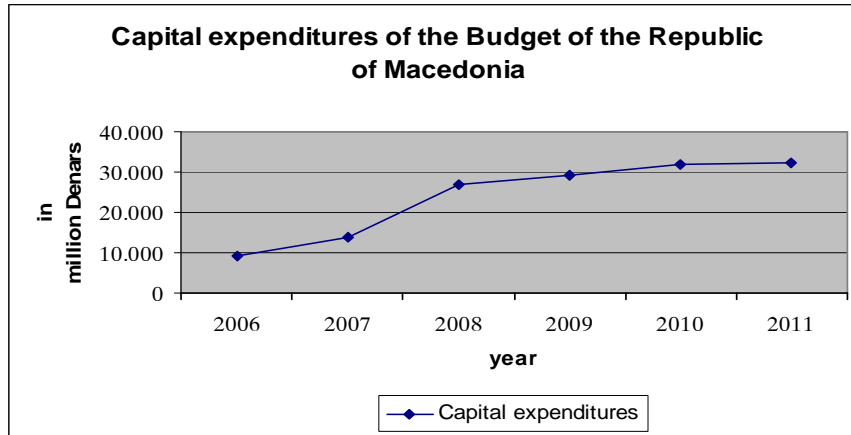
The necessity for public investment intensification, due to its positive influence on the economic activity, led to increase of planned investments principally in road and utility infrastructure, state penitentiary institutions, for improvement of the shape of educational and health system, as well as for advancement of the cultural and social life of citizens. In the field of road infrastructure, Agency for State Roads, within the budget resources, will continue the construction of Corridor 8 road sections: Radovis-Strumica, Gradsko-Prilep (3 lanes), Kozuf ski center, Ohrid by-pass, Krklino entry in Bitola, Kolomot-Blizansko, Sun City, Tetovo-Jazine, Kuklis-Bankso. Funds from World Bank credit line will be aimed at rehabilitation of 11 regional roads (Ilinden-Kalugerac, Pzanicinp-Sv. Nikola-Susica, Lakvica-Negotino, Davidovo-Rabrovo, Stracin-Probistip, etc.), while EBRD credit funds will be used for construction of 9 regional roads (Argulica-Zrnovce, Vasilevo-Angelce, Radovis-Konce, Struga-Debar, Kavadarci-Musov grob and Demir Kapija-Musov grob).

At the same time, funds are allocated for expropriation-related activities on Corridors 8 and 10, Miladinovci-Stip and national and regional roads, as well as for preparation of project and technical documentation for certain road sections.

In the coming period, additional funds will be provided for construction of railroad tracks – Corridor 8 towards Bulgaria, continuous maintenance of the existing railway infrastructure, as well as for coverage of unprofitable public transportation.

Total amount of capital investments also includes funds for improvement of education infrastructure through construction of 100 new schools, continuation with the projects in health sector, procurement of medical equipment, reconstruction of 45 health institutions, electronic health card and information system in public health institutions, construction of outpatient departments in rural areas, etc.

Chart 7: Capital expenditures of the Budget of Republic of Macedonia



Source: MoF

Projected Deficit and Its Financing

The Budget of Republic of Macedonia in the next medium-term period will be characterised with controlled level of deficit of 2,8% of the projected GDP, including the central budget deficit and the deficit of the Agency for State Roads.

Central budget deficit in the period 2006-2008 is projected at around 2% - 2,4% of the projected GDP (including credit disbursements by budget users to their own accounts in the amount of around 0,7% of GDP).

Projected deficit of the Budget of Republic of Macedonia in the medium-term period will be mainly financed from domestic sources via continuous issues of government securities and bonds, usage of government deposits and eventually from foreign loans. At the same time, foreign loans as a source of financing such as World Bank credits and credit lines will be used for financing concrete infrastructural projects

(millions denars)

DEFICIT AND FINANCING	2009	2010	2011
BUDGET BALANCE	-11.582	-13.470	-14.522
FINANCING OF DEFICIT	11.582	13.470	14.522
Inflow	19.689	21.542	23.529
Privatisation Receipts	2.500	1.100	1.100
Foreign Loans	7.155	14.024	17.189
Domestic Borrowing	6.050	6.010	7.005
Deposits / Additional sources	3.984	408	-1.765
Outflow	8.107	8.072	9.007
Repayment of foreign loans	2.271	2.504	2.860
Repayment of domestic loans	5.836	5.568	6.147

Local Government Budget

Budgets of local government units, as annual plans covering revenues, other inflows and appropriations in the coming medium-term period, will become even more important for the successful management of public finances.

New economic classification provides greater flexibility when planning the budgetary funds for

programme realization, and improves the manner of reporting in line with the international standards, as well as the transparency by establishing programmes and sub-programmes. Municipal budget form was harmonized with the one of the state budget. Adoption of budget calendar by the municipalities and observance of the deadlines set therein has proven to be a positive instrument in the overall budget process.

Consolidated management of public finances and application of budget principles in financing the local government units, as well as strengthened financial controls, enable the realization of the fiscal decentralization and proper management of public finances on local level.

Second stage of the fiscal decentralization process commenced in the course of 2007. At the beginning of 2008, financing of the transferred competences to 66 municipalities, which fulfilled the requirements for full fiscal decentralization, is carried out through block grants. These grants also contain the funds necessary for the salaries and allowances to the employees in the local institutions in the field of education (primary and secondary schools), culture (museum, houses of culture, libraries, etc.) and social protection (kindergartens and homes for elderly persons).

Taking into account that local government units cannot borrow in the initial period of the decentralization, planned revenues and expenditures in their budgets are fully harmonized. Thereby, total revenues and expenditures account for around 3.0% of GDP in the first phase of the decentralization process, while after 2008, by transferring block grants from the central budget, which includes salaries of the employees from the delegated competences to local level, revenues and expenditures of local government are expected to rise to around 5.3% of GDP.

Genuine revenues of municipalities are provided from local taxes and fees established by the Municipal Council within the set range of proportionate rates and the municipality makes its own assessment of revenues, and they are informed through the budget circular of the Minister of Finance on the amounts of the transfers from the central budget. Additional, i.e. new tax revenue of the municipalities will be the tax on business immovable property, i.e. taxation of residential buildings in villages and mountainous regions and these changes started applying from 1st January 2008. Pursuant to the Law on Utility Fees, utility fee for street lighting is increased, and pursuant to the Law on Administrative Fees, part of municipal fees is increased, thus increasing the municipal revenues.

Modifications to the laws regulating the utilization of public national goods (mineral raw materials) ensure the municipalities revenues from concessions up to 40% of the set concession fee in cases when public goods being exploited are on their territories. Revenue structure shows significant share of revenues from property tax and utility taxes, as well as transfers from the central government.

In this period, expenditure side of the budget of local government shows significant share of capital expenditures (around 43% of total expenditures), while after the implementation of the second phase of the decentralization, expenditure structure changed in favour of the current expenditures including the salaries of the employees in education, child care and social protection and culture.

3.1.2 Structural Balance

Potential Growth and Cyclical Position of the Republic of Macedonia

One of the main parameters used in projecting the basic macroeconomic aggregates is the potential growth of GDP in the Republic of Macedonia. Two methodologies have been used to calculate the potential output. The first one, which belongs to the group of statistical approaches, is Hodrick-Prescott trend determination. Accordingly, trend value (s^*) is determined by minimizing the gap between the real domestic production (s) and the trend and the variability thereof for the whole sample (T):

$$\text{Min } \sum_{t=0}^T (Y_t - Y_t^*)^2 + \alpha \sum_{t=2}^{T-1} ((Y_{t+1}^* - Y_t^*) - (Y_t^* - Y_{t-1}^*))^2$$

where α is parameter for smoothing the time series. According to literature, the assumption is that the value of the parameter is 30. Thereby, we would like to point out that having in mind the many structural disturbances that occurred in the past period, as well as the external shocks which the Republic of Macedonia was exposed to, together with the long period of transition (i.e. significant decline of the

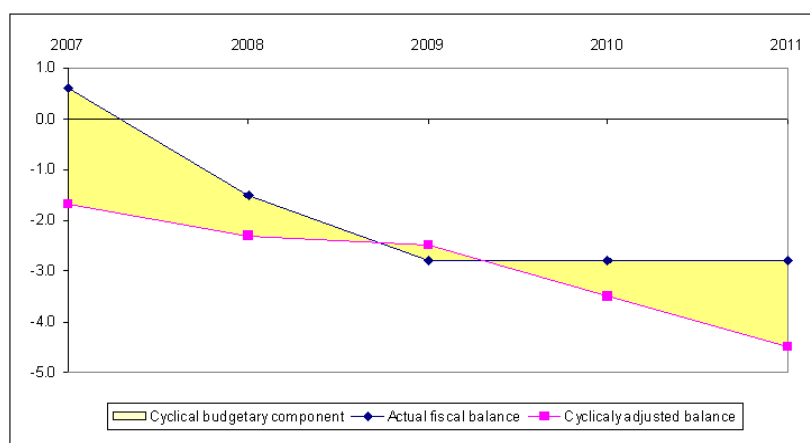
economic activity by 1995), there is a great probability that the Hodrick-Prescott method produces biased results in the case of Macedonia.

	2007	2008	2009	2010	2011
GDP	5,9	6,0	5,5	6,5	7,0
Potential growth	5,1	5,7	6,1	6,3	6,5
Output gap	0,8	0,3	-0,6	0,2	0,5

The estimate shows that potential GDP growth in the period 1999 – 2010⁷ is 4.1%, whereby GDP gap is positive and is 0.1 percentage point, having in mind the current (and the projected) economic growth in this period is 4.2%. GDP growth had (has) slowed down pace in 2007 and 2008 as a result of the positive economic gap. Taking into account that consequence of the global economic crisis are expected to be felt the most next year, it led to lower GDP growth rate compared to the potential in 2009. Such trends of the economy above and below the trend growth path do not show the real fiscal position of the country.

In order to discover the effect of the cyclical fluctuations over the budget balance, we will calculate the cyclical component of the budget, i.e. assume what would have happened with the budget balance should the real GDP had been within its trend growth path, i.e. that there is no gap between the realized (projected) and potential output⁸. Thus, if we remove the cyclical component from the current (projected) budget balance, we obtain the cyclical adjusted budget balance, i.e. the balance that shows more closely the intentions of the authorities, i.e. its fiscal policy. Taking this into account, the results point to the following: cyclical budget component was positive in 2007 and 2008 since the economic growth was/is below the potential, whereby the cyclical adjusted deficit was higher than the realized. In 2009, cyclical component of the budget is negative (-0.3 percentage point), while starting 2010, when the economy is expected to grow with higher rates than the potential economic growth, cyclical adjusted deficit will exceed the projected one. In the period 2009 - 2011, budget deficit is projected at 2.8% of GDP, which is within the Maastricht Criteria (-3% of GDP). Such expansive fiscal policy, implemented through increased capital investments, is expected to instigate economic growth, projected to be below the potential one, thus leading to cyclical adjusted budget deficit of 4.5% of GDP in 2011.

Chart 8: Cyclically Adjusted Budget



Source: Calculations of the Ministry of Finance

Second methodology on determining the potential growth is the structural approach. Thus, according to function production approach, based on the functional relation between GDP and capital and labour force, potential growth is 4.3%. In fact, in addition to historical data, medium-term assessments on growth of employment and investments were used when doing the calculations. Thereby, Hodrick-Prescott filter is applied at all growth components.

⁷ 2001 is excluded due to non-economic developments

⁸ Macroeconomy - Michael Burda, Charles Wyplosz

3.1.4 Debt level and developments, analysis of below-the-line operations and stock-flow adjustments

Legal regulations governing the borrowing of public sector in the Republic of Macedonia encompass the following: Public Debt Law, Budget Law, Law on Local Financing, Public Debt Management Strategy and Manual on the manner and procedure for borrowing by municipalities, public enterprises and companies fully or predominantly owned by the state, the municipalities, the municipalities in the City of Skopje and the City of Skopje.

Public sector can borrow in the form of loans from domestic or foreign creditors or in the form of government securities issues on domestic or foreign capital markets.

Public debt issuers, pursuant to the Public Debt Law, are the following: Government of the Republic of Macedonia, municipalities, municipalities in the City of Skopje and the City of Skopje, public enterprises and companies being fully or predominantly owned by the state, the municipalities, the municipalities in the City of Skopje and the City of Skopje and the National Bank of Macedonia.

Basic objectives of public debt management, pursuant to the Public Debt Law, are the following:

- stable financing of the needs of the state with minimum cost, on medium- and long- term, and with reasonable risk level; and
- development and maintenance of efficient domestic financial market.

Regarding external and domestic borrowing, as well as issuance of sovereign guarantees for external and domestic financing, pursuant to the Public Debt Law, positive opinion must be obtained from the Ministry of Finance, followed by an approval by the Government of the Republic of Macedonia. Furthermore, for external borrowing and issuance of sovereign guarantees for external borrowing, a law needs to be adopted by the Parliament of the Republic of Macedonia.

Borrowing by local government units is regulated pursuant to the Law on Local Financing and the Law on the City of Skopje. Municipal borrowing can be short-term and long-term. Total amount of short-term borrowing cannot exceed 20% of the level of operating revenues realized in the previous fiscal year, while total amount of the long-term borrowing cannot exceed 15% of the level of operating revenues realized in the previous fiscal year.

The borrowing procedure is more precisely elaborated in the Manual on the manner and the procedure for borrowing by municipalities, public enterprises and companies fully or predominantly owned by the state, the municipalities, the municipalities in the City of Skopje and the City of Skopje

A framework for detailed elaboration of the borrowing policy in Macedonia is the Medium-Term Public Debt Management Strategy, adopted by the Parliament of the Republic of Macedonia. It sets the framework for external and domestic borrowing in the period 2008 – 2010 and provides guidelines for improvement of the features of the debt portfolio of Republic of Macedonia.

Regarding the organizational structure of the Public Debt Management Department, it is fully equipped with 11 persons, and comprises the following Units:

- Department for borrowing and investments - Front Office
- Department for public debt management policy and risk analysis - Middle Office
- Department for record, observation and service of public debt obligations - Back Office

The Ministry of Finance has signed an agreement engaging the National Bank of the Republic of Macedonia as its fiscal agent to carry out auctions of government securities and an agreement with the Central Securities Depository for registering, keeping and submitting data on government securities holders.

Public Debt of Republic of Macedonia

Total public debt of the Republic of Macedonia, according to GSF methodology, was in the amount of EUR 1,827.7 million at the end of September 2008, accounting for 28.5% of GDP. According to the same methodology, general government debt amounted to EUR 1,337.8 million, i.e. 20.8% of GDP, being significantly lower in relation to Maastricht criteria, pursuant to which general government debt

must not exceed 60% of GDP. According to 2009-2011 Fiscal Strategy, higher budget deficit is projected in the coming period, subsequently leading to higher public debt. Such increase of the debt is mainly due to new investments in road and railway infrastructure, water supply and sewerage, sports facilities, construction of social flats, as well as investments in education. In addition, more investments are expected in the energy sector, to be realized through borrowing by public enterprises in this sector, by providing sovereign guarantee. These investments will have implications on the level of public debt and it will experience certain increase in the period from 2009 to 2011 by around 9 percentage points in relation to GDP.

External debt accounts for around 57% in the total public debt portfolio, while regarding the currency structure, foreign currency denominated debt accounts for 76.7%. Interest rate structure is balanced, whereby 54% of the public debt portfolio is with fixed interest rates and 46% with floating interest rates (this percent includes the debt with a maturity period of 12 months, including treasury bills and central bank bills).

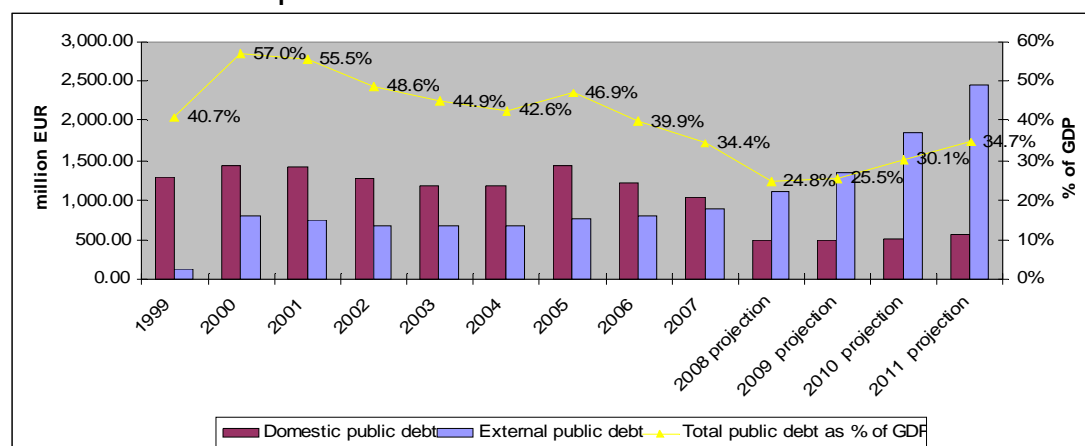
Table 4: Stock of public debt

in million EUR		1999	2000	2001	2002	2003	2004	2005	2006	2007	30.09.2008
EXTERNAL PUBLIC DEBT		1.289,6	1.427,7	1.397,6	1.267,6	1.178,9	1.178,6	1.441,2	1.223,0	1.027,9	1.045,0
General Government Debt		1.024,7	1.153,9	1.191,9	1.089,0	1.005,5	993,2	1.245,4	1.025,2	877,2	886,5
Central Government (consolidated)		1.024,7	1.153,9	1.191,9	1.089,0	1.005,5	993,2	1.245,4	1.025,2	877,2	886,5
Central Government		971,5	1.101,0	1.144,1	1.050,4	972,6	962,3	1.208,0	981,9	841,8	851,9
Public Funds		53,2	52,9	47,8	38,6	33,0	30,9	37,4	43,3	35,4	34,6
Municipalities		0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Central Bank		101,2	87,7	80,3	64,7	54,7	46,0	52,7	42,4	0,0	0,0
Public enterprises		163,6	186,2	125,4	114,0	118,7	139,4	143,2	155,4	150,6	158,5
DOMESTIC PUBLIC DEBT		113,6	791,0	733,3	676,0	665,0	663,9	750,4	806,5	899,9	782,7
General Government Debt		79,9	711,7	681,5	626,9	593,6	589,8	603,7	648,4	552,8	451,3
Central Government Debt		79,9	711,7	681,5	626,9	593,6	589,8	603,5	648,2	552,8	451,3
Municipalities		0,0	0,0	0,0	0,0	0,0	0,0	0,2	0,2	0,0	0,0
Central Bank		33,8	79,3	51,8	49,1	71,4	74,1	146,7	155,3	344,3	327,7
Public enterprises**		N/A	N/A	N/A	N/A	N/A	N/A	N/A	2,8	2,8	3,7
TOTAL PUBLIC DEBT-GFS		1.403,2	2.218,7	2.130,9	1.943,7	1.843,9	1.842,5	2.191,6	2.029,5	1.927,8	1.827,7
Public debt as % of GDP		40,7	57,0	55,5	48,6	44,9	42,6	47,1	40,6	34,4	28,5
Public debt as % of average export		125,6	154,8	165,2	164,7	153,1	136,7	133,6	106,1	74,3	59,8

Source: Ministry of Finance

**Since April 2006, public enterprises began submitting the first reports on public debt stock (in line with the Public Debt Law) to the Ministry of Finance.

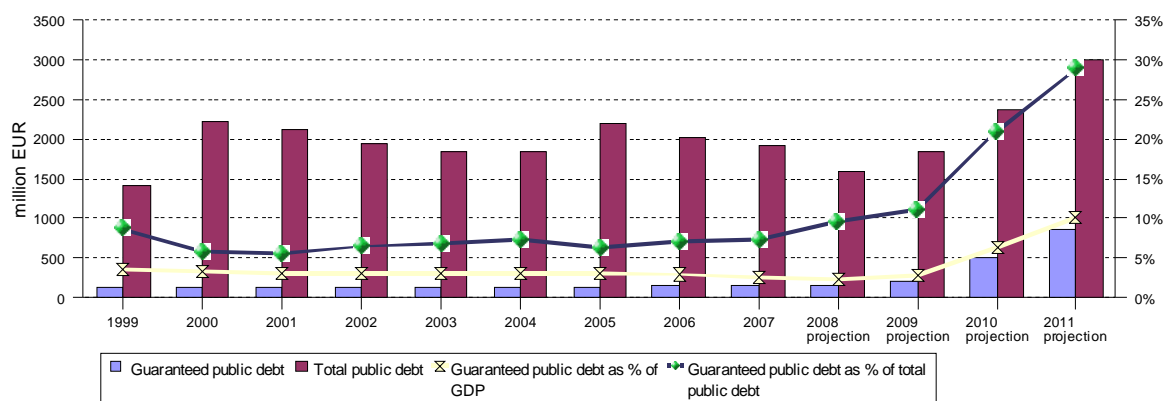
Chart 9: Trends of total public debt in relation to GDP



Source: Ministry of Finance

Issued sovereign guarantees are potential liabilities for the Budget of the Republic of Macedonia, which, on September 30, 2008 amounted to EUR 140.9 million, accounting for 7.7% of the total public debt or only 2.2% of GDP of the Republic of Macedonia.

Chart 10: Guaranteed public debt



Source: Ministry of Finance

Basic principles taken into account when drafting and implementing Public Debt Management Strategy are as follows:

- establishing the optimum structure of debt portfolio and its harmonization with the national macroeconomic policy;
- harmonizing the debt portfolio costs with the ones set in the government budget for each year individually and on medium term; and
- restricting and eliminating the effect of financial risks on public debt sustainability in the medium and the long run.

Public Debt Management Strategy sets the level of total public debt in relation to GDP and the level of guaranteed debt, maximum amount of new borrowing, newly issued sovereign guarantees, as well as currency structure of public debt portfolio.

Table 5: Target set in 2008-2010 Public Debt Management Strategy of the Republic of Macedonia and their realization

Targets	Public debt portfolio parameters as of September 2008*	Targets for 2008 - 2010
	Public debt to GDP ratio	23.4%
General government debt to GDP ratio	20,8%	not to exceed 35%
Total guaranteed debt to GDP ratio	2.2%	not to exceed 6%

Targets	Public debt portfolio parameters as of September 2008*	Targets for 2008 - 2010
Ratio between domestic currency denominated debt and foreign currency denominated debt	Domestic currency denominated debt – 6.5%	Domestic currency denominated debt - 9-18% (with 2 p.p. deviation)
Share of euro-denominated debt in the external debt	64.8%	67-70% (with 3% p.p. deviation)
New borrowing	EUR 137.6 million	EUR 530 million
Newly issued guarantees in 2008	EUR 11 million	EUR 150 million

Source: Ministry of Finance

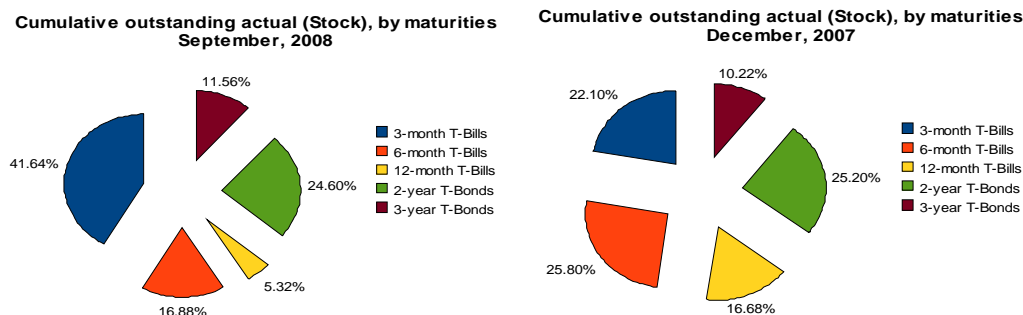
* When monitoring the realization of the targets, NBRM debt was not included in the calculations of the total public debt pursuant to the Law on Modifications and Amendments to the Public Debt Law regarding the Strategy.

Primary government securities market

Activities related to **the development of government securities market** began in 2003 when the Government adopted the Strategy for Development of Government Securities Market. Adoption of this Strategy was basis for initiation of an issue of continuous government securities. In January **2004**, Ministry of Finance successfully launched the first issue of continuous government securities (3-month treasury bills), and as of September 2008, it regularly issues 3, 6 and 12-month treasury bills and 2 and 3-year government bonds. During this period, Ministry of Finance also issued 5-year government bond, and an early buyback was performed in December 2006. Government securities are denominated in Denars and are issued in dematerialized form.

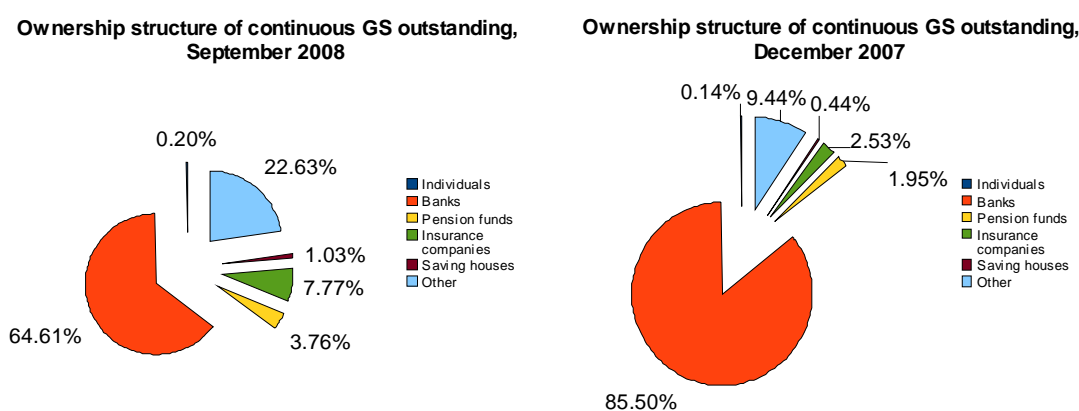
As of September 2006, stock of government securities outstanding was Denar 4.89 billion, Denar 3.12 billion of which were treasury bills, and the remaining Denar 1.77 billion were government bonds. The charts below show the stock of outstanding government securities by maturity period and ownership structure (December 2007 and September 2008).

Charts 11 and 12: Maturity structure of government securities



Source: Ministry of Finance

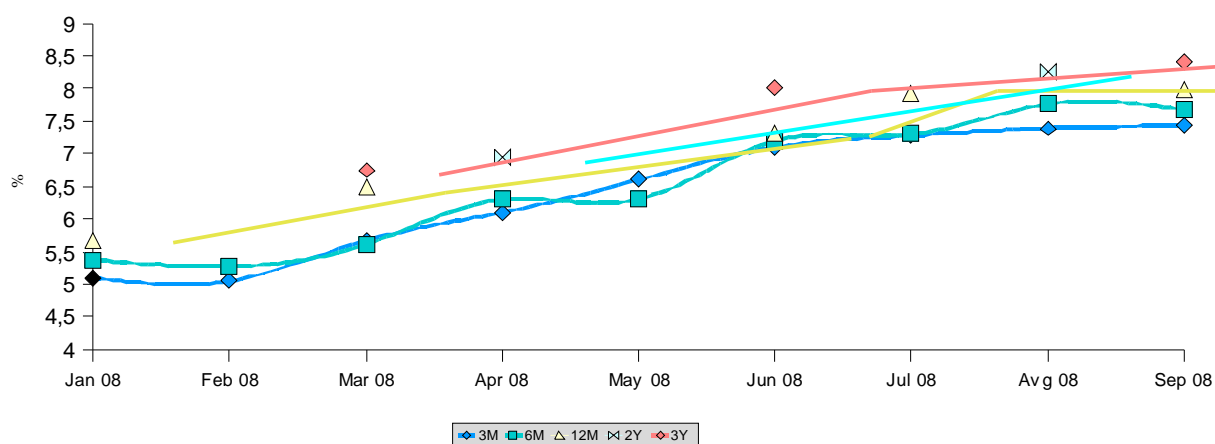
Charts 13 and 14: Ownership structure of government securities



Source: Ministry of Finance

Since introduction of treasury bills, their interest rates are market determined, i.e. they are determined by the demand and the supply on the auctions. The chart shows the trend of interest rates on government securities by maturity period from January 2008 to September 2008. The chart clearly shows continuous upward trend of interest rates on government securities at all maturities, and depending on maturity, interest rates increased from 2 p.p. to 2.5 p.p. at average.

Chart 15: Interest rates of government securities



Source: Ministry of Finance

Secondary government securities market

Existing regulations on secondary trading in the Republic of Macedonia enable trading of government securities on the Macedonian Stock Exchange, as well as trading of continuous government securities on the OTC market.

In April 2005, NBRM, in cooperation with the Ministry of Finance, adopted Rulebook on the Manner and the Procedure for Trading and Settling Transactions of Securities on Over-the-Counter Market. By adopting this Rulebook, over-the-counter market (OTC) for trading of treasury bills was introduced officially, and as of July 2006, it was supplemented by trading in continuous government bonds. In the course of 2007, to the end of further improvement of OTC market, Rulebook on the Manner and the Procedure for Trading and Settling Transactions of Securities on Over-the-Counter Market was amended (Official Gazette of the RM, no. 14/07). National Bank of the Republic of Macedonia, in cooperation with Ministry of Finance, for the purpose of promoting the trading of government securities on the OTC market, made certain changes in the Rules on the Manner and Procedure for Trading and Settling Transactions of Securities over the OTC Market, introducing mandatory listing of government securities in the amount of Denar 1,000,000. Mandatory listing started applying as from March 1, 2007 for government securities, while for government bonds, mandatory listing was introduced on September 1, 2007.

Trading on the OTC market currently incurs no transaction costs. The participating banks earn profit only from the spread between purchase and sale price. Additional advantage of this market is that settlement of transactions is in real time, i.e. immediately after the transaction is executed. As a result of the aforementioned advantages, the number of transactions on this market gradually increases.

This set of measures is undertaken so as to enhance the development of the secondary market.

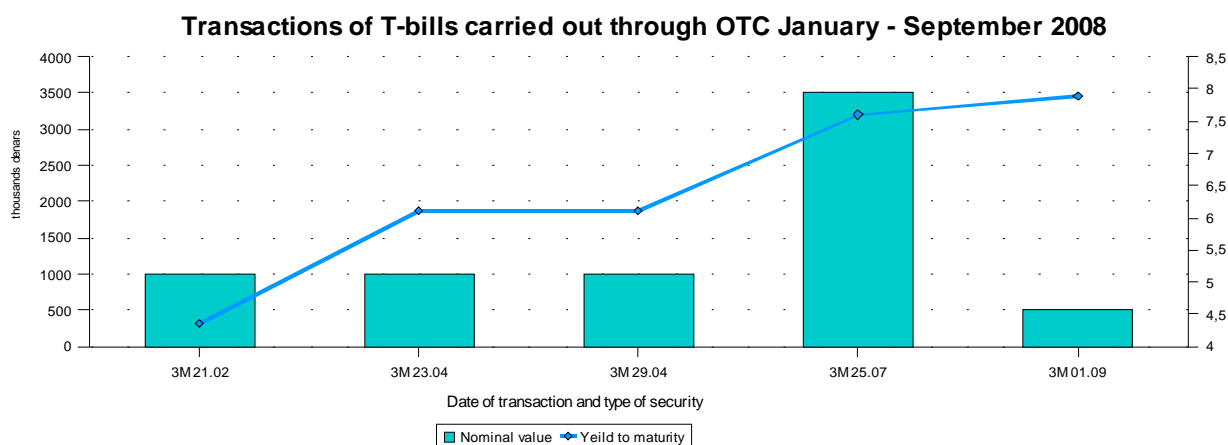
In the course of 2008, in parallel with the development of the primary market, secondary trading of government securities was also developed. Tradings are made on the Macedonian Stock Exchange AD Skopje and the OTC market.

The following is listed on the Macedonian Stock Exchange: structural bonds (seven issues of government bonds for denationalization, old foreign exchange saving bonds and bonds for selective credits) and continuous bonds. To the end of stimulating the development of the continuous government bond market, starting 11 January 2007, Macedonian Stock Exchange AD - Skopje abolished the trading fee on continuous government securities.

During 2008, both government bonds for denationalization and old foreign exchange saving bonds were traded. Total trading volume in the period January-September 2008 amounted EUR 11,344,092, while total trading turnover was realized in the amount of Denar 596,450,195 or EUR 9,703,543.

During the same period, 5 transactions of treasury bills were realized on the OTC market, while there were no transactions of government bonds. Total nominal amount of trading was Denar 7,000,000.

Chart 16: Transactions of T-bills on the OTC market



Source: Ministry of Finance

3.1.5. Budget Implications of Main Structural Reforms

Economic policy of the Government of the Republic of Macedonia is focused on realizing sustainable economic growth and increasing competitiveness of the Macedonian economy by creating favourable business climate, development of knowledge-based economy and intensifying the investment activity, in both the private and the public sector.

In line with this objective, significant amount of funds is allocated to structural adjustment of the Macedonian economy, i.e. for reforms in number of areas, necessary for improving the business climate. This Pre-Accession Economic Programme explains in details the structural reforms undertaken by the Government of the Republic of Macedonia, while Table 10 presents details of the fiscal implications from various reforms. In fact, fiscal implications actually present the funds (budget funds, as well as loans and credits and donations) necessary for implementing structural reforms.

Most important structural reform in the period 2009-2011 is the social contributions reforms, being a comprehensive reform comprising three pillars: introduction of the gross salary concept, integration of contributions collection in the Public Revenue Office and reduction of social contribution rates. Forgone revenues from this reform will be one to two percentage points of GDP in the coming period.

Important reform in the field of infrastructure is the construction, given under concession, of the airports in Skopje, Ohrid and Stip, an investment worth more than EUR 250 million. Thus, air traffic in the Republic of Macedonia can maintain the already commenced trend of strong growth of the traffic, and such investment will also contribute to growth in the construction sector of the Republic of Macedonia.

Support to the agricultural sector is another significant reform being implemented in the Republic of Macedonia, the main objective of which is improving the quality of the production (according to European standards), as well as improving the financial status of the agricultural producers. Such support to the agriculture will be worth EUR 75 million in 2009 and EUR 100 million in 2010.

3.2. Sensitivity analysis

Sensitivity Analysis of Budget Deficit

This Chapter provides review of the results from the sensitive analysis of budget deficit. In fact, three scenarios were prepared, based on different assumptions (differing from the medium-term projections taken as starting point in the baseline scenario) and they analyse the effect, i.e. the change occurred at the budget deficit in case an economic variable deviates from the envisaged path according to the medium-term projections.

Taking into account the unfavourable economic situation which, in conditions of high level of globalization, spills over from one country to another at high speed, of special significance is to carry out sensitive analysis, that would reflect the consequences if an economic variable takes unforeseen course, to the end of undertaking appropriate measures to prevent the negative consequences or to minimize them.

