

**DOCUMENT OF THE EUROPEAN BANK  
FOR RECONSTRUCTION AND DEVELOPMENT**

**STRATEGY FOR  
THE FORMER YUGOSLAV REPUBLIC OF  
MACEDONIA  
2010 - 2013**

**As approved by the Board of Directors at its meeting on 23 February 2010.**

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## List of Abbreviations

BAS/TAM	Business Advisory Services/Turn-Around Management
BEEPS	Business Environment and Enterprise Performance Survey
BOO/BOOT	Build-Own-Operate/Build-Own-Operate-Transfer
CCUP	Climate Change Unit Program
CEB	Council of Europe Development Bank
CEE	Central and Eastern Europe
CEI	Central European Initiative
CPI	Corruption Perception Index
CSR	Corporate Social Responsibility
DMEP	Disaster Management and Emergency Preparedness Programme
EIB	European Investment Bank
EC	European Commission
ECB	Export and Credit Bank, Skopje, FYR Macedonia
ECHO	European Commission Humanitarian Aid
ELEM	Elektrani na Makedonija AD
EPO	European Patent Office
ESM	Macedonian Power Company
EU	European Union
FDI	Foreign Direct Investment
GDI	Gender Development Indicator
GDP	Gross Domestic Product
GEF	Global Environment Facility
GHG	Greenhouse Gas
GRD	General Roads Directorate
GRECO	Council of Europe Group of States against Corruption
GSM	Global System for Mobile communications
GTZ	Deutsche Gesellschaft für Zusammenarbeit
HPP	Hydro Power Plant
IBRD	International Bank for Reconstruction and Development (World Bank)
ICC	International Criminal Court
IDA	International Development Association (World Bank)
IFC	International Finance Corporation (World Bank)
IFI	International Financial Institution
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IPA	Instrument for Pre-Accession Assistance
IRENA	International Renewable Energy Agency
JBIC	Japan Bank for International Cooperation
KfW	Kreditanstalt für Wiederaufbau
LEF	EBRD-Italy Local Enterprise Facility
LIS	Legal Indicator Survey
LTT	Legal Transition Team
MBDP	Macedonian Bank for Development Promotion
MCCF	Medium Size Co-Financing Facility
MDG	Millennium Development Goals
MEI	Municipal and Environmental Infrastructure
MSME	Micro, Small and Medium Enterprises

NATO	North Atlantic Treaty Organisation
NBFI	Non-Bank Financial Institutions
NBG	National Bank of Greece
NBRM	National Bank of the Republic of Macedonia
NEAP	National Environmental Action Plan
NPLs	Non Performing Loans
NSSED	National Strategy for Social and Economic Development
PHARE	Programme of Community aid to the countries of Central and Eastern Europe
PPP	Private Public Partnership
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
OCE	Office of the Chief Economist
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OSCE	Organisation for Security and Co-operation in Europe
SAA	Stabilisation and Association Agreement
SECI	South East Cooperation Initiative
SECO	State Secretariat for Economic Affairs
SMEs/MSEs	Small and Medium Enterprises/Micro and Small Enterprises
S&P	Standard and Poor's
TIMS	Transition Impact Monitoring System
TNA	Technology Needs Assessment
TSO	Transmission System Operator
UNDP	United Nations Development Programme
UNEP	United Nations Environmental Programme
UNFCCC	United Nations Framework Convention on Climate Change
UNICEF	United Nations Children's Fund
USAID	United States Agency for International Development
WBIF	Western Balkans Investment Framework
WDPA	World Database of Protected Areas
WeBSEDF	Western Balkans Sustainable Energy Direct Financing Facility
WeBSECLF	Western Balkans Sustainable Energy Efficiency Credit Line Facility
WTO	World Trade Organization

### **Currencies**

EUR	Euro, European Union Currency
MKD	Macedonian Denar
SDR	Special Drawing Right, IMF "currency"
USD	United States Dollar

### **Exchange Rates as at 30 September 2009**

1 EUR	61.17 MKD
1 USD	42.05 MKD

## I. EXECUTIVE SUMMARY

The Former Yugoslav Republic of Macedonia (FYR Macedonia) continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank.

FYR Macedonia has made further progress on key reforms, geared towards integration into the EU. After FYR Macedonia acquired formal status of an EU candidate country in December 2005 the European Commission recommended in October 2009 to open EU accession negotiations. The implementation of the Ohrid Framework Agreement, which ended the armed conflict in 2001, continues to support political stability in the country, highlighted by the smooth functioning of the current multi-ethnic governing coalition. Political stability has further increased due to the peaceful and orderly conduct of the latest elections in March and April 2009. However, the country still faces significant institutional and economic pre-accession reform challenges. The Bank aims to assist it in meeting these challenges successfully over the Strategy period.

FYR Macedonia has built a strong record of macroeconomic stability in recent years. GDP growth picked up to 5.9 and 4.8 per cent in 2007 and 2008, respectively, led by stronger domestic demand and increasing investments. In the last quarter of 2008 and in the first half of 2009, however, the economy began to feel the impact of the global financial crisis. Exports, capital inflows and investments as well as industrial production dropped significantly, with the metal sector being hit particularly hard. The banking sector has been less affected thus far than other countries in the region due to FYR Macedonia's lower level of financial integration, limited financial intermediation and an improvement in regulation and supervision. However, there has been a material reduction in bank lending, which is having a serious impact on the real economy, while the annual growth of deposits came to a virtual standstill. At the same time, the number of non-performing loans increased to 8.4 per cent at end-June from 6.8 per cent at the end of 2008, and is expected to increase further as a result of the economic downturn. However, so far the banks remain well capitalised, including through continued support by overseas parent banks. The central bank remains committed to the current fixed exchange rate system and repeatedly intervened in foreign exchange markets in support of this aim.