The baseline scenario takes into account the medium-term projections, i.e. it assumes GDP growth of 5.5% in 2009, budget revenues increase of 3.8% and budget expenditure increase of 6.7%. In such conditions, budget deficit is projected at 2.8% of GDP.

First scenario takes deceleration of the economic activity into account, more precisely that real GDP growth in 2009 and 2010 will be reduced by half in relation to the GDP growth projected in medium-term macroeconomic projections. Analysis results show that in such conditions budget deficit in 2009 would be by 1.1 percentage point higher than the projected budget deficit in the baseline scenario. Both the table and the chart show that in the next year the situation deteriorates, i.e. budget deficit is higher by 1.6 p.p. compared to the baseline scenario, and in 2011 it drops but still surpasses the projection by 0.6 p.p.

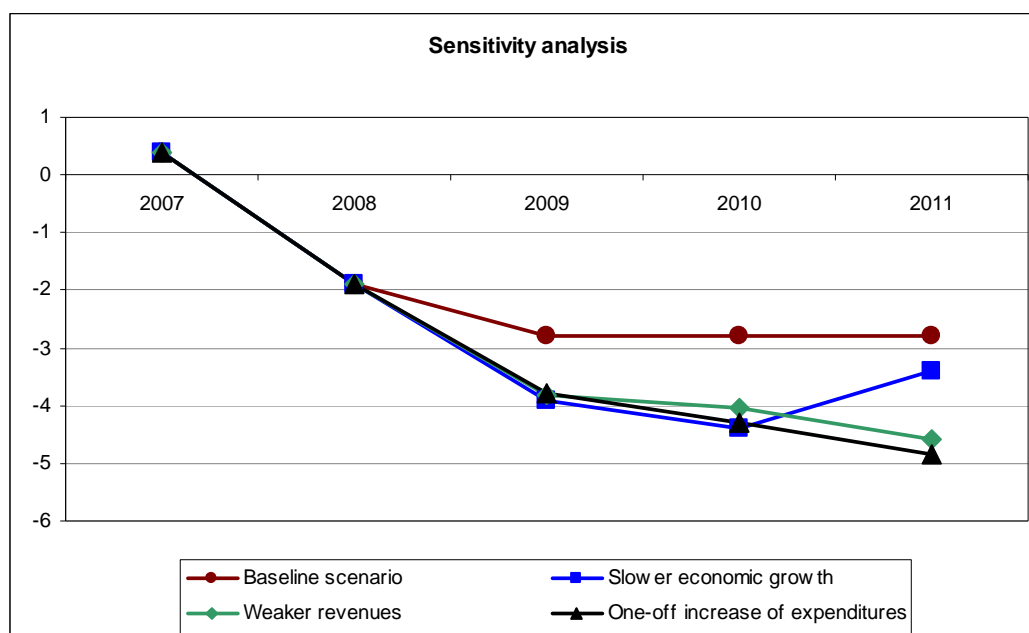
Other case of analysis takes the assumption that budget revenues surge by only $\frac{1}{4}$ of the projected increase. Consequences of such negative shock over the budget balance would lead to increase of budget deficit by 1 p.p. of the projected one in the baseline scenario. The situation aggravates in the next two years, i.e. budget deficit continues to increase.

Third scenario assumes one-off shock on budget expenditure side. In fact, it is a matter of 2% one-off increase of budget expenditures compared to the projections in the baseline scenario. Results in this scenario point out that budget deficit would increase by almost 1 p.p. in relation to the baseline scenario and the gap continues to intensively increase in the coming years.

Analysis has been made on the basis of hypothetical assumptions, however, it shows the effects on the budget balance that might be expected on the medium term, if underlying postulates move in unfavourable direction. Results of the sensitive analysis can be used in determining the actions to be taken, if such or similar situation occurs.

	2007	2008	2009	2010	2011
Main assumptions:					
GDP, real growth rate (%)	5.9	6.0	5.5	6.0	7.0
Inflation (GDP-deflator)	7.4	8.0	3.5	2.8	2.8
Budget revenues, growth rate	15	20.6	3.8	8.0	6.4
Budget expenditures, growth rate	11.5	28.0	7.2	9.6	8.2
Budget deficit:					
Baseline scenario	0.4	-1.9	-2,8	-2,8	-2,8
Slowed-down economic growth	0.4	-1.9	-3.9	-4.4	-3.4
Slowed-down increase of budget revenues	0.4	-1.9	-3.8	-4.0	-4.6
One-off increase of budget expenditure	0.4	-1.9	-3.8	-4.3	-4.8

Chart 17: Sensitivity Analysis of Budget Deficit



Sensitivity Analysis of Public Debt

To the end of examining the sensitivity of public debt portfolio of the Republic of Macedonia to exposure to market risk, i.e. interest rate risk and exchange rate risk, influence from the change of interest rates and the exchange rate on external general government debt was analysed.

Table 6: Index of interest costs in the Budget of Republic of Macedonia on the basis of external debt in case of interest rate or exchange rate risk

	Base scenario	Decreasing of interest rate for 0.5% points	Increasing of interest rate for 0.5% points	Decreasing of interest rate for 1% points	Increasing of interest rate for 1% points	Appreciation of euro against other currencies for 10%	Depreciation of euro against other currencies for 10%
2008	100	94,6	105,4	89,1	110,9	98,9	101,1
2009	100	94,1	105,9	88,1	111,9	99,0	101,0
2010	100	93,4	106,6	86,9	113,1	99,1	100,9
2011	100	93,0	107,0	86,1	113,9	99,1	100,9

Source: Ministry of Finance

This sensitive analysis of the interest expenditures trends in the Budget of the Republic of Macedonia on the basis of external debt is based on the following **assumptions**:

- By changing a single variable, all other variables remain unchanged, i.e. ceteris paribus.
- In case of possible movements at other currencies in relation to Euro, Denar exchange rate in relation to Euro keeps the stable value.
- Absence of correlation between interest rate movements and exchange rate movements.

Main conclusions arising from this analysis are as follows:

1. Debt servicing costs on the basis of external general government debt are **highly sensitive** to interest rate movements. If interest rates in 2009 increase/drop by only 1 p.p., it would cause increase/drop in debt servicing costs by 5.1%. This sensitivity is a result of high exposure of the debt portfolio to interest rate risk, being a consequence of relatively high share of the variable debt.

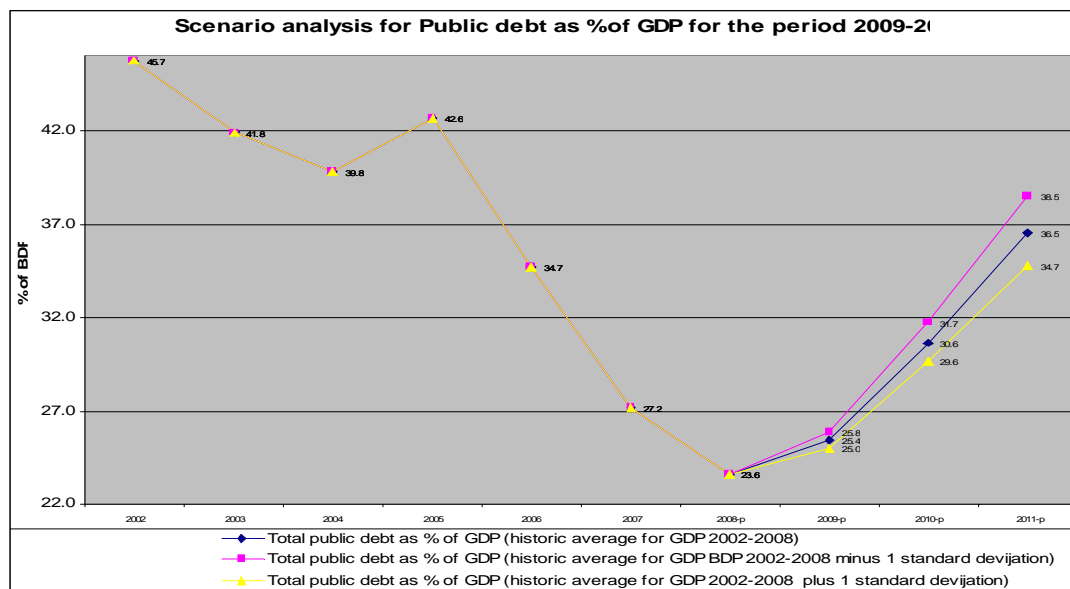
2. The results from sensitivity analysis **do not show noticeable upward or downward trend** of sensitivity of debt servicing costs as a result of changes in interest rates. That is result of keeping interest structure at the existing level.

3. Future 10% **appreciation/depreciation of Euro** in relation to other currencies in the portfolio (US dollar, Japanese Yen and SDR) will lead to reduction/increase in debt servicing costs due to fixed exchange rate regime of the domestic currency, the Denar, in relation to the Euro. However, possible unfavourable trends in exchange rates of other currencies in relation to the Euro **will not strongly affect the debt servicing costs** due to the fact that most of the external debt of the general government is denominated in Euro.

4. In the next three years, share of servicing euro-denominated debt in the total servicing will drop from 80.5% in 2009, to 73.9%, i.e. 71% in 2010 and 2011 respectively. Accordingly, analysis of debt servicing costs for these three years points out to increase in the sensitivity to exchange rate changes from 1.2% in 2009 to 1.4%, i.e. 1.4% in 2010 and 2011.

Taking into account the recent developments of world financial crisis and most of the developed countries falling into recession, there are challenges to attaining the projected GDP of Republic of Macedonia. Having in mind the fact that Public Debt Management Strategy of the Republic of Macedonia includes quantitative target of the level of total public debt in relation to GDP, an analysis has been carried out on GDP trends and the effects thereto.

Chart 18: Scenario analysis for public debt



Source: Ministry of Finance

Following assumptions were used:

- There is no correlation between GDP and level of total public debt;
- In the coming period, GDP will keep the variability as in the period in which conclusions were drawn for the average value (4%) and the standard deviation (1.8%), i.e. for 2002-2008.

According to the results on public debt to GDP ratio, one can come to the following conclusion:

- There is high variability in GDP trends;
- If variability of the analyzed time series of GDP is replicated in the coming period, there is no risk to exceed the limits set in the 2008-2010 Public Debt Management Strategy;
- Possible adverse shocks on GDP would lead to unsustainability of this target, starting from 2011 onwards.

Comparison with previous programme

As envisaged in the PEP 2007, the GDP growth in 2007 was almost as MF projections, which points out that 2007 was very positive year for the Republic of Macedonia. Regarding the medium term growth prospective the difference is mainly due to the financial crisis, which is already taking place in Macedonia. The Ministry of Finance reduced the GDP growth projection by 1 percentage point, which can be considered as optimistic as most of the international financial institutions are projecting lower economic growth for Macedonia (EBRD is projecting 3% growth). However, the ambitious economic government programme is the key reason why we expect the GDP growth in 2009 to be around 5-5,5%. The government is projecting higher economic growth than the other institutions due to the planned counter cyclical fiscal policy with a focus on capital investments. Namely for the period 2009-2011, the projected fiscal deficit is 2.8% of GDP with highest increase of the capital expenditures which are necessary for the infrastructural development of the country. This includes significant increase of the expenditures for the energy sector, railway reconstruction, road construction and improvement of the educational infrastructure. The increase of the planned capital investments for 2009 is 47% when compared with the execution in 2008, which is a policy measure accepted by many other countries (United Kingdom etc.). This capital expenditures increase is the main reason for the difference between the previous programme regarding the government deficit (1.3 percentage points higher projected deficit). Further more, the concept of gross wage which was introduced as of January 2009 and well explained in this programme will contribute to the increased deficit on medium term.

The financing of the deficit contributed to a difference in the medium term public debt developments. Namely, according to the current programme the projected public debt will be 2.2 percentage points higher than what projected in the previous programme, mainly because of the higher financial needs for the envisaged projects.

Finally, the difference between the two programmes can be seen in the fiscal implications table. Namely, the planned expenditures for structural reforms (including infrastructure building of the country) are much higher in the current programme. This shows the commitment of the government to increase the funds for meeting the EU benchmarks, infrastructural building of the country, as well as improving the business climate.

3.3. Quality of Public Finances

The Government of Republic of Macedonia remains consistent to its goal and reform policy aimed at quality management of public finances, putting strong efforts to improving the collection of public fees, thereby taking account of their efficient usage in projects aimed at improving the Macedonian society and attaining the European standards.

Tax administration

To the end of improving services to taxpayers, increasing efficiency of the control and increasing revenues on the basis of all public fees, continuous and active operations are undertaken to operationalise the strategic objectives, defined in the 2009-2011 Strategic Plan of the Public Revenue Office (PRO).

By implementing the strategic objectives administrative capacities of the tax administration are strengthened and its functions and competences are expanded, thus ensuring increased tax revenues in the state budget, improved services to taxpayers, development of human resources and strengthened international cooperation with the bodies and institutions in the EU Member States and broader.

Expansion of the functions and competences are realized by introducing an integrated system of collection of social contributions and taxes. Such operations will increase efficiency and effectiveness of revenue collection, at the same time facilitating and simplifying the procedures and the obligations of taxpayers.

At the same time, to the end of decentralizing services to taxpayers and facilitating communication tax officer – taxpayer, new organizational entities and communication channels have been established, which are easily accessible and fully correspond to the needs for rendering quality and fast services to taxpayers. Thus, in 2008, second stage of the Project for E-Services to Small and Medium Taxpayers

was put into operation, and preparations commenced for such services to be available to natural persons as well.

Introduction of the system for centralized data processing led to unification of the processing of tax returns, whereby the ultimate goal of the project is issuance of all tax decisions at one place.

With respect to annual tax returns where information are matched from third parties, collection of personal income tax increased and educational trainings were organized aimed at voluntary payment of tax liabilities.

Undertaken activities regarding old tax debt management resulted in increased collection on the basis of all taxes on the short run.

For the purpose of improving the quality of public finances, tax administration continuously undergoes modernization, the ultimate goal being for it to become an efficient service to the taxpayers.

In addition, it is exceptionally important to point out that implemented reform in the field of salary taxation, i.e. recent introduction of flat tax and reduction of previous progressive tax rates (15%, 18% and 24%) to 10%, Republic of Macedonia is in the group of countries with the lowest personal income tax. The reform has proven to be exceptionally successful, whereby lower tax rates brought higher tax revenues, i.e. the effective tax rate has increased.

To the end of reducing both tax burden and administrative burden for the enterprises, i.e. to the end of creating more transparent system, with easily distinguished labor force costs, the Government undertakes structural reform in the system to begin in January 2009, comprising the following:

- full harmonization of the bases for payment of contributions and reduction of minimum base for social insurance contributions from 65% to 50%,
- reduction of social contribution rates from 32.0% to 27.9% and further on to 22% in 2011,
- introduction of the concept of gross salary of workers and broadening the tax base (incorporating food and travel allowances), and
- integrated collection of social insurance contributions and personal income tax in the Public Revenue Office.

By harmonizing and integrating the bases, calculations and collection of social contributions, good basis will be created for more accurate monitoring and simplified control over the payment of contributions by the competent institutions and equal competition among the economic entities is promoted.

Reduction of the minimum base for payment of contributions will provide for progression of the taxation system, as opposed to the present regression, and will contribute to narrowing the payment gap, especially regarding lower salaries. In addition, lower minimum base will stimulate, to a certain degree, the employers to register as employees and to socially insure the workers (especially those in branches receiving lower salaries), thus increasing tax revenues.

According to the changes in the calculation and the concept of payment of salaries, liable person for payment of social insurance contributions is the employee, while the employer pays the contributions on behalf and for the account of the employee, whereby food and travel allowances will become an integral part of the gross salary and will not be exempt from payment of social insurance contributions. Employees will have full insight in whether their obligations are met and will have greater interest in pressuring the employer to pay the contributions. Paid contributions will be shown in certified written salary statement.

After introducing the concept of gross salary, single cost for the employer is employee's salary, whereby salary calculation will be simplified, thus narrowing down the margins for possible manipulation by the employer so as to avoid the obligation to pay contributions, since the obligation to pay them is related to the salary payment.

Integrated collection of social insurance contributions and personal income tax by the Public Revenue Office will provide for simplification of the system, more rational utilization of public resources (employees in funds and PRO), better centralized records keeping and evasion reduction, thus

contributing to improvement of the quality of public finances.

Public procurement

Further on, it should be pointed out that due to harmonization with the European legislation, Parliament of the Republic of Macedonia adopted the Law on Public Procurement on 6 November 2007, which started to apply on 1 January 2008. In the meantime, and within the legally prescribed deadline, all envisaged bylaws were adopted, except for the Common Procurement Vocabulary, which, pursuant to the Law, should be adopted by the end of 2008.

European Commission assessed the Law as highly harmonized with the Directives on public procurement, and it incorporates good international practices. One of the novelties in the Law is the introduction of electronic auctions and full system of electronic public procurement, available to the contracting authorities.

Experience shows that since being enforced, the Law strengthens the public procurement system through:

- introduction of new accelerated procedures and completion of the electronic public procurement system and electronic auctions;
- implementation of European rules and regulations arising from EU Directives on public procurement, thus making progress in the integration of the Republic of Macedonia in the EU;
- introduction of good international practices on all issues not being regulated by the European regulations on public procurement;
- implementation of new web information system for publication of notices on public procurement, being consistent with TED publications of notices in the Official Journal in the EU,
- introduction of acceptable procedures which provide for reduction of the procedural costs for both the contracting authorities and the business community .

Decentralization

In addition, commitment of the fiscal policy to full implementation of the decentralization process should be pointed out, being one of the key reforms of the Government of the Republic of Macedonia, not only for the European integration processes, but also for development of the country. Republic of Macedonia has been implementing reforms in the local government for some time now, which should be finalized with the establishment of real fiscal decentralization.

First stage commenced in the second half of 2005 by transferring the competences to the municipalities, as well as the necessary resources for their execution. Second stage commenced two years afterward, which was in line with the legally prescribed deadline. All in all, on the basis of objective criteria by the Commission for Evaluation of Fulfillment of Requirements, so far, over 70% of all municipalities have entered the second stage, and it is expected, as a result of all efforts put, over 90% of the municipalities to be covered with this process by the end of the year.

Thus, it is important to point out the implementation of the project "Support to Municipalities in Public Finance Management", aimed at strengthening the capacity of the tax administration, managing the budget cycle and accounting, internal audit and financial management and control, intended for the municipalities that, when the Project commenced, were not or are still not in the second stage of fiscal decentralization.

Development of stable financial management and control system and independent internal audit is also one of the priorities of the Republic of Macedonia within the reforms in the field of public finance management.

Capital investments

On the other hand, focus of the budget spending will be placed on attaining more dynamic economic development and increased number of productive public investments. Therefore, fiscal policy will remain to be more relaxed in the field of capital investments. Starting 2007, public investments increased (in 2006, their share was 3.8% of GDP), whereby in 2009, it is expected for them to reach over 6% of GDP, being within the average of the new EU Member State. According to the medium-term fiscal strategy of the Republic of Macedonia and in line with the medium-term projections on investments, share of capital

expenditures in the total expenditures of the core Budget of the Republic of Macedonia is envisaged to increase from 11.8% in 2007 to 17.6% in 2009. Thus, investments in infrastructure are of vital importance for unemployment and poverty reduction, increase of competitiveness of the national economy, higher economic growth and equal regional development, aimed at intensification of the Euro integration process of the Republic of Macedonia.

In addition, the Government, observing the public sector as potential growth generator, has decided to deepen and intensify structural and legal reforms in this sector, to the end of commercialization and de-monopolization, taking into account the preferential development needs.

Investments in education, as one of the safest path to create strong individuals and strong country, are one of the strategic priorities of the Government of the Republic of Macedonia. Global policy and development strategy in the education sector is aimed at improving primary, secondary and high education through construction, reconstruction and rehabilitation of the facilities and their equipping, computerization of the schools, to the end of improving the quality of education in line with the demand on the labour market and the economic needs.

3.4. Sustainability of public finances

The analysis of the long term sustainability of the public finances is based on the following long term assumptions:

- Strong GDP growth in the following forty years of more than 4%;
- Stable productivity growth of more than 2%;
- Small increase of the male participation rate (from 72% to 78% in 2050);
- Significant increase of the female participation rate (from 49.2 to 72%);
- Strong decline in the unemployment rate (from 33% to 12%);
- Steady participation growth of the older population of 1.5 percentage points per ten year

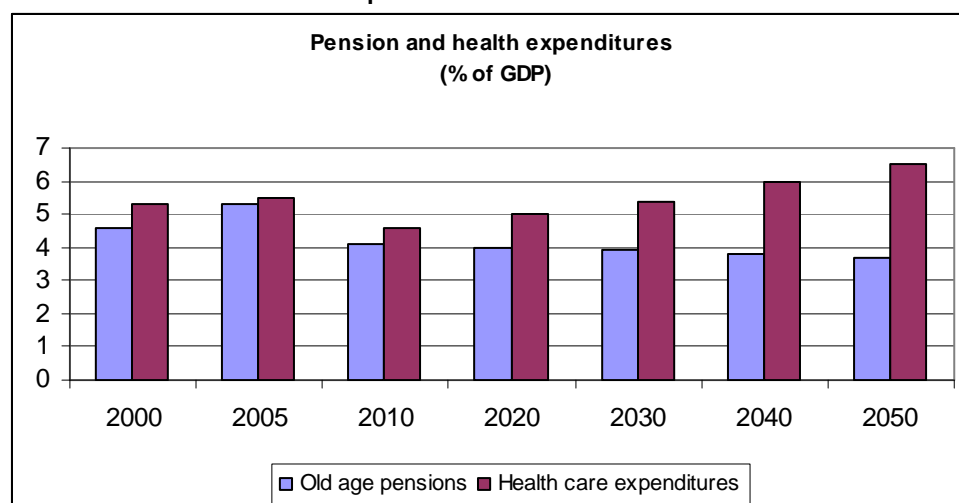
Introduction of the concept of gross wage and the reduction of the social contributions rate is also included in the calculations. It is also assumed that there will be no further changes in the regulations. Furthermore, it is further assumed that all other public revenues, with the exception of social security contributions, as a share of GDP will stay the same, and all other expenditures, except for pension, health and interest expenditures, will retain their current share in GDP.

On the basis of the assumptions described above, a moderate decrease in revenues from pension insurance contributions is estimated: from 6.6% of GDP in 2005 to 5.2% of GDP in 2020, stabilising in subsequent years. Such decline in the first years can be explained by a gradual decrease of the social contributions rate introduced with the social security reform. The share of revenues from pension contributions is expected to stabilise at the level of 6.2% of GDP after 2015, as a result of the assumption that real growth of wage per employee is equal to labour productivity and that there will be a reduction of the unemployment rate.

The projection results show a significant decrease in public pension expenditures, from 5.3% of GDP in 2005 to 3.7% of GDP in 2050. Public pension expenditures include only the expenditures of the Macedonian Pension Fund and not the expenditures under private pension insurance funds (whether mandatory or voluntary). Such decrease in public expenditures is primarily a result of the decrease in relative pensions (pension-wage ratio) paid from the first pillar. It is expected that payments from the second pillar will partially or completely compensate for the decrease in relative pensions. It should be noted that the projections take into account a gradual decrease in the share of those pensioners whose pensions are paid entirely from the first pillar, and the growing share of those who are paid part of their pensions from the first pillar and the other part from the second.

Public expenditures in the health care system are projected to grow from 5.5% of GDP in 2005 to 6.5% of GDP in 2050. Such growth is a result of the estimated pure effect of aging population and rising health expenditures in line with productivity growth. The expenditure growth arising from the pure aging effect is a result of a growing share of the population in older age groups who absorb relatively large amounts of health expenditures.

Chart 19: Pension and health expenditures



Source: Ministry of Finance

3.5. Institutional Features of Public Finances

Public finances area in the Macedonian institutional and legal system is regulated with many acts. Main act that sets the general regulations on the fiscal sector is the Budget Law, while public finances are also regulated through the annual Budget of the Republic of Macedonia and the adopted decrees, rulebooks and other bylaws.

To the end of further harmonisation of the legal regulations in the field of budget operations with the EU regulations, modifications and amendments were proposed to the adopted Budget Law. Existing Budget Law is based on most of the main objectives and principles in budget management, however what remains is the obligation to apply all principles on which the budgets of the EU Member States, i.e. candidate countries, are based. Therefore, proposed modifications and amendments to the Budget Law fully cover the objectives and the principles of a contemporary budget. Modifications and amendments to the Budget Law also define adequate terminology and set the procedures under which the Budget Law becomes an instrument that enables multi-annual budgeting, i.e. consistent realisation of the development-aimed goal of the budget.

Defining the provisions that regulate budget planning and execution is made in line with Council Regulation (EC, Euratom) no. 1605/2002 and Council Regulation (EC, Euratom) no. 1995/2006 on the Financial Regulation applicable to the general budget of the European Communities, providing the legal framework for application of basic principles when executing the budgets (unity, specification, budget equilibrium, economy, efficiency, effectiveness, transparency and sound financial management), i.e. the principles on which the budgets of the EU Member States and the candidate countries are based. In line with the above-mentioned, this Law also proposes amendment to the contents of the Budget of the Republic of Macedonia, which comprises: general, special and development part. Development section of the budget presents medium-term plans for the budget users' programs intended for development-aimed investments approved by the Government of the Republic of Macedonia.

The proposed Law also introduces changes in the budget process, i.e. in the stages of preparation and harmonisation of the draft budget. Budget preparation process introduces a new stage - preparation of development program plans, representing medium-term review of the programs intended for development-aimed investments, prepared by the budget users at executive power level and the Funds. Budget users at executive power level, after having received the budget circular, prepared draft plan for development programs and submit it to the Government of the Republic of Macedonia. Government of the Republic of Macedonia decides upon the proposals for development program plans of the budget users at executive power level and the Funds, in line with its strategic priorities and produces a list of approved development program plans, submitted to all budget users at executive power level and the

Funds. Budget users at executive power level and the Funds submit the approved development program plan, as an integral part of their budget request, to the Ministry of Finance.

Novelty being introduced with the proposed modifications and amendments is also the procedure for negotiating/harmonizing the budget request between the head of the budget user and the Ministry of Finance, as well as the obligation of the Minister of Finance to inform the Government of the Republic of Macedonia, when submitting the draft budget, on the disagreed budget requests.

In addition, draft Law on Modifications and Amendments to the Budget Law, in the Budget Execution Section, introduces several essential changes to the existing provisions in the Budget Law, aimed at the necessary harmonisation with the European Acquis, as well as detailed clarification and amendment to the existing legal provisions. This section also contains modification to the Law, with a provision pursuant to which the Budget of the Republic of Macedonia is executed under a special law adopted by the Parliament of the Republic of Macedonia. The modification mentioned is actually a legal standardisation to the practice so far, for special law to be adopted for the execution of the Budget of the Republic of Macedonia. Provisions governing the functions of the Treasury contain modifications that extend the Treasury competence, aimed at creating legal basis for the following: debiting the account within the Treasury Ledger on the basis of contractual authorisations and in case of correction of an error by the treasury, liquidity management regarding the accounts within the Treasury Ledger, as well as stopping the execution of certain payments of the central government budget users and the spending units in case of detected undermining of the financial discipline and in conditions of deterioration in the projected liquidity in the treasury account. These modifications are carried out as a result of the observations made in the so-far practice since the establishment of the Treasury (2002), and they are aimed at enabling greater efficiency of the Treasury.

Regarding the submission of the budget final statements, there is an amendment so as to make more precise the existing legal provision in terms of regulating the obligation for submission of final statement of the Budget of the Republic of Macedonia to the Government of the Republic of Macedonia, having the report by the authorised state auditor on the audit carried out over the basic budget as attachment. This is proposed due to the fact that the proposed legal obligation is applicable only from the point of view of the scope and deadlines for performing an audit.

At the same time, when preparing the modifications and amendments to the Budget Law, recommendations by the State Audit Office have been taken into consideration so as to introduce more efficient procedures for management of budget funds.

4. Structural reforms

4.1. Enterprise sector

4.1.1. Industrial policy and strategy

Basic elements of the industrial policy of the Republic of Macedonia are the following:

- Conducting proactive industrial policy which is enhancing competitiveness of the industry, based on knowledge and innovation,
- Reforms for creating operative market economy, with consequent harmonisation and accepting of Acquis
- Completion of the privatisation process and strengthening the process of private public cooperation
- Conducting policies that are supporting cooperation between companies through clusters and cooperation between business and science
- Enhancing the process of internationalisation of the companies and institutions,
- Implementation of the measures for improving the business climate and stimulating the growth of domestic and foreign investments
- Promotion of SME and entrepreneurship development

Ministry of economy prepared National document for industrial policy as an integrated and comprehensive policy that will lead toward increasing the competitiveness of the economy. The Document was developed in coordination with the Interministerial working group consisted of representatives from different ministries and institutions, in cooperation with the consultants and permanent dialogue with the business community and the science. In the process of development of policy a study for measuring the indicators for competitiveness is prepared as well, that identifies the competitiveness of the economy and the priorities for intervention.

The national document for industrial policy should be accepted by the Government in the beginning of 2009 and will comprise concrete measures and instruments for increasing of the competitiveness of the economy with aim to fulfill the priorities.

The document refer for the period 2009-2020 "Industrial Policy of the Republic of Macedonia 2009-2020", as an integrative proactive policy clearly defining priorities, aims and instruments for creating competitive economy. In the document are defined few areas of intervention through program and measures covered by different ministries:

- Increase of applicable research, development and innovation by intensification of investments in R&D, by development of high-quality interdisciplinary interaction between industry, institutions and government.
- Increased international cooperation of key economic development stakeholders (enterprises, academia and research & development institutions) with purpose of creating new businesses, learning and new knowledge creation by strengthening of the international relations, exchange of knowledge and experience, learning of best practices for improvement of management capacities increasing the productivity (international management training).
- Promotion of sustainable development by using the natural opportunities for production of renewable and alternative energy as well as natural eco and environmental opportunities existing in the country, for production of high value added products and services (transforming environmental conditions into opportunities for favourable economic development).
- Increasing competitiveness of Macedonian industry by stimulating collaboration through regionally and internationally networking of clusters and other associations of small enterprises (gaining the benefits like: sharing of costs, more efficient market research, more efficient flow of labor, capital, technology, innovation and information).
- Advanced development of small and medium enterprises and entrepreneurship by strengthening the institutional infrastructure by financing the activities of APPRM, strengthening the capacities of the business centres, SME Observatory, redesign the way of functioning the SME Forum, cofinancing of EEN, cofinancing the HRDF and
- Increasing the inflow of domestic and foreign investments for faster economic growth

Principles of the EU Industrial policy are integrated in the document. Policies in general have horizontal approach, with separate sectoral approach by strategies and programs for restructuring of the key sectors where it is necessary. All measures and instruments will be in accordance to the state aid rules.

One of the proposed projects is accepting the idea and supporting companies in active participation in clusters, understanding the advantage of associating and foundation of network of clusters. The activities related with initiating and support of clusters are intensified and are coordinated by the Ministry of Economy through supporting of the existing and foundation of new clusters for increasing the competitiveness of some sectors. Based on the analyses in the process of clustering in the Republic of Macedonia, there are activities for preparation of 4 years program for support of cluster associations.

Except the cluster projects, within the vertical aspect of industrial policy, few strategies for development of some sectors are prepared (as textile, steel, tourism).

Within the Department for industry in the Ministry of Economy, the Strategy for development of textile industry and Action plan for revitalization of the textile industry is prepared. This document should stimulate development of textile industry in future through it's restructuring towards production of higher profit products, with own brand, easily leaving the present low profit work based on lon system.

Within steel industry is prepared and is implemented National strategy for restructuring of steel industry prepared as an obligation from Protocol 2 from SAA. Strategic objective of the National strategy for restructuring is creation of conditions where compnaies from steel industry can reach maximal profitability and decrease the costs for what are prepared individual busines plans for each company. In 2007 was published first Bulletin for steel industry and in 2008 was prepared the second one.

4.1.2 Entrepreneurship and Small and Medium Enterprises

The small and medium size enterprises are a dominant type of enterprises in the Macedonian economy. In 2007, 99.9% of all enterprises were small and medium enterprises. Since 2003, in particular, the SME has developed successfully. The number of active SME (legal entities) has increased by 72% (from 37,000 in 2002 to 50,965 in 2007), that presents an average annual increase of more than 2,300 SME's.

As to the number of SME to 1000 inhabitants, the number has increased from 19 to 25. As a result, the employment increased by 51%, from 110,000 employees (in 2002) to 214,471 employees (in 2007).

Table 7: Share of SME in National economy in relation to Employees, Enterprises, Gross value added (structure in %)

	No. of Employees			No. of active enterprises			Gross value added		
	2005	2006	2007	2005	2006	2007	2004	2005	2006
Small	54.4	58.8	64.2	98.8	98.9	99.0	51.6	52.3	53.3
Medium	21.3	18.9	12.0	1.0	0.9	0.8	20.3	11.5	12.0
Total SME	75.7	79.6	77.8	99.8	99.8	99.8	72.9	63.8	65.3
Big	24.3	20.4	22.2	0.2	0.2	0.2	28.1	36.2	34.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Central registry

Based on the four year program, the government also adopted a 2008 Program for Development of entrepreneurship, competitiveness and innovation of small and medium enterprises, which provides purpose of resources for the support of entrepreneurship as provided from the 2008 Republic of Macedonia Budget.

The support of the SME development, in 2008, was directed towards more effective enterprise working and support of competitiveness and innovation strengthening, by:

- Strengthening the institutional infrastructure by financing the Agency activities (Agency for entrepreneurship support-APPRM), co-financing the establishment of 12 new business centers, Observatory for SME's, Forum for SME's, Info pull- project in cooperation with regional centers for business support, co-financing of European Information and Innovation Centre-Enterprise Europe Network and co-financing of Human Resource Development Fund (HRDF).

-Business environment improvement and access to financing for SME (A Low on establishment of Credit Bureau is adopted), trainings for alternative source of financing have been realized.

-Improvement of competitiveness and innovation of SME through: co-financing of clusters, new business incubators, co-financing costs of regional centers projects for non-financial SME support, co-financing of voucher consultancy scheme, entrepreneurship awards, entrepreneurship education, EU entrepreneurship Day, projects awareness IKT raising, campaign for quality standards implementation, science-innovation connecting, international science cooperation, intellectual property rights awareness rising.

The third phase of the Project Human Resource Development Fund has been finished in 2008, and it has started its implementation in 2007. Different workshops and trainings were realized and specially under following components: enterprises, national trainers, networking, support of HRDF. About 300 managers from 100 enterprises were trained under the training program of this project. Also, 5 managers clubs were established aimed to promote exchange of manager's experience and best practices, representing part of the activities of the groups for experience exchange (Manager Club) and for the improvement of consultant services through trainings.

APPRM was actively involved in the implementation of practical directions (checking, evaluation and ranking of mini business plans) for the implementation of government employment active policies for 2008 (government project for self-employment support through crediting).

Also, in 2008, APPRM continued with active participation in implementation of the government project-self-employment support through granting, where 500 unemployed persons and 107 unemployed persons with informal business were selected and will be registered as official business.

Three new business incubators, beside 7 existing, were established: in Skopje for IT companies, at the mechanical faculty in Skopje and in Bitola-Business start up centre (incubator, with Dutch government support).

The incubators annual program activities have been financially supported by the 2008 Program for Development of Entrepreneurship, Competitiveness and Innovation of SME.

Mid-term goals 2009-2011

Mid term goals for SME support should contribute for creating competitiveness and more effective enterprise working. They have been defined in the *National strategy for SME development 2002-2013* and *Program for Development of Entrepreneurship, Competitiveness and Innovation of SME 2007-2010*.

As a result of implementation of these activities, the number of SME is expected to increase by approximately 4-5% including an increase in the number of jobs by 4-5% annually on average, in the period 2009-2010.

4.1.3 Tourism and catering industry

Tourism and catering industry in Republic of Macedonia contribute to GDP by 2 percentage points, with tendency of enhancement of their conduciveness. The tourist market in the past period was expanding, allowing us to conclude that Republic of Macedonia is becoming an attractive tourist destination.

Table 8: Number of tourists and nights spent in Republic of Macedonia (source:SSO)

	2004	2005	2006	2007	2007/2006 in %
1. Number of tourists					
total	465 015	509 706	499 473	536 212	107.3%
domestic	299 709	312 490	297 116	306 132	103%
foreign	165 306	197 216	202 357	230 080	113.7%
Participation in %					
total	100.0	100.0	100.0	100.0	
domestic	64.4	61.3	59.5	57.1	
foreign	35.6	38.7	40.5	42.9	

2. Number of nights spent					
total	1 865 434	1 970 041	1 917 395	2 019 712	105.3%
domestic	1 504 845	1 527 053	1 474 550	1 501 624	101.8%
foreign	360 589	442 988	442 845	518 088	117%
Participation in %					
total	100.0	100.0	100.0	100.0	
domestic	80.7	77.5	76.9	74.3	
foreign	19.3	22.5	23.1	25.7	

From the forgoing statistical data it can be noticed that the total tourist circulation is rising, with exception of 2006 when a small downfall is perceived. The total tourist circulation growth index, expressed in percents for 2007 relative to 2006 has increased by 7.3%, and domestic and foreign tourist circulation have increased by 3% and 13.7%, respectively. The total nights spent have also increased by 5.3% in 2007 relative to 2006, while domestic and foreign nights spent have risen by 1.8% and 17%, respectively. The participation of number of foreign tourist and nights spent in the total number of foreign tourist and nights spent has continuously risen by around 3.5%, unlike the participation of number of domestic tourist and nights spent in the total number of foreign tourist and nights spent which registers a slight decrease by around 2%.

Table 9: Foreign tourists

	2004	2005	2006	2007	Index 07/06
EU countries	69 498	79 897	54 185	65 914	121.6
neighbour countries	56 379	73 477	102 652	109 753	106.9
other European countries	20 635	27 953	20 708	25 982	125.4
other countries	18 794	15 889	24 812	28 431	114.6
Total	165 306	197 216	202 357	230 080	113.7

Source: SSO

Table 10: Foreign tourists nights spent

	2004	2005	2006	2007	Index 07/06
EU countries	152 034	190 200	121 591	142 411	117.1
neighbour countries	114 794	154 590	217 328	252 511	116.2
other European countries	42 562	54 114	46 859	56 590	120.8
other countries	51 199	44 084	57 067	66 576	116.7
Total	360 589	442 988	442 845	518 088	117.0

Source: SSO

Republic of Macedonia as attractive tourist market is interesting for a number of foreign tourists that come from all around the world. From the statistical data we can see that the majority of tourists come from EU countries (including the countries that accessed in EU in 2004) and from the neighbour countries. Each year the number of foreign tourists is increasing, but a major growth of 13% is noticed in 2007, while tourists from EU and neighbour countries that are coming and spending nights contribute the most in growth. It can be concluded that the largest potential tourist market for Republic of Macedonia is the European market and the markets of the neighbour countries.

Table 11: Number of employees in tourism and catering industry in relation to the total number of employees in the economy (in %)

	2004	2005	2006	2007	2010 Proj.
55. Hotels and restaurants	3.0	3.0	3.1	3.2	4.0
66.3 Travel agencies and tour-operators activity	0.1	0.2	0.2	0.2	0.4

Source: SSO

Table 12: Foreign currency inflow from tourism (in dollars)

	2004	2005	2006	2007	2010 П
Tourism, net	17,340,000	24,250,000	58,450,000	84,250,000	120,000,000
Inflow	71,810,000	83,900,000	129,170,000	185,840,000	220,000,000
Outflow	54,470,000	59,650,000	70,720,000	101,600,00	100,000,000

Source: NBRM

Tourism and catering industry have brought positive foreign currency inflow of 84 millions dollars, and the projections are that realized foreign currency inflow in 2010 will reach 120 millions dollars.

Table 13: Investments in tourism (in euros)

	2003	2004	2005	2006	2007
Hotels and restaurants	9,798,153	2,255,036	3,864,545	11,918,290	13,288,805

Source: NBRM

In the past few years the total investment in this area is enhancing, and the largest investment of 13,288,805 euros is realized in 2007, while the total investment for the past 5 years amount 41,124,829 euros. Mainly, these are investments in construction of hotels, family hotels and private apartments, as well as reconstruction and modernization of the present hotels and apartments.

In 2004, two new laws were adopted that regulate these matter, Law on tourism activity and Law on catering industry. The two laws are completely harmonized with European legislation (EU 90/314 Directive) and they were prepared in technical cooperation with international experts from France. In 2008, there were ammendments and supplements to the Law on tourism activity and Law on catering industry in the part that regulates supervision and penalties and in the part of customer protection. The Ministry of economy has prepared rules and by-laws such as: Rulebook of minimal technical terms for catering industry, Rulebook of minimal technical terms for tourist objects, Rulebook of terms for tourist objects categorization and a number of rulebooks of specimen documents for record keeping according to these laws. In 2007, a process of adoption of medium -term National strategy for tourism development 2009-2013 has started, that will contain basic parametars and action programmes for tourist development of the country. Its adoption by the Government of Republic of Macedonia will occur in 2009.

The Government of Republic of Macedonia, accordind to the Annual macroeconomic development programmes and Annual tourism development programmes, has specified the following strategic tasks for development of tourism and catering industry:

1. Amplification of accomodation capacities and tourist infrastructure
2. Improvement of the quality of services
3. Intensified promotion of tourism in order to make Macedonia a recognisable tourist destination
4. Foundation of Agency for promotion and support of tourism
5. Promotion of principles for sustainable development
6. Protection of natural and tourist enviroment
7. Improvement of the shape of tourist locations

8. Development of new types of tourist products:
 - a) development of rural tourism
 - b) development of cultural tourism
 - c) development of health tourism
 - d) development of conference tourism

4.2. Financial Sector

4.2.1. Banking System

Banking system of the Republic of Macedonia comprises 18 banks and 11 saving houses (as of 30th June 2008), being by one saving house less compared to the end of 2007. Role of saving houses regarding the total banking system continues to be marginal⁹.

Relatively high concentration, particularly in the field of operations with the population, remained to be one of the main features of the banking system in the Republic of Macedonia. Despite the trend of market consolidation present in the past several years, there is still space for further strengthening and intensifying of the activities in the banking system of the Republic of Macedonia. This should lead towards increasing the banks' role as financial intermediaries, as well as improving the offer and quality of services. Role of the banking sector as financial intermediary continuously increases, mainly due to the higher growth rate of the assets of banks compared to the annual GDP growth rate. On 30th June 2008, level of financial intermediation of the banking system, expressed as ratio of total assets, gross credits and total deposits to GDP reached 70.3%, 43.5% and 51.5% respectively (30th June 2007: 64%, 33.8% and 46.7% respectively).

Financial institutions are the dominant owners of banks in the Republic of Macedonia, participating with almost 63% in the ownership structure of ordinary shares (as of 30th June 2008). This share means an increase by 2.2 percentage points for a period of 6 months only due to the take over of one small bank by foreign financial institution. As of the end of the second quarter of 2008 inclusive, 6 banks of the Republic of Macedonia are branches of foreign banks.

Share of foreign capital in the ownership structure of the banking system continuously increase, although it experienced slower dynamics in the first half of 2008. At the end of June 2008, the share of the foreign capital in the total equity of the banks accounted for 71.3% (semi-annual increase by 2.2 percentage points). Number of banks dominantly owned by foreign shareholders increased from 11 to 13. Share of assets of banks dominantly owned by foreign capital in the total assets of the banking system of the Republic of Macedonia amounted to almost 90%. Significance of foreign shareholders for the banking system of the Republic of Macedonia will be also additionally increased by the realisation of the announced overtake of two banks by foreign investors from abroad in the second half of 2008.

Assets of the banking system continuously increased reaching Denar 241,088 million on 30th June 2008. In the course of 2008, slower dynamic of the increase in assets (semi-annual growth rate of 7.8%) compared to the same period in 2007 (semi-annual growth rate of 14.3%) was observed.

Deposits of non-financial entities remained to be the main driver of the increase in the assets. Semi-annual growth rate of deposits amounted to 10.2% in the first half of 2008. Increase in deposits also experienced certain slowdown, which can be observed when comparing the semi-annual growth rate of 17.8% for June. Total deposits of non-financial entities amounted to Denar 176,798 million on 30th June 2008. Domestic deposits of non-financial entities are the main source, where the banks finance their own activities. Foreign borrowing is mainly through the "parent" banks or already known credit lines, whereby the share of foreign exchange borrowings and deposits from foreign banks amounted to around 8% in the total liabilities of the banking system.

⁹ On 30th June 2008, the share of saving houses in the total assets of the banking system, the total credits to non-financial entities and in the total households' deposits amounted to 1.4%, 2% and 0.7% respectively.

Contrary to the slowed down growth dynamics of both the assets and the deposits, the credits continued to experience accelerated growth. This increase amounted to 19.5% in the first half of 2008 (17% for the same period last year). On annual basis (June 2008/June 2007) the growth of credits amounted to 42%. Such trends in assets, credits and deposits of the banking system show that the credit growth was financed not only through the increased deposit potential, but also from the transformation of the assets (with relatively higher liquidity, such as securities and placements with foreign banks) into credits. Total deposits of non-financial entities amounted to Denar 149,254 million on 30th June 2008.

Intensive increase in the banks' credit activity, particularly towards the population, in conditions of global increase of prices of both the energy sources and the food, led to increasing the macroeconomic risks in the domestic economy, presented through the increased inflation rate and the trade deficit growth. To the end of their reducing and maintaining monetary and fiscal stability, NBRM made certain changes in the set-up of the monetary policy instruments and undertook prudent measures in the first half of 2008. In fact, the treatment of claims on the basis of credit cards and negative balances on the basis of current accounts when calculating the Capital Adequacy Ratio was stricter in the second quarter of 2008. These measures were primarily focused on slowing the credit growth towards the households sector, which first obvious effects were expected in the second half of 2008¹⁰.

Share of credits to households in the total credits of non-financial entities amounted to 39.%% (semi-annual increase by almost 1 percentage point). Despite the permanent decrease of the share of credits of the enterprises by 0.8 percentage points, they retained the dominant position in the total credits of non-financial entities, with a share of 60%. On 30th June 2008, almost 55% of the credits to non-financial entities were with currency component (in foreign currencies or denars with foreign exchange clause). According to the maturity structure of credits, the long-terms credits predominated, with a share of 61% in the total deposits.

Quality of exposure to credit risk was continuously improved. This was mainly due to the intensive increase in the credit activity in the last several years. However, signs of diminishment in the quality and increase of the risk level were observed in certain segments of the credit portfolio. On 30th June 2008, share of non-performing credits in the total exposure to credit risk amounted to 4.1%, remaining unchanged compared to the end of 2007. However, the absolute amount of non-performing credits increased by Denar 839 million or by 8.8%, unlike 2007, when the absolute amount of non-performing credits on annual basis reduced by Denar 784 million (semi-annual increase amounted to Denar 399 million at the end of June 2007). Credits to households were the biggest "contribution" to this increase. Share of exposure classified in the risk categories C, D and E in the total exposure of credit risks amounted to 5.5% on 30th June 2008. Although this share meant decrease by 0.2 percentage points compared to the end of 2007, the absolute amount and the exposure classified in the categories C, D and E increased by Denar 458 million or by 3.4% on semi-annual basis. As comparison, exposure to credit risk classified in the risk categories C, D and E dropped by Denar 6 million on annual basis in 2007 (this exposure increased by Denar 99 million in the first half of 2007).

Information that the major parts of banks' credits are structured with annuity repayment, enabling timely identification of the possible problems in the repayment is of huge importance.

On 30th June 2008, banking system of the Republic of Macedonia realised profit of Denar 2.5 billion, being by Denar 0.3 billion compared to the period January-June 2007. Revenues from regular bank activities are the main contribution to the profitable operations of the banks. In the first half of 2008, some of the indicators for operational efficiency of the banking system worsened, arising from the more dynamic annual increase in the operational costs, unlike the increase in the revenue categories. On 30th June 2008 ROA amounted to 2.2% (30th June 2007: 2.4% and 31st December 2007: 1.8%) and ROE 19.1% (30th June 2007: 18.3% and 31st December 2007: 15,2%).

¹⁰ In line with the Credit Activity Survey, banks expect stricter conditions for granting consumer credits to households, while no bigger changes in both the conditions for granting housing credits and the conditions for crediting the enterprises are expected for the third quarter of 2008. In addition, banks did not change the conditions for granting consumer credits in the second quarter of 2008, unlike the previous quarters, when the conditions for granting such types of credits were continuously loosen.

Trend of narrowing the interest spread between weighted lending and deposit rates (interest rate spread) also continued in 2008. This was particularly caused by the increase in interest rates on deposits and the decrease in interest rates on credits. At the end of June 2008, the interest spread amounted to 5.9 percentage points between the foreign exchange interest rates, 4.1 percentage points between Denar interest rates and 4.6 percentage points for those with foreign exchange clause.

Banks maintain satisfactory liquidity, with continuous upward liquidity trend, in particular of the high-liquid assets. However, in the first half of 2008, certain decrease in some of the liquidity indicators was observed, being mainly due to both the developments in the structure of the banks' balances and the strengthened growth of the other balance categories. On 30th June 2008, share of the liquid assets in the total assets of the banking system was 29.9%, being much lower than the share in the same period last year, when it amounted to 36.3%. Decrease in the share of the high-liquid assets in the total assets (amounting to 18.1%) compared to June 2007 was slighter amounting to 0.7 percentage points.

Capital Adequacy Rate of the banking system despite the downward trend remained to be high amounting to 15.6% in June 2008. Thereby, the existing capital position of banks fully covered the identified risks for banks.

Exposure of banks to the currency risks was mainly within the stipulated frameworks. Exposure to the other market risks was minimum, banks' trading portfolio was minimum comprising mainly domestic securities. By using certain protective clauses, banks transfer the currency risk and the interest rate risk¹¹ to the final beneficiaries, transforming these risks into indirect credit risk.

Global financial crisis, shaking the developed economies had no direct consequences over the domestic economy and the financial system. Relatively small level of integration of the financial system of the Republic of Macedonia into the global financial flows, the predominant orientation towards the operations with domestic entities and the absence of complex structured products in the activities of the domestic financial institutions were the main factors, due to which the financial system of the Republic of Macedonia did not feel the negative consequences from the expressed turbulences on the global financial markets during 2007 and 2008. However, in the second half of 2007 and the beginning of 2008, trends in the global economy adversely affected the trend in certain domestic macroeconomic variables, which, in conditions of increased competition led to stricter conditions in the business surrounding of the more distinct segments of the financial system.

Last stress-test analysis for the resistance of the banking system to hypothetical shocks, carried out by NBRM, showed high level of resistance of the banks in the Republic of Macedonia to possible unfavorable shocks in the field of liquid, credit and currency risk.

Legal Framework

In June 2007, new Law on Banking was adopted, obtaining positive grades by the recent Financial Sector Assessment Program. . This Law means advancement, form several aspects, such as:

- Liberalizing the market by enabling entrance of foreign banks, including also EU banks,
- Improving the corporate governance of a bank, by strengthening the role and responsibilities of the bank management bodies, internal control systems, role of the external auditor, transparency increase when performing financial activities, strengthening the accounting standards
- Licensing, by strengthening the criteria for bank shareholder,
- Extending the range of measures NBRM may undertake towards the banks
- Risk management,
- Strengthening the market discipline, etc.

Within 9 months after the adoption of the Banking Law, NBRM adopted almost completely new by-laws for the banks (23 by-laws in total). Last FSAP Mission from April 2008 pointed out to high level of harmonisation of the bank regulation with the 25 Banking Supervision Basel Core Principles.

¹¹ Using currency clause

Credit Registry

In the course of 2008, NBRM activities that lasted several months aimed at advancing the NBRM Credit Registry were rounded up. Despite the creation of appropriate software application, the activities also included preparation of adequate regulative framework for the contents of the Credit Registry, as well as for the manner of data submission and usage thereof. Advanced Credit Registry started to be applied from 2008.

Supervision Capacity

NBRM assesses the safety, stability, riskiness and harmonisation of the banks' operations with the regulations through its supervision. Special accents is put on quantification and monitoring of the bank's exposure to different risks, such as the credit risk, liquid risk, operational risk, currency risk and other risks. Bank supervision assesses the adequacy of the procedures and systems determined by the banks, used for identifying, measuring or assessing, monitoring and controlling or reducing the risks. Supervisory functions are carried out through:

- Permanent off-site monitoring of the banks' operations
- Direct full or partial control within the banks themselves
- Maintaining contacts with members of the bank bodies and the Audit Company
- Cooperation and exchange of data and information with other supervisory bodies

Within the activities for developing the supervision, the activities for further improvement of the supervisory capacity will continue, through formal process of training of the employees for applying the supervisory procedures, by attending seminars organised in the country and abroad, organising trainings in the National Bank in cooperation with external consultants, organising internal trainings in the National Bank, using FSI Connect¹². In 2000, within the Dutch Grant as support to the World Bank PDPL3 Arrangement, trainings for management of the operational and IT risk, management of the liquid risk, management of the market risks and others will be carried out.

Challenges

Manner of determining the necessary capital for the operational risk (basic indicator/standardised approach) will be regulated until the end of 2008.

In the course of 2009, analyses of the effects from the modifications to the regulation framework with certain additional segments of the New Capital Accord (Basel 2) are planned, such as the regulation of the manner of applying the standardised approach when determining the necessary capital for covering the banks' credit risk, in accordance with the nature and the characteristics of the banking system of the country. At the same time, this activity is also an obligation undertaken within NPAA. Within these frameworks, an analysis of the manner, in which the ratings of the rating agencies can be used for the purpose of determining the capital adequacy will be carried out. Results from the carried out analysis will be adequately included in the Methodology for Determining the Capital Adequacy.

In addition, to the end of strengthening the activities in the filed of preventing the money laundering and pursuant to the provisions of Article 46 of the Law on Prevention of Money Laundering and Other Proceeds of Crime and Financing of Terrorism ("Official Gazette of the Republic of Macedonia" no. 4/2008), Decision on the Manner and the Procedure for Introducing and Applying Programs on Prevention of Money Laundering in the Banks will be adopted in 2009. This by-law will also adequately include the recommendations of the Special Committee of the Council of Europe included in the Report on Harmonisation of the FATF Recommendations, adopted in July 2008.

For the purpose of precise application of the provisions of the Law on Banking during the introduced possibility for transfer of funds and liabilities in the administration of other bank, procedure for implementing the plan for transfer of funds and liabilities from a bank to the administration of another bank will be prepared. At the same time, procedures for implementing the sale of assets of a bank in

¹² FSI Connect is web application developed by Financial Stability Institute (FSI), tool through which, the bank supervisors can acquire new knowledge.

administration will be prepared, thus providing greater uniformity and transparency in the implementation of this procedure.

In the course of 2009, the challenge of the new regulation implementation, and particularly the new accounting regulations occurred before both the bank supervision and the overall banking industry.

Appendix: Global financial crisis and the Macedonian banking system

In the past period, the global economy and the global financial system faced huge number of challenges and serious consequences arising from the financial crisis starting in USA and spreading quickly afterwards in the other countries elsewhere as well. Financial system is one of the channels for transferring these effects from the global economy to the economies of other countries. Increased cost of capital, impaired confidence of the investors and the fear that the funds deposited on the accounts at other banks are among the main challenges the financial institutions face. In the Republic of Macedonia, the financial system is characterized by relatively simple structure and domination of the banking segment. Therefore, the banking sector stability plays the most important role in the stability of the overall financial system. Current level of development of the Banking Sector in the Republic of Macedonia and its concentration on the traditional banking largely contributed for it being isolated from the global financial flows, due to which, the Macedonian financial system will not be directly affected by the turbulences of the global crisis. At the same time, the financial indicators show that the banking sector in the Republic of Macedonia is characterized by high profitability, solvency and efficiency of its operations. Furthermore, the major part of state-owned banks are subsidiaries of foreign banks, i.e. they are specific legal entities with their own capital being subject to supervision by the National Bank of the Republic of Macedonia (NBRM). As a result of the dynamic development of the Banking Sector and the increased confidence in it, saving is the only source of funds being placed by the banks as credits in the real sector in the last several years. At the end of the third quarter of 2008, total deposits reached an amount of Denar 253.5 billion, being by 11.2% more compared to 2007. Therefore, banks have smaller need, i.e. they almost do not rely on the foreign credit lines. In fact, analyses show that only 2.8% of the total liabilities account for liabilities on the basis of borrowings from foreign banks. Since the households' deposits and the economy are the main source of financing of our banks, they do not depend on the international financial markets for security of funds, because of which, the possible increase of the foreign capital price will not have significant effect on the banking system. It is important to mention that the saving deposits of citizens are insured under the Deposit Insurance Fund, which in the case of possible problems of banks, it will indemnify the citizens. Thereby, the Fund provides high percentage of protection of total deposits in particular with regard to the small savers. Strict criteria for granting credits (clause for variable interest rate and the high percentage of security among the others) enable the Macedonian banks to have quality credit portfolio, whereby only 7.5% of the total granted credits are considered to be non-performing credits. Participation of the exposure classified in the higher categories of risk C, D and E in the total exposure of credit risk at the level of the Banking Sector amounts to 5.5% and compared to the same period in 2007 it improved by 0.2 percentage points. Compared to 2007, improvement by 0.8 percentage points was also felt by the indicator for participation of unreserved amount of the exposure classified in the risk categories B, D and E in their own funds.

Banks in the Republic of Macedonia are well capitalized, they have adequate level of their own funds and fully cover the identified risks, whereby the capital adequacy ratio, as basic measure for the stability of the banks, throughout the whole banking sector is 15.6%, being by 7.6 percentage points higher than the legally prescribed minimum.

Despite this, as a reaction to the global trends, the National Bank has already undertaken preventive measures for limiting the possible risks in the banking sector, being the following:

- obligations for the banks to maintain certain minimum level of liquid assets for covering their liabilities falling due in the next 30 and 180 days
- obligation for allocation of mandatory deposit at the National Bank if the stock of credits to households exceeds the projected growth interest for each separate month
- possibility for the banks to keep the foreign exchange deposits within the National Bank of the Republic of Macedonia

- obligation for exposure of domestic banks to foreign renowned banks to be included in the calculation of the exposure limits in full amount, instead of the so far 20% of the amount
- determination of the type of securities which the authorized banks may purchase and sell abroad etc.

4.2.2. Non-Banking Sector

Capital Market

Actual developments

As of 31st November 2008, 38 companies were listed on the Macedonian Stock Exchange, and the total market capitalisation amounted to Denar 142.3 billion, the market capitalisation of shares, out of which was Denar 124.4 billion and the market capitalisation of bonds was Denar 17.9 billion in the same period. Trading in shares of listed Joint Stock Companies, bonds issued by the Republic of Macedonia such as the denationalisation bonds from 7 issues, bond for old foreign exchange saving and corporate bond is carried out on the Stock Exchange. At the moment, there are 28 authorised participants, 21 of which brokerage companies and 7 banks on the Stock Exchange in the Republic of Macedonia.

In December 2007, Procredit Bank issued the first three-year corporate bond. Total of 5000 bonds amounting to Denar 300,000,000.00 were issued. In the second half of 2008, the Securities and Exchange Commission approved the first issue of corporate bonds of NLB Tutunska AD Skopje via public offer. Total of 12,000 bonds in the total amount of EUR 12,000,000 were issued.

With regard to the continuous government bonds, so far the Republic of Macedonia has issued nine two-year bonds, five three-year- and one five-year government bond.

In the period January-June 2008, the turnover realised on the Macedonian Stock Exchange amounted to around Denar 4.47 billion or EUR 73.28 million, being decrease by 68.90% compared to the same period in 2007. Turnover of shares amounted to Denar 4.03 billion or around EUR 66.2 million being decrease by 70.36% compared to the same period in 2007, while trading in bonds issued by the Republic of Macedonia amounted to Denar 432.06 million or EUR 7.08 million being decrease by 42.35% compared to the same period in 2007.

Such negative trends on the capital market in the Republic of Macedonia were not only result of the global financial crisis, but also of the negative psychological effects at investors, which caused for investors to refrain from investing in securities, as well as selling securities in order to avoid potential capital losses.

In the period January-June 2008, Macedonian Stock Exchange Index (MBI 10) amounted to 4,885.99 indexed points being decrease by 29.37% compared to the same period in 2007.

In the period January-September 2008, five transactions in Treasury Bills in the nominal amount of Denar 7,000,000 were realised on the Over-the-Counter Market.

As of 31st November, average share of foreign investors in the turnover realised when buying the Macedonian Stock Exchange amounted to 21.12%, while their average share in the turnover realised when selling the Macedonian Stock Exchange amounted to 25.59%.

At the moment, five Investment Fund Management Companies, managing with eight Open-End Investment Funds operate on the capital market in the Republic of Macedonia. Three, out of the total eight Open-End Investment Funds are already active, and five are under the procedure of collecting funds. In addition, the Securities and Exchange Commission registered 14 Private Investment Fund managed by 9 Private Investment Fund Management Companies. Establishment of Investment Funds in the Republic of Macedonia is of huge importance for further activation and dynamic development of the capital market in the Republic of Macedonia. Investment Funds by investing the collected money in the shares of the Joint Stock Companies in the Republic of Macedonia as well will directly contribute to the entrance of fresh capital necessary for instigating the domestic economy and its more dynamic development.

Regulation

Securities Law, being largely harmonised with the European Directives is the main law regulating the field of the capital market. Law on Investment Funds, Law on Takeover of Joint Stock Companies, as well as the by-laws arising thereof are the other laws regulating this field.

Securities and Exchange Commission is competent institution regulating and controlling the operations with securities on the territory of the Republic of Macedonia, responsible for legal and efficient functioning of the securities market and the protection of the rights of investors, to the end of constant strengthening of the confidence of the public in the institutions on the securities market in the Republic of Macedonia.

Central Securities Depository is responsible for registration of securities, settlement of trade transactions and performance of non-trading transfers with securities.

In January 2008, the new Law on Investment Funds was submitted to the European Commission, for opinion, which submitted remarks thereon. After the implementation of the remarks in the law, it was submitted to the Government of the Republic of Macedonia in December 2008, being under parliamentary procedure at the moment.

Future Activities

Starting from October 2008, activities for Amendments and Modifications to the Securities Law were commenced, to the end of further harmonisation with the European Directives. Main amendments to the Law are aimed at harmonizing the domestic regulation in the field of establishing investor-compensation schemes in the securities field in securities and Guarantee Fund in the case they fail to settle stock exchange transactions, as well as introducing concept for qualifying holding.

Continuous process of harmonisation of the regulation in the field of the capital market with the European Acquis and the IOSCO principles will continue in future.

Insurance

The insurance market in ten Republic of Macedonia shows upward variety, regarding the number of new licensed entities as well as the offer of services. At the end of the third quarter of 2008, 12 insurance undertakings, 8 brokerage companies and 3 insurance brokerage companies were established and operated on the territory of the Republic of Macedonia. In the Republic of Macedonia, the establishment of insurance undertakings performing activities in the two insurance groups – life and non-life insurance is forbidden by law. Two, out of the insurance companies perform life insurance activities, and the others perform insurance activities in the non-life insurance group. Insurance and brokerage companies perform insurance and brokerage activities within all insurance classes, on behalf and on the account of the insurers.

According to the data on insurance companies for the third quarter of 2008, total capital of insurance companies was somewhat above Denar 2,995 million, being below 1% of GDP of the country for 2007. Capital of life insurance companies is Denar 228 million. From the point of view of the ownership structure, foreign legal entities are dominant accounting for 76.23%, while the state capital accounts for 5.3%. Foreign capital is dominant in 11 insurance companies, while 6 companies are fully owned by foreign legal entities.

The capital on only of insurance company (non-life) was over the necessary solvency margin being under the procedure of capitalisation and reorganisation of its operations. All other companies are solvent and perform regularly the obligations of the insurance contracts.

Gross policy premium under the group of non-life insurance amounted to Denar 4,481 million in the period 1st January 2008 –30th September 2008 and compared to the same period last year grew by 5%.

Regarding the non-life insurance, the share of the insurance of owners of motor vehicles against damages caused by third parties (Motor TPL Insurance) is still dominant in the total gross policy premium accounting for 54.4 %. This insurance class is noticeable by the fact that unlike the same period last year when more than half of the total amount of the gross policy premium in this insurance class belonged to two insurance companies, the breakout of the “new” insurance companies, established in the period after 2002 was noticeable in the first three quarters of the current year. Part of the Motor TPL Insurance premium referring to fulfilment of the obligations of the insurance contract (technical premium) is under the control by the Government of the Republic of Macedonia, being by

30% lower compared to the last year. This is expected to contribute to increase in the number of insurers and more efficient collection of the premium by the insurers. This purpose will also include the amendments to the 2008 Law, by which the Stations for Technical Attestation of Motor Vehicles were forbidden to play the role of insurers and insurance representatives, thus largely redistributing the premium flows from the insurance companies to the Drivers Associations and the Stations for Technical Attestation of Motor Vehicles.

Only two insurance companies perform life insurance activities¹³. One of them is under full foreign ownership, while 70% of the capital of other one is foreign. Life insurance mainly refers to mixed endowment insurance policies.

Gross policy premium under the group of life insurance amounted to Denar 170,806 in the period 1st January 2008 – 30th September 2008 and compared to the same period last year grew by 37% (third quarter 2007: Denar 124,616 thousand).

During the first three quarters of 2008, the supervision functioned within the Financial System Department in line with the Internal Acts on Organisation and Systematisation of Working Posts in the Ministry of Finance. Ministry of Finance is body responsible for issuing licenses and consents, implementing on-site and off-site supervision and imposing supervision measures pursuant to the Insurance Supervision Law.

Pursuant to the modifications and amendments to the Insurance Supervision Law (“Official Gazette of the Republic of Macedonia”, no. 79/07) for the purpose of improving the supervisory function, building stable and sustainable insurance system and greater security of insurers in the insurance services on the market of the Republic of Macedonia, the establishment of Insurance Supervision Agency, an independent supervisory body is envisaged. Agency will be responsible for implementing supervision and imposing supervision and misdemeanour measures as well as adopting by-laws of the insurance market in the Republic of Macedonia to the end of establishing unique manner of informing the market entities, enabling comparative analysis within the financial system in both the country and abroad.

Therefore, inter-agency working group including representatives from the Ministry of Finance, MAPAS (Agency for Supervision of Fully Funded Pension Insurance), NBRM and the private sector adopted Action Plan for Reorganisation the Insurance Supervision. In line with the plan, it is envisaged for the Agency to be established with funds from the 2009 Budget of the Republic of Macedonia, and for the Ministry of Finance to implement all preparatory activities referring to staff, organisational and technical establishment of the Agency.

It is envisaged for the Agency to perform all procedures commenced before the Ministry of Finance pursuant to the Insurance Supervision Law and the Law on Motor TPL Insurance, to prepare and adopt by-laws referring to risk management in insurance companies, financial reporting and accounting in the insurance companies, procedures for obtaining licenses and consents and the other by-laws, by which the operations of the Agency should be regulated, on the short run..

Insurance market is expected to experience further development of life insurance services, as well as the services offered by the third pillar form the reformed pension system.

Interest of farmers to be insured against natural disasters is expected to be developed, particularly after the stimulative measures undertaken by the Government of the Republic of Macedonia for participating in the premium payment of 30%.

On the other hand, in future, the quality of corporate governance of the insurance companies and usage of benefits from the transparent operations and disclosure of the data on market data is expected to be improved on the long run.

¹³ One Insurance and Reinsurance Company stopped concluding new life insurance contracts in 2004, but it services the liabilities under the previously concluded life insurance contracts and gives separate reports on the financial outcome and the operations within the two insurance groups.

Further harmonisation of the national legislation with the EU Legal Acts referring to insurance groups, financial conglomerates, reporting on consolidated basis and the concept of Solvency 2 for risk-based supervision is envisaged on the medium run.

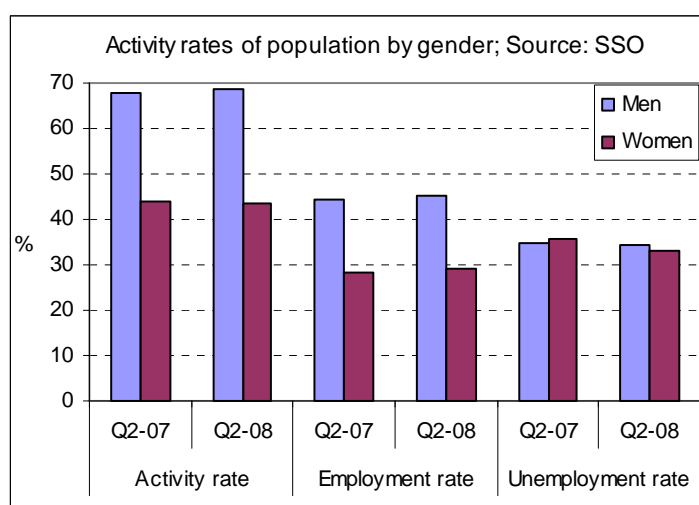
In line with the envisaged dynamics for modifications and amendments to the regulation of the financial services market, appropriate priorities for institutional improvement of the supervisory body operations and reviewing alternatives for integrating the supervisory bodies on the financial market of the Republic of Macedonia will be also dimensioned.

4.3. Development of Human Capital

4.3.1 Current Background on the Labor Market

Economic activity of the population aged over 15 years¹⁴ in Q2-2008 increased by 56.2%, being an increase by 0.5 percentage points (p.p.) compared to the same quarter last year. Activity rate was the highest for the age group 25-49 years (so called primary working group) reaching 79%.