As a result of the crisis, FYR Macedonia is likely to experience negative GDP growth in 2009, accompanied by rising unemployment which at 34 per cent is already one of the highest rates in the region. In the medium-term, however, it is expected that an economic recovery in FYR Macedonia's main export markets as well as continued progress in the EU accession process will contribute to the realisation of the country's growth potential.

Significant improvements in the business environment were achieved before the crisis, for example by reducing the taxes for corporate and personal income, introducing a "one-stop-shop" for business registration and the new bankruptcy legislation. The competition law has been strengthened, and the competition office has proven its capacity to enforce competition policy. In the financial sector, the implementation of a new banking law has strengthened the stability of the banking system and the central bank's supervisory authority. In infrastructure, the country has received positive scores on improved tariff setting methodology for water and waste water and increased competition in the telecoms sector. FYR Macedonia has made progress in unbundling the power sector, including the privatisation of the electricity distribution company to a strategic foreign investor.

Building on this strong record of reform in recent years, the **main transition challenges** for the coming Strategy period include:

- *Acceleration of improvement in the business environment.* Corruption and judicial shortcomings and the lack of effective rule of law and the uncertainty of property rights undermine investments. Important challenges also remain to dealing with permits, licenses and authorisations, as well as bottlenecks in the bankruptcy process.
- *Further strengthening of the financial sector to improve private companies' access to finance.* Banks still face problems with enforcement of financial collateral and the court procedures. Lending has become more restricted as a result of the crisis and companies see poor access to credit as a major problem.
- *Modernisation of infrastructure.* Ensuring reliable power supplies is still a concern. The policy of gradually increasing electricity prices to market-based cost recovery levels must continue. Effective tariff reforms based on transparent methodology and regulation and liberalisation are key for new entrants to participate in the generation and supply markets. In transport, the main challenges are the further upgrade of the regional and local road networks, the development of motorway concessions, the sound implementation of the airport concession, the resolution of railway border-crossing bottlenecks and the improvement in the railway operations.

In light of the transition challenges, as well as the need to strengthen FYR Macedonia's economic integration in the region, the **Bank's strategic priorities** will be:

**Corporate Sector:** Support to the real economy will be the priority of the next strategic period, in response to the crisis, improve competitiveness and energy efficiency and promote diversification of exports. Assistance to local enterprises will be provided through the EBRD-Italy Local Enterprise Facility (LEF) and TAM/BAS programmes.

**Financial Sector:** In response to the crisis the Bank will focus on (i) providing banks with equity and long term funding as well as institutional support to help mitigate the impact of the global crisis; (ii) assisting the banks to develop new products (including co-financing and energy efficiency facilities), grow their business on a sustainable basis, and improve corporate governance; and (iii) channelling more funding to SMEs and MSMEs through commercial banks and micro-lending institutions. The Bank will also provide additional equity to existing partner banks to improve capitalisation and counter any asset deterioration as a result of the crisis.

**Infrastructure:** In the *Energy* sector, the Bank will focus on (i) investments in new and rehabilitated generation capacity to alleviate growing capacity problems and improve the efficiency and environmental performance of the existing infrastructure; (ii) investments in renewable and sustainable energy to reduce the current high carbon intensity, including through the Western Balkans Sustainable Energy Direct Financing Facility (WeBSEDF); and (iii) energy projects that support the regional energy market development and integration such as regional electricity and gas interconnections. The Bank's strategic priorities in the *Transport* sector will focus on (i) promoting road and railway transport networks in the country and their regional interconnection; (ii) the support to Macedonian Airports concession; and (iii) restructuring of the road maintenance sector. The Bank will promote introduction of private investors in the infrastructure including through PPPs. In the *Municipal* infrastructure, the Bank will be supporting water, district heating and public transport investments. Efforts will be made to promote the commercialisation of utilities.

The Bank will reinforce policy dialogue efforts, with a focus on addressing legal and regulatory issues, including those arising from specific project experiences. As in the past, the Bank will coordinate its activities with other IFIs and donors, especially in the context of the new Western Balkans Investment Framework (WBIF) together with the EC, EIB, CEB and bilateral donors. In

such context, the Bank will seek support of donors in terms of TC and grant co-financing for priority transport, energy and municipal projects.

The Bank will continue to ensure that all of its operations in FYR Macedonia are subject to the Bank's Environmental and Social Policy and incorporate, where appropriate, Environmental and Social Action Plans.



## II. COUNTRY STRATEGY

### 1. THE BANK'S PORTFOLIO

#### 1.1. Overview of Activities to Date

The Bank has been operational in FYR Macedonia since 1993. As of 31 August 2009, the Bank had signed 58 projects across various sectors with cumulative business volume of EUR 506 million (including regional allocations). With its financing, the Bank mobilised additional EUR 593 million, representing a multiplier of 1.2.

In the period July 2006 to 1 October 2009, the Bank signed 14 new stand-alone projects totalling EUR 132<sup>1</sup> million. (see Annex 7 for detailed list of projects). In addition, EUR 22 million was allocated to the country under regional frameworks for different private sector projects. Only one of these investments, the Regional and Local Roads Rehabilitation Programme of EUR 50 million is in the public sector, all other projects signed in the past three years were in the private sector.