Chart 20: Activity rates of population by gender



Employment rate increased by 37.2% in the second quarter, being an increase by 1 p.p. compared to the same quarter in the previous year. In this period, the number of employees increased by 17,871 individuals, being an increase by 3%. Thereby, on net basis, the working posts were created by the private sector, where the number of employees increased by 6%, while the unemployment dropped by 3.9% in the other part of the economy. Analysed according to the economic status of the employees, the number of self-employed persons significantly increased (so called employees for their own account) by 18.5%, partially as a result of the measures and the support of the Government for encouraging the entrepreneurship and the private initiative (and the active policies on the labour market, primarily the granting of credits for starting private business).

Thus, the share of the self-employees in the total number of employees increased by 13.4%, from 11.7% in Q2 2007 (see chart).

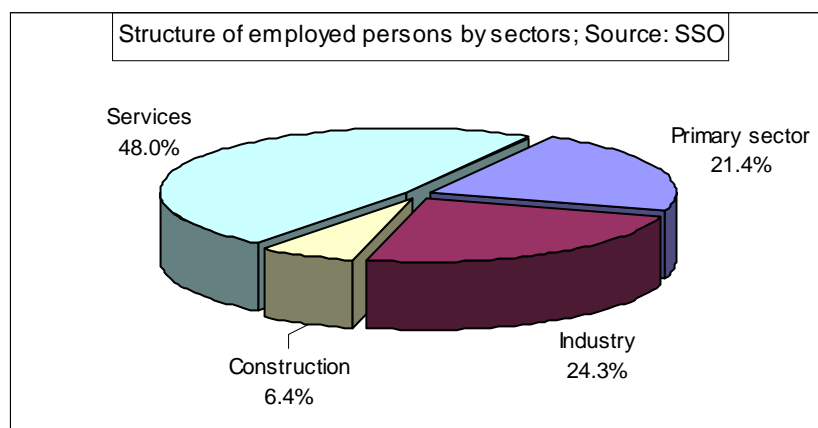
Number of employers decreased by 4.7%, number of workers increased by 1.6%, while the number of unpaid family workers increased insignificantly.

According to the economic sector, the highest employment growth in Q2 2008 compared to Q2 2007 was observed in the primary sector (14.7%), while the employment growth amounted to 2% in the industry. Unexpectedly, taking into account the high (real) growth of the value added in the construction sector by almost 17% in the first half of 2008 compared to the same period last year (even 23% in Q2 2008), the employment in the field of construction dropped by 3.2%, pointing out possibly to the strong productivity growth.

¹⁴ According to ILO (MOT) definition, population at the age of 15-80 years is considered to be working-age population

Regarding the services, as the biggest “employer”, there were no significant changes on net basis. Therefore, the productivity growth was the highest in the industry, with 10.4%, the services (including the construction) increased by 4.7%, while the productivity dropped by 10.3% in the field of the agriculture. Average growth of the productivity in the economy was 3.4%.

Chart 21: Structure of employed persons by sectors



Analysed according to age categories, number of employees/employment rate increased at the age group 25-49 years by 3.1% to 54.1%, regarding the elder age group 50-64 years, it increased by 5.1% to 39.6%, while with regard to the youngest age group the employment decreased by 4.9% to 15.6%. Thus, the Employment rate measured for the population 15-64 years amounted to 41.8% compared to 40.7% in the second quarter of 2007.

Unemployment rate reached the lowest level of 2003, amounting to 33.8% in the second quarter of 2008, being decrease by 1.2 percentage points compared to the same quarter last year. Number of unemployed persons was lower by 2.1%, whereby the age group 15-24 years experienced the biggest drop by 4%, although the unemployment rate at this age group increased by 56%. This is due to the higher decrease of the labour force at this category, i.e. increase of the inactivity. Regarding the category 25-49 years unemployment/unemployment rate reduced by 2.4% to 31.6%. Oldest age group (50-64) experienced decrease of the unemployment rate, amounting to 28.8% in the second quarter. Thus, the unemployment rate for the population 15-64 was 34% compared to 35.2% in the second quarter of 2007.

Analysed according to the school preparation, persons with primary and lower education had the highest unemployment rate (of 40.4%), being lower by 1.6 percentage points compared to the one in the second quarter of 2007. Unemployment rate of persons with secondary (high-school) education dropped by 1.9 percentage points, amounting to 33.3%, while the unemployment rate of the persons with higher education increased by 1.3 percentage points, to 22.5%.

Taking into account the fact that the growth of the number of employees is the highest (by 10.6%) for the persons with primary and lower education and the majority of the new employments were created in the field of agriculture, where the salary amounted to 60% of the average one, and that the productivity was very low (regarding the services the status related to the employment was “status quo”), one can conclude that despite being necessary to increase the level of education in the country, it is desirable to modernise the agricultural production, i.e. transfer towards higher processing phase and bigger value added.

Employment Elasticity

Employment elasticity shows the extent to which the employment is instigated by the economic growth, i.e. how big is the employment created as a result of the economic strengthening of the country.

$$\epsilon = (\Delta Y / \Delta E) * E / Y$$

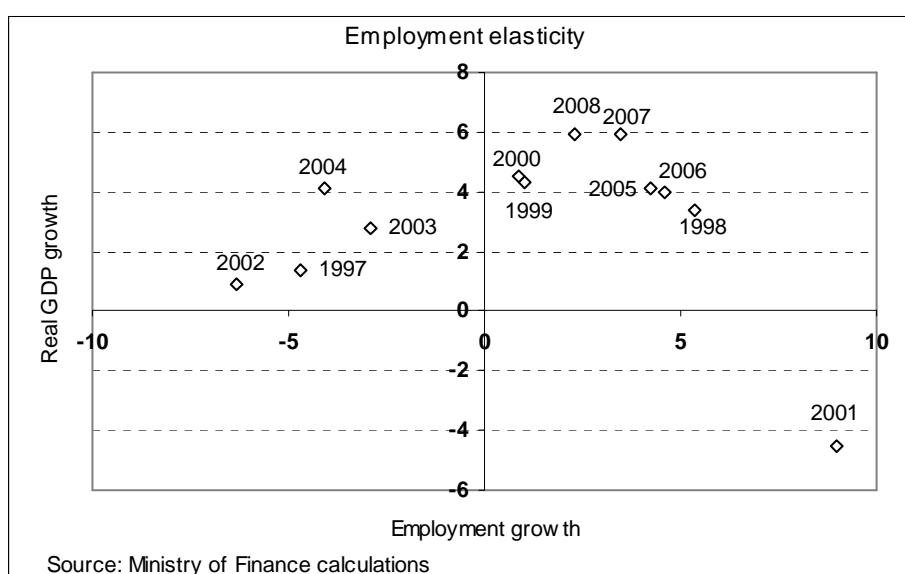
Where:

ϵ – employment elasticity

Y – Gross Domestic Product

E - Employment

Data (calculations) on the last four years show that 80% of the employment growth is explained by the economic growth, i.e. real GDP growth by 1.1 percentage point caused increase in the employment by 0.8 percentage points. Thus the real GDP growth by 5.5% for 2009 would cause employment growth by 4.5%.



Data from the Employment Agency of the Republic of Macedonia

During 2008, the number of persons registered as unemployed in the Employment Agency of the Republic of Macedonia constantly decreased reaching 343,692 persons at the end of September. Thereby, 20% of these individuals said that they register as unemployed solely for the purposes of using free health insurance. In September, the outflow of individuals from the registry amounted to 2.8% of the registered unemployed persons, while the outflow in the registry was lower, i.e. 9,127 individuals, 48.2% out of which lost their job.

In the period January-September 2008, 155,674 new employments were registered, being by 9.8% higher compared to the same period in 2007. Thereby, the sector of services absorbed the majority of the new employment (share of 58%), mainly in the field of trade. The industry comprised 32.5% of the new employment, while the construction comprised 6.2%. New job creation was the lowest in the primary sector, participating with 3.2%.

4.3.2. Educational Reforms – Human Capital

The human capital is an essential input in the manufacturing process, rising up or slowing down the economical growth. The functioning of the labor market is conditioned by the matching degree between the offered and required human capital. In other words, the companies should easily find workers owning adequate skills for the job. On the other hand, the analysis show that higher educated persons have increased opportunity of finding jobs/or earning higher profit.

Inheritance deficiencies in the formal and informal education which are relevant for creating and increasing the human capital, present serious obstacle for rapid and harmonized development of the Republic of Macedonia. Mainly the reason for such situation is the lack of investments and focusing on the inputs instead of the outputs (the knowledge accumulated in the individuals), and partly, it is the slow implementation of the reforms in the transition period, and therefore the indicators for education in the Republic of Macedonia are weak.

The analysis of the educational structure in Republic of Macedonia, show that almost half (49.39%) of the persons under 15 years old, do not own any education at all or they own low level of education (illiterate, not completed primary education or with a primary education). Other international analysis (such as PISA –Programme for International Student Assessment) show that the overall knowledge of the Macedonian pupils fall behind the knowledge level of the pupils in the other countries.

Therefore, in the last two years, significant measures for improvement of the quality of the education are undertaken, as well as linking it to the labor market. Some of the undertaken measures are significant as measures for decreasing the social exclusion of the vulnerable groups.

Primary education

The main purpose of the reforms in the educational system is the adoption of the European standards in all of the educational degrees as well as improvement of the gained knowledge of the pupils. The reforms of the primary education have its main axis, which is introducing the nine year compulsory education starting from the 2007/2008 year. International researches point out that the decreasing of the age of the pupils attending primary schools is efficient mean for decreasing the influence of the family social and economical status to the achievements of the pupils. This is especially important having in mind that only 12.4% of the children at the age of 0-6 years in the Republic of Macedonia attend kindergarten.

In July 2008 a new Law on primary education was adopted, where EU measures concerning the right of the education for the children citizens of the EU, as well as harmonization of the legal regulations in the area of the education.

With the reforms in the primary education the number of the pupils enrolled in the first grade is increased. In the school year 2006/2007 24,056 pupils were enrolled in the first grade, and in the school year 2007/2008 44,384 pupils were enrolled in the first grade. From the social inclusion aspect, important indicator is that roma pupils enrolled in the first grade is increased up to 30%.

Secondary education

One of the key challenges in Republic of Macedonia is increasing the level of the education and the skills of the working force, due to the generally low level of the education of the Macedonian citizens that can be an obstacle for the future development of the Republic of Macedonia. For that purpose the Government of the Republic of Macedonia has adopted Amendments of the Law on secondary education, where a compulsory secondary education is introduced starting form the school year 2008/2009. In the same time, this measure is important for decreasing of the social exclusion and poverty, if we keep in mind that the low education is the main factor for unemployment of the vulnerable groups.

Second significant change in the secondary education is the introduction of the external evaluation of the achievements of the pupils. So far the method for evaluation of the achievements of the pupils from their teachers was unrealistic, and the grades not always were good indicator of the gained knowledge, respectively there was so called appearance "inflation of the grades".

There is why, the secondary educational institutions did not send quality signals concerning the educational and skills quality of the pupil to the future educational institutions (faculties) as well as to the labor market. With the introduction of the external evaluation, there will be improvement of the signals, respectively the grades will be relatively better indicator of the gained pupils' knowledge, which will help easily to determinate the better pupils, future students or workers. In the same time, on the basis of the incoming results form the external evaluation the teacher's impartiality and professionalism will be evaluated.

In June 2008, the first phase of the State Matura was successfully conducted, and each pupil was examined on compulsory subject –mother tongue-external, elective subject-foreign language or mathematics-external, two elective subjects and projects task-internal.

Adult education

With the adoption of the Law on adult education in January 2008, a small improvement has been made in the area of the adult education. This Law provides legal framework for regulation of all of the types for adult education (formal and informal), aims and the tasks of the adult education, the offers of the services for adult education, competent institutions for adult education, as well as financing the adult education. Unfortunately, no significant improvement is accomplished in the process of the implementation of this law.

Higher education

The higher education is integral and undivided component for development of each country. Not only it is the strongest moving force which determines the socio-economical development of the country, but the quality as well, that determines the countries. The world trends imposed the stressed need for immediate transformation of the overall set of the higher education in the Republic of Macedonia as well as introduction of the quality adequate to the country needs, in direction of achieving its international competitiveness.

This should reflect on efficiency increscent of the studies, students' mobility and the academic staff, improved quality of the educational process, increasing of the working possibilities for the graduated students on the domestic labor market as well as competitiveness with the European and world higher educational institutions. In this direction, the undertaken and planned reforms in the higher education represent implementation and structural adoption of the principles and recommendations coming from the Bologna process in the higher education in the Republic of Macedonia.

In March 2008, a new Law on higher education was adopted. This law consists the fundamental principles of the Magna Carta of the Universities and the basic principles and recommendations of the Bologna Declaration, and it is consisted with the following novelties: integrated university concept; first, second and third cycle studies; new criteria for election of the junior assistant; junior lector and junior artistic assistant; issuing of the diploma supplement as well as joint degree, simplifying the procedure for academic recognition of the foreign qualification; development and realization of the study programmes for vocational and professional improvement in the contest of the Life Long Learning; realization of the programmes for joint degrees within one or more universities, etc.

With the Law on Amendment of the Law for establishing a State University in Tetovo, several new faculties have been established within this university. The number of the faculties within the State University of "Goce Delcev" in Stip, as well as the University of "St.Kliment Ohridsk" in Bitola has been increased. Part of these are functioning as dispersed faculties in the cities near the above mention universities, in order to alleviate the admission to the higher education for all citizens of the Republic of Macedonia.

National agency for European educational programmes and mobility (NA)

The Ministry of education and science, last year has full filed the administrative preconditions for full participation in the Community programmes : Life Long learning and Youth in Action.

The Law for establishment of the National agency foe European educational programmes and mobility was adopted in September 2007. The working programme for 2009 is adopted. From January 2009, the National Agency will start the pilot projects in cooperation with other European agencies.

For the first time, in 2008 Republic of Macedonia has organized the event "Researchers night" with directive support from the European commission. The event had main purpose to increase the public awareness of the scientific workers job, bringing it closely to the public through presentations of their scientific works, projects etc.

Planned reform activities in the area of education

- Establishing State Exam Centre-its competence refers to the preparation and realisation of the State Matura exams, as well as realisation of the external evaluation in the primary and secondary education. Basic purpose of this Centre is to contribute towards efficiency and quality in the education;
- Action Plan for life long learning is in the phase of preparation, and it is expected to be adopted by the end of 2008. Till the end of 2008, a Centre for adult education is planned to be established, as a body responsible for realisation of all the activities for adult education, and the Council for adult education, established by the Government of the Republic of Macedonia, will be an advisory body, proposing strategic questions referring the policy on adult education;
- Literate and gaining first degree of professional qualifications for persons in custody in the Penalty Correction Institutions in Republic of Macedonia, through the Centre for adult education;
- In phase of preparations are the Occupational standards, teaching materials and exam plans for specified scarce occupations, which are determined by the Centre for vocational education on the basis of carried out analysis of the labour market;

Introduction of the occupational standards refers to increasing the connection between the educational system and the labor market. The above mentioned activities are connected with the implementation of the Operational Programme on activities and measures for employment.

4.3.3 Reforms for advancement of labor market functioning in the Republic of Macedonia

Main objective of the employment policy in the Republic of Macedonia is to further advance functioning of the labour market and better match labour force supply and demand. Thus, the policy is mainly consisted of three elements:

- Further improvement of legislation and its enforcement
- Strengthening the capacity of the labour market institutions
- Implementing active labour market measures that influence knowledge and qualifications of the labour force or subsidy the employment of vulnerable groups of population.

In 2008 CARDS project "Technical assistance to support of employment policy- phase III" continued being implemented. The project lasts for 18 months and has objective to strengthen the capacity of all relevant institutions and actors to effectively implement, monitor and evaluate employment policies, further modernization of Employment Service Agency and improvement of its services and operations, as well as strengthening capacities of social partners.

In line with the National employment strategy 2010 and National action plan for employment 2006-2008, financial allocations for active measures for employment are continuously increased by the Government of Republic of Macedonia, and in the same time types and coverage of measures is advanced in order to increase efficiency in integrating target groups in the labour market and increase employability of these persons.

In 2008 an Operational plan for active employment programmes and measures was implemented. This plan included several active employment measures and policies targeting different vulnerable groups of unemployed persons, namely:

1. Self-employment programme- The programme is realized through training provided for interested unemployed persons regarding the introduction with the entrepreneurship, preparation of solid and sustainable business plans, assistance regarding the registration of business and subsidy for business start up.

The Self-Employment Programme was implemented through the following measures:

- 1.1. Self-employment of young unemployed persons up to 27 years of age
 - 1.2. Self-employment of unemployed women, registered by EARM for more than two years
 - 1.3. Self-employment of long-term unemployed, registered by EARM for more than two years
2. Programme for support of family businesses formalization, whose purpose is the formalization of businesses started by unemployed persons and legal inclusion in the labor market in order to reduce

grey economy. This programme is realized by means of assistance upon the registration of the existing business of persons having informal experience in the area in which they work and needing subsidy for business formalization.

3. Programme for preparation for employment that offers training, retraining and additional training and advising of unemployed persons regarding the acquiring of knowledge and skills in order to increase their employability. Programme included following measures:

- 3.1. Vocational training, retraining or additional training for a known employer;
- 3.2. Training in the job clubs for acquiring knowledge and skills (foreign languages and computers);
- 3.3. Pilot training project for certain professions and skills that are in demand on the labour market, according to the Skill Need Analysis for the labour market in RM, conducted by the EARM on the basis of the employers' survey made in 2007;
- 3.4. Education for starting up a business.

4. Employment subsidizing, realized through these measures:

- 4.1. Subvention for employment of children without parents
- 4.2. Subvention for employment of disabled persons
- 4.3. Subvention for employment of single parents
- 4.4. Subvention for employment of elderly persons (55-64 years of age)
- 4.5. Subvention for employment of young persons up to 27 years of age and unemployed redundant persons from closure of dominant state owned enterprises.

5. Internship as a support for the first employment of young persons up to the age of 27.

The aim of this programme was inclusion of young, educated, unemployed persons which will lead to their permanent employment. This measure prepared them for entering into the labour market.

6. According to the Programme for Roma employment, 100 Roma persons were included into training on account of their employment.

In 2008, for these programmes and measures from the Operational plan for active employment programmes and measures 294 millions denars were allocated and 6707 persons were included.

Besides the programmes and measures included in the Operational plan, the Government has provided 6.3 millions Euros for business start-up for employing unemployed persons from the target groups. The loans in an amount of 3000 Euros per unemployed person have interest rate of 1% on annual level and payment deadline of 3 years.

In total, 682 millions denars (0.17% of GDP) are allocated for active employment policies and measures in 2008, with a coverage of 8771 persons. For comparison, amount allocated to active labour market measures in new EU member states as percentage of GDP is: Estonia 0.06%, Romania 0.13%, Latvia 0.15%, Czech Republic 0.18%, Poland 0.28%, Bulgaria 0.39% and Hungary 0.45%, or in average these countries allocate 0.2% of GDP, against 0.5% of GDP in EU-15.

Having in mind the importance of the local dimension upon the preparation of economic development plans and plans for increasing employment rate, based on experience of preparation of national action plans for employment, as well as European guidelines and experiences, local action plans for employment have been prepared in five pilot municipalities (Bitola, Struga, Kumanovo, Stip with Karbinci and Berovo with Pehcevo). In order to achieve successful preparation of these local action plans for employment and taking in consideration the specific local circumstances, needs and possibilities, there has been establishment of cooperation between relevant subjects on local level, including the local self-government, local employment centers, social partners, non-governmental organizations, training providers etc. This activity continues by the preparation of 6 additional local action plans for employment.

Part of the planned activities to strengthen the capacities for creating policies, programmes and measures for employment, as well as to effectively implement, monitor and evaluate achievements and results were conducted with support of CARDS project "Technical assistance to support of employment policy- phase III".

In 2008, focus was on creation of functional system for monitoring and evaluation of the implementation of the National Employment Strategy 2010 and National Action Plan for Employment 2006-2008, which will be in accordance with the European principles and experiences and use of EU indicators for employment. Practical training on monitoring and reporting on implementation of employment policies and main strategic document in this filed was organized for persons actively included in this.

Modernization of the Employment Agency of Republic of Macedonia

Employment agency of the Republic of Macedonia, as the most important institution on the labour market, continued the reinforcing of its own capacities and the continuous modernization during 2008.

In order to advance the process of design of labour market policies Employment Service Agency of the Republic of Macedonia started to regularly conduct research and skills needs analysis of the labour market. In June 2007 Employment Service Agency published its first national report of the skills needs analysis of the labour market in the Republic of Macedonia. ESA started to perform individual employment plans as part of the efforts to offer more quality service to the unemployed persons.

In 2008, main focus of CARDS project "Technical assistance to support of employment policy- phase III" was strengthening the capacities of ESA, through developing new service model, support in creation of local action plans for employment, training on the base of mid-term training plan, etc.

4.3.4 Labor law reform

In March 2008, the European Commission approved the twinning project for harmonization of the labour legislation with the EU legislation. The project initiated in May 2008. Within the twinning project an assessment is conducted on the degree of harmonization of the Macedonian labour legislation with the EU directives, tables of concordance were prepared, and in the mid 2009 proposals for amending laws will come with aim to fully transpose directives into Macedonian laws.

In 2008, the Assembly of Republic of Macedonia has amended the Law on labour relations twice. The amendments are in direction of improving business climate, greater flexibility of the labour market and simplifying the administrative procedures for the employers, and in general making labour market more dynamic. The amendments include:

- Opportunity for the employers to electronically (on line) register and unregister employees;
- Electronic data exchange between the Employment Agency of Macedonia and the institutions for social insurance;
- Increase of the period of fixed term employment contracts from 4 to 5 years and extension of the basis for concluding such contract;
- Removing of the provisions by which the employers were obligated not to engage workers in the same work post, for one year after dismissal of employees, and give employment privilege to the previously dismissed worker;
- Harmonizing the provisions for professional rehabilitation and disability insurance;
- Harmonizing the provisions for wages and allowances with the Law on mandatory health insurance contributions;
- Increasing penalties for violating the provisions from the Law.

Planned activities

Government of Republic of Macedonia will undertake the following measures and activities for improving of labour market functioning:

- Preparing of National reform program, according to the European guidelines for growth and jobs;
- Creation and implementation of the Operational plan for active policies and measures for employment in 2009;
- Finalizing and adoption of the model for reporting of employment policies realization, fortified indicators and realization of goals and tasks for implementation of employment policies and measures;
- Development of local action plans for employment, based on experience of preparing national action plans for employment, as well as European guidelines and practices;
- Further strengthening of the EARM capacities, staff and technical equipment for EARM and the local centers for employment;

- Promotion activities (brochures, flyers, web information etc.) in order to familiarize clients with EARM, through promotion of services, presentation of information, as well as operational achievements and implementation of labour market measures;
- Training of EARM staff for utilization of the new service model
- Training, seminars and other activities for improving knowledge and skills of staff in creation of employment policies and strategic documents, evaluation of the results of their implementation, as well as functioning and administering programmes supported by European social fund;
- Realization of preliminary activities, personnel and technical completion of IPA units/sectors in the Ministry of labour and social policy and Ministry of education and science, in order to independently and fully take over the function of Operative structure for the fourth component of IPA;
- Training for the employees in MLSP and EARM related to the policy, network and operational structure as well as practical working at EURES (European employment services), training on preparation of labour market projects that should be financed by IPA and training on grant schemes management.
- Trainings on preparation of labour market projects for utilization of IPA funds (4 component) and trainings for the work and role of European social fund.

4.3.5 Introducing the Concept of Gross Salary and Reform of the System for Financing of Social Contributions

Government of the Republic of Macedonia started essential reform in the field of salary taxation i.e. labour force costs aimed at encouraging new job creation. At the moment, the Republic of Macedonia is in the group of countries with the lowest personal income tax due to the recent introduction of flat tax and the reduction of previous progressive tax rates (15, 18 and 24%) to 10%. However, the current total tax burden is still relatively high, primarily for the low-qualified worker, being the most vulnerable group from the point of view of unemployment and informal employment. High tax burden at low paid workers was result of the existence of minimum base for paying the mandatory social insurance contributions amounting to 65% of the average salary in the country. Thus, the tax burden for average paid worker receiving food allowance exempted from taxation (food and travel allowance) amounted to 33%, while the tax burden for worker earning half of the average salary (including the food allowances exempt from taxation as well) was higher amounting to around 39%. Thus, the system of "taxation" of the labour force is regressive.

To the end of reducing both tax burden and administrative burden for the enterprises, i.e. to the end of creating more transparent system, with easy recognizable labour force costs, the Government undertook essential system reform. Reform begun in January 2009, including the following:

- full harmonisation of the bases for payment of contributions and reduction of the minimum base for social insurance contributions from 65% to 50%,
- reduction of the social contribution rates from 32.0% to 27.9% and further on to 22% in 2011.
- introduction of the concept of gross salary of workers with broadened tax base (incorporating food and travel allowances), and
- integrated collection of social insurance contributions and personal income tax in the Public Revenue Office.

By harmonising and integrating the bases, calculating and collecting social contributions, the administrative burden for enterprises will be reduced in a way that the calculation will not be carried out on different basis for different contributions. In addition, this measure will create good basis for more accurate monitoring and simplified control over the payment of contributions by the competent institutions and equal competition among the economic entities.

Reduction of the minimum base for payment of contributions will provide for progression of the taxation system, as opposed to the present regression, and will contribute to narrowing the payment gap, especially regarding lower salaries. In addition, lower minimum base will stimulate, to a certain degree, the employers to register and to socially insure the workers (in particular those in branches receiving lower salaries).

Reduction of contributions rates will additionally reduce the payment gap. Reduction of the social contributions rates will be gradually carried out from the current 32% to total amount of 22% until 2011.

According to the changes in the calculation and the concept of payment of salaries, liable person for payment of social insurance contributions is the employee, while the employer pays the contributions on behalf and for the account of the employee. Workers will have full insight in whether their obligation is met and will have greater interest in pressuring the employer to pay the contributions. Paid contributions will be shown in verified written salary statement

Food and travel allowances will become an integral part of the gross salary and will not be exempt from payment of social insurance contributions, since, in reality, they are frequently paid in cash, rather than as hot meal, bus ticket etc., they lost the proper function in time. In addition, their non-taxation (up to certain amount) was abused by certain employers who actually substitute the salary with the food and travel allowances. For the purpose of smoothing the effect from the inclusion of the food and travel allowance in the salary and its taxation, the amount of the personal exemption from personal income tax will increase from the current Denar 3,294 to Denar 7,000 for 2009. Within the new system, the amount of gross salary the worker receives will be defined in the work contracts.

After introducing the concept of gross salary, single cost for the employer is employee's salary. In addition, the salary calculation will be simplified, thus the administrative costs of the employer will be reduced. Furthermore, the margins for possible manipulation by the employer were narrowed so as to avoid the obligation to pay contributions, since the obligation to pay them is related to the salary payment.

Integrated collection of the social insurance contributions and the personal income tax by the Public Revenue Office will enable simpler and cheaper system, better and centralised records and evasion reduction.

Fiscal Effects of the Social Contributions Reform

On the basis of the calculations of the Ministry of Finance, being confirmed by the World Bank¹⁵, the fiscal influences from the social contributions reform will not be significant. In fact, on the basis of the following assumptions for 2009:

- economic growth by 5.5%,
- low inflation from 3-3.5%,
- increase of the average salary by 10%
- as well as employment increase by 4%

In 2009, it is expected that the loss of revenues in the budget will not exceed 0.2% of GDP. In more details, the loss of revenues would amount:

- Health Insurance Fund – 5.2% reduced revenues in 2009 compared to 2008,
- Pension Insurance Fund – 3% more revenues in 2009 compared to 2008,
- Employment Agency – same level of revenues in 2009 as in 2008.

The proposed reform will significantly decrease the labour taxation due to the reduction of social contributions rates by 4.1 percentage points in 2009, 3.2 percentage points in 2010 and 2.7 percentage points in 2011.

¹⁵ Evgenij Najdov (2008) Technical Note – Fiscal impact of Planned reduction in Social Security Contribution Rates

Thereby, it is very important that the labour taxation decrease will be observed at the low-paid workers, which will decrease from 40% to 32% in 2009. Of course, bigger labour taxation decrease will be observed in 2010 and 2011.

Social contributions reform effects on employment

Main motif of the Government of the Republic of Macedonia to introduce social contributions reforms is the improvement of the conditions on the labor market, i.e. employment increase and unemployment reduction. Ministry of Finance, in cooperation with the World Bank¹⁶, has made simulations on the influence of the reform on formal employment (on the basis of data on insurers in the Pension and Disability Insurance Fund). Thereby, calculated increase of employment refers to creation of new jobs, as well as reduction of grey economy, i.e. pass through of workers from the informal to the formal sector. Analysis has been made on the basis of different assumptions on labor demand elasticity, as well as the pass through effect. Labour demand elasticity shows the employment increase as a result of reduction of the labour costs by 1 p.p. On the basis of literature, we assume elasticity is higher at lower salaries. Pass through effect shows the percentage decline of labour costs, as a result of reduction of the labour taxation by 1%¹⁷.

Increase in employment is calculated on the basis of the following formula:

$\Delta E = \tau \eta E_0$, whereby,

$G(e) = \tau \eta$

where τ is the pass through effect, η is labour demand elasticity, and $G(e)$ is employment growth rate, $\Delta E / \Delta E_0$.

Thereby, estimated effects on employment depend on the assumptions for τ and η magnitude. Thus, three scenarios are possible:

- optimistic, where τ is 0.4, and η is 0.5
- baseline, where τ is 0.3, and η is 0.5
- pessimistic, where τ is 0.2, and η is 0.3

On the basis of such calculations, employment increase as a result of social contributions reforms will be as follows:

	2009	2010	2011	2009-2011
Reduction of labour taxation (percentage points)	4.1	3.2	3.7	10.0
Effect on employment – additional job positions				
Optimistic scenario	3,178	2,480	2,093	7,750
Baseline scenario	1,919	1,949	1,264	4,680
Pessimistic scenario	992	774	653	2,420

On the basis of such presented data, we conclude that 1 p.p. out of the planned 4% employment increase in 2009 will result from the reform, while the remaining 3 percentage points will be result of the economic growth.

¹⁶ Jan Rutkowski, Technical Note, Employment Effect of the Planned Labour Tax Reform - results of sensitivity analysis, World Bank (2008)

¹⁷ Reduced labour taxation, i.e. reduced social contribution rates, is not fully reflected on reduction of labour cost, and it has partial influence on increase of salaries of employees.

4.4 Infrastructure

4.4.1. Energy market

Law on Changing and Amending the Energy Law was enacted by the Assembly of the Republic of Macedonia on August 26, 2008. With the Law on Changing and Amending the Energy Law a further compliance is made to the Directive 2003/54/EC for general rules of the internal electricity market thus enabling creation of conditions for implementation of the liberalisation of the electricity market in the field of the direct consumers, i.e. the consumers directly connected to the transmission network. These consumers become qualified consumers and are obliged to provide their electricity needs on the open electricity market. This solution stipulates opening of the market in amount of about 42% of the total electricity consumption. This enables entry of more electricity traders that would supply the eligible consumers.

The above mentioned changes and amendments of the Energy Law also create conditions for functioning of the natural gas market, as well as for increasing the participation of the renewable energy sources in the energy balance of the country.

Investments in the energy sector- Security in the electricity supply

The Ministry of Economy signed an agreement with the Macedonian Academy of Science and Arts for preparation of a Strategy for Energy Development. According to the Agreement, the Academy prepared and submitted to the Ministry a draft final version of the Strategy determining the long-term objectives for development of separate energy activities in order to provide security in energy supply.

On December 19, 2008 an international public call was published for expression of interest for participation in a pre-qualification procedure for construction of HPP "Chebren" and HPP "Galishte". The construction of both HPPs is envisaged to last 8 years. The deadline for submission of applications is March 19, 2009.

The Ministry of Economy published an international public competition for expression of interest for participation in a pre-qualification for awarding a concession for construction of HPP "Boshkov Most", whose construction would be based on concession at BOT model (build, operate, transfer). The qualified companies, on October 22, 2008, were invited to collect tender documentation. The deadline for submission of bids is February 11, 2009.

For construction of the combined gas heating thermo power plant, JSC ELEM on September 19, 2008, published an international public call for financing, construction and operational use of the combined gas heating plant "Energetika" as a partner in a joint venture with JSC ELEM. This plant is envisaged to have installed power of 300MW for electricity generation and 150 MW for heat generation. The expected annual electricity generation will be 2000GWh and 500 GWh heating energy. The total investment value will be 250 million EUR. The interested potential investors for this project should submit their bids latest by March 31, 2009 after which there will be a process of bids evaluation and selection of the most favourable bidder.

On December 15, 2008 a third international public call was published for awarding a water concession for 20 small HPPs. The deadline for submission of bids is April 16, 2009. In the course of 2009 and 2010 it is envisaged to publish new announcements for awarding water concession for small HPPs.

In December 2008 started the operation of the first 400 kV interconnection between the power systems of the Republic of Macedonia and Republic of Bulgaria (Shtip-Crvena Mogila), which enables reliable and secure work of the two power systems.

The Government of the Republic of Macedonia approved a state guarantee in amount of 11 million EUR for construction of the interconnection line Shtip (Republic of Macedonia) – Nish (Republic of Serbia), where 3 million EUR would be funds of JSC MEPSO. For that purpose, JSC MEPSO has submitted to all international financial institutions and bilateral creditors the conditions of the stipulated credit. The World Bank was elected as the most favourable bidder. The length of this long-distance line on the Macedonian part is 70 km.

On October 27, 2008 the Ministry of Economy published an international announcement for expression

of interest for participation in prequalification for construction, operation and transfer of 12 HPPs in the course of the Vardar River, based on the concession model. The 12 HPPs have total installed power of about 325 MW, annual generation of about 1050 GWh and total investment value of about 1.2 billion EUR. The prequalification announcement is open until March 16, 2009.

With the aim of further development of the gas system in the Republic of Macedonia, on September 3, 2008 an announcement was published for preparation of a Feasibility study for the gas system in the Republic of Macedonia with an idea project. The Study will provide technical and economic analysis for: the existing situation of the constructed gas line system, regional, cross-border and other conditions for development, proposals and way finalisation of construction of the system pursuant to the conditions in South-East Europe and wider and examining the possibilities for utilisation of gas in the course of period of 20-30 years from now. By preparing the Feasibility Study defined would be the strategic conditions and the phases for time realisation of the gas system, as well as the adequate priority direction for fastest realisation. In the course of 2009 Gasification Study of the Republic of Macedonia will be prepared and a decision will be made for the direction of extending the gas system.

In the course of 2010 и 2011 it is planed to start several specific projects in the field of electricity and in the field of the gas sector, which would increase the security of supply with energy in the country, as follows: 400 kV interconnection line Bitola (R. Macedonia) – Elbasan (R. Albania) – Italy and upgrading of the existing 200kV interconnection line Macedonia-Kosovo at 400kV voltage level.

Subsidies for greater utilization of solar energy

During 2007 a stimulation measure was realised for subsidising the first 500 buyers of solar thermal collector systems, which were adequately installed in their homes. The simulative measure was 30% of the investment, but no more than 300 EUR per applicant.

Due to the big interest for using the solar energy in households, and at the same time due to the success of the implemented subsidy measures, the Ministry of Economy, in the budget for 2009 stipulated funds in amount of 9.000.000 denars for further subsidising of the households that would install solar thermal systems in their households. In the course of January, the Ministry of Economy published the announcement for stimulation measure for subsidising of the first 500 buyers of solar thermal collector systems that would adequately be installed in their homes.

“Solar water heaters” Project

This project is realised with grant from the Austrian Government in amount of 300.000 EUR and participation of the Macedonian side in amount of 20.000 EUR. Within this project in the Hydro meteorological Administration –Skopje a solar test center (laboratory) was installed with the objective of testing the solar collectors from the aspect of meeting the valid standards for their further placement on the domestic and foreign market.

The future activities related to the solar test center should move in direction of training and upgrading the responsible persons in the Hydro meteorological Administration for the work and the maintenance of the laboratory, with the aim of making the center as soon as possible to be operative and start testing the first solar collectors.

4.4.2. Road transport

In order to increase the efficiency of the transport system in the Republic of Macedonia, intensive work has been completed on the finalisation of the legal framework that regulates the relations in the area of transport.

Therefore, Amendments to the Law on Transport in the Road Traffic have been prepared, (Official Gazette of the Republic of Macedonia No. 68/04 and 127/06) thus providing further harmonisation of certain provisions of the law with the EU acquis from this field, which above all are related to the conditions of the procedure for issuing licences for performing certain types of transport in the road traffic.

In order to provide complete implementation of the provisions of the law, by-laws have been brought forth, which analyse certain provisions of the law in details, thus providing conditions for starting the procedure for issuing licences.

Pursuant to the law, a Regulation has been brought forth for the manner and procedure of distribution of the licenses of international transport of goods (Official Gazette of the Republic of Macedonia No.107/07). The regulation introduces an electronic manner of distribution of licenses for international transport of goods that shall provide better efficiency and transparency as well as elimination of the corruption in the process of distribution.

The Republic of Macedonia, regarding the bilateral agreements for international transport of goods with certain countries of Europe, exchanges around 100 000 licences for truck carriage of goods.

As a member of the European Conference of the Ministers of Transport of Europe (ECMT), for 2009, the Republic of Macedonia shall use 845 licenses for truck transport of goods from the quote of ECMT.

The Ministry of Transport and Communications acquired new software for electronic distribution of licenses for licenses in the international transport of goods, thus providing better transparency in the distribution, as well as elimination of the corruption.

The Law on Public Roads has been enacted (Official Gazette of the Republic of Macedonia No.84/08)
According to this Law, ongoing is the road sector restructuring. Namely, the Public Roads Agency is formed instead of the Fund for National and Regional Roads and there is an ongoing transformation of Makedonijapat. The Government of the Republic of Macedonia on proposal of the Ministry of Transport and Communications has adopted the plan of restructuring of the public enterprise Makedonijapat and the Law on transformation of the PE Makedonijapat is in a procedure of adoption by the Assembly of the Republic of Macedonia.

A new Law for the Transport of Dangerous Goods in the road and railway traffic (Official Gazette of the Republic of Macedonia No. 107/06) has been enacted. The proposed decisions in the Proposal Law shall contribute towards harmonisation of the national with the EU acquis, thus providing quality and safely functioning of the transport of dangerous goods, acquiring knowledge for the risks of transport as well as improvement of the quality of services, in order to set the transport of dangerous goods and conditions for its quality and safety functioning to be on European level.

According to the High Level Group Final Report in which both Corridor 10 and Corridor 8 are recognized as transnational axes and multimodal routes, the following have been foreseen as priority projects to be implemented by 2010 in the Republic of Macedonia

- Construction of motorway Kumanovo-Tabanovce;
- Construction of motorway Demir Kapija- Smokvica; and
- Construction of motorway border with R.Albania-Skopje-border with R.Bulgaria.

The construction of the motorway Kumanovo-Tabanovce commenced on the 20th of October 2008 and its completion is expected in 18 months.

In October IPAA application for the construction of a new motorway Demir Kapija-Smokvica has been submitted.

In December a tender for a project for the motorway Demir Kapija-Smokvica has been announced/published.

The annual plans for roads construction are done based on the budget of the Public Roads Agency, encompassing further investments in the road sector, construction of new motorways and maintenance according the middle-term and long-term priorities identified in the Public Investments Programme as a framework for the investments in the road sector in the Republic of Macedonia.

Investments in the Corridors VIII and X that run through the territory of the Republic of Macedonia financed by IFI (EIB, EBRD) and funds from FNRR:

- Bypass Skopje Phase I (K-8);
- Bypass Skopje Phase II (K-8);
- Phase II of the Bypass Skopje, the part Orizari-Saraj was officially open for public use on the 24th of July 2008;
- Enforcement of bridges and rehabilitation of the part of E-75 (K-10), financed by NATO;
- Investments from own funds for the national and regional road network in the Republic of Macedonia: Radovis-Strumica road
- Maintenance of the national and regional road network in the Republic of Macedonia.

The National Council for road safety has prepared a National Strategy for road safety for the period of 2009-2014 and it is compatible with the National Transport Strategy 2007-2017.

4.4.3. Rail transport

Legal framework

Upon a proposal of the Government of the Republic of Macedonia, the Assembly of the Republic of Macedonia in January 2008, adopted the Law on the Agency on regulation of the railway services market (Official Gazette of RM No. 07/08).

In 2008 the by-laws were prepared arising from the Law on Railways (Official Gazette of RM No. 64/05, 24/07) and Law on Safety in Railway Traffic (Official Gazette of RM No. 40/07).

In the course of 2009, it is foreseen amendments to the already adopted laws with the third railway package of the legislation for the railways of EU.

Process of transformation of PE Macedonian railways - The transformation process in the railway sectors continues by implementation of the railway infrastructure user charges and services of public interest in the railway transport of passengers pursue to the Law on Railways.

Therefore, the World Bank credit entitled as Reforms in the railways by mid 2008 was used to prepare: Study for defining of railway infrastructure user charge and Study for services of public interest in the railway transport of passengers. Ongoing is the preparation of a Study for decrease of the charges and increase of the productivity.

Railway infrastructure user charge - Once the Study on railway infrastructure user charges have been implemented, the results are implemented by the PE Railway Infrastructure by preparation of a package of services (minimum package, additional package, assisting services for user charges, charges for the service objects and provision of services) and pricelists for the provided services and they should be applied by 01.01.2009.

Obligations for public interest services - Once the Study on the public interest services in the railway transport of passengers was prepared, the Government of the Republic of Macedonia provided funds, within the Budget of the Ministry of Transport and Communications for 2009, in amount of MKD 122.000.000 foreseen for compensation of all lines that work with loss in the railway transport of passengers.

Liberalization of the railway market - As from 01.01.2008, the market for provision of railway services in the cargo traffic is liberalized, i.e. each legal entity that meets the conditions of the Law on Railways can apply at the Ministry of Transport and Communications so as to acquire a license for conducting public transport and decision for safety.

Financing of the railway infrastructure - Pursue to the article 56 paragraph (3) of the Law on Railways (Official Gazette of RM No. 64/05 and 24/07) in the Budget of the Ministry of Transport and Communications for 2008 provided funds in amount of MKD 181.000.000 for investments in the railway infrastructure and additional MKD 160.000.000 with the Program for additional investments in the railway infrastructure for 2008.

The Budget for 2009 foresees funds in amount of MKD 180.000.000 for construction, reconstruction, modernization, repair and maintenance of the railway infrastructure, as well as MKD 610.000,000 for the finalization of the Corridor VIII, the part towards Republic of Bulgaria.

Resolving of the status of the debts with the two companies - The Ministry of finance is in the phase of submission of a proposal text of the Decision for the old debts of the two companies to the Government of the Republic of Macedonia. More specific, in 2008, Macedonian Railways Transport AD Skopje has already reimbursed certain foreign debts, as follows:

Ministry of Finance is in a phase of submission of proposal text of the Decision for the old debts of the two companies to the Government of the Republic Macedonia. More specifically, in 2008 Macedonian Railways Transport AD Skopje has already reimbursed foreign debts, as follows: conventional debts for the period 1991-1995 in amount of EUR 1.039.000 of MAV (Hungarian railways) and other foreign

railways for the period 1996-2006 in amount of EUR 475.541.

Agency for regulation of the railway services market - Upon a proposal of the Government of the Republic of Macedonia, the Assembly of the Republic of Macedonia in January 2008, adopted the Law on the Agency on regulation of the railway services market (Official Gazette of RM No. 07/08). Pursue to the foreseen provisions of the Law, the Agency has to act upon complaints between the railway transporter and the infrastructure manager.

By the end of 2008, upon a proposal of the Commission on the issues of the elections and appointing in the Assembly of the Republic of Macedonia, the President and the members of the Steering committee should be selected (a total of 3 members) of the Agency of railway services market. The Steering Committee of the Agency, through a public call should appoint the Director of the Agency. Pursue to the Law, the Agency should start functioning as from 01.01.2009.

4.4.4. Air transport

Current situation

Legal frame

The Law on the Obligations and Material Rights Relations in Air Transport - adopted by the Parliament of Republic of Macedonia in July 2008, (Official Gazette of the Republic of Macedonia No 85/08). The Law regulates the private law issues in the aviation domain related to the transport agreement, i.e. the fare for passenger transport, responsibilities of the air carriers arising from the transport agreement, damage compensation, insurance, etc. This Law is harmonised with the following EU measures: 31992R2409; 31997R2027, 32002R0889, 32004R0261, 32005R2111, 32004R0785, 31989R2299 and 31999R0323.

The Law Amending the Law on Aviation - adopted by the Parliament of Republic of Macedonia in August 2008 (Official Gazette of the Republic of Macedonia No 103/08). The amendments regulate the airport fees (e.g. passenger fee, safety and landing fee) and give the possibility for the airport fees to be defined by the airport operator, upon a previous approval by the Government of the Republic of Macedonia.

Concession of the airport „Alexander the Great“ – Skopje and the airport „St. Paul the Apostle“ – Ohrid, and construction of a new cargo airport in Stip

The Minister of Transport and Communications at the beginning of July 2007 brought a decision for choosing the most favourable bid for hiring a consultant team for preparation of a Study with a concession model for development of the airports “Alexander the Great”, Skopje, and “St. Paul the Apostle”, Ohrid. In September 2007 the Contract for Consulting services was signed with the most favourable bidder-the company NACO B.V from Netherlands which is obliged, within a period of 6 months after the contract becomes effective, to prepare a Study with a concession model for development of the two airports in the region, possibilities for financial support of the development and strategy for the investment needs of the airports. Apart from this, the consultant is obliged to check the spatial-urbanistic and aviation-traffic possibilities for construction of smaller cargo airport in Stip, class 3D and visual access.

In December 2007 the consultant sent a Draft report to the Ministry of Transport and Communications and it was adopted by the Government of the Republic of Macedonia. The Government of the Republic of Macedonia started the procedure for awarding concession for construction, reconstruction and use of the both airports in the Republic of Macedonia (“Alexander the Great”, Skopje, and “St. Paul the Apostle”, Ohrid) as well as, for construction of a new cargo airport in Shtip, by adopting the Decision (Official Gazette of the Republic of Macedonia No 39/08). Previously, the Government adopted a Decision (Official Gazette of the Republic of Macedonia No 23/08) which terminates the real-estate of the current user (Civil Aviation Agency) and grants usage of real-estate to the Public Enterprise for Airport Services “Makedonija” – Skopje, for indefinite duration, no fees charged.

In this context, the following has been undertaken:

- Expression of interest was published for all parties interested in participating in the procedure for awarding concessions for the two airports and construction of a new cargo airport in Shtip, issued by the Ministry of Transport and Communications on 29.02.2008 and 01.03.2008
- Public call to all interested entities to submit a request for participation in the procedure for awarding concession or the two airports and construction of a new cargo airport in Shtip, issued on 10.04.2008
- Public opening of the tender documentation in the first phase (May 19, 2008)
- The Information on the tender dossier for Phase II "Request for Offer" regarding the procedure for awarding concession for construction, reconstruction and use of the airport "Alexander the Great" - Skopje, the airport "St. Paul the Apostle"- Ohrid and for construction of a new cargo airport in Stip (adopted by the Government of the Republic of Macedonia at the 104th session on July 12, 2008)
- Issuance RFP (July 15, 2008)
- Submission of tender documentation for phase II RFP (July 15, 2008)
- Data Room access granted to Qualified Bidders (July 15, 2008)
- Conference in Skopje for Qualified Bidders and Site visit (August 06-08, 2008)
- Submission deadline for Qualified Bidder questions on RFP (August 06, 2008)
- Submission of answers (August 15-18, 2008)
- Deadline for submission of bids (August 25, 2008)
- Decision for selection of a concessionaire in the procedure for awarding a concession for the airports "Alexander the Great" – Skopje and "St. Paul the Apostle" – Ohrid, and for construction of a new cargo airport in Shtip (adopted on the session of the Government of the Republic of Macedonia on August 29, 2008 and published in the Official Gazette of Republic of Macedonia No 108/08)
- Notification of the tender winner (September 02, 2008)
- Registered "TAV Macedonia" DOOEL
- Signing the Concession Agreement (September 24, 2008)
- Entry into force of the Concession Agreement (within a period of 341 days as of the date of signing the Agreement)

The signed Concession agreement refers to a concession with duration of 20 years.

Full membership of the Republic of Macedonia in the Joint Aviation Authorities (JAA)

The aviation authorities of the European member countries of ECAC in 1970 established associative body of ECAC entitled as Joint Aviation Authorities so as to develop high safety aviation standards in Europe.

The aviation authority of the Republic of Macedonia was established in 1993 as a Civil Aviation Authority, which became a candidate member to Joint Aviation Authorities - JAA in 1999. The application for full membership was submitted in 2002.

The adoption of the new Aviation Law in 2006 and the possibility for transposing of standards with reference without translation, enabled, through the bylaws adopted in 2007, transposing of more than 90% of the JAR standards in the national legislation. Following this significant progress, a JAA team was summoned for a new evaluation visit.

The last assessment visit regarding the compliance with the full membership conditions was carried out in the period June 23-26, 2008 by the JAA expert team; the Republic of Macedonia was positively evaluated as regards the full JAA membership.

The Republic of Macedonia received an invitation for obtaining full JAA membership at the meeting of the Board of Directors of the JAA member-countries aviation authorities, held on December 03, 2008 in Paris, France, thus making the Civil Aviation Agency officially a full JAA member.

Within the context of the previous, the Republic of Macedonia fulfilled one of the most important commitments from Protocol V of the Multilateral Agreement establishing the European Common Aviation Area concluded with the European Union.

After obtaining the full membership, the Civil Aviation Agency shall be subject to a standardization visit in spring 2009, during which it shall be evaluated whether the undertook actions were in compliance with the Action Plan.

Forthcoming Activities

Concession of airports “Alexander the Great” – Skopje and “St. Paul the Apostle” – Ohrid and for construction of a new cargo airport in Shtip

On September 24, 2008 a Concession Contract was signed between the Government of Republic of Macedonia and “TAV Macedonia” DOOEL Skopje, for a period of 20 years.

The subject of the concession is construction, reconstruction and usage of the airports “Alexander the Great” – Skopje and “St. Paul the Apostle” – Ohrid and for construction of a new cargo airport in Shtip.

A period of 90 days is foreseen from signing the agreement to its entering into force..

In accordance with Article 5 of the Decision for selection of a concessionaire in the procedure for awarding a concession for the airports “Alexander the Great” – Skopje and “St. Paul the Apostle” – Ohrid and for construction of a new cargo airport in Shtip (Official Gazette of Republic of Macedonia No 108/08), the Ministry of Transport and Communications should perform regular and permanent supervision over the manner for performing the concession activity and realization of the Concession Agreement.

For that purpose, the Ministry of Transport and Communications shall engage a consulting team for a period of 3 years for performing the regular and permanent supervision over the manner for performing the concession activity and realization of the Concession Agreement. Throughout the course of its activities, the consulting team is obliged to regularly report to the Government of the Republic of Macedonia on the degree of realization of the joint commitments foreseen with the Concession Agreement, and in particular on the degree of realization of the Concessionaire’s commitments.

The concessionaire TAV is expected, within a period of 20 months, to perform the following activities on the **airport “Alexander the Great” in Skopje**: construction of a new terminal building, extension of the runway, construction of a car parking area, access road with new intersection, installation of earth navigation systems, construction of the necessary communal infrastructure, upgrading of the administrative building, new cargo terminal, new firefighting station and new aircrafts parking area.

The following activities are to be performed on the **airport “St. Paul the Apostle” in Ohrid** within a period of 12 months: reconstruction of the existing parking area, renovation of the cargo center facilities, construction of a VIP building, treatment station, reconstruction of the existing administrative building, procurement of new patrolling and firefighting vehicles, as well as procurement of new necessary equipment, so that the airport could function in accordance with the international standards.

The new **cargo airport in Shtip**, which is to be constructed within a period of 36 months, is intended to function as alternative airport for the civil aviation requirements, with a possibility to become a main airport in Macedonia. The following construction activities are foreseen for the cargo airport: construction of a runway, new terminal building, two hangars for export and import, two hangars for aircraft parking, construction of the administrative capacities, vehicle parking area, construction of the necessary communal infrastructure, procurement of patrolling and firefighting vehicles for the purposes of optimum functioning of the airport, as well as procurement of the overall necessary equipment in compliance with the international standards.

4.4.5. Post

Actual developments (2007-2008)

As part of the harmonization of the domestic with the European legislation in 2007 a preparation of the Strategy for the development of the postal services in Republic of Macedonia for the period 2007-2010 was foreseen as a strategic document. This document has been defined by the Government of the Republic of Macedonia and on 11.06.2008 issued in the Official Gazette of RM No. 72/2007. This Strategy stipulates the development of the postal sector, by defining clear and measurable tasks and goals of priority importance for the Republic of Macedonia. The Strategy for the development of the postal services covers the issues for provision of postal services in the Republic of Macedonia and define the goals for the further development of the postal services.

This Strategy defines the necessity of establishment of new regulation frame, thus bringing the new Law on postal services (Official Gazette of RM No. 9/08) on January 4, 2008. This Law has been partially harmonized with the Directives of the European Parliament and the Council and its full harmonization

has been completed by the adoption of the by-laws arising from the Law so as to help its implementation.

The Law transposes the Directive 32003L0039 of European Parliament and Council from 10 June 2002 related to the further opening and competitiveness into the postal service market thus providing gradual and controlled liberalization of the postal market.

The new Law foresees establishment of the Independent regulatory body for postal services that is separate and independent operationally from the postal services providers. The Agency on posts is a regulatory body that regulates the postal market and to implement gradual and controlled liberalization of the market.

The Agency on posts in October 2008 adopted the foreseen by-laws and issued them in the Official Gazette of RM No. 131/2008, thus completely harmonizing them with the Directive of the European Parliament and Council. The new Law from 2008 ensures compulsory and continuous provision of postal services with defined capacity on the whole territory of RM with favourable prices for all citizens.

In order to liberalize the postal market, it is foreseen to decrease the weight of the reserved postal service, thus as from January 1st, 2012, there will be no provision of postal services.

Pursue to the new Law, AD Makedonska Posta is universal postal service provider, with reserved postal service pursue to the individual license issued by the Agency on Posts.

Planned activities (2009-2011)

In the future period it is necessary to implement the Strategy for the development of the postal services in the Republic of Macedonia 2008-2010 as well as the Law on postal services.

The Ministry of Transport and Communications pursue to the measures foreseen within the Strategy should prepare measures for modernization and restructuring, economic strengthening of the AD Makedonska Posta as Provider of universal postal service and provision of long-term security in the new liberalized and open postal market. Therefore the Ministry of Transport and Communications has issued a tender for hiring a consultant team that shall define and check the possibilities for sale of part of the shares and attract renowned companies in this area.

The implementation of these by-laws arising from the Law on postal services shall be supervised by the Agency on posts.

The Agency on posts should also adopt common acts for provision of postal services (individual license, standard license and approval) thus creating a data base of providers of postal services.

4.4.6. Electronic communications

The application of the Information and Communications Technologies (ICT) directly encourages productivity increase, which constitutes a prerequisite for GDP growth. At an EU level, 25% of the GDP growth and 40% of the productivity growth is a result of the ICT usage. The differences in economic performances among the countries are largely caused by the level of investments in ICT research, development and usage.

The policy of the Government of the Republic of Macedonia in the electronic communications sector is directed towards supporting the development and process of liberalization of the electronic communications, services accessible to each person offered by cost-based prices, mass broadband Internet usage, resulting into a digital gap reduction, increased economic development and strengthening of the market business model in the Republic of Macedonia.

The competition development and the entry of new operators shall establish the necessary infrastructure so as to provide for efficient, quality, safe and timely delivery of digital content and services of the Information Society. The sustainable economic development is a benefit from the information society development, and concurrently, the instigator to the process itself. It also represents an important aspect in the early phases of creation of the critical mass of interested participants dedicated to the Information Society development in the Republic of Macedonia.

Although, the Law on Electronic Communications was adopted in 2005 (which is completely harmonized with the EU Directives), due to several reasons, as well as due to the lack of transparent policy for development in this economic sector, the Republic of Macedonia compared to the European Union

countries is still behind in terms of liberalization and investments in the electronic communications. The digital gap, within the country, as well as compared to the EU countries, is ascending.

In order to prevent for further digital gap increase, the Government of the Republic of Macedonia is firmly determined to provide conditions for fast economy development, so as to achieve the economy development level as in the new EU member states, and to include the Republic of Macedonia in the global networked economy.

The need of the Republic of Macedonia to achieve as soon as possible significant leap frogging in the ICT development sector asks for review and application of new innovative solutions, thus creating conditions for achieving the foreseen leap.

Because of the previously stated, the Government of the Republic of Macedonia adopted the National Strategy for Development of Electronic Communications with Information Technologies (NSECIT), which contains new innovative solutions and measures. The efficient, effective and proactive implementation of those measures should provide for fast development of the ICT sector.

The Government of the Republic of Macedonia, through the National Strategy for Development of Electronic Communications with Information Technologies, clearly defines the strategic European orientation – knowledge-based society development (Information Society), i.e. digital economy development.

The National Strategy for Development of Electronic Communications with Information Technologies has the following elements:

- *Vision - Republic of Macedonia – an advanced Information Society*
- *Mission - Enabling aggressive introduction and massively and efficient use of electronic communications and information technologies that will contribute to make the Republic of Macedonia a part of the global networked economy and to achieve a significant leap frogging in the economy.*
- *Objectives - Measured against all most important ICT indicators, the Republic of Macedonia should achieve:*
 - *80% of the average of the new EU member countries in 2010*
 - *90% of the average of the new EU member countries in 2012*

The measures defined in the strategy are fully based on the priorities of 2010 initiative of the European Union, and the same could be classified in three pillars: creation of a single information space with open and competitive market of offers for access to electronic communications services and digital contents, promotion of ICT development as motive power for digital society development, and creation of inclusive information society through overcoming of the digital gap.

While creating the NSECIT, the proactive implementation of measures through multi-partner approach was taken into consideration, i.e. all information society concerned parties participated in an active and coordinated manner, while making sure that the measures are consistent and non-isolated with the other policies and activities that deal with the Information Society development in the country. Due to the previously mentioned, the National Strategy for Development of Information Society with Information Technologies, and the adopted National Strategy for Information Society Development in the Republic of Macedonia, constitute a single concept that establishes the directions for creation of the new digital environment, i.e. they shall create a proactive ambient for creation and development of the new digital economy and digital gap reduction as regards both levels (information access level being bridged through ICT infrastructure accessibility and Information Society service level).

For the purposes of achieving the expected leap frogging in the ICT sector, all NSECIT measures are foreseen to be implemented till the beginning of 2010.

In order to efficiently implement the measured defined in the strategy, and with an objective to provide for leap frogging for the purposes of overcoming the digital gap, it is foreseen that the government shall establish a new body – a National Council for Development of Information Society, which will consist of representatives of the public, private, NGO sector, as well as from the universities. The National Council is basically a body intended for coordination and provision of participation (kind of a forum) of all

information society development actors, supported by the Ministry responsible for information society development.

The decisions of the regulatory bodies in charge of development of the Information Society and media have direct impact on the development of the liberalization and competition of the market, due to which, it is crucial to respect the independence of the regulator. The institutional capacity strengthening of the regulators should be provided on a continuous basis. The coordination between the state agencies in terms of implementation of laws, as well as for monitoring of the market movements is of utmost importance, and its provision should be on a continuous basis.

The ICT indicators monitoring should be provided on a continuous basis. Therefore, the Government of the Republic of Macedonia shall make additional efforts aimed towards capacity strengthening of the state institutions, especially of the State Statistical Office.

The development of the market of electronic communications directly depends on the efficiency and effectiveness of the judicial system, having in mind, in particular, the specific aspects and the dynamics of the regulation of this market. Therefore, it is necessary to strengthen the capacities of the judicial system in the Republic of Macedonia on a continuous basis.

The Government of Republic of Macedonia is making efforts to implement a change of institutional character, which refers to the merger of the regulatory bodies for electronic communications, broadcasting and posts. This merger is with an objective to provide for conditions so as to fully implement the existing convergence in the regulation, i.e. the technological convergence between the electronic communications and the broadcasting. The basic principle of guaranteed independence of the new regulator, according to the Government of the Republic of Macedonia, must be taken into account.

The broadband Internet plays a key role in the modernization of the economies and the societies. It is the basis for the diffusion of the informatic society and for the development of the Information and Communication Technologies (ICT). These technologies are the basic drivers of the growth of productivity and the overall economy. The broadband Internet allows creating new and innovative services, applications and content. It promotes the development of new services and improves their current delivery, and allows for reorganization of the work and production processes.

Currently, a Strategy for development of the next generation of broadband Internet in the Republic of Macedonia is being developed. The strategy includes both the offer and demand side of the broadband Internet. On the offer side this strategy will provide harmonization of the legal framework in order to promote the development of the next generation of the electronic communication networks by applying the principles of transparency and equality. On the demand side for broadband Internet, the strategy will foresee measures that will promote the development of innovative public services such as e-health, e-government, e-education, etc. By promoting these services the demand will increase and subsequently the investments in the development of the next generation of broadband Internet will increase as well, and at the same time a bigger cooperation among the small and medium enterprises will be achieved.

The Government of the Republic of Macedonia will support the process of digitalization of the electronic media and for that reason it will provide means for the construction of a DVB-T multiplex for the needs of the public service programmes. The Agency for electronic communications will announce a tender for providing three DVB-T commercial multiplexes on national level.

4.5. Agriculture

In the last few years, the agricultural sector was exposed to significant structural and legal reforms, especially in the process of compliance of the national legislation and establishing i.e. strengthening of the institutional/administrative structure according to EU standards, in the areas managed by CAP (Common Agricultural Policy). EU integration processes are fundamental for strengthening and establishing competitive agricultural and rural sector in accordance with EU requirements. In this direction, the Ministry of Agriculture, Forestry and Water Economy (MAFWE) introduced policies, measures and mechanisms for implementation of the adjustments and development processes in

agricultural production and markets, agricultural policy, rural development, budgetary support of the agricultural development and rural areas.

Reform processes are based on the National Strategy for Agriculture and Rural Development 2007-2013 adopted by the Government of Republic of Macedonia in May 2007. The document specifies the basis, directions and measures of agriculture and rural development policy, as well as the institutional development and unification of the national priorities within the general agenda for integration into EU.

The agriculture is an important sector in the economy of the Republic of Macedonia. The gross value added of the primary agricultural production, including the forestry and hunting participates with 8,7% in total GDP of 2007. According to the agriculture census conducted in June 2007, 167,992 people are engaged in the agricultural sector and 24.812 of them are with a full-time job.

Legislation

The Law on Agriculture and Rural Development, (Official Gazette of RM No. 134/07) which regulates the sectors for agriculture and rural development, introduces new provisions that serve as a legal basis for adopting legal acts and by-laws arising from the Common EU Agricultural Policy.

The legal framework for regulation of wine sector is established by the Law on Wine (Official Gazette of RM, No. 69/2004). All rulebooks for production of wine and grape products have been adopted on the basis of the Law on wine.

On the basis of the Law on Tobacco and Tobacco Products (Official Gazette of RM No. 24/2006 and 88/2008), several by-laws have been adopted, which define more precisely the production and marketing of tobacco and tobacco products.

The legal framework for regulation of the market of beef, milk and dairy products, poultry and eggs, pork, sheep meat and goat meat comprises several laws - Law on Agriculture and Rural Development (Official Gazette of RM No. 134/07), Law on Veterinary Health (Official Gazette of RM No. 113/07), Law on Public Veterinary Health (Official Gazette of RM No. 113/07) and Law on Cattle Breeding (Official Gazette of RM No. 7/08) which are partially in compliance with the EU legal regulation. An adoption of by-laws for regulation of markets of different agricultural products is planned during 2009.

An adoption of a Strategy for Marketing of the Macedonian Wine, as well as amendments to the Law on Wine (Official Gazette of the Republic of Macedonia 69/2004 and 89/2008) is planned also for 2009. After adoption of the amendments to the Law on Wine, a revision of all previously adopted by-laws is envisaged i.e. adoption of rulebooks for their supplementing and amending or adoption of entirely new rulebooks.

An establishment of a system for data management is prearranged within the market information system.

Regarding the tobacco, an adoption of Law Amending the Law on Tobacco and Tobacco Products is planned in reference to the liberalization of the tobacco market and the Programme for financing of primary tobacco production activities in 2009. An additional equipment and software programme has been provided for the purposes of keeping records of parcels, production, concluded contracts and tobacco redeemers.

The organization and coordination of the MAFWE regional units is of great importance in order to establish systems in the agricultural sector.

Currently, the legal framework for organic agricultural production is regulated by the Law on Organic Agricultural Production (Official Gazette of RM No. 16/04) which is in compliance with the Council Regulation No. 2092/91. Several by-laws are adopted on the basis of this law, and the "National Strategy with an Action Plan for Organic Agriculture in Republic of Macedonia 2008-2011" was adopted in September 2007.

A new Law on Organic Agriculture Production with by-laws regulating the area of production, processing, labelling, packing, storage and transport of organic products, authorization and certification, as well as systems for control is planned to be adopted until the end of 2009.

In 2009 software programmes will be completed within the Unique Register for Agricultural Economy in order to register producers of organic agricultural products.

The Law on Industrial Property (Official Gazette of RM No. 47/2002, 42/2003, 9/2004, 39/2006 and 79/2007) also regulates the protection of geographical names with a mark of origin and geographic mark, as well as the use of protected geographic names. According to the law, the protection of non-geographic, traditional names is regulated by the provisions referring to the protection of geographic names. A Rulebook for protection of geographic names (Official Gazette of RM No. 18/04) has been prepared based on the law.

In 2009, preparation of reports and protection of 5-6 agricultural products is envisaged, and a new Law on Industrial property and Rulebook on Geographic Names will be adopted.

4.5.1. Reforms in the area of agricultural land

Approximately 1,3 million ha (50%) of the total area in the country are classified as agricultural land¹⁸. 600.000 ha (51%) of this resource, are classified as arable land and 700.000 ha as pastures (mainly uplands). The rest of it, approximately 1 million ha are upland and mountain forests and approximately 2 percents are lakes, Ohrid, Prespa and Dojran Lake being the biggest among them. The individual farmers own or rent approximately 80% (463.000 ha) of the total arable land, and the rest of it is owned by the state. Large part of the pastures is owned by the state, which administers them by public enterprises.

The agricultural land is good of general interest for the country, and the new Law on Agricultural Land regulates its use, disposition and protection. Thus, the law regulates the measures for use of the state owned agricultural land, for increasing the area of arable land, implementation of agro-technical and agro-meliorative measures, prevention from erosion, pollution and infection of the agricultural land and for regulation of the manner of temporal and permanent reuse.

The measures defined in the Law provide higher legal security during the use of agricultural land with an equal treatment of domestic and foreign legal entities, resolving the issue of cessation of previous users right of agricultural land utilization, the primacy right etc.

MAFWE is an institution authorised for creating and implementing the agricultural policy. Systematized records of the agricultural land are in a phase of introduction, i.e. establishment of Integrated Administrative Control System, introduction of Land Parcels Identification System in several pilot municipalities after carrying out air recording and interpretation of the ortophoto materials. A support is provided through the Project (World Bank and the Government of the Republic of Macedonia) for strengthening of the agriculture and EU accession - Component 1 (*Strengthening of the administrative and managing capacity of MAFWE in accordance with the requirements for accession in EU*) i.e. a preparation and realization is planned for several procurements for providing services for air recording and data processing, as well as provision of the necessary equipment and software and its installation and testing. In this manner, in 2009, an adoption of by-laws regulating this area is planned, in relation to the Law on Agriculture and Rural Development, as well as by-laws for introduction and exchange of data within the Agricultural Market Information System.

Hence, in 2009, key agricultural policy activities include acceleration of the process for improvement of the state owned land management, development of market of agricultural land according to the principles of transparency and efficiency, unification of fragmented agricultural land and improvement of the protection of agricultural land pursuant to the Law on Agricultural Land.

Certain activities are undertaken in order to strengthen capacity of the state administration for implementation of the system of allocation of the state owned agricultural land and for introduction of information system for allocation of the state owned agricultural land

In 2008, 12 public calls were announced for allocation of 44 000 ha of state owned land, an area of approximately 10 000 ha was allocated, and 1.200 contracts for lease of state owned agricultural land were made. At the moment, an Agenda of Regions is being prepared, which will be announced in 2009 comprising the areas available for allocation of the state owned agricultural land.

¹⁸ The agricultural land includes arable land and pastures. The arable land includes land on disposition for breeding agricultural cultures, plus the land with orchards, vine plantations. The arable land includes land with yearly cultures (grains, industrial, vegetable and forage plants), plus nurseries and uncultivated land/ fallow land.

Arrangements were made for initiating the project for Land Management supported by the Dutch Government.

Also, implementation of the final activities of the second phase of the project for Introduction of National System for Monitoring and Management of vine plantations on the total area of vine plantations in Republic of Macedonia is in progress (it is expected to be finalized in May 2009). This system will be integrated in and serves as a base for development of the register of agricultural land for the total agricultural area.

The system for record keeping of land parcels will be extended from the pilot municipalities and it will be introduced on the entire territory of the country. The Unique Register for Agricultural Economy will be regularly updated, and at the same time other registers will be integrated within MAFWE's System of Animal Identification and Registration, the Register of Vine Plantations and the System for Land Parcels Identification and Registration. In this period, the agricultural information system is expected to be finalized and operational.