The active portfolio at the end of August 2009 comprised 24 projects totalling EUR 268 million. The current portfolio is equally split between the private and the public sector. Debt is the dominant instrument (85 per cent), with equity concentrated in the banking sector and small private local companies through LEF. The most dominant sectors in the portfolio are the Transport (33 per cent), Energy (25 per cent) and Financial Institutions (20 per cent).

**Table 1: Bank's Portfolio in FYR Macedonia as at 31 August 2009**

SECTORS	NET CUMULATIVE BUSINESS VOLUME				CURRENT PORTFOLIO STOCK				
	Number of Projects	Total Project Cost	EBRD Signed	Weight by Sector	Number of Projects	Portfolio	Weight by Sector	Operating assets	Operating Assets Ratio
Amounts in EUR millions									
<b>Financial Institutions</b>	<b>31</b>	<b>286</b>	<b>110</b>	<b>22%</b>	<b>17</b>	<b>53.3</b>	<b>20%</b>	<b>43.4</b>	<b>16%</b>
Bank lending/guarantee	18	139	66	13%	9	18.7	7%	13.7	5%
Bank equity *	4	111	26	5%	5	24.2	9%	23.9	9%
Non Bank Financial Institutions	1	1	1	0%	/	/	/	/	/
Equity Funds	5	17	5	1%	1	2.9	1%	1.3	0%
Small Business	3	18	13	3%	2	7.4	3%	4.4	2%
<b>Infrastructure</b>	<b>6</b>	<b>354</b>	<b>136</b>	<b>27%</b>	<b>5</b>	<b>99.1</b>	<b>37%</b>	<b>49.1</b>	<b>18%</b>
Transport	5	317	119	24%	4	89.1	33%	39.1	15%
Municipal	1	37	17	3%	1	9.9	4%	9.9	4%
<b>Energy</b>	<b>5</b>	<b>237</b>	<b>126</b>	<b>25%</b>	<b>4</b>	<b>69</b>	<b>26%</b>	<b>52.3</b>	<b>20%</b>
Power & energy	4	164	109	22%	2	69	26%	52.3	20%
Natural resources	1	73	17	3%	2	/	/	/	/
<b>Specialised Industries</b>	<b>10</b>	<b>153</b>	<b>86</b>	<b>17%</b>	<b>5</b>	<b>27.5</b>	<b>10%</b>	<b>25.2</b>	<b>9%</b>
Telecommunications	2	73	45	9%	1	1	0%	1	0%
Property and Tourism	4	43	11	2%	/	11.1	4%	9.2	3%
Agribusiness	4	37	30	6%	4	15.4	6%	15	6%
<b>General Industry</b>	<b>6</b>	<b>137</b>	<b>48</b>	<b>9%</b>	<b>3</b>	<b>19.3</b>	<b>7%</b>	<b>19.3</b>	<b>7%</b>
<b>COUNTRY TOTAL</b>	<b>58</b>	<b>1.167</b>	<b>506</b>	<b>100%</b>	<b>34</b>	<b>268.1</b>	<b>100%</b>	<b>189.3</b>	<b>71%</b>

<sup>1</sup> Excluding TFP guarantees.

Operating assets represented nearly 71 per cent of the portfolio at end August 2009. The two major infrastructure projects (Regional and Local Roads Rehabilitation and the Macedonia-Bulgaria Power Transmission Line), represent 85 per cent (EUR 66 million) of the undisbursed portfolio.

## **1.2. Implementation of the Bank's Strategy to Date**

The last country strategy, approved in July 2006, outlined the following strategic priorities and transition goals for the Bank:

- (1) Support foreign investors and local export-oriented companies by providing loans, guarantees or making equity investments.
- (2) In the financial sector, the focus was on: (i) channelling more funding to SMEs through commercial banks and micro-lending institutions; (ii) supporting banking sector consolidation through mergers and acquisitions; (iii) promoting further entry of foreign strategic investors in the banking sector; and (iv) expanding the range of instruments offered to banks by increasing the number of TFP participating banks, offering co-financing for large local corporate clients, and supporting local banks' operations in mortgage lending, consumer finance and leasing.
- (3) The priorities in the infrastructure sector included: (i) accelerating disbursements on existing projects; (ii) supporting utility restructuring and privatisation through the implementation of the pre-privatisation agreement for the electricity company; (iii) energy projects that fit the regional energy market development such as regional electricity and gas interconnections; (iv) promoting road network rehabilitation in conjunction with restructuring of the road maintenance sector; and (v) developing, where possible, municipal guaranteed water sector investments.

Overall, the Bank has achieved the operational objectives set out in the 2006 Country Strategy.

The limited flow of FDIs in the country has constrained the Bank's activities with strategic investors, however, the Bank has focused more on supporting local SMEs and MSMEs, for which the LEF facility was instrumental. The Bank remained an important investor in the financial sector, with 24 per cent of new commitments. The Bank financed 7 new agribusiness projects totalling EUR 16 million. 66 per cent of the new business was in infrastructure.