The following has been realized in order to strengthen the institutional capacity of authorities involved in regulation of animal and vegetable agricultural products markets:

- A complete computer equipment is provided for introduction of the National Register of Vine Plantations on the entire territory of Republic of Macedonia, including the necessary software,
- The essential laboratory equipment is provided for the reference laboratory in Public Scientific Institution Agricultural Institute - Skopje for conducting oenological researches and analysis,
- The necessary computer equipment is provided for introduction of the Agricultural Market Informative System on a state level,
- A software has been developed for record keeping of the production and purchase of tobacco.

Regarding the Agricultural Information System (AIS), a Strategy and Operative Plan for development of sustainable and efficient system have been prepared, which will be supported by EU and World Bank project for strengthening of the agriculture.

The agriculture census realized in June 2007 is supportive to AIS, providing statistical data, processed following the methodology and the statistical standards of EU. After receiving the results of the agriculture census, the following planned step is to introduce a Register of Farms and integration of various databases into the Register.

A system for identification and registration of bovine has been established, and a system for identification and registration of sheep and goats is in a phase of additional elaboration. The system is supported by the project for introduction of the National System for Animal Identification and Registration - third phase.

Regarding the strengthening of the institutional capacity of wine sector, a National Register of Wine Plantations has been established for the pilot sub-region Tikvesh covering 15 cadastral municipalities, with area of approximately 18.000 hectares, approximately 11.000 hectares of which are vine plantations. The extension of this register to the entire territory of the country is in progress according to the second phase (started in July 2007) of the project for Introduction of the National System for Monitoring and Management of Vine Plantations.

4.5.2. Rural development

MAFWE is establishing coherent rural development policy, through integrating different programmes and initiatives for development of the rural areas in the Republic of Macedonia.

The IPARD Programme is adopted with Decision of the Commission on 25.02.2008. On 23.10.2008, the Sectorial Agreement of rules for using the instrument for pre-accession assistance of EU for rural development was ratified by the Parliament of the Republic of Macedonia. In addition, the Government of the Republic of Macedonia adopted Decree for determining the mutual relations of the bodies and structures for fully decentralized management with the fifth component of the Instrument of pre-accession assistance (IPA) of the European Union (Official Gazette of RM No. 144/2008) which defines the bodies and the structures of fully decentralized management with the fifth component from the Instrument of pre-accession assistance (IPA) and the provisions for arranging their mutual relations. In order to provide legal framework for implementing the IPARD Programme through the Budget of the

Republic of Macedonia, a Programme for agriculture and rural development was adopted within the EU Instrument of pre-accession assistance intended for rural development (IPARD) for 2009 and a Decree for implementing the EU Instrument for pre-accession assistance intended for rural development (IPARD).

In order to accredit the Management Body and the Agency for financial support of agriculture and rural development, for usage of assets from the V component of IPA, a final package of internal procedures and manuals for work, revision and adequacy of the operative structure with the accreditation criteria in context of national accreditation was prepared.

Regarding the due informing of the users of IPARD funds for the opportunities of the IPARD Programme, in 2009 the public relations activities will be intensified by implementing campaigns.

National funding of measures for rural development is implementing in accordance with the realization of the measures from the Programme on financial support of rural development.

An adoption of by-laws regarding the area of regulation of markets of various agricultural products is planned during 2009. Concerning the homage of the multifunctional character of the agriculture activity and providing a legal framework for realization of agriculture and rural development policies while taking into account the environment protection, the Codex of good agricultural and hygiene practice will be adopted.

The list of areas with limited opportunities of agricultural production in the year 2010, mostly depends on the undertaken activities for analysis of the area, in accordance with the determined criteria and the availability of qualitative data from the established systems for cadastre of land, climate conditions, etc.

4.5.3. Phytosanitary policy

The Phytosanitary Office is responsible for following and monitoring of harmful organisms on the territory of Republic of Macedonia, repression and protection against them, phytosanitary inspections of shipments of plants and vegetable products for import, export, re-export and transit, issue of decisions and approvals for sale of products for protection of plants and manures etc.

In 2008, according to the Law on Plants Health (Official Gazette of RM. 29/05), the Phytosanitary Office has elaborated the Lists of Harmful Organisms allowed in Republic of Macedonia according to the Directive 2000/29/EEC. In these lists the harmful organisms are stated according to the risk for plants health, for survival of certain types of plants and in relation with the risk of the economical damage which they can cause.

Measures for repression and localization of new manifestations, repression of calamities and manifestations with high intensity, decrease of their potential in the following years, decrease of economic damages and indemnity of the owners of destroyed plants and products have also been implemented.

IT system was introduced for exchange of information between the competent institutions and a database was also established.

Currently, there is a procedure of signing an Agreement between the Government of Republic of Macedonia and the Government of Republic of Ukraine for cooperation in the area of quarantine and protection of plants. A number of by-laws have been elaborated and implemented in relation to the Law on Products for Protection of Plants (Official Gazette of RM 110/07) according to the Directive 91/414/EEC, thus regulating the approval, the placement on the market, the use and control of the products for protection of plants, their placement on the market and control of the active substances with provisions for products, maximal level of residues, equipment for use of products, exchange of information regarding the products, production of products, keeping records of the legal and private entities included in the production and placement of the products on the market and requirements for authorising the competent bodies for implementation, monitoring and control.

The Rotterdam Convention was supported according to prior announced procedure (PIC) for certain harmful substances and pesticides in the international trade, and by-laws resulting from the Law on Manures (Official Gazette of RM 110/07) are in a phase of elaboration according to the Regulation 2003/2003/EC.

In 2009, the Phytosanitary Office will continue to approximate the national legislation with the EU regulations and implement the international standards and methods.

Detailed regulation of the area of plants health will be realized by an adoption of the rest by-laws resulting from the Law on Plants Health (Official Gazette of RM. 29/05), thus providing the Lists of harmful organisms allowed in RM according to the Directive 2000/29/EEC, as well as initiating the implementation of Annex V according to the same Directive, which means introduction of the passport system for plants in Republic of Macedonia.

Detailed regulation in the area of products for protection of plants will be realized by an adoption of the Law on Products for Plants Protection (Official Gazette of RM 110/07) according to the Directive 91/414/EEC, and detailed regulation in the area of manures will be realized by an adoption of by-laws resulting from the Law on Manures (Official Gazette of RM. 110/07) according to the Regulation 2003/2003/EC. The latter will provide detailed regulation of the requirements for production, placement on market, import, use of manures, types of fertilizers, identification, quality, composition, sampling, packaging, labelling, researching, declaring, monitoring, registering and other issues related to manures.

4.5.4. Seed and seedling materials and sanitary policy

Seed and Seedling Material Office implements the responsibilities regarding the production, preparation for trade, labelling, trade, export and import of seedling material, seedling material for agricultural plants (grain, forage plants, garden crops, oil-producing plants, turnip, potato, tobacco, decorative plants, fruits and vine) and eatable mushrooms mycelium, responsibilities of the persons involved in production, finalisation, trade, export and import of seed and seedling material for agricultural plants, reporting, researching, approving, registering and maintaining of different types of seeds and seedling material, public authorisations, authorised laboratories, storing of final exemplars of seeds and seedling material and other issues in the area of seeds and seedling material.

In 2008, by adoption of the Law on selection rights, the Republic of Macedonia became member of the UPOV Convention with headquarters in Geneva. The enrolment in this organisation provides copyrights protection of selectors of new types of plants in the country and in the other member countries of this organisation. The membership opened new possibilities and perspectives referring to the appearance on new markets for placement of quality seed material, i.e. by this step the Republic of Macedonia can once more become country-exporter of sort seeds. The Rulebook for trading with seed material from different agricultural cultures has already been prepared, and in 2009 according to the Law on seed and seedling material rulebooks in the area of seeds and seedling material will also be adopted.

4.5.5. Veterinary policy

As a continuation of the harmonization of the national legislation in the area of the veterinary medicine with the relevant EU legislation in 2008, we have adopted many by-laws arising from the laws adopted in 2007 regulating this area. In particular, according to the *Law on veterinary health* ("Official Gazette of the Republic of Macedonia" 113/07), 19 by-laws have been adopted, which are harmonised with the relevant EU legislation provisions, in accordance with the *Law on identification and registration of animals* ("Official Gazette of the Republic of Macedonia" 54/05 and 81/07), the Rulebook for identification and registration of sheep and goats was adopted, and in accordance with the Law on protection and animal welfare, the Rulebook for protection and animal welfare during slaughtering was adopted. Certain number of by-laws arising from the above-mentioned laws is in a pre-adoption procedure and it is expected to be adopted by the end of 2008.

By the end of 2008, the adoption of one specific law, the Law on veterinary medical preparations is expected which in details shall provide detailed regulation of the veterinary area.

By the end of 2009 the adoption of remaining acts harmonized with the EU legislation whose legal base are the laws regulating the veterinary area is expected, i.e. the Law on Veterinary Health ("Official Gazette of the republic of Macedonia" 113/07), the Law on Public Veterinary Health ("Official Gazette of the republic of Macedonia" 114/07), the Law on Animal Welfare ("Official Gazette of the Republic of Macedonia" 113/07), as well as certain part of the by-laws whose legal basis is the Law on veterinary - medical preparations.

The future activities related to the institutional amendments and the upgrading of the Veterinary Directorate are aimed at creating of unique competent authority for food safety, in a form of independent Food and Veterinary Medicine Agency, in accordance to EU recommendations. A Project plan in accordance to the IPA instrument for 2009, Component I has been prepared for administrative capacities building of the competent authority.

IPA 2009 pre-accession instrument for the Republic of Macedonia- component I

The project includes technical assistance for strengthening the capacities of the competent veterinary medicine and food authority in order to eliminate the overlapping in legislation and competences on one hand, and for optimal usage of available resources regarding hiring staff, equipment and facilities on the other one.

Regarding the strengthening of the institutional capacity, at the beginning of 2008, 20 persons have been employed, 18 of them on the position of veterinary inspectors in the regional branches or at border crossings and 2 of them in the Veterinary Directorate in the Sector of normative and legal matters. There is an ongoing procedure regarding the employment of 20 persons whose realization is expected to finish in 2009.

In 2008, there have been trainings intended for all responsible persons employed in the area of veterinary examinations at border crossings, animal welfare in the organisation of DG SANCO etc. Veterinary inspections at border crossings (practical training on border crossings in Republic of Slovenia); identification and registration of the cattle in slaughterhouses, facilitation of trade and training for communication and exchange of information as a veterinary component for Integrated Border Management - IBM, procedures for executing veterinary examinations, TRACES and CVED, quality management training, animal welfare, control and eradication of the avian influenza and the bluetongue disease represent trainings organised or realized in cooperation with the EU.

In 2008, part of the Veterinary Directorate and veterinary inspection services have been equipped with IT equipment and field equipment in order to strengthen the capacity of the State Veterinary Service.

In 2009, employment of 20 highly trained persons for activities related to the veterinary policy is expected to occur.

In order to achieve strengthening of the administrative capacity, and in accordance with the process of EU integration of the Republic of Macedonia, the Veterinary Directorate employees in 2009 shall attend several trainings in number of areas, such as: Animal health protection, animal welfare (theoretic training, study training, practical training), control of veterinary and medical preparations - VMP (theoretic training, study training, practical training), elaboration of legal acts in the area of veterinary medicine in accordance to EU procedures and practices (theoretic training, study training, practical training), quality management system (theoretic training, study training, practical training) etc.

IT support - Veterinarian Information System (VIS)

The application of IT technology in the Veterinary Directorate has started by establishment and upgrade of the system for identification and registration of animals through the Project for identification and registration of animals, with financial assistance of the EU. At the moment, there are plans for additional activities in order to implement and use IT technology in all veterinary areas which are subjected to official controls. Regarding the IT application already developed by the Veterinary Directorate the following can be concluded:

- Activities related to upgrading of the system for *identification and registration of cattle* are already finished. Further activities include routine implementation and permanent updating of the central database.

- The activities related to the upgrading of the system for identification and registration of rearing establishments for small ruminant animals (sheep/goats) are in the final stage.

Shortly, in 2009 the Veterinary Directorate envisages development of the following IT applications:

- *System for identification and registration of pigs*- the activities are in the initial phase. In 2008 Strategy for identification and registration of pigs was prepared. In order to provide legal regulation of the identification and registration of pigs in 2009, it is expected amendments and supplements of the Law on identification and registration of animals and consecutive adoption of a Rulebook for identification

and registration of pigs. Following the adoption of the above-mentioned legislation in 2009, the activities shall be focused on the procurement of the necessary equipment for animal identification and registration.

- Development and integration of the Veterinarian Information System (VIS) within the R&D database.

The VIS shall be composed of functionally independent modules for:

- TRACES-like IT system that shall be used on border crossings;
- Sample management module that shall provide complete traceability of any kind of samples tested for any purpose by the official controls;
- Module for implementation of emergency measures plans- including introduction of restricted areas and rearing establishments, applicable control and safety measures, as well as resources planning;
- Module for implementation and documentation of official controls on a farm/facility level, or animal/product type- This module shall include separate procedures (work-flows) for specific activities, such as localization of disease hotbeds, programmes for control/eradication of tuberculosis and cattle brucellosis, TCE supervision/monitoring, control of food/fodder production or processing facilities, etc. For each procedure, the module shall record and link the different control types, the results and the subsequent measures. The module shall be easily expanded by additional procedures;
- Module of cross examination and verification of the additional documentation for payment of compensation for the animals eliminated within the programmes;
- Task list for every veterinarian inspector for determined time period that can be enlarged by corresponding working procedures;
- Document bank that shall be updated with the forms and documents which are frequently used by separate official controls;
- Statistical information means for reporting, interpretation and aggregation on different levels, for statistical and operational objectives.

Completion of VIS, as well as integration of the complete Agricultural Information System that is being maintained and managed by the MAFWE shall be realized in the period 2009-2010 through the *Project for strengthening of the agriculture and EU access with financial assistance from the World Bank*.

Project for Integrated Border Management (CARDS 2006 Programme)- veterinary component

As a continuation of the activities in 2008, this project envisages construction of infrastructure for border crossings in Republic of Macedonia: Tabanovce, Blace, Aerodrom-Skopje and Kjafasan which are planned to be in function of conducting veterinary and sanitary examinations, as well as procurement of adequate equipment for the facilities located in border inspection locations.

4.5.6. Forestry

The Sector for Forestry and Hunting, working within the MAFWE performs certain administrative, professional and other activities in the working scope of the Ministry, with competences related to the forestry and hunting, i.e. the spatial planning and the usage of forests, forestation and rearing, forest protection and hunting development.

The task and responsibility of the Sector is to provide legal, institutional and economic framework for implementation of sustainable forest and game management in Republic of Macedonia and provision of permanent financial mechanism that shall improve the condition of forests and game. The Sector within its competences, among other, is taking into consideration the social, economic and ecologic segments in the society on local level.

At the moment, the forestry and hunting in Republic of Macedonia are regulated by the Law on Forests ("Official gazette of the Republic of Macedonia" No. 47/97, 7/2000, 89/04, 54/07 и 103/08), the Law on Hunting ("Official gazette of the Republic of Macedonia" No. 20/96, 26/96, 34/97, 69/04, 84/07, 113/07 и 88/08) and the Law on reproduction material of forest tree types ("Official gazette of the Republic of Macedonia" No. 55/07).

In June 2006, the Government of the Republic of Macedonia adopted the Strategy for sustainable development of the forestry in Republic of Macedonia, accompanied by Action Plan 2007-2009 with precisely determined time dynamics and necessary financial resources.

One part of the actions envisaged in the Strategy are financed by the Programme for expanded forest reproduction, which in accordance to the Law on Forests is adopted by the Government of Republic of Macedonia each year.

The main objective is the maintenance of sustainable development of forests and game in Republic of Macedonia.

In 2009, the following is envisaged:

- Adoption of two new laws: Law on Forests and Law on Hunting,
- Adoption of the Programme for expanded reproduction of the forests for 2009,
- Preparation of Information for health condition of the forests in Republic of Macedonia for 2008 with draft-measures.
- Preparation of three studies in accordance with the Action Plan 2007-2009 from the National strategy for sustainable development of the forestry including:
 1. Study for preventive and pre-suppressive protection of forests against fire,
 2. Study for forest areas subjected to erosion, and
 3. Study for development of forest road network in the Republic of Macedonia.

In regard to the strengthening of the administrative capacities, in 2009 new employments in the Sector for Forestry and Hunting and organisation of professional trainings for the employees in the area of project management, elaboration of strategies and studies and working with GIS technology are also planned to be undertaken.

4.5.7. International cooperation

Republic of Macedonia continues with the reforms in the agricultural-food sector. In that direction, an international, i.e. multilateral, bilateral and trade cooperation is formed and implemented, which is in function of development of the sectors in competence of MAFWE.

Regarding the processes of the structural reforms and adjustment of the agricultural-food sector, the projects supported by the European Union and managed by the European Agency for Reconstruction are implementing, through the CARDS programmes for 2006.

Founding a system for monitoring and control of vine plantations (second phase)

The main goal of the project is to establish a National registry of vine plantations on the entire territory of the Republic of Macedonia.

The project is consisted of four components:

1. Establishing a National system for monitoring and management of vine plantations for the entire state
2. Adjustment of the Macedonian legislation for wine with the EU legislation
3. Preparation of Strategy for international marketing of Macedonian wine
4. Institutional strengthening of MAFWE.

The project ends on May 15, 2009.

Establishing national system for identification of animals (third phase)

The purpose of the project is establishing a system for identification and registration of the small ruminants, which is in accordance with EU requirements, as well as preparation of identification and registration system for pigs and possible integration with the IT systems of MAFWE. The project ends on 28 February 2009.

Support of IPARD structures

The main aim of the project is efficient and effective implementation of the IPARD programme in Macedonia and benefit of the farmers and the rural population from the programme. The concrete purpose of the project is EU accreditation of the Executive structure for this programme, consisted of Managing institution and the IPARD Payment agency.

The results from this project are directed to strengthening the legal, administrative and personnel capacity of the Managing institution and the IPARD Payment agency, through the project *"Implementing EU directives in the Macedonian agricultural policy and support of the cooperation in the agricultural-food sector with the states in the region"* - through this project activities in the area of bringing closer the agricultural-food sector of RM to the one of EU, as well as for strengthening the regional cooperation in the sector have been realized. The project ends in December 2009.

Technical support for restructuring and strengthening the advisory services in agricultural sector of Republic of Macedonia is provided by MAASP phase 2 (*Programme for support of the Macedonian advisory services in the agricultural sector*) funded by SIDA. The project supports development of qualitative agricultural advisory services in the agricultural sector (MAASP), in direction of implementing the Programme for rural development and in function of the IPARD programme.

SIDA provided technical assistance for support of the Cabinet of the Ministry of agriculture, forestry and water economy of the Republic of Macedonia, by financing the project *Advisory services for the Cabinet of MAFWE regarding the EU integrations*.

SFARM 3 – Support of the agricultural associations in the Republic of Macedonia

SFARM 3 is a twinning project between the Swedish Farmers Federation (LRF) and the Farmers Federation of Republic of Macedonia (FFRM).

The general goal of SFARM 3 is to support development of the structure of the Farmers Federation of Republic of Macedonia in order to outgrow into a sustainable organization that is managed according to the guidelines of democracy and transparency.

USAID AgBiz Program

The goal of the project is to increase competitiveness of the agricultural producers, manufactures and traders, which by working in a group or separately, participate in the value-added chains that have potential for export of value-added products.

The project financed by *World Bank - Strengthening the agriculture and the EU integration* is in direction of creating modern and competitive agricultural sector, which will have important economic and social role, as well as assistance for the country to increase the absorption capacity and implementing the reforms in the agricultural sector.

The project is consisted of four components, as follows:

- strengthening the administrative and managing capacities of the Ministry of agriculture, forestry and water economy in accordance with the requests for EU accession and establishing an integrated administrative and control system;
- support of the Ministry of agriculture, forestry and water economy and the Payment Agency for better usage of the EU funds for rural development;
- building effective capacity of the veterinary service;
- completion of the reforms in the water economy.

FAO - Regional project OSRO/GLO/702/CAN B3 - OSRO/GLO/604/UK – draft plans for Eastern Europe

The main goal of the project is strengthening the capacities of the state in case of avian influence. The project ended in December 2008.

Defining and promoting the legal framework for organizing the producers

This project is supported by the Norwegian Royal Ministry of foreign affairs. The project aims to create a legal framework for establishing producers' organization and its promotion in front of the prospective members.

Strengthening the readiness for protection of the national forests against fire

The project goal is prevention, monitoring, registering, repression and safety against forests fire, education and establishing informative system for protection against forest fire. The project has duration from October 2008 to 2010.

In 2009, an institutional upgrade of the administrative capacity is foreseen for implementing the agriculture and rural development policies - project financed by the EU pre-accession assistance for 2009, Component I (IPA-TAIB).

4.6. Administrative reforms

Introduction

Strong and decisive commitment of the Government of the Republic of Macedonia to continue the activities for commencing the negotiations is translated in the Decision on Determining 2009 Strategic Priorities of the Government, where one of the main priorities is the integration of the Republic of Macedonia in the EU.

Thus, what is of exceptional importance is institutional strengthening of administrative structures and capacities, i.e. creation of professional and motivated government service with modern knowledge and skills, so as to be able to cope with the challenges of the new era.

4.6.1. Institutional improvement of administrative structures and strengthening the administrative capacities

Organisational setup and scope of operations and competences of the Government of the Republic of Macedonia are regulated by the Law on Government of the Republic of Macedonia.

To the end of creating legal assumptions and institutional and operating conditions for the public administration reform, Government adopted series of acts in the period 2007-2008: modifications and amendments to the Rules of Procedure of the Government of the Republic of Macedonia (regarding the e-sessions of the Government and introduction of mechanism for regulation influence assessment in terms of the procedure for preparation of laws), as well as cleared version of the Rules of Procedure of Government of the Republic of Macedonia, Decision on Determining 2009 Strategic Priorities of the Government of the Republic of Macedonia, 2008 Annual Operational Programme of the Government, Regulation Influence Assessment Methodology (RIA), Decision on the Form and the Contents of Regulation Influence Assessment Forms, Programme on Organising and Implementing Training in the field of Strategic Planning and Analysis of Policies and Coordination of Civil Servants in the Ministries and Other State Administration Bodies in 2008, Methodology on Strategic Planning and Preparation of Annual Operational Programme of the Government.

To the end of improving the administrative structures and strengthening the administrative capacities, National System for Training Coordination was revised, and the Government adopted 2009-2011 Strategy on Training of Civil Servants in the Republic of Macedonia in September 2008. It defines both the goals and the principles, the training system and the target groups, as well as the manner of financing and the risks related to the establishment of the training system for civil servants. Action Plan on Strategy implementation is an integral part of the Strategy on Training of Civil Servants in the Republic of Macedonia. It is envisaged for the Strategy to be focused on attaining the following special goals: development of sustainable and stable system for quality training with clearly defined goals of the training in line with the needs of the target groups, building capacities of the system for coordination of the civil servants training, development of sustainable and stable system for financing the training, development of culture for permanent learning and development of human potential in the government service.

Modifications and amendments to the systemic Budget Law led to introduction of new method on financing through relating the strategic planning to the financial implications. According to the Strategic Planning Methodology and the preparation of Annual Operational Programme of the Government, the ministries and other state administration bodies successfully are completing the fourth cycle of strategic planning, whereby three-year strategic plans have been prepared, identifying their strategic priorities and goals, as well as the planned measures and activities to the end of realizing both the strategic priorities of the Government and the priorities of the ministries themselves. Programmes in the strategic plans, through the matrix, are directly related to the strategic priorities of the Government, NPAA and the priorities and the objectives of the concerned body. At the same time, strategic plans also present the necessary measures to restructure the body, the principle of equitable representation, joint functions, as well as the need to train the human resources. To the end of building capacities for strategic planning, General Secretariat of the Government implemented series of training on strategic planning (generic and specialised), intended for the civil servants in the ministries and the state administration bodies.

Larger number of state administration bodies submitted reports to the Civil Servants Agency and there are indicators that the trainings are of great importance. In the coming period, consistent dynamics of application and development of the already established systems for strategic planning and policy creation in the General Secretariat and the ministries will resume through continuous training on strategic planning and policy creation; Development of the already established systems for strategic planning and analysis of the policies and coordination, by strengthening the capacities in the General Secretariat, ministries and local government, through continuous trainings for strategic planning and policy creation; system for horizontal coordination will be continuously upgraded, paying special attention when introducing systems and procedures for vertical coordination, i.e. strengthening the functions of the state administration that contribute to their development into modern organisations (strategic planning, policy analysis, human resource management, internal control, IT), thus strengthening the administrative capacities.

The Government and all state administration bodies will consistently implement the Law on Civil Servants, and modifications and amendments to the Law will subsequently be adopted. Civil Servants Agency will regularly inform on the consistent implementation of the Law on Civil Servants by submitting data on implemented procedures on selection and employment, evaluation and disciplinary procedures.

In the period to come, Strategy on Public Administration Reform should be updated and at the same time, capacity building should continue in the Unit for Public Administration Reform on monitoring the implementation of the Strategy. In addition, process on human resource management should be improved, through established organisational framework on strengthening the human resource management system.

4.6.2. Improvement of transparency and accountability of the administration

One of the key goals of the public administration reform in the Republic of Macedonia is making the administration an efficient and transparent service to the citizens, economic entities and other legal entities, thus providing protection of the rights of citizens and partnership with the civil and the business sector. Thus, main principles of administration operations when exercising the rights are the following: equality of citizens, foreseeability of the administration operations, participation of citizens, business entities and all interested parties in the creation of government policies, as one of the fundamental values of the democratic society.

Pursuant to the Law on Organisation and Operations of State Administration Bodies, when preparing laws and other regulations within their competence, state administration bodies consult with (they publish the regulations, organise public platforms) and collect opinions from associations of citizens and other legal entities.

Law on Government also stimulates the participation of the citizens in the work of the Government. From an institutional point of view, following activities aimed at improving the administration transparency were organised:

- improvement of the mechanism Citizens's Log – efficient and innovative instrument in improving the quality of services rendered by the public service;
- improvement of services on the portal including contents from the Citizen's Log and information and data on other two bodies (Commission on Relations with Religious Communities and Religious Groups and the State Archive of the Republic of Macedonia);
- implementation of the Strategy on Cooperation with the Civil Sector according to the Action Plan on Implementation;
- continuous strengthening of administrative capacities on implementation of the Law on Administrative Inspection;
- certain progress in the implementation of the Law on free Access to Public Information;
- continuous activities aimed at raising the public awareness for the ombudsman as potential mechanism to act upon complaints related to corruption in the public administration, and mechanism

was established, by which, the Government is informed, on the basis of quarter reports, about the acting of the state administration bodies, upon the cases of the ombudsman.

- with respect to the obligation arising from the Code of Ethics so as for the civil servants to report on any illegal activities, three cases were registered, leading to one pursuit.

Implementation of the rulebooks and other acts of the local government units in line with the Law on Civil Servants, as well as supervision over the enforcement of the Law, are efforts aimed at establishment of transparent and accountable local administrations and development of internal control and audit when managing the decentralised funds.

In addition, realisation of the supervision function of the inspection services in the Republic of Macedonia was analysed and coordination of inspection services was strengthened.

4.7. Additional reform activities for business climate improvement

4.7.1. Market entry / exit

One of the basic strategic priorities of the Government of Republic of Macedonia is the improvement of the business environment. It is a process through which the country improves its legal framework for doing business, strengthen the capacity of the regulatory bodies that monitor and surveil the market and developing institutional framework for communication between public and private sector, all in accordance with the EU acquis in the area of company law, accounting and audit.

The establishment of harmonized legal framework with EU acquis for the one-stop-shop system is essential for establishment of competitive business in the country. The Republic of Macedonia is among the top countries in the world by the time of registration (4 hours) and has electronic interconnection of all involved institutions in the process of business registration. The central register of the Republic of Macedonia is the key responsible institution for maintaining the register of companies and conducting the registration process. In 2008 the electronic system for submission of annual accounts has been developed, and essential projects were prepared for further development of the one stop shop known as "phase 2". The projects are financed by the BERIS project.

During 2007 there was continuous implementation of the Bankruptcy law and generally since 31.12.2005 until June 2008 the total time for bankruptcy procedures was lowered. The same applies for the number of unresolved/unfinished bankruptcy procedures (they are decreasing too).

4.7.2. Judicial system reforms

The realization of the reforms in the judicial system continues in direction of implementation of the adopted reform laws, strengthening of the independence and increasing of the efficiency of the judiciary, which will contribute to efficient realization of the constitutionally guaranteed rights of the citizens.

The effects and results from the realization of the judicial reforms shows that in comparison with the last year, when it was recorded a constant increase of the number of newly received court cases, in 2008, it was recorded for the first time, a significant decrease of the court cases influx for 40.6% (or 205.000 cases) and it was recorded for the first time a decrease of the backlogs, or the unsolved cases, for 13,7% (or 125.000 court cases).

With the implementation of the Law on Judicial Council, the authority in the process of election and dismissal of the judges was changed and redefined, as a guarantee for judicial independence and integrity. The Judicial council was completed and now it functions in its full composition, and performs continuous election and dismissal of judges.

All by-laws were adopted previously envisaged with the Law on Judicial Council. The Rule Book of Regulations and application forms for following and assessing of the judges work were also adopted.

In order to show the initial achievements of the judge's work, 9 pilot – courts were chosen to fill in these application forms. From the analysis of the data, it was concluded that almost 80 % of the judges who filled in these application forms have achieved the results according to established criteria for quality and quantity of their work.

Regarding the fulfillment of the standards for impartial and independent judiciary, and according to the Law on Courts, in the framework of basic courts with expanded authority, specialized court departments were established, which act upon commercial disputes, which enables more efficient solution of the procedures in that area.

In accordance with the Law on Courts, all bylaws were adopted. Regarding the established Court of Appeal – Gostivar and the Administrative Court, their complete functioning was obtained, regarding the supply of equipment and personnel.

In direction of modernization and improvement of the judicial infrastructure, within the Project for Legal and Judicial Implementation and Institutional Support, currently there are activities going on for equipping of 11 courts with expanded authority, and a renovation and expansion of all facilities, refurbishing of facades, equipping of court rooms, offices and court archives.

With the Court Rules of Procedure novelties are implemented for improved managing of court cases through obligatory electronic recording of court cases and their electronic distribution by random choice of judges.

In order to implement the Court Rules of Procedure efficiently, a Program for training of judicial administration was realized, and 250 court clerks were trained to record and manage the court enrollee.

In order to improve the efficiency of the court administration, as well as to increase the efficiency of the courts, a Law on Court Service was adopted and it shall start implementing on 01.01.2009. It shall regulate the rights, status and obligations of the court administration, as well as the issues related to the special status and the salaries of the court services. This law regulates the matter of administrating of court cases.

In order to improve the status of the judges, a Law on Judges Salaries was adopted which contains the latest international standards for improvement of the economic and material conditions and position of the judges, regarding the strengthening of their independence and efficiency, and regarding the good and prompt processing of cases.

According to the recommendations of the Assessment Mission of the EC, on transferring the authority for managing with the court budget to the Judicial Council, in August 2008, a Law on Amendments to the Law on Court Budget was adopted, according to which the management with the financial resources is transferred to the Judicial Council of the Republic of Macedonia.

In a direction of removing the reasons for slow realization of the process of enforcement of court decisions in civil cases, as one of the main priorities in the European partnership, the Law on Enforcement was implemented. In order to overcome the shortages that were noticed, since the Law on Enforcement started its implementation practically, in January 2008, a Law on Amendments and Supplements to the Law on Enforcement was adopted.

The changes envisage that the enforcement, which is arranged with other laws, should remain under the court authority (ex. handing over of children cases) and should remain under the courts' authority in future, regarding the specific nature of the cases that should be realized: expansion of the list of the public books and registers, from which the enforcement agents obtain their information that are necessary for the enforcement process, clarification of the procedure for declaring void transactions, as well as the forms in which the request can be submitted to the enforcement agent, definition of the extent to which a person can ask for withdrawal of the submitted request to the enforcement agent, definition of the status of the enforcement agent, as a person that performs public authorizations and clarification of the legal consequences if the person does not start his/her work within several months after his/her appointment as an enforcement agent, arranging of the time limit for transferring of the collected payment to a special account of the enforcement agents and to the accounts of the creditor, developing more precise way of delivering by the enforcement agents, introducing a delivery with public press announcement, and the need to raise the amount of the insurance sum for the enforcement agents from 50.000 to 100.000 EUR was also arranged.

Aiming towards increasing the number of the enforcement agents on the territory of the basic courts from 69 to 132, the Rule Book of Regulations was changed regarding the number of the enforcement agents. The new available enforcement agents posts, are aiming towards strengthening of the capacity

for managing the scope of work, after the final judicial decisions could be put into effect, and they will be transferred solely to the enforcement agents.

The Ministry of Justice, has prepared the Law on Changes and Additions to the Law on Litigation (adopted on 1.09.2008) based on Information with proposal measures for improvement of the business climate, according to the recommendations of the Doing Business Report of the World Bank.

The changes introduced solutions for acceleration of judicial procedures, in direction to improve the efficiency of the courts, which will be obtained through non registering of those court cases without paid court taxes, it also arranges obtaining of legal option for wider application of this procedure in small amounts disputes and procedures for issuing of payment order, as special procedures in the frames of the general litigation procedure, which will enlarge the maximum amount of the suit claim which pertains to the cash demand in procedures which are going to be solved as disputes of small amounts, i.e. in the procedure for issuing of payment orders.

Further improvement was made with solutions for electronic delivery in the litigation procedures, which is expected to enable the courts to make their deliveries in a quick and contemporary way.

The changes provide a possibility, besides the notary agents who are also courts agents, the delivery court writs to be done by other legally authorized persons, which will become operational as a legal opportunity with the Law on enforcement, and it will be entrusted to the enforcement agents.

In a direction of more efficient solution of disputes with the provisions from the Law on Mediation, an alternative, out of court settlement of disputes was arranged, which will unburden courts from significant number of cases and will provide an efficient alternative solution of disputes. The Chamber of Mediators has started its functioning, with a total of 98 elected mediators. For the first time a Center for Mediation was opened in Skopje. In order to establish the legal status of the Chamber and to obtain its proper functioning and its registration at the Central Register of the Republic of Macedonia, changes and additions were performed to the Law on Mediation.

In order to decrease the number of the unsolved criminal cases, an implementation of the Law on Misdemeanors was started, and in that context, all state organs harmonized the laws that contain misdemeanor provisions, simultaneously 43 Commissions for misdemeanor were formed, and processing of misdemeanor cases has already started.

The President of the Supreme Court during the months of August and July 2008 undertook activities for quicker solution of misdemeanor cases, and the courts were obliged to act upon the misdemeanor cases which were out of date, issuing of Decision of Prescription and their simultaneous erasing from the evidence of backlogs.

Regarding of functioning of the IT at the judiciary and regarding the efficient managing of the judicial cases, activities have started for implementation of Automated Court Cases Management Information System (ACCMIS) and it will be finished until the end of 2009. With the realization of this activity, the quality of the IT solutions for court cases management will be improved. The software, Automated Court Case Management Information System (ACCMIS) is in its production phase.

There has been a harmonization of the nomenclatures with the court procedures with the rest of the legislation. The courts have obtained Internet and an e – mail system. With the realization of the Tender for Internet connection to all courts, which was initiated by the Ministry of Justice, all courts on 36 locations, starting from 01.12.2008 will have internet connection and anti – virus protection intended for 1 420 users.

Regarding the equipping of court institutions with IT equipment, there have been installed 270 PC's for electronic case managing and additional 600 PC's are going to be obtained.

Future reform activities in judicial area

The forthcoming activities regarding the strengthening of the judicial independence and improving of the enforcement of the judicial authority, will be directed towards implementation of legal solutions, which provides independence as well as responsibility during the course of performing the judicial function as well as enlargement of quality and assessment of the basis for promotion of this goal.

Aiming towards the continuous court and judicial reforms, it will be proceeded with the implementation of the Law on Courts and the Law on Judicial Council, application of the Rule Book of Procedures and the criteria for following and assessing of judges work, implementation of the Law on Court Service, adoption of the Law on Salaries of the Members of the Court Council etc.

Finalization of the activities for improvement of the judicial infrastructure – a new court facility was built in Skopje, and there was a reconstruction and modernization process of 11 courts with expanded authority.

During 2009 it is expected the implementation of the IPA Project Support to begin for better, more efficient and modern functioning of the Administrative court. The activities from this project will contribute to more efficient solution of the administrative disputes, improvement of the capacities for human resources in the area of managing of administrative cases from their evidence as well as for improvement of the information system.

4.7.3. Regulatory reform

The Economic programme of the Government of the Republic of Macedonia is focused on private sector development, increase of investments level (domestic and foreign) and job creation. The activities are designed to improve business climate and create equal conditions for all economic entities.

Since, regulatory burden was identified as one of the barriers for doing business and for obtaining quality public services for citizens, the Government is implementing Regulatory Reforms which are divided into two areas:

- Streamlining existing regulations through the Regulatory Guillotine
- Systematic review of new regulations.

Regulatory Guillotine

Regulatory Guillotine is a mechanism for reviewing and streamlining existing regulations, including simplification and abolishment of all unnecessary formalities.

The measures implemented include decrease of statutory time limits for various licenses and permits; reduction of forms and documents including promotion of electronic data interoperability; cut of fees and tariffs; introduction of “silent is consent” principle. By decree, all laws and bylaws from the period of ex-Yugoslavia which are not in compliance with the legislation of Republic of Macedonia were abolished.

Inventory of 2000 regulations (laws and by-laws) were screened and revised, first by Government institutions, then by business community which provided more than 900 proposals and lastly, final recommendations were prepared by the Sector for regulatory reforms with support of independent experts. Based on the overall recommendations and analysis, the Government has adopted three sets of measures (two in July and one in November 2007), scoping around 64 Laws and 481 by-laws.

So far, the Government has approved 40 laws which are also adopted by the Parliament and abolished 383 by-laws.

Regulatory Impact Assessment

To enhance systematic review of new regulation and assessment of its economical, social and environmental effects, the Government of Republic of Macedonia is working on gradual introduction of Regulatory Impact Assessment (RIA). From the legal point of view, the assessment process is introduced through amendments of Government Rules of procedures (Official Gazette No. 29/2008) and with by-law for RIA Methodology (Official Gazette No. 37/2008).

Implementation of RIA methodology will include two phases, screening RIA and full RIA, respecting best EU practices. The process will include regular public-private consultations and use of Unique National Electronic Registry. Systematic monitoring and evaluation of the quality of new regulations will gradually increase its scope. Sector for economic policy and regulatory reforms has engaged consultants through World Bank BERIS project and EAR/GOFRE projects for providing technical assistance to the RIA process as well as USAID support for preparation of National Electronic Registry and for reduction of

formalities. Building capacity of administration and training programs are carrying out in 2008 and also will continue in 2009.

From September 2008, pilot projects were carried out as part of the RIA training and strengthening administration capacity for RIA implementation. The first pilot project is the drafting of the Law on Court Taxes.

For implementation of this Pilot project a working group was established including representatives from the Sector for economic policy and regulatory reform, Ministry of justice, Ministry of Finance, local consultants, Supreme Court, Secretariat for European affairs.

4.7.4. Foreign Trade Facilitation

The Customs Administration, together with several government institutions which issue authorisations, permits and licenses for import, export and transit, is working on the introduction of a Single Window System for import, export and transit licenses and One Stop Shop. For the needs of the Project, IT equipment has been procured and installed and an electronic application has also been installed. The future activities will be focused on training and professional education of the users of the application and network connection among the institutions. The implementation of this system will enable the Macedonian companies involved in external trade to apply and obtain licences for import, export and transit electronically from all fifteen issuing institutions. Besides the licenses and allocation of quota, the system will enable electronic application and processing of the transit customs declarations. In addition, the system simplifies the data and information availability and their use, thus enabling faster and simple data and information exchange between the public and the private sector. This concept provides diminishing of the non-trade barriers and has a positive effect on the economic operators' work. The system is available on the internet site www.exim.gov.mk. Following the completion of the testing of the system, its implementation is expected to take place by the end of the year.

The afore-mentioned amendments to the Trade Law and the Law on Administrative Taxes are aimed to provide further trade facilitation.

In addition to this, the Customs Administration is undertaking intensified activities for promotion of the possibilities for simplified customs procedures.

An Advisory Body comprised of representatives from the Customs Administration, Economic Chambers, the Macedonian International Forwarders Association and the Macedonian Trucking Associations has been set up to develop proposals for trade facilitation, simplified and faster customs procedures. The Body also proposes for and gives opinions on possible amendments to the legal and sub-legal acts regulating the customs operations and work.

The cooperation with the business community was intensified and a practice to publish Draft Acts (operational instructions and guidelines) on the Customs Administration internet web site, thus enabling the wider public to comment and give proposals on relevant issues.

Ongoing and upcoming activities

The Customs Administration shall continue the reform and modernisation process, in accordance with the Strategic Plan and the national Programme for Adoption of the EU Acquis.

By the end of 2007, the Customs Administration adopted a new Development Strategy for 2008-2010 having five strategic goals:

- Legal framework – alignment with the EU legislation;
- Efficient collection of import duties and implementation of trade policy measures;
- Protection of citizens and fight against organised crime;
- Effective application of ICT technology;
- Modernization of the Customs Service and strengthening of the cooperation

The following activities will particularly be intensified:

- Promotion of the authorised economic operator and simplified customs procedures;

- Full implementation of the Single Window and One Stop Shop;
- Full functioning of the customs laboratory;
- Introduction of integrated EU customs and statistical nomenclature – TARIC (Tarif Intégré de la Communauté);
- Enhancement of the customs surveillance mechanisms;
- Development and modernisation of the risk analysis and selectivity methods for detection of illegal trade and organised crime;
- Enhancement of the cooperation and data exchange with national and foreign institutions and the business community;
- Introduction of a new ICT system, interoperable with the EU IT systems.

4.7.5. Property Rights Protection

Real Estate Cadastre

During the period June 2007-June 2008, the pace of establishing Real Estate Cadastre on the territory of Republic of Macedonia was pursued according to the planned dynamics within the activities envisaged in annual and quarterly plans of the Real Estate Cadastre and Registration project.

In the first quarter of 2008 (31.03.2008) the percentage of established Real Estate Cadastre amounted 71,5%, and in the second quarter it amounted 75% of the territory of Republic of Macedonia.

According to the annual working programme of the Agency for Real Estate Cadastre for 2008, it is intended by the end of 2008 to be established Real Estate Cadastre on 82% of the territory of Republic of Macedonia, with possibility of outperforming the plan.

By the end of 2009, it is envisaged the territory of Republic of Macedonia to be 100% covered with Real Estate Cadastre.

Planned activities for 2009

In the subsequent period the following activities are envisaged:

- introduction of e-cadastre for all district divisions throughout Republic of Macedonia during 2009;
- completing the Global Navigation Satellite System on the entire territory of Republic of Macedonia during 2009;
- conversion and vectorization of geodetic maps by the end of second quarter of 2009;
- exchange of data with affiliate institutions by the end of first quarter of 2009;
- adoption of the Registry of area units by the end of second quarter of 2009;
- E-store (Internet) by the end of first quarter of 2009.

4.7.6. Foreign Direct Investments

Investment trends

One of the key priorities of the Economic Program of the Republic of Macedonia is increasing the inflow of foreign investments, with an aim to revive the Macedonian economy, increase economic growth, decrease unemployment and introduce new technology and know-how. According to the National Bank of the Republic of Macedonia data, in the period 1997 – 2007, the cumulative inflow of FDI is 2.543 billion EUR, which is unsatisfactory. From January to September 2008, the cumulative amount of FDI is 409 million EUR, which surpasses the projected amounts for FDI inflow for this year, besides the global economic crises. The largest share of FDI with 8,8% in GDP is in 2007, while in 2008 it is 6,2%. The inflow of FDI per capita is largest in 2007 and amounts to 247.5 EUR, while in 2008 (January-September) amounts to 199.7 EUR.

Table 14: Inflow of FDIs in RM and their share in GDP

Year	million EUR							
	2001	2002	2003	2004	2005	2006	2007	2008/ 1-9
Total amount	233,3	499,5	100,4	260,7	77,2	344,8	506,0	409,0
Share of FDI in GDP	6,0	13,0	2,4	6,0	1,7	6,8	8,8	6,2
FDI per capita	115,2	245,4	49,5	128,3	37,9	169,0	247,5	199,7

Source: National Bank of RM

Regarding the origin of investments, in the past years, largest investors are: Holland, Hungary (Macedonian Telecommunications), Greece (Okta, Stopanska Bank, etc.), Austria (EVN), Switzerland, Slovenia, Germany, Serbia, etc. The largest inflow of FDI is realized through privatization and post-privatization (72%), while Greenfield investments that have greater economic effects are less present.

Analyzed by sectors, the largest inflow of FDI is in Energy sector (35%) and it is expected that it will continue to remain on the top, Industry sector (18%), Telecommunication sector (15%), Banking sector (11%), followed by Real estate, Trade, Mining, Catering, Agriculture, etc. In all sectors the inflow of FDI has positive influence.

Legal and institutional framework for FDI – Macedonian Constitution guarantees national treatment for all investors. Generally, there are no restrictions for enter of foreign capital, except in the trade with narcotics and protection of historical monuments and cultural heritage. Republic of Macedonia with the MIGA membership since 1994 has obtained protection of FDI from political risk. Also, Republic of Macedonia has signed Bilateral Investment Treaties with 31 country, as well as Agreements for avoiding double taxation with 30 countries.

The Government of the Republic of Macedonia, besides improving the investment climate with aim to increase the FDI inflow, is constantly building the institutional capacity for investments through Governmental bodies: Team Macedonia, Minister in the Government for FDI, Ministry of Economy – Department for stimulating investments and economic promotion, Agency for foreign investments of RM, Directorate for TIDZ, Agency for development and investments. Ministry of economy is in charge of investment policy for the purpose of increasing investments, while the Agency for foreign investments “Invest Macedonia” is focused on promoting the country as attractive location for investment, but also as a service for investors, providing them with all relevant information and services at one place.

In the past period, the Government of Macedonia, besides financial and staff building of the Agency for foreign investments, has appointed 23 economic promoters in 21 targeted countries, with a purpose for more intensive promotion of Macedonian potentials, possibilities and incentives for investment.

Planned measures and activities – The Government of Republic of Macedonia is firmly determined to increase the attractiveness of the country for foreign and domestic investors through improving the business environment and aggressive promotion. In 2008 the reforms in tax system continued (lowest taxes in the region; gradual decreasing of contributions for 1/3 of pension, health and social contribution in the period 2009-2011); reforms in customs (modernization, professionalism and computerization of customs procedure – one stop shop system in customs is functioning); reforms in banking system (harmonization of legislation), reforms in legislation (over 500 laws and bylaws were abolished by Regulatory Guillotine, RIA was introduces, procedures for doing business were simplified, the one-stop shop in the Central Registry is successful and registration takes only 4 hours with a tendency to be only 1 hour) and reforms in the Cadastre (with the World Bank support, the fight against crime and corruption is improved).

The implementation of the Program for stimulating investment in the Republic of Macedonia 2007-2010 is successful. The first monitoring of the measures from the Action plan in the Program for the period January – December 2007 has showed that the percentage of realization is 97,5 %. In this period, many laws and bylaws harmonized with European legislation are adopted or are in the process of adoption and measures concerned with organization, staff improvement and finances are undertaken. This contributes for improvement of the investment climate, as well as to the accelerated economic development.

One of the realized measures of the Program for stimulating investment in the Republic of Macedonia 2007-2010, which will increase the competitiveness of the Macedonian companies and their added value in the global market, is the establishment and the efficient functioning of the National Coordinating Body on Corporate Social Responsibility (CSR), supported by UNDP, USAID and InWent. The Coordinating body realized planned activities for 2008 and prepared the Nation Agenda for CSR for RM 2008-2012, which was adopted by the Government on 21 October, 2008. This strategic document is the basis for preparing the National Strategy for CSR of RM.

Republic of Macedonia is one of the few countries that have adopted national policy for CSR and it is a leader in the Region, and the Government of the RM, for the first time, in 2008 has provided financial support for the realization of the CSR activities according to the National Agenda on CSR 2008-2012.

The Economic Program of the Government anticipates the following: annual cumulative inflow of FDI to amount to 2 billion EUR in the period 2008-2012, increased rate of share of investment in GDP, increased foreign Greenfield and Brownfield investment, attraction of export oriented investments, improved image of the country as attractive location for investment and continuous promotion of incentives and potentials for investment in RM.

It is expected that the carried out reforms will improve the investment climate and will contribute to increased inflow of FDI in medium term period.

Matrix of planned reforms

Industrial policy		
Objective	Measure	Deadline
Improvement of the competitiveness of the Macedonian industry	Preparation of industrial strategy	2009
	Preparation of a four years program for clusters support	2009
Entrepreneurship and small and medium enterprises		
Goal	Measure	Realization
Straightening of institutional infrastructure	Observatory for SME's – monitoring and analyzing of statistical data for SME's and preparing Report	2009
	Forum for SME's- organizing national and local fora	2009
	Info pull- project in cooperation with regional centers for business support for SME's	2010
	Co-financing of European Information and Innovation Centre in Macedonia (EIICM)-Enterprise Europe Network	2009
Improving of business environment and access to financing	Inter-ministerial cooperation for realization of the Program for Development of Entrepreneurship, Competitiveness and Innovation of SME 2007-2010 and European Charter for small enterprises	2009
	Change of the credit guaranties scheme (Guaranty Fund)	2009
	Trainings for alternative source of financing	2009
Improving of competitiveness and innovation of SME's	Co-financing of incubators, co-financing costs of regional centers projects for non-financial SME support, co-financing of voucher consultancy scheme, entrepreneurship awards, publishing of brochures, campaigns and promotional activities.	2009
	Organizing "EU day of entrepreneur"	2009
	Implementation of the system for accreditation of consultants and trainers	2009
	International science cooperation	2009
Tourism		
Objective	Measure	Deadline
Republic of Macedonia – Recognisable tourist destination	Promotion activities of the international tourist fairs (Urteht, Ohrid, Ljubljana, Sofia, Belgrade, Berlin, Moscow, Keln, Kiev and London)	2009
	Implementation of the national strategy for tourism development 2009-2013	Continuous
	Agency for tourism promotion in the Republic of Macedonia	2009
Increase and improvement of the standards and the quality of the tourist infrastructure and services.	Categorisation of the accommodation capacities according to the law	2009
	Categorisation of the accommodation capacities according to the law by the local community	2009

	Giving state land for investments through international bids	2010
Development of alternative types of tourism	Support of the tourism supply based on traditional, natural, cultural and other values	2009-2011
	Development of new kind of alternative tourism (rural, cultural, health, conference tourism etc.)	2009-2011
Banking sector		
Objective	Measure	Deadline
Supervision strengthening	Analysis of the way of use of the ratings of the rating agencies for determining the capital adequacy.	2009
Grey economy reduction	Decision for introduction and implementation of the programmes for banks money laundering	2009
Insurance		
Objective	Measure	Deadline
Strengthening of the insurance supervision	Creation of an agency for insurance supervision	2009
Road transport		
Goal	Measure	Deadline
Improvement of the road infrastructure	Construction of a motorway Kumanovo - Tabanovce, Demir Kapija - Smokvica and Albanian border - Skopje - Bulgarian border	2010
	Reinforcement of the bridges and rehabilitation of a segment of E-75	2010
	Private (own) funds investments in the regional and local road network in Macedonia	2010
	Law on transformation of PE "Makedonijapat"	2009
Railway transport		
Goal	Measure	Deadline
Modernization and reconstruction of the railway infrastructure and introducing border-crossings trading and transport facilitating system	Installation of the central railway transport control system	2009
	Modernization of the railway transport of 27 railway stations in the railway of Corridor 10 from Tabanovce to Gevgelija	2009
	Project "Support for implementation of measures for the core regional transport network of South Eastern Europe	2012
	Modernization of the telecommunications systems along the railway Corridor 10 and harmonization of the goods data that need to be entered in the software used by the railways and the customs.	2009 and ongoing
	Procurement of two electro-locomotives	2010
Financing of the PE for railway infrastructure from the Budget of the Republic of Macedonia	National program for investments in the railway infrastructure	2009 and ongoing

	Preparation of a One Year Plan for construction, reconstruction, modernization, servicing and maintenance of the railway infrastructure for the current year and a Report for the realization of the One Year Program for railway infrastructure for the previous year.	2009 and ongoing
Air Transport		
Infrastructure improvements	Construction of the new cargo-airport in Stip	2012
	Construction, reconstruction and operation of the airport "Alexander the Great" - Skopje and the airport "St. Apostol Pavle" - Ohrid	2011
	Amendments on the Law on air transport	2009
Electronic communications		
Goal	Measure	Deadline
Defining the legal framework in the area of electronic communications and broadcasting with the aim of implementing the new package of directives from this area	Amendments and supplements of the Law on electronic communications	2009
	Amendments and supplements of the Law on broadcasting	2009
	Amendments and supplements of the Law on founding a PE MRD (where a construction of DVB-T multiplex is planned for the needs of the public service)	2009
Implementation of the measures of the National Strategy for development of electronic communications with information technologies - NSEKIT and the measures that will derive from the Strategy for development of broadband internet in the Republic of Macedonia	Preparation of a Strategy for development of the next generation of broadband internet in the Republic of Macedonia	2009
Post offices		
Goal	Measure	Deadline
Implementation of the Strategy for postal services development 2008-2010, as well as the Law on postal services	Modernization and restructuring, economical reinforcement of AD Macedonian Post	2009
	Contracting a team of consultants that will define the conditions and will investigate the possibility of selling part of the shares	2009
	Enactment of general acts for providing postal services (individual license, standard license and approval)	2009
	Creating a database of postal services providers	2009
	Methodology for postal services market analysis	2009
Education		
Goal	Measure	Deadline
Gaining adequate level of	Establishing of the Centre for adult education	2009

education for all adult groups	Vocational training for adults who have not finished the first level of professional qualifications	2009
	Qualifications and trainings for employed persons	2009
	Literacy and training for first level of qualifications for convicts in Republic of Macedonia	2009
	Infrastructure improvement (building new schools and sport halls)	2011
Decreasing the unemployed rate, through trainings and professional improvements according the labour market needs.	Analysing the labour market needs	2009
	Creation of professional standards, teching plans and exam programmes	2009
	Training for vocational qualifications	2009
Judicial reforms		
Objectives	Measures	Deadline
Implementation of the reform laws aiming towards strengthening of independence of the judiciary, as well as strengthening of the whole capacity of the judicial system.	Following and assessing of judges' work	2009
	Adoption of the Law on Salaries for the members of the Judicial Council	2009
	Transfer of the Judicial Budget Council Office from the Supreme Court to the Judicial Council of the Republic of Macedonia.	2009
	Forming of the organizational structures at the Judicial Council for managing of the Judicial Budget..	2009
	Strengthening of the administrative capacities for managing of the Judicial Budget	2009
	Assessment on implementation of the Law on Mediation	2009
	Training of mediators	continuous
	Changes and additions to the Law on Mediation	2010
	Adoption of the Law on Free Legal Assistance	2009
	Training for implementation of the Law on Free Legal Assistance	2009
Improvement of the court infrastructure.	Building of new court facility in Skopje	2010
	Reconstruction and modernization of 11 courts with expanded authority.	2009
Establishing of efficient and functional IT system in the judicial institutions.	Introducing of judicial electronic portal	2009
	Supplying of hardware equipment, system software and upgrading of software application as well as their maintaining.	2009
	Introduction of Automated Court Cases Management Information System (ACCMIS)	2010
	Organizing of training for all judges and public prosecutors in order to upgrade their knowledge about working with PC's and using of judicial IT system.	2010
Improvement in the enforcement of the court cases and establishing of efficient system of delivery to the court summons.	Transfer of enforcement cases from courts to the enforcement agents.	2010
	Continuous appointment of enforcement agents for vacant enforcement agents positions	2009
	Assessment on implementation of the Law on Enforcement	2009

Public administration reform		
Goal	Measures	Deadline
Institutional improvement of administrative structures and strengthening of administrative capacities	Preparation of a Training program and Professional training of state officials on a central level	continuous
	Establishment of a Unit for training support of state officials in Skopje	2009
	Training for Strategic planning and Policy making	continuous
Improvement of transparency and responsibility of administration	Development of general catalogue of all government services with key information of their responsibilities, connection with the portal – Services and distribution to the business community, local authorities, non-governmental organizations and media	2009
Implementation of a Strategy for cooperation between Government and civil sector	Modification and Amendment of Civil Communities and Foundations Law	2009
	Establishment of functioning network for communication and coordination of activities related to development of civil sector	2011
	Promotion of efficient cooperation with civil sector	2011
	Incorporation of the civil sector in Policy making and Legislative related to euro-integration	2011
	Creation of favourable tax and fiscal support framework	2011
	Stimulation of philanthropy and promotion of volunteering	2009
	Training for employees in the Unit for cooperation with Non-government organizations and Ministries	2008-2011
	Stimulation of development of civil sector, particularly outside the capital and in the rural environment	2008-2011
	Preparation of a Plan for training for improvement of principle for appropriate representation of minorities	2008-2009
Improvement of the quality of regulation	Providing Regulation Impact Assessment	2010
Energy		
Goal	Measures	Deadline
Improvement of energy infrastructure	Strategy for development of energy	2009
	HPP “Chebren“ и HPP “Galiste“	2011
	HPP „Boshkov most“	2011
	Combined gas power plant “Energetika“	2011
	12 hydro power plants along river Vardar	2011
	Preparation of Feasibility study for gas-system in Republic of Macedonia	2010
	40 small hydro power plants	2011
	400 kV interconnection Shtip (R.Macedonia)- Nish (R.Serbia)	2010

Labour market reforms		
Goal	Measures	Deadline
Active employment measures	Program for self-employment	2009
	Supporting programme for formalization of family businesses	2009
	Employment Preparation Programme	2009
	Subventions for employment	2009
	Practice work as support for first employment of young people under the age of 27	2009
	Public work in the Local Government Units	2009
	Employment Loans for unemployment persons	2009
Labour Legislation reforms	Amendment of the Labour Law	2008
Decrease of tax burden for employment in RM	Social Contribution Reform	2011
	Implementation of the "Gross salary" concept	2009
Improvement of administrative capacity in MLSP and EARM	Trainings for employees in MLSP and EARM related to policy, network and operative structure, as well as practice work in EURES (European employment services)	continuous
	Training for monitoring and evaluation of the active measures in the market	2009
Agriculture		
Policy goal	Proposed measures	deadline
Strengthening the competition of the Macedonian agricultural and rural sector in the process of EU accession	Programme for financial support of the agriculture	2010
	Decree for direct payments in the agriculture	2009
Managing the markets for agricultural products and support of the income for the agricultural economies	Programme for financial support of the agriculture	2010
	Adopting Strategy for marketing of the Macedonian wine, as well as amending and complementing the Law on wine (Official Gazette of the Republic of Macedonia 69/2004 and 89/2008).	2009
Continuity of transposition and implementation of the national legislation in the area of agriculture with the relevant EU legislation	Adopting the Law on amending and complementing the Law on tobacco and tobacco products.	2010
	Establishing system of data management within the market information system	2010
	Preparing new Law on organic agricultural production.	2010
	Establishing single registry of agricultural economies	2009

	Creating priority list of agricultural products that have potential for export and that could be subjected to origin protection and marketing promotion at the foreign markets.	2010
	Preparing a Programme of standards for quality and food safety	2010
	Preparing elaborations and protection of 5-6 agricultural products and preparing new Law on industrial ownership and Rulebook on geographical names.	2010
<i>Agricultural land</i>	Establishing Integrated administrative control system	2010
<i>Rural development</i>	Internal procedures and working manuals for auditing the adequacy of the operative structure with the accreditation criteria in context of national accreditation.	2010
	establishing monitoring and evaluation system for implementing the IPARD Program, which system needs to be completely functional before implementing the IPARD Program	2010
	Agro-ecological plan for preparing the institutions and the legal framework for implementation of the measures and for their planning in the midterm period	2010
	Performing analysis of needs for training the agricultural producers in accordance with the challenges of the market and the possibilities that the rural development policy offers and creating a Program for education and training of the agricultural producers.	2009
Phyto-sanitary policy	Agreement between the Government of the Republic of Macedonia and the Government of the Republic of Ukraine for collaboration in the area of quarantine and plants protection. Prepared larger number of bylaws that result from the Law on products for plants protection (Official Gazette of the republic of Macedonia 110/07) by the Directive 91/414 EE	2011
Seeds and seeding material	Preparation of Rulebooks in the area of seeds and seeding materials	2011
Forestry	adopting two new laws as follows: Law on forests and Law on hunting	2009
	preparing the Program for expanded reproduction of the forests for the year 2009,	2009
Strengthening the state veterinary service in accordance with the relevant EU standards		
Establishing and implementing efficient system for animal welfare according to the EU standards	Preparing a plan for raising awareness of all interested parties (veterinary workers, farmers, transporters, etc.)	2009
Establishing and implementing efficient system for safety of food from animal origin according to the EU standards	Development of a Plan for food crisis management	2011
	Planning and establishing Official controls that refer to the preconditioned programs DHP and DPP programs and HACCP – based procedures in the food facilities	2011
	Developing National monitoring plan for residues and forbidden substances	2011
	Developing National plan for monitoring and control of zoonoses and zoonosis agents	2011

	Developing National plan for monitoring of antimicrobiological resistance	2011
	Investigating epidemics caused by food	2011
Official controls that refer to Identification of animals and registration of rearing establishments in accordance with the EU standards	Updating and maintaining the system for animals identification, registration of rearing establishments and system for control of cattle movement	2009
	Establishing and maintaining the system for animals identification, registration of rearing establishments and system for control of sheep and goats movement	2009
	Establishing and maintaining the system for animals identification, registration of rearing establishments and system for control of pigs movement	2009
	Establishing and operating of VIS and integration with I&R and the data base of MAFWE	2009

Matrix of Policy Commitments

		2009	2010	2011
		-	-	-
B	Net direct budgetary effects	20.541.417	21.289.093	25.551.032
B1	Direct effect on revenues	6.067.351	6.868.051	6.114.890
B2	Direct effect on expenditures	26.608.768	28.157.144	31.665.922
	Description of policy			
	Industrial policy			
	Improvement of the competitiveness of the Macedonian industry			
A	Implementation profile	X		X
B	Net direct budgetary effects	-37.330	-44.050	-41.334
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	37.330	44.050	41.334
	Entrepreneurship and small and medium enterprises			
	Improvement of the institutional infrastructure			
A	Implementation profile	X		X
B	Net direct budgetary effects	-10.000	-15.450	-15.950
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	10.000	15.450	15.950
	Improvement of the competitiveness and innovativeness of the SMEs			
A	Implementation profile	X		X
B	Net direct budgetary effects	-50.000	-60.000	-60.000
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	50.000	60.000	60.000
	Business environment improvement			
	Improvement of the business environment (Exit and entry to the market, patents registration, licences, facilitation of foreign trade)			
A	Implementation profile	X		X
B	Net direct budgetary effects	-774.451	-705.000	-780.000
B1	Direct effect on revenues	0	25.818	25.568
B2	Direct effect on expenditures	774.451	730.818	805.568
	Cadastre reform			
	Implementation profile	X		X
	Net direct budgetary effects	-110.350	-110.000	-115.000
	Direct effect on revenues	302.000	305.000	305.000
	Direct effect on expenditures	412.350	415.000	420.000
	Tourism			
	Republic of Macedonia - recognisable tourist destination			
A	Implementation profile	X		X
B	Net direct budgetary effects	-21.036	-14.441	-19.815
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	21.036	14.441	19.815
	Improvement of standards and quality of tourist infrastructure and services			
A	Implementation profile	X		X
B	Net direct budgetary effects	-10.000	-10.000	-10.000
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	10.000	10.000	10.000
	Development of alternative types of tourism			
A	Implementation profile	X		X

B	Net direct budgetary effects	-10.000	-10.000	-10.000
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	10.000	10.000	10.000
Banking sector				
Strengthening of supervision				
A	Implementation profile	X	X	
B	Net direct budgetary effects	-20.000	-10.000	
B1	Direct effect on revenues	0	0	
B2	Direct effect on expenditures	20.000	10.000	
Insurance				
Strengthening of insurance supervision - Creation of Agency for insurance supervision				
		2009	2010	2011
A	Implementation profile	X		
B	Net direct budgetary effects	-20.000		
B1	Direct effect on revenues	0		
B2	Direct effect on expenditures	20.000		
Road transport				
Improvement of road infrastructure				
A	Implementation profile	X		X
B	Net direct budgetary effects	-5.748.570	-6.520.000	-7.660.000
B1	Direct effect on revenues	2.255.500	2.993.556	2.084.540
B2	Direct effect on expenditures	8.004.070	9.513.556	9.744.540
Railway transport				
Modernization and reconstruction of railway infrastructure and introduction of system for alleviation of trade and transport through border crossings				
A	Implementation profile	X		X
B	Net direct budgetary effects	-916.000	-903.000	-915.000
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	916.000	903.000	915.000
Air transport				
Infrastructure expropriation				
A	Implementation profile	X		
B	Net direct budgetary effects	-183.000		
B1	Direct effect on revenues	0		
B2	Direct effect on expenditures	183.000		
Agency for civil aviation - provider and regulator				
A	Implementation profile	X		X
B	Net direct budgetary effects	-570.000	-570.000	-570.000
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	570.000	570.000	570.000
Electronic communications				
Completion of legal framework in the area of electronic communications and radio broadcasting in order to implement the new directives				
A	Implementation profile	X		X
B	Net direct budgetary effects	-5000	-6000	-6500
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	5000	6000	6500
Implementation of measures from the National strategy for development of electronic communications with information technologies and measures from the Strategy for development of broadband internet in RM				
A	Implementation profile	X		X
B	Net direct budgetary effects	-750000	-750000	-750000

B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	750000	750000	750000
	Post office			
	Implementation of the Strategy for development of postal services in Republic of Macedonia 2008-2010 and the Law on postal services			
A	Implementation profile	X		
B	Net direct budgetary effects	-12000		
B1	Direct effect on revenues	0		
B2	Direct effect on expenditures	12000		
	Education			
	Improving the level of education for all adult groups			
A	Implementation profile	X		X
B	Net direct budgetary effects	-4.314.832	-4.400.000	-4.400.000
B1	Direct effect on revenues	2.716.627	2.800.000	2.900.000
B2	Direct effect on expenditures	7.031.459	7.200.000	7.300.000
	Infrastructure improvement of the education system			
A	Implementation profile	X		X
B	Net direct budgetary effects	-1.288.528	-1.350.000	-1.400.000
B1	Direct effect on revenues	611.259	650.000	700.000
B2	Direct effect on expenditures	1.899.787	2.000.000	2.100.000
	Decrease of unemployment through trainings and specializations according to the needs of labor market			
A	Implementation profile	X		X
B	Net direct budgetary effects	-20.170	-28.152	-32.433
B1	Direct effect on revenues	615	677	782
B2	Direct effect on expenditures	20.785	28.829	33.215
	Life-long learning and youth in action			
A	Implementation profile	X		X
B	Net direct budgetary effects	-6.150	-9.000	-10.000
B1	Direct effect on revenues	55.350	56.000	60.000
B2	Direct effect on expenditures	61.500	65.000	70.000
	Building of sports halls for youth			
A	Implementation profile	X		X
B	Net direct budgetary effects	-122.000	-130.000	-135.000
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	122.000	130.000	135.000
	Judicial reforms			
	Implementation of reform laws in order to strengthen independence and efficiency of judiciary and to invigorate the overall capacity of judicial system			
		2009	2010	2011
A	Implementation profile	X		X
B	Net direct budgetary effects	-10000	-10000	-10000
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	10000	10000	10000
	Improvement of judicial infrastructure			
A	Implementation profile	X		X
B	Net direct budgetary effects	-147000	-91000	-91000
B1	Direct effect on revenues	114000	22000	22000
B2	Direct effect on expenditures	261000	113000	113000

	Establishment of efficient and functional information technology in judicial institutions			
A	Implementation profile	X		X
B	Net direct budgetary effects	-145000	-15000	-150000
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	145000	15000	150000
	Improvement of execution of judicial cases and establishment of efficient system for delivery of court invitations			
A	Implementation profile	X		X
B	Net direct budgetary effects	-10000	-10000	-10000
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	10000	10000	10000
	Public administration reform			
	Institutional improvement of administrative structures and strengthening of administrative capacities			
A	Implementation profile	X		X
B	Net direct budgetary effects	1000	3000	4000
B1	Direct effect on revenues	12000	15000	17000
B2	Direct effect on expenditures	11000	12000	13000
	Improvement of transparency and responsibility of administration			
A	Implementation profile	X		X
B	Net direct budgetary effects	-5000	-6000	-6000
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	5000	6000	6000
	Implementation of the Strategy for cooperation between Government and civil sector			
A	Implementation profile	X		X
B	Net direct budgetary effects	-2000	-2000	-3000
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	2000	2000	3000
	Improvement of regulation quality			
A	Implementation profile	X		X
B	Net direct budgetary effects	-3000	-3000	-4000
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	3000	3000	4000
	Energy sector			
	Improvement of energy infrastructure			
A	Implementation profile	X		X
B	Net direct budgetary effects	-153.487	-190.000	-190.000
B1	Direct effect on revenues	55.000	60.000	60.000
B2	Direct effect on expenditures	208.487	250.000	250.000
	Labor market reforms			
	Active employment measures			
A	Implementation profile	X		X
B	Net direct budgetary effects	-100.000	-100.000	-100.000
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	100.000	100.000	100000
	Promotion of national policies in the area of social inclusion			
	Implementation profile	X		X
	Net direct budgetary effects	-280.000	-350.000	-350.000
	Direct effect on revenues	0	0	0
	Direct effect on expenditures	280.000	350.000	350000
	Health insurance subvention for young people under 27			
	Implementation profile	X		X