In 2006, the Bank supported the Macedonian financial sector through several investments. Two projects were signed with TTK Bank to support the much needed banking sector consolidation. The investment was followed by a TC programme funded by the Norwegian Ministry of Foreign Affairs to help raise corporate governance standards, strengthen control processes and risk management procedures and train staff. An SME credit line of EUR 5 million was also extended to TTK. The Italian Government provided technical cooperation funds to support TTK in the development and implementation of the SME programme. The Bank's relationship with NLB Tutunska Banka, the third largest bank, was further extended with the second syndicated loan of EUR 55 million. The loan was used to help meet private businesses' and retail customers' growing demands for finance. In December 2006 the TFP was extended to include Pro Credit Bank, a bank specialised in financing MSMEs.

In February 2007, the first LEF transaction was signed with Vitaminka Prilep, the largest Macedonian branded food manufacturer to finance the development of new products and regional expansion. In December 2007, the Bank approved an equity investment in a small family owned healthy food producer Vitaliato expand its production capacity and enhance

export potential. Also in December 2007, the Bank extended a guarantee facility of EUR 3 million to the largest savings house Moznosti, an important player on the microlending market. The Bank’s guarantee enabled Moznosti to raise local currency funding to finance local MSMEs.

Through its partial exit from Export & Credit Bank in 2008, the Bank was instrumental in attracting new foreign investor to the Macedonian banking sector. Demir Halk Bank Netherlands acquired 67 per cent of ECB’s equity and required that the Bank remains a shareholder with 25 per cent for at least 3 years.

In March 2008, the Bank provided a EUR 35 million loan alongside a matching loan from IFC to EVN Makedonija to finance its EUR 90 million investment program to upgrade the country’s electricity distribution network following the company's privatisation to Austria's EVN AG. In October 2008, the Bank invested equity of EUR 6 million in the leading Macedonian wine producer Tikves to boost its competitive position.

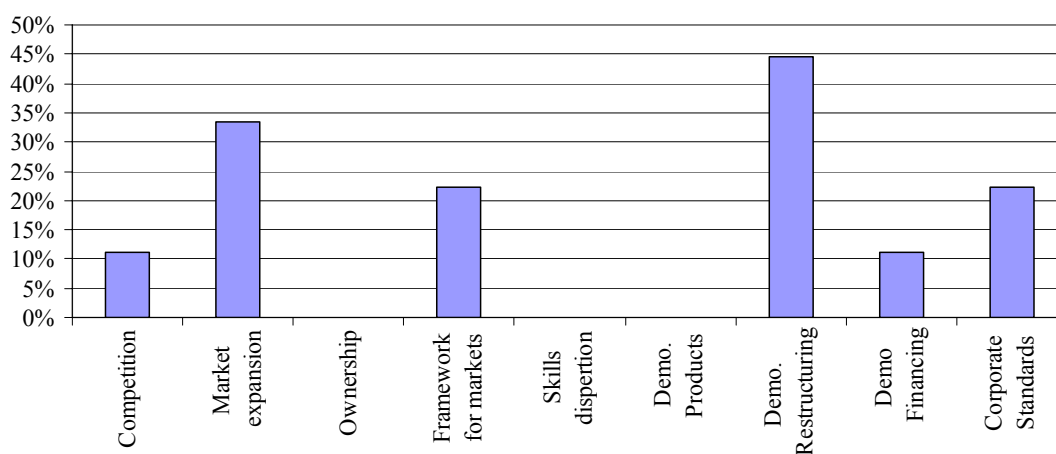
In January 2009, the Bank provided a EUR 50 million loan to finance the improvement and upgrade of more than 400 kilometres of existing regional and local roads. TC has been provided to support reforms in the Road sector including the restructuring of the state road maintenance company Makedonija Pat and to assist with the commercialisation of the routine maintenance.

### 1.3. Transition Impact and Lessons Learned

A review of operations rated by the Office of the Chief Economist (OCE) and monitored through the Bank’s Transition Impact Monitoring System (TIMS) shows that the average transition impact rating of projects in FYR Macedonia is slightly above the overall stock of Bank projects. As of end Q2 2009, the portfolio of monitored operations in FYR Macedonia included a sample of 9 rated projects.

The review also identified *demonstration effects of successful restructuring and market expansion* as the main areas driving transition impact.

**Figure 1: Transition impacts pursued by EBRD projects - 2005- Q2 2009**



The following analysis of the impact of the Bank’s portfolio and lessons learnt relies upon findings presented in the Transition Impact Retrospective Reports (TIRs), OCE updates on

remaining challenges, TIMS reports, and studies undertaken by the Bank's Evaluation Department.

### ***1.3.1. Enterprise Sector***

The Bank had two projects in agribusiness, through which it managed to achieve demonstration impact including restructuring and changes in corporate governance in the largest bakery. In 1999, the Bank co-financed with IFC a loan to the largest pharmaceutical company, Alkaloid. Although missing some of its objectives, the project generated positive transition impact at the level of the corporation, the sector and the economy as a whole through setting standards for corporate governance and business conduct. In the natural resource sector, the Bank's exposure has been limited to the Thessaloniki-Skopje Crude Oil Pipeline Project. While the project helped set industry standards and transfer of skills, there were several key exclusive concessions that were granted to Greece's Hellenic which had significant transition impact risks, as they had the potential to inhibit competition and private sector development. In 2005, the Bank provided working capital for ArcelorMittal Skopje. The project implementation successfully overcame the country's persistent transition challenges and the delayed EU accession process, thus helping Mittal turnaround the company. On the negative side, Mittal has delayed some environmental investments, especially the new wastewater treatment plant. A *lesson learnt* from the Bank's project with Mittal is that projects are vulnerable to infrastructure bottlenecks. In this case, an internal dispute at the national gas company continues to delay the implementation of a key energy efficiency investment at Mittal Skopje (PE08-426).

### ***1.3.2. Financial Sector***

The Bank has contributed substantially to the development and consolidation of the banking sector since 1994. When privatisation of the largest bank Stopanska Banka emerged as the key transition challenge for the sector, the Bank's participation enabled a successful sale of Stopanska Banka to NBG. An equity investment for supporting the merger between Teteks Kreditna and Tetovka Banka – approved in 2006 – has led to the implementation of a business plan and facilitated corporate transition. It is yet too early to conclude on the overall transition impact achieved. The Bank has also had transition impact through SME credit lines extended to a number of local banks. The project with the Export & Credit Bank (ECB) has achieved its objectives and has left ECB with a recognised strong focus on the micro and SME market. In addition, the Bank took an equity stake in ECB as well as in a newly established and dedicated microfinance bank, Procredit Bank Macedonia. These projects showed excellent results and even exceeded some of its objectives. A *lesson learned* from the ECB Equity Investment project is the necessity to have closer coordination among similar programmes from donors, especially if the same local partner institution participates in a number of them (PE02-210). Overall, a *Moderate to Significant* transition impact has been achieved in the *Financial Sector*.

### ***1.3.3. Infrastructure***

The Bank has supported the country's overall electricity reforms primarily by assisting the privatisation of the state-owned power company ESM and the amendment of primary legislation, as well as the introduction of a new tariff methodology. The ESM II Distribution Grid Efficiency Investment was signed in 2008 and aims at improving the efficiency of the company and supporting a privatised company in an otherwise state-dominated sector. The Bank has also financed the transmission interconnection line between FYR Macedonia and

Bulgaria which was completed in December 2008. The project has excellent transition prospects by supporting cross border electricity trade as part of wider efforts to create a regional energy trading market. Nonetheless, ensuring reliable power supplies is still a concern. The Bank has made three investments in the civil aviation and two in the road sector. The transition impact of the Regional Roads Project signed in 2003 was evaluated as *Satisfactory*. In January 2009 the Bank signed the Regional and Local Roads Rehabilitation Project that aims to build on the output of this first operation through strengthening the Agency for State Roads in line with the new Law on Roads, including the contracting out of all maintenance. In the MEI sector, the Bank's single initiative in 2000 has been to on-lend to water utilities for rehabilitation and extension of infrastructure in six municipalities. Effective implementation of the commercialisation objectives was delayed, however, due to the slow legislative process and political interference in tariff setting. A *lesson learnt* from the MEAP is that centralised top-down approaches to MEI programs, with many municipalities involved, should give more consideration to building basic capacity at the local level support as a first step before attempting wider reforms (PE07-398S).

#### **1.3.4. Technical Cooperation**

To date, the Bank has committed EUR 19.6 million in technical assistance to FYR Macedonia, with 111 technical co-operation (TC) projects in the banking, telecommunications, transport, municipal and the private enterprise sectors. Nearly EUR 6 million in 41 projects were committed in the strategy period 2006 to date. Disbursement of TC funds as of April 2004 stood at EUR 15.7 million, reflecting the fact that projects are still on-going in the small business finance and infrastructure (transport) sectors. (See details on TC programmes of the Bank in the strategy period in Annex 8.)

#### **1.4. Portfolio Ratio and Quality**

Based on the end-August 2009 portfolio of EUR 268 million, the private/public portfolio ratio stands at 50/50. In terms of number of projects, private sector transactions are expected to dominate the project pipeline in the forthcoming strategy period. However, considering the smaller size of such private sector projects it is unlikely that the Bank could achieve a 60/40 private/public sector portfolio in 2010-2013.

The average risk rating of the portfolio stands at 6.14 (public 6.13; private 6.15). As of end August 2009, almost 7 per cent of portfolio assets in FYR Macedonia were impaired. All impaired assets are in the private sector and 80 per cent are equity investments.

## **2. OPERATIONAL ENVIRONMENT**

### **2.1. The General Reform Environment**

#### **2.1.1. Political Developments**

The ruling party, pro-reform centre-right VMRO-DPMNE, which has been in power since 2006, continues to enjoy high level of popular support, which has not been affected much by the global financial crisis. It has further consolidated its power after the early parliamentary elections in 2008 and the presidential and local elections in 2009. Representatives of the ruling VMRO-DPMNE currently hold the positions of the President and the Prime Minister, make an overwhelming majority in the national Parliament, and are in majority in more than 60 per cent

of the municipalities, including the capital Skopje. Certain inter-ethnic tensions persist, particularly on the local level, but reshuffled governing coalition, which since 2008 includes as a junior coalition partner the strongest ethnic Albanian political party, DUI, functions reasonably well. The implementation of the Ohrid Framework Agreement, which ended the armed inter-ethnic conflict in 2001, continues to maintain political stability.

The EU approximation process remains the main external anchor for reform. FYR Macedonia received the status of an official EU candidate country in December 2005. Based on the progress in reforms over the past few years, the European Commission in October 2009 made its recommendation to the Council of the EU to begin accession negotiations with FYR Macedonia. However, no decision has been made yet about the date for the opening of these negotiations. The unresolved dispute over the country's official name has become an additional obstacle for country's further progress in the integration into EU, as well as for obtaining NATO membership, another top priority for the government. Despite significant regional challenges the country has managed to maintain balanced relations with the rest of its neighbors. It has been involved in various cross-border projects and there is support to furthering these from the current government.

### ***2.1.2. Business Environment***

The business environment improved further over the past few years. Progress was made regarding the introduction of low and simplified taxation, the "regulatory guillotine" (the process of eliminating and simplifying regulations quickly), and customs reform. The authorities took steps to improve the legislation on the "one-stop shop" system, reducing the time required to register a business to four hours and the costs of registration to less than EUR 50. Significant progress was made in establishing the real estate cadastre, which by mid-2009 covered more than 90 per cent of the country. Property registration was eased by reducing the average time to register a title deed by eight days. Amendments to the labour law introduced in January 2009 led to a reduction in minimum social contributions and made hiring of workers more flexible. The authorities also harmonised the bases for social security contributions and personal income tax and made these dependent on gross rather than net wages. These improvements are reflected in the World Bank's Doing Business 2010 survey, which ranks FYR Macedonia 32<sup>nd</sup> out of 183 countries (up from 69<sup>th</sup>) and also places it third amongst the top 10 reformers globally with regard to business environment reforms implemented over the past year.

Improvements to the judicial system and the functioning of courts are required to bring the country to EU standards as well as to increase the country's attractiveness as an investment destination. The latest round of the EBRD/World Bank Business Environment and Enterprise Performance Survey (BEEPS IV) found that dealing with courts is a severe constraint on businesses. Legal procedures are still slow, hampering contract enforcement. For example, while the average duration of bankruptcy procedures has fallen slightly, it still takes around two years on average to wind up a business. Furthermore, lack of clear property rights protection represents a significant barrier to increased foreign investment-led economic growth.

Finally, corruption continues to be a significant problem for business development in some areas; however, there have been signs of progress recently. FYR Macedonia is ranked 72<sup>nd</sup> in the 2008 Transparency International Corruption Perceptions Index, up from 84<sup>th</sup> place in 2007. Corruption in the awarding of public sector contracts is perceived to be less prevalent in FYR

Macedonia than in other countries in SEE, and a less severe constraint on business overall. However, there are significant areas of concern in relation to corruption in dealing with the courts, the customs service and in infrastructure services. In response to these problems and inducement from the EU to tackle corruption, Prime Minister Gruevski has recently appointed former Romanian justice minister Monica Macovei as his anti-corruption advisor. It is also expected that the law on the Civil Service which was recently passed and which makes the appointment of civil servants independent from the political parties will contribute to the reduction in the level of corruption among civil servants.

### ***2.1.3. Social and Labour Issues***

Despite positive GDP growth rates of between 4 and 6 percent since 2004, living standards remain far below those in the EU and social exclusion and poverty remain severe problems in FYR Macedonia. In terms of purchasing power parity, GDP per capita is only 25 per cent of the EU average. There are also relatively high regional disparities, with GDP in the capital city Skopje at almost 50 per cent of the EU average, far above the rest of the country. According to State Statistical Office data, in 2008 28.7 per cent of the total population lived below the national poverty threshold, defined as having an income lower than 60 per cent of the average revenue of households. The most vulnerable ethnic group are the Roma, with 64 per cent of Roma households living below the income-based poverty line. Education is another important determinant of poverty: 56.6 per cent of the poor live in households where the head of the household does not have, or has not completed, primary education. While FYR Macedonia has accomplished much in the realm of primary school enrolment (in 2005 the primary school net enrolment ratio was 92 per cent), the government has not been as successful in increasing enrolments in pre-primary, secondary and tertiary education. The country is on track to achieve the MDGs in regard to health. There is a positive trend with regard to reducing child mortality (the under-five mortality rate is 17 per 1,000 live births) and the maternal mortality rate is decreasing, but most health-related indicators are still far below the EU average.

The unemployment rate in the country, at 34.8 per cent, is one of the highest in Europe, even though it has declined in recent years. Among the unemployed, the largest groups are the people with educational level up to primary school (54 per cent) and secondary education (33 per cent), whereas 6 per cent of the unemployed lack a complete primary education (UNDP, 2008). About 20 per cent of the unemployed are between 15 and 24 years old. The poverty rate for unemployed people is 38.4 per cent. Labour force participation rates among women are amongst the lowest in the Europe and Central Asia (ECA) region. In the medium term, it is expected that continued progress in the EU accession process as well as recent changes to the labour regulation (including easing conditions for hiring and firing employees, facilitating the use of fixed-term and part-time contracts, and reducing minimum social contributions) will have a positive effect on the unemployment rate. For a more detailed analysis of social and labour issues, see Annex 5.

### ***2.1.4. Environmental Issues***

Landlocked and located in the central Balkan Peninsula, FYR Macedonia represents a major transportation corridor from western and central Europe to the Aegean Sea and from Southern Europe to Western Europe. Covering approximately 25,713km<sup>2</sup> of varied landscape, its territory is predominantly mountainous; due to its Mediterranean climate the flora and fauna are rich and diverse, with a large number of protected species of animals and plants. According to the WDPA, 8.07% of Macedonia is designated protected area, including three national

parks: Galicica, Pelister and Mavrovo, two protected natural areas: Ezerani and Jasen, 14 eco-reserves and 48 natural monuments.

The Ministry of Environment and Physical Planning (MoEPP) oversees the environmental management process, ruled by both the National Environmental Action Plan (NEAP) and the National Plan for Approximation to the Acquis. A National Program for the Approximation of the Legislation (NPAL) was adopted, developing a specific Action Plan for Environmental Legislation Harmonisation to address the transposition of environmental law into domestic laws. The institutional framework is well developed although cooperation and distribution of responsibilities between the institutions should be further strengthened. In the environmental arena, although good progress is apparent within horizontal legislation, improvement is still needed in enforcement and administration capacity.

The National Strategy for Sustainable Development (NSSD) was developed in 2008, establishing as short-term priorities for the implementation of environmental legislation and the development of environmental investment strategies paired with the strengthening of execution and enforcement institutions. For medium and long term objectives, the alignment of the legislative framework to international standards takes precedence, with the commitment to integrate environmental protection requirements into sector-specific policies and increase environmental infrastructure investments, especially in the area of waste water management, drinking water supplies and air pollution. The National Strategy for Environmental Approximation (NSEA) and the National Waste Management Plan for 2006-2012 are examples of the country's initiative to incorporate international practice into its national environmental legislation.

The country joined forces with the United Nations Framework Convention on climate Change (UNFCCC) and is signatory to the Kyoto Protocol.

The potential environmental and social issues associated with the strategic priorities are shown in the table in Annex 5.

The Bank will continue to identify areas for environmental enhancement and development opportunities, such as the current working programme of upgrade and rehabilitation for both the regional roads (Tranche 1) and local roads (Tranche 2).

All EBRD operations in FYR Macedonia are subject to the Bank's Environmental and Social Policy (2008) and incorporate, where appropriate, Environmental and Social Action Plans into the legal documentation in line with the Bank's mandate to actively support environmentally sound and sustainable development through its investment projects.

### ***2.1.5. Legal Reform***

FYR Macedonia has made further progress in terms of introducing changes in the legal framework aimed at improving the business environment. The commitment of the country to implement reforms has been widely recognised at an international level. In addition FYR Macedonia has pursued its plan to integrate in the EU by, amongst other initiatives, becoming a member of the EPO and the IRENA.

The challenge facing FYR Macedonia in the coming years is to ensure that the considerable progress made in the legislative framework translates into an effective implementation of the statutory provisions. The main obstacles to the practical effectiveness of the reforms are represented by some deficiencies still existing in the statutes and by the lack of adequate training for the members of the judiciary and other professionals (such as bankruptcy administrators) entrusted with the enforcement of the laws.



In the context of the securities market, for instance, despite the satisfactory standards imposed by the existing legislation, the establishment of public offerings and underwriting practices which meet international standards is proving difficult due to a combination of the reluctance on the part of the market participants to provide sufficient disclosure in the prospectus and the failure of the legislation to impose a duty to provide information relating to insider ownership and related party transactions.

A similar set of problems arises in connection with bankruptcy proceedings. While the bankruptcy laws are generally in compliance with international standards there are some areas (such as the court power to reject a restructuring plan approved by the creditors or the absence of a duty to notify the creditors of the deadline to submit their claims) that still need improving. The length of the bankruptcy procedures and the lack of expertise at the level of the judges and the bankruptcy administrators are perceived to be additional impediments to the satisfactory functioning of the bankruptcy process. In this respect, it must be noted that in 2008 the Bankruptcy Department of the Ministry of Economy established a Working Programme which seeks to address some of the issues described above.

Other areas which require further improvement include secured transactions. The ability to create valid security over the assets of a debtor is still subject to quite cumbersome requirements (such as the need to include in the security documentation a detailed description of the secured claim).

## **2.2. Progress in the Transition and the Economy's Response**

### ***2.2.1. Macroeconomic Conditions Relevant for Bank's Operations***

FYR Macedonia has built a strong record of macroeconomic stability in recent years. Growth performance picked up to 5.9 and 4.8 per cent in 2007 and 2008, respectively, led by stronger domestic demand and increasing investments. In the last quarter of 2008 and in the first half of 2009, however, the economy began to feel the impact of the global financial crisis. Exports, capital inflows and investments as well as industrial production dropped significantly, with the metal sector being hit particularly hard. With a decline of real GDP of -0.9 per cent in the first quarter and -1.4 per cent in the second quarter of 2009, the contraction has been less severe than in many countries in CEE, primarily due to a continued positive performance of the construction and services sectors. Other factors include timely interventions by the central bank to support the de-facto peg of the denar to the euro as well as anti-crisis measures by the government. In response to the crisis, in November 2008 the authorities introduced a number of fiscal measures, including a further lowering of taxes on profits and agricultural incomes and a reduction of some import tariffs. In March 2009 the government adopted set of measures for direct credit support to the private sector through a loan by EIB in the amount of EUR 100 million as support to small- and medium-size enterprises. At the same time, the government presented a EUR 8 billion investment programme for the next seven years, focusing on large infrastructure projects in the energy, transport, environmental protection, education and culture. In June 2009, following lower than projected revenues in the first months of 2009 and in order to preserve the projected 2009 budget deficit at -2.8 per cent of GDP, the parliament adopted a revised budget which included a cut in public expenditures of 6.2 per cent, mainly through a hiring freeze and a suspension of public wage increases.

The expansionary policy of the government, reflecting anti-crisis measures but also the need to modernise the country's infrastructure, will result in a shift from the close-to-balance fiscal stance of previous years to higher deficits in the near future. Inflation is likely to ease considerably turning into moderate deflation for 2009. As a result of the crisis, FYR Macedonia is likely to experience negative GDP growth in 2009. In the medium-term, however, it is expected that an economic recovery in FYR Macedonia's main export markets as well as continued progress in the EU accession process will contribute to the realisation of the country's growth potential.

The crisis has so far only had a limited impact on commercial banks' liquidity as they rely mainly on domestic deposits to fund lending and deposit withdrawals have been limited. The banking sector has been less affected thus far than other countries due to FYR Macedonia's lower level of financial integration, limited financial intermediation and an improvement in regulations and supervision. However, there has been a material reduction in bank lending, which has had a serious impact on the real economy. Bank lending to the private sector slowed significantly to 11.2 per cent year on year by the end of July 2009, compared with 34 per cent at the end of 2008. At the same time, the annual growth of deposits came to a virtual standstill in July 2009, compared with a 12.4 per cent growth at the end of 2008. Overall, banks remain well capitalised, including through continued support by overseas parent banks, and the capital adequacy ratio remained stable at 16.5 per cent after the first quarter of 2009, double the minimum that is required by law. At the same time, the NPLs in the banking sector increased slightly to 8.3 per cent at end of June from 6.8 per cent at the end of 2008. The central bank remains committed to the current fixed exchange rate system and repeatedly intervened in foreign exchange markets in support of this aim. As a result, foreign exchange reserves fell to 3.4 months of imports in May 2009, but have stabilised since then at a level of above 4 months of imports, supported by the issuing of a Eurobond as well as inflows based on SDR allocations. Total external debt was around 49 per cent at end-2008, out of which 17 per cent is public.

### ***2.2.2 Transition Success and Transition Challenges***

**Enterprise Sector and Competition:** FYR Macedonia has made progress with privatisation and restructuring in the enterprise sector over the last few years, although this is yet to be reflected in improved efficiency and productivity. Progress was made regarding the introduction of low and simplified taxation, the "regulatory guillotine" (the process of eliminating and simplifying regulations quickly), customs reform and the process of issuing building permits. The authorities took steps to improve the legislation reducing the time required to register a business. Customs has implemented a web based system to reduce bureaucratic procedures. This was reflected in BEEPS IV, which found that typical red tape issues – labour regulations, business licensing and inspections and compulsory certification – were not deemed to be significant obstacles for firms. The implementation of the new Law on Real Estate Cadastre introduced in 2008 led to a significant shortening of the registration process for new buildings, which will encourage the use of land as loan collateral and should ultimately help to lower borrowing costs. Legislative changes introduced in 2007 to allow foreign individuals and legal entities from the OECD countries to own construction land are expected to encourage increased FDI. FYR Macedonia became the third country in Europe after Denmark and Lithuania to adopt the National Agenda for Corporate Social Responsibility (CSR) 2008-2012, thus successfully promoting the concept of CSR that contributes towards increased competition of business entities and strengthening of public private dialogue in this area. Although the legal framework for corporate governance and protection of shareholders' rights is largely harmonised with the EU regulation and the OECD principles of corporate governance, the actual implementation should be further improved. The

key challenge for the sector is to improve the general business environment including the effective implementation of legal and administrative changes.

The rule of law in FYR Macedonia is relatively weak, and some 75 per cent of firms report in BEEPS IV that dealing with courts is an important obstacle to their operations. Despite ongoing reforms to speed up court procedures, legal procedures are still slow, hampering contract enforcement. Some progress has been made in judicial reform, but there is still a need to strengthen the independence and professionalism of the judiciary to bring the country to EU standards and to increase the country's attractiveness as an investment destination.

**Infrastructure Upgrade:** Ensuring reliable power supplies is still a concern. While the unbundling of the sector has been completed along the lines of generation, transmission and distribution, the generation segment is still dominated by the state-owned ELEM and the government decided to abandon earlier plans to privatise the only other large generator, TEC Negotino. In 2006, the power distribution and supply company was sold to the Austrian power utility company EVN AG, which has introduced private sector expertise and capital to the renovation of FYR Macedonia's electricity distribution network. The liberalisation of the electricity market for large industrial users came into effect on 1 January 2008, in line with the provisions of the Energy Community Treaty. A robust feed-in tariff mechanism to support renewable energy has been implemented. The policy of gradually increasing electricity prices to cost-reflective levels (building on the 13 per cent increase in household tariffs of November 2008) must continue in order to tackle the sector's financial problems and to ensure more reliable power supplies, along with the implementation of the Social Action Plan to reduce energy poverty and target assistance to the most vulnerable consumers. The new energy law introduced in July 2008 will likely reduce the government's fiscal risk stemming from the electricity sector. The government is actively engaged in a reform of the energy law in order to address concerns about the structure of the market. These efforts are encouraged in order to allow liberalisation through the introduction of genuine competition in generation and supply.

In April 2008, the government launched a tender for a 20-year concession for the management, operation and maintenance of the airport system (comprising Skopje and Ohrid airports and the construction of a new cargo airport in Stip), which was won by Turkish company TAV in September 2008. However, the start of construction works has been postponed to 2010 due to pressure resulting from the global economic crisis. In the road sector, the agency for state roads (ASR) was created as an independent state-owned entity responsible for the operation and maintenance of the main road networks. The authorities are committed to introduce fair competition as well as best practice maintenance contracts. In July 2008 the government initiated a motorway network concession for the construction, financing and maintenance of 560 kilometres of motorways with an estimated cost of EUR 2.4 billion. The financial position of Macedonian Railways improved due to a significant increase in traffic levels in the last year after the company had been split into a state-owned rail infrastructure company and a joint-stock