	Net direct budgetary effects	-168.000	-180.000	-200.000
	Direct effect on revenues	0	0	0
	Direct effect on expenditures	168.000	180.000	200.000
Improvement of administrative capacity of MLSP and EARM				
A	Implementation profile	X		X
B	Net direct budgetary effects	-1.500	-2.000	-2.500
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	1.500	2.000	2.500
Agriculture				
Strengthening competitiveness of macedonian agricultural and rural sector towards EU accession process				
A	Implementation profile	X		X
B	Net direct budgetary effects	-2.300.000	-2.500.000	-2.800.000
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	2.300.000	2.500.000	2.800.000
Regulation of agricultural products markets and support of the income of agricultural economy				
A	Implementation profile	X		X
B	Net direct budgetary effects	-2.000.000	-2.000.000	-2.000.000
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	2.000.000	2.000.000	2.000.000
Improvement of system for formal controls in the area of health protection of animals in accordance with EU standards				
A	Implementation profile	X		X
B	Net direct budgetary effects	-273.000	-280.000	-2.800.000
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	273.000	280.000	2.800.000
Introduction and implementation of efficient system for animal welfare in accordance with EU standards				
A	Implementation profile	X		X
B	Net direct budgetary effects	-100000	-100000	-100000
B1	Direct effect on revenues	0	0	0
B2	Direct effect on expenditures	100000	100000	100000

Structural Reform Agenda achievements of the last years PEP			
Measures foreseen in PEP 2007	Accepted Yes/No	Date	Comment
Privatization			
Competition of the privatization process	Yes		Privatization process is considered as completed
Strategies and policies in industry – Improvement of the competitiveness of Macedonian industry and increasing of the industrial production			
Strategy for development of textile industry	Yes	2007	Strategy is adopted by the Government in 2007
Action Plan	No		Action plan and Program for revitalization are prepared and should be adopted by the Government in April 2009
Implementation of the strategy for development of textile industry	Yes	2007	Program for revitalisation of textile industry for 2009 is prepared and adopted
Implementation of National strategy for restructuring of steel industry	Yes	2008	
Issuing Bulletin for steel industry	Yes	2008	
Study for measuring the indicators for competitiveness - defining the set of indicators that will allow international comparison of Macedonian industry	No		In process of preparation, it should be prepared by 2009
National document for industrial policy of RM 2009-2020, it's implementation will propose measures and instruments for increasing the competitiveness of the industry	No		In process of preparation, it should be prepared by 2009
Internationalization – creation of better data base for export opportunities and improvement of the promotion of Macedonian companies on foreign markets	No		Postponed for 2009
Clustering – creation of new association of clusters for increasing competitiveness of industrial sectors	No		In preparation is 4 year program that should be adopted by Government till March 2009. Government have adopted Yearly program for support of clusters for 2009
Energy			
Implementation of the Agreement for establishment energy community	Yes	2008	
Implementation of a Project for system for governing with environment	Yes	2008	
Small and medium enterprises			
New business centres	Yes	2008	
Increasing of the level and standards for trainings and trainers - HRDF	Yes	2008	Since, Project co-financed by EU, has been finished, activities for finding legal solution for further sustainability of HRDF, without EU support, are ongoing.
Straightening of the public-private partnership (Forum)	Yes	2008	One National and 5 regional forums were organised. This activity will continue in 2009
Straightening of the capacity of the Observatory	No	2009	APERM has to provide this through its capacity.
European Information and Innovation Centre in Macedonia – Enterprise Europe Network	Yes	2008	Will continue in 2009
Straightening of the awareness for the importance of EU Charter for small enterprises	Yes	2008	
Straightening of the Guaranty Fund and issuing guaranties	No		Postponed for 2009. Chages for the fill of work of the Guaranty fund are under preparation
Founding of private Credit bureau	Yes	2009	It has been founded in 2008 and it has to become functional.
Incubators, clusters , innovative projects, promotion support	Yes	2008	Will continue in 2009
Straightening of the voucher system	Yes	2008	Voucher system will continue in 2009

Tourism			
National strategy for tourism development	Yes	2008	
Financial services			
Forming of private credit bureau	Yes	2008	
Improvement of the insurance system			
Establishment of Agency for insurance supervision	Yes	2008	
Conducting insurance broker exam	Yes	2008	
Capital Market			
Laws for establishment of a guarantee fund for compensation of the investors who's settlement was not executed	Yes	2008	
New investments funds law	Yes	2008	
Road transport			
Forming the Agency for state roads	yes	2008	
implementing of electronic system for allocation of licences for international transport of goods	yes	2008	
new software for electronic distribution of licences for international transport of goods	yes	2008	
National strategy for road safety for the period 2009 - 2014	yes	2008	
Law on transportation of dangerous goods in road and rail traffic	yes	2008	
Rail transport			
Liberalisation on railway transport	yes	2008	
Study for establishing a charge for access to the railway infrastructure	yes	2008	
Study for services in public interest in railway transportation of passengers	yes	2008	
Agency for regulating of the market in railway services	yes	2008	
Air transport			
Concession of the airport „ALEXANDER THE GREAT“ – Skopje and „ST. PAUL THE APOSTLE“ – Ohrid	yes	2008	
Decision on forming JSC-ANSP with Statute for forming	yes	2008	Decision for initiating a procedure for establishment of a JSC in state ownership for performing activity such as providing services to the air navigation (Official Gazette of RM No. 133/08) and Statute of the JSC in state ownership for performing activity such as providing services to the air navigation (Official Gazette of RM No. 139/08)
Decision for compensation and payment method for air-navigation services, and for determining the part of this amount that will be used for financing of the Agency	yes	2008	Decision on the payment and the manner for payment and distribution of the user charges for the air navigation and the amount and the manner on the user charges of the air navigation (Official Gazette of RM No. 147/08)
A decision for determining the compensation for protective measures against illegal acts at the airport and during the usage of the airport infrastructure and for determining the part of this amount that will be used for financing of the Agency	No		According the extract of the Draft-report from the 26th meeting held on the 4th of November 2008 the Government of the RM has postponed the Decision on the amount and the way of determining the part of the fee for protection of illegal acts and the part of the fee for using the airport infrastructure.
Preparation of allocation balance of assets, personnel, rights and duties of ACA	Yes	2008	
Transferring the rest JAR (i.e. FCL-3) into the national law according to the Protocol V of the ECAA Agreement	No (current)		
Electronic Communications			
Amendments of Law on Electronic communications	yes	Official Gazette of the Republic of Macedonia No.98 / 04.08.2008	In the amendments is envisaged the termination of the existing agreement on concessions, finishing the legislation in the part of number transferring, also with these amendments is abolished the right of the Commission for the electronic communication to make decisions in second instance complaint procedure, i.e. there is a court protection against the decision of the Director of the Agency for electronic communications.

Amendments on Law on Broadcasting activities	yes	Official Gazette of the Republic of Macedonia No.103 / 19.08.2008	The amendments foresee decrease of the broadcasting fee by 37% thus increasing the payment itself, there is also possibility within the frames of the Law to regulate the part of possible redundancy leave and liquidation of the public broadcasting enterprise through a possibility for additional financing of the public service with funds from the Budget of the Republic of Macedonia, thus creating efficient and functional public broadcasting service.
National Strategy for Development of Electronic Communications with Information Technologies	yes	Official Gazette of the R.M No.95 / 30.07.2008	The measures arising from the Strategy are to be realized within the period 2008-2012
Action Plan for implementing of the National Strategy for Development of Electronic Communications with Information Technologies	yes	Adopted by Gov. of R.M. in July 2008	The Government of the Republic of Macedonia adopted the Action Plan for implementation of the National Strategy and the institutions started pro-actively to complete the measures stipulated in it
Decision for Establishing of National Council for IT Society	yes	Official Gazette of the Republic of Macedonia No. 97 / 01.08.2008	National Council for information society shall control the implementation of the Action plan of the National strategy for development of the electronic communications with information technologies
Post office			
Law on post services	yes	Official Gazette of the R. M No. 4/08	
Strategy for development of the post services	yes	Official Gazette of the R. M No. 72/07	
New employment in Department for communications - post traffic unit	No		Estimated employment is planed to be realised in 2009
Forming of independent regulatory body for postal services – Post agency	Yes	2008	Post agency has started working in June 2008
Public administration reform (PAR)			
Training for state officials – Study visit about methodology for development of PAR Strategy	Yes	2009	
Building capacities of the unit for PAR for monitoring implementation of the Strategy	Yes	2009	
Establishment of organizational frameworks for strengthening of the human resources governing system	Yes	2008	
Preparation of a Training program and Professional improving of state officials on a central level	Yes	2008	
Establishment of a Unit for training support of state officials in Skopje	Yes		
Creation of a training programme for 2008	Yes	2008	
Training for Strategic planning and Policy making	Yes	2008	
Reports by the public serves institutions to the Government related to the recommendations in NP on quarterly basis	Yes	2008	
Assessment of the Government measures for activities according to the findings of NP included in the Annual Report	Yes	2008	
Submitting Annual report by the Commission for protection of the right to free access to public information	Yes	2008	
Development of general catalogue of all government services with key information of their responsibilities, connection with the portal – Services and distribution to the business community, local authorities, non-governmental organizations, media	No		Postponed for 2009

Establishment of a messaging serves for direct access by responsible persons for every civil requirement	Yes	2008	
Introduction of new portal structure	Yes	2008	
Preposition of measures by public serves institution who have not improved conditions in two successive quarters	Yes	2008	
Modification and Amendment of Civil Communities and Foundations Low	No		Postponed for 2009
Establishment of a mechanism for civilians participation and their organizations in decision making processes	Yes	2008	
Active participation of representatives of civilian organizations in state advisories and other entities	Yes	2008	
Establishment of functioning network for communication and coordination of activities related to development of civilian sector	Yes	2007	
Improvement of the framework for direct financing by the Government	Yes	Continuous	
Stimulating philanthropy	Yes	Continuous	
Promotions of volunteering	Yes	Continuous	
Stimulation of development of civil sector, particularly outside the capital and in the rural environment	Yes	2007	
Preparation of a Plan for training for improvement of principle for appropriate representation of the minorities	Yes	2008	
Location of unnecessary formalities and administrative barriers with impact in doing business	Yes	2007	
Completing the Unique Electronic regulation register	Yes	2007	
Education			
Adoption of the Statute and election of the Steering Committees for the National Agency	Yes	2008	
Election of Director of the National Agency	Yes	2008	
Trainings for the employees in the National Agency	Yes	2008	
Accreditation of the National Agency	No	2008	Expected in 2009
Equipment and preparation for implementation of the working methodologies for the European Commission for the work of the National Agency	Yes	2008	
Paying entry ticket for participation in the actions for Life long learning Programme	Yes	2008	
Teaching programmes for religion and ethics, IT , English language	No		Postponed for 2009
IT equipment in the primary schools	Yes	2008	
Conception for Compulsory secondary education	No	2008	
Reform of the two year and three year secondary education	Yes	2008	
Conception for postsecondary education	No	2008	
Development of the Curricula for postsecondary education	No		Postponed for 2009.
Environment			
Preparation and adoption of a National Strategy for sustainable development with AP of RM	Yes	2008	In process, preposition strategy is in a procedure of Inter ministerial consultation and is expected to be adopted in January 2009

Preparation of a National strategy for environmental investment	Yes	2008	In process, proposition strategy is in a procedure of Inter ministerial consultation and is expected to be adopted in January 2009
Environment education - Green package project	Yes	2008	
Upgrade of the system for automatic data collection, through purchasing a software for automatic validation of data	Yes	2008	The activity will continue in 2009
Establishment of vault water monitoring – preparation of a programme for monitoring vault water	No		Not started as a result of un-provided finances for this purpose
Preparation of a Strategy for protection of nature	No		Not started as a result of un-provided finances for this purpose
Development of a National programme for monitoring of biodiversity components and biodiversity indicators of NATURA 2000	No		Not started as a result of un-provided finances for this purpose
Implementation of a governing environmental data Strategy- development of a software component of national information environmental system	Yes	2008	Activities started
Preparation of second National climate changes communication	Yes	2008	
Protection of ozone – realization of the fifth phase of the ozone protection project	Yes	2008	
Judicial reform			
Implementation of the new Courts law	Yes	2008	
Training for judges and prosecutors	Yes	2008	
Strengthening the mechanisms for planning and managing the judicial budget	Yes	2008	
Advancing the system for court orders execution	Yes	2008	
Implementing the law for mediation	Yes	2008	
Implementation of the changed concept for court protection	Yes	2008	
Implementation of the constitutional bylaws for the public prosecution	Yes	2008	
Strengthening the system for the Pentair legal framework	Yes	2008	
Enhancing the system for free legal advice	Yes	2008	
Introduction of effective information technology in the judicial institutions	In process		
Health			
Implementation of measures for early diagnosing of ill from diabetes and their proper and timely treatment	Yes	2008	
Adoption of Strategy for un-contagious diseases in accordance with European Strategy of WHO	Yes	2008	Prepared. Inter ministerial consultation are In procedure
Defining basic services package in mandatory health	Yes	2008	Prepared- in adoption procedure
Reorganization of the urgent medical help service	Yes	2008	Preparation of a Strategy for development of urgent services in RM (urgent medical help and urgent centres) with implementation period of 5 years. The assessment of the required number of teams and equipment for urgent medical help in settlements with less than 20000 citizens where the urgent medical help does not exist but chosen doctors provide it through duties.
Formation of public health institute	Yes	2008	

Preparation of a Strategy for public health	Yes	2008	
Adoption of Strategy for adolescent health	Yes	2008	Prepared. Inter ministerial consultation are In procedure
Development of integrated system for safety and food control	Yes	2008	Activities for implementation of the integrated system for safety and food control are undertaken in 2008 in accordance with the Strategy for food safety in RM (adopted by the Government in October 2007)
Adjustment of educational plans and programmes for undergraduate and postgraduate studies and specialization in every profile in the health sector	Yes	Continuous	Started activities. Continuous activities of the working groups
Preparation of accredited programs and courses for continuous education	Yes	2008	
Assessment of referent prices for medications on positive list by generic , dose, form and shape	Yes	2008	
Completing the information system in HIF	Yes	2008	
Implementation of mandatory electronic reporting to HIF	Yes	2008	

ANNEX: TABLES

Table 1a: Macroeconomic prospects

	ESA Code	Year 2007	Year 2007	Year 2008	Year 2009	Year 2010	Year 2011
		Level (€)	Rate of change				
1. Real GDP at market prices	B1*g	4159	5,9	6,0	5,5	6,0	7,0
2. GDP at market prices	B1*g	5782	13,8	14,5	9,2	9,0	10,0
Components of real GDP							
3. Private consumption expenditure	P3	272886	77,1	76,0	75,3	79,3	77,0
4. Government consumption expenditure	P3	61902	17,5	16,3	15,6	14,8	13,8
5. Gross fixed capital formation	P51	71557	20,2	21,5	22,6	21,9	22,5
6. Changes in inventories and net acquisition of valuables (% of GDP)	P52+P53	14105	4,0	4,0	4,1	3,9	3,8
7. Exports of goods and services	P6	189309	53,5	58,0	56,0	56,1	54,8
8. Imports of goods and services	P7	255971	72,4	73,8	75,8	76,3	72,5
Contribution to real GDP growth							
9. Final domestic demand		334788	6,8	6,1	5,4	4,5	4,8
10. Change in inventories and net acquisition of valuables	P52+P53	14105	1,2	0,6	0,5	0,0	0,5
11. External balance of goods/services	B11	-66662	-4,1	-3,0	-2,5	-0,9	-1,2

Table 1b: Price developments

Percentage changes, annual averages unless otherwise indicated	ESA Code	Year 2007	Year 2008	Year 2009	Year 2010	Year 2011
1. GDP deflator		7,4	8,0	3,5	2,8	2,8
2. Private consumption deflator		3,8	3,0	2,9	2,4	2,4
3. HICP		n.a	n.a	n.a	n.a	n.a
4. National CPI change		2,3	8,3	3,5	2,8	2,8
5. Public consumption deflator		4,2	3,8	3,4	2,9	2,9
6. Investment deflator		8,0	5,0	4,6	5,5	5,5
7. Export price deflator (goods & services)		7,0	5,0	5,1	4,6	4,6
8. Import price deflator (goods & services)		3,0	6,1	6,1	5,6	5,6

Table 1c: Labour markets developments

	ESA Code	2007	2007	2008	2009	2010	2011
		Level	Rate of change				
1. Population (thousands)			2044308	2048397	2052494	2056599	2060712
2. Population (growth rate in %)			0.2	0.2	0.2	0.2	0.2
3. Working-age population (persons)			1628635	1642091	1644956	1647834	1650722
4. Participation rate			55.7	56.4	56.3	56.2	56.0
5. Employment, persons 19			590234	613859	638413	663950	690508
6. Employment, hours worked ²⁰			n.a	n.a	n.a	n.a	n.a
7. Employment (growth rate in %)			3.5	4.0	4.0	4.0	4.0
8. Public sector employment (persons)			111229	109980	n.a	n.a	n.a
9. Public sector employment (growth in %)			3.0	-1.1	n.a	n.a	n.a
10. Unemployment rate ²¹			34.9	33.7	33.5	33.0	32.4
11. Labour productivity, persons ²²		392761	2.3	1.9	1.4	1.9	2.9
12. Labour productivity, hours worked ²³			n.a	n.a	n.a	n.a	n.a
13. Compensation of employees	D1	14584	7.9	10.4	11.0	11.0	11.4

19

Occupied population, domestic concept national accounts definition

20

National accounts definition

21

Harmonised definition, EURtat; levels

22

Real GDP per person employed.

23

Real GDP per hour worked.

Table 1d: Sectoral balances

Percentages of GDP	ESA code	2007	2008 ²⁴	2009	2010	2011
1. Net lending/borrowing vis-à-vis the rest of the world ²⁵	B.9	-1.5	-1.3	-2,1	-5,2	-4,9
of which:						
- Balance of goods and services		-19.9	-22.3	-25,0	-23,9	-22,6
- Balance of primary incomes and transfers		12.7	12.0	13,9	13,4	12,5
- Capital and financial account ²⁶		9.5	12.4	13,2	15,4	15,0
2. Net lending/borrowing of the private sector ²⁷	B.9/ EDP B.9	-6,6	-12	-13,9	-12,9	-12,9
3. Net lending/borrowing of general government ²⁸		0.6	-0.8	-2,8	-2,8	-2,8
4. Statistical discrepancy			optional	optional	optional	optional

Table 1e: GDP, investment and gross value added

	ESA Code	2007	2008	2009	2010	2011
GDP and investment						
GDP level at current market prices (in domestic currency)	B1g	353786	405014	442245	481906	530077
Investment ratio (% of GDP)		24,2	30,0	29,7	30,2	30,5
Growth of Gross Value Added, percentage changes at constant prices						
1. Agriculture		-2,0	6,1	3,9	4,5	4,5
2. Industry (excluding construction)		4,2	7,7	4,8	6,8	6,4
3. Construction		5,8	10,7	7,4	12,8	14,8
4. Services		6,9	5,1	6,0	7,0	7,1

²⁴ Last available data as of 10.2008.

²⁵ Financing item in the balance of payments.

²⁶ Capital and financial account without official foreign reserves.




²⁷ Private net external debt, including public enterprises. Last available data as of 30.09.2008.

²⁸ Central government fiscal balance.

Table 1f: External sector developments

Euro mill. unless otherwise indicated	Year 2007	Year 2008	Year 2009	Year 2010	Year 2011
1. Current account balance (% of GDP)	-7,2	-11,3	-11,1	-10,2	-10,1
2. Export of goods	2441,5	3214,9	3767,5	4223,3	4664,5
3. Import of goods	-3616,3	-4978,8	-5677,8	-6251,9	-6799
4. Trade balance	-1174,8	-1763,8	-1910,2	-2028,6	-2134,6
5. Export of services	594,2	800,6	938,2	1051,7	1161,6
6. Import of services	568,7	-783,5	-893,5	-983,8	-1069,9
7. Service balance	25,5	17,2	44,8	67,9	91,7
8. Net interest payments from abroad	-17,9	-28,2	-43,1	-63,3	-96,1
9. Other net factor income from abroad	-103,1	-113,3	-105,6	-107,3	-108,7
10. Current transfers	1012,1	1060,8	1162,3	1230,8	1284,6
11. <i>Of which</i> from EU	n.a	n.a	n.a	n.a	n.a
12. Current account balance	-414,8	-761,4	-829,9	-836,6	-912,5
13. Foreign direct investment, net	506,9	538,5	565,4	607,8	653,4
14. Foreign reserves	-101,8	53,8	-155,6	-428,5	-440,6
15. Foreign debt	2840,2	-	-	-	-
16 Public foreign debt	1,407.22	1,440.50	1,726.32	2,382.74	2,953.86
18. <i>O/w</i> : repayments due	389.4	175.4	181.7	270.2	407.6
19. Exchange rate vis-à-vis EUR (end-year)	61,2	61,2	61,2	61,2	61,2
20. Exchange rate vis-à-vis EUR (annual average)	61,18	61,18	61,18	61,18	61,18
21. Net foreign saving (lines 21-25: percentages of GDP)	-	-	-	-	-
22. Domestic saving	3,4	3.1	4.9	6.4	7.8
23. Domestic investment	24,2	n.a.	n.a.	n.a.	n.a.

Table 2: General government budgetary prospects

	ESA code	Year 2007	Year 2007	Year 2008	Year 2009	Year 2010	Year 2011
		Level	% of GDP				
Net lending (B9) by sub-sectors							
1. General government	S13	2426	-0.8	-1.0	-2.8	-2.8	-2.8
2. Central government	S1311	1708	-0.6	-1.0	-2.8	-2.8	-2.8
3. State government	S1312	-1008	-0.3	-0.7	-2.4	-2.4	-2.5
4. Local government	S1313	0.0	0.0	0.0	0.0	0.0	0.0
5. Social security funds	S1314		-0.2	-0.3	-0.4	-0.4	-0.3
General government (S13)							
6. Total revenue	TR	117752	38.1	37.6	39.0	35.0	30.6
7. Total expenditure 	TE	120178	38.9	38.6	41.7	37.5	35.1
8. Net borrowing/lending	EDP.B9						
9. Interest expenditure	EDP.D41 incl. FISIM	3364	1.1	0.8	0.8	0.9	1.0
p.m. 9a. FISIM							
10. Primary balance 		2426	-0.8	-1.0	-2.8	-2.8	-2.8
Components of revenues							
11. Total taxes (11 = 11a+11b+11c)		62646	20.2	21.2	21.3	18.9	18.3
11a. Taxes on production and imports	D2	23298	7.5	8.0	7.5	5.8	5.3
11b. Current taxes on income and wealth	D5	35630	11.5	12.0	12.7	12.2	12.2
11c. Capital taxes	D91	3718	1.2	1.1	1.1	0.9	0.8
12. Social contributions	D61	30579	9.9	9.4	9.1	7.9	7.2
13. Property income	D4	5343	1.7	1.8	1.5	1.4	1.3
14. Other (14 = 15-(11+12+13))		19184	6.2	5.2	7.1	6.8	3.8
15 = 6. Total revenue	TR	117752	38.1	37.6	39.0	35.0	30.6
p.m.: Tax burden (D2+D5+D61+D91-D995) 		n.a	n.a	n.a	n.a	n.a	n.a



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



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



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

Table 2 (continued)

	ESA code	Year 2007	Year 2007	Year 2008	Year 2009	Year 2010	Year 2011
		Level	% of GDP				
Selected components of expenditures							
16. Collective consumption	P32	44447	14.4	14.8	15.6	13.2	11.9
17. Total social transfers	D62 + D63	49569	16.0	15.2	15.1	13.5	12.9
17a. Social transfers in kind	P31 = D63	n.a	n.a	n.a	n.a	n.a	n.a
17b. Social transfers other than in kind	D62	n.a	n.a	n.a	n.a	n.a	n.a
18 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	33.64	1.1	0.8	0.8	0.9	1.0
19. Subsidies	D3	6191	2.0	2.1	2.2	2.2	2.1
20. Gross fixed capital formation	P51	16607	5.4	5.7	8.0	7.7	7.2
21. Other (21 = 22-(16+17+18+19+20))		0	0	0	0	0	0
22. Total expenditures ¹	TE	120178	38.9	38.6	41.7	37.5	35.1
p.m. compensation of employees	D1						

¹

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

Table 3: General government expenditure by function	COFOG Code	Year 2005	Year 2008	Year 2009	Year 2010	Year 2011
1. General public services	1	5885	17257	16.610	n.a	n.a
2. Defence	2	5885	8099	8.441	n.a	n.a
3. Public order and safety	3	8398	12204	14.519	n.a	n.a
4. Economic affairs	4	15877	18771	33.441	n.a	n.a
5. Environmental protection	5	368	427	1.104	n.a	n.a
6. Housing and community amenities	6	858	3316	2.247	n.a	n.a
7. Health	7	613	2020	2.103	n.a	n.a
8. Recreation, culture and religion	8	1471	2564	4.152	n.a	n.a
9. Education	9	9869	20523	22.754	n.a	n.a
10. Social protection	10	17103	17592	24.249	n.a	n.a
11. Total expenditure (item 7 = 26 in Table 2)	TE	66327	102773	129.620	n.a	n.a

Table 4: General government debt developments

Percentages of GDP	ESA code	Year 2007	Year 2008	Year 2009	Year 2010	Year 2011
1. Gross debt ³³		24,7	21,4	22,7	24,7	25,8
2. Change in gross debt ratio		-8,2	-3,3	1,3	2	1,1
Contributions to change in gross debt						
3. Primary balance ³⁴		1,2	-0,2	-2,0	-2,0	-1,9
4. Interest expenditure (incl. FISIM) ³⁵		0,8	0,7	0,7	0,9	1,0
5. Stock-flow adjustment		n.a	n.a	n.a	n.a	n.a
of which:		n.a	n.a	n.a	n.a	n.a
- Differences between cash and accruals ³⁶		n.a	n.a	n.a	n.a	n.a
- Net accumulation of financial assets		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 ³⁷		n.a	n.a	n.a	n.a	n.a
p.m. implicit interest rate on debt ³⁸						
Other relevant variables						
6. Liquid financial assets ³⁹		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

³³ As defined in Regulation 3605/93 (not an ESA concept).

³⁴ Cf. item 10 in Table 2.

³⁵ Cf. item 9 in Table 2.

³⁶ The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

³⁷ Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

³⁸ Changes due to exchange rate movement, and operation in secondary market could be distinguished when relevant.

³⁹ Proxies by interest expenditure (incl. FISIM recorded as consumption) divided by the debt level of the previous year.

Table 5: Cyclical developments

Percentages of GDP	ESA Code	Year 2007	Year 2008	Year 2009	Year 2010	Year 2011
1. Real GDP growth (%)	B1g	5,9	6,0	5,5	6,0	7,0
2. Net lending of general government	EDP.B.9	0.6	-1.5	-2.8	-2.8	-2.8
3. Interest expenditure (incl. FISIM recorded as consumption)	EDP.D.41 + FISIM	0.8	0.7	0.8	0.9	1.0
4. Potential GDP growth (%) ⁴⁰		5.0	5.4	5.8	6.2	6.6
Contributions:						
- labour		1.5	1.8	2.2	2.5	2.8
- capital		1.5	1.5	1.6	1.6	1.6
- total factor productivity		2.0	2.0	2.1	2.1	2.1
5. Output gap		0,8	0,3	-0,6	0,2	0,5
6. Cyclical budgetary component		2.3	0.8	-0.3	0.7	1.7
7. Cyclically-adjusted balance (2-6)		-1.7	-2.3	-2.5	-3.5	-4.5
8. Cyclically-adjusted primary balance (7-3)		1.4	-0.8	2.0	-1.9	-1.8

Table 6: Divergence from previous programme

	Year 2007	Year 2008	Year 2009	Year 2010	Year 2011
1. GDP growth (%)					
Previous programme	6,0	6,0	6,5	6,5	
Latest programme	5,9	6,0	5,5	6,0	7,0
Difference	0,1	0,0	1,0	0,5	
2. General government net lending (% of GDP)					
Previous programme	-1,0	-1,5	-1,5	-1,5	
Latest programme	0,6	-0,8	-2,8	-2,8	-2,8
Difference	1,6	0,7	1,3	1,3	
3. General government gross debt (% of GDP)					
Previous programme	26,1	25,2	23,9	22,5	
Latest programme	24,7	21,4	22,7	24,7	25,8
Difference	1,4	3,8	1,2	-2,2	

⁴⁰ Until an agreement on the Production Function Method is reached, Member States can use their own figures (SP).

Table 7: Long-term sustainability of public finances

Percentages of GDP	2000	2005	2010	2020	2030	2040	2050
Total expenditure	36.6	36.2	37.5	38.0	38.0	38.0	38.0
of which:							
- Age-related expenditures	n.a	n.a	n.a	n.a	n.a	n.a	n.a
- Pension expenditure	4.6	5.3	7.6	7.5	7.5	7.5	7.5
- 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	5.3	5.5	3.9	4.0	4.0	4.0	4.0
- 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	4.5	4.7	5.7	5.8	6.0	6.2	6.4
Other age-related expenditures	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Interest expenditure	1.62	1.12	0.9	n.a	n.a	n.a	n.a
Total revenues	34.1	36.6	35.0	36.0	36.0	36.0	36.0
<i>of which:</i> property income	n.a	n.a	n.a	n.a	n.a	n.a	n.a
<i>of which:</i> from pensions contributions (or social contributions, if appropriate)	7.0	6.6	5.3	5.6	5.8	6.0	6.1
Pension reserve fund assets	n.a	n.a	n.a	n.a	n.a	n.a	n.a
<i>of which:</i> consolidated public pension fund assets (assets other than government liabilities)	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Assumptions							
Labour productivity growth	4.2	2.0	2.0	2.3	2.0	2.0	1.8
Real GDP growth	4.5	4.1	6.5	6.0	5.5	5.0	4.5
Participation rate males (aged 20-64)	71.7	72.0	74.0	75.0	77.0	77.0	78.0
Participation rates females (aged 20-64)	47.7	49.2	55.0	59.0	64.0	68.0	72.0
Total participation rates (20-64)	59.7	60.8	64.6	67.5	68.5	71.0	74.0
Unemployment rate	32.5	37.3	32	22	18	15	12
Population aged 65+ over total population		10.8	n.a	n.a	n.a	n.a	n.a

Table 8: Basic assumptions on the external economic environment underlying the 2008 PEP framework⁴¹

VARIABLE (annual growth rates in %, if not otherwise stated)	ASSUMPTIONS FOR						COMMENTS	
	Year 2007	Year 2008	Year 2009	Year 2010	Year 2011			
	change*	change*	change*	change*	change*			
Interest rates (in % p.a., annual averages)								
- Euro area: short-term interest rate (3-months inter-bank rates)	4.3	4.3	-0.1	3.8	-0.5	3.8	3.8	EU Commission's Spring 2008 forecast
- Euro area: long-term term interest rate (10 year gov. bonds)	4.2	4.0	-0.5	4.0	-0.5	4.0	4.0	EU Commission's Spring 2008 forecast
- USA: short-term (3 months money markets)								
- USA: long-term (10 year government bonds)								
Exchange rates (annual average "-" depreciation)								
Exchange rate vis-à-vis €	61.18	61.27	-0.1	61.31	-0.1	61.31	61.31	NBRM/IMF
USD / €	1.37	1.55	+0.13	1.57	+0.15	1.57	1.57	EU Commission's Spring 2008 forecast
Nominal effective exchange rate								
Real effective exchange rate **								
GDP (in real terms)								
- World, excluding EU	5.2	4.4	-0.9	4.2	-1.2	4.2	4.2	EU Commission's Spring 2008 forecast
- USA	2.2	0.9	-0.8	0.7	-1.9	0.7	0.7	EU Commission's Spring 2008 forecast
- Japan	2.0	1.2	-0.7	1.1	-1.2	1.1	1.1	EU Commission's Spring 2008 forecast
- EU 27	2.8	2.0	-0.4	1.8	-0.6	1.8	1.8	EU Commission's Spring 2008 forecast
World trade (% change, goods)								
Country export markets								
EU export markets, extra - EU (volumes)	8.3	7.2	0.0	6.7	-0.8	6.7	6.7	EU Commission's Spring 2008 forecast
World imports, excl. EU (volumes)	7.8	6.8	-0.3	6.4	-1.3	6.4	6.4	EU Commission's Spring 2008 forecast
World import prices (in USD)	7.0	11.7	+6.5	2.6	+0.9	2.6	2.6	EU Commission's Spring 2008 forecast

⁴¹ This table should preferably be included in the programme itself; if not, these assumptions should be transmitted to the Council and the Commission together with the programme.

International prices										
World import prices (goods, in €)										
Oil Prices (Brent – level in USD/barrel)	72.5		96.82	+33.5	56.3	-41.9	56.3		56.3	EU Commission's Spring 2008 forecast; for 2008 and 2009 Bloomberg projections
Non-oil commodity prices (in USD, % change)	15.3		22.3	+18.0	-0.2	+1.9	-0.2		-0.2	EU Commission's Spring 2008 forecast

*: change vis-à-vis assumptions made for last PEP

** : please indicate type of calculation (number of currencies, type of price index for deflation)

ANNEX 4

ASSUMPTIONS ON THE EXTERNAL ECONOMIC ENVIRONMENT UNDERLYING THE
SPRING 2008 FORECASTS

VARIABLE	ASSUMPTIONS FOR				
	2007	2008		2009	
(annual averages)			Change*		Change*
Interest rates (in % p.a.)					
- Euro area: short-term (3-months inter-bank rates)	4.3	4.3	-0.1	3.8	-0.5
- Euro area: long-term (10-year gov. bonds)	4.2	4.0	-0.5	4.0	-0.5
Exchange rates (% depreciation of the €)					
USD / € (level)	1.37	1.55	+0.13	1.57	+0.15
GDP (in real terms, % change)					
- World, excluding EU	5.2	4.4	-0.9	4.2	-1.2
- USA	2.2	0.9	-0.8	0.7	-1.9
- Japan	2.0	1.2	-0.7	1.1	-1.2
- EU-27	2.8	2.0	-0.4	1.8	-0.6
World trade (% change, goods)					
EU export markets, extra-EU (volumes)	8.3	7.2	0.0	6.7	-0.8
World import, excl. EU (volumes)	7.8	6.8	-0.3	6.4	-1.3
World import prices (in USD)	7.0	11.7	+6.5	2.6	+0.9
Commodity prices					
Oil prices (Brent, level in USD/barrel)	72.5	101.2	+22.4	100.0	+24
Oil prices (Brent, level in EUR/barrel)	52.9	65.3	+7.4	63.7	+10.2
Non-oil commodity prices (in USD, % change)	15.3	22.3	+18.0	-0.2	+1.9
Non-oil commodity prices (in EUR, % change)	6.0	8.1	+7.8	-1.5	+0.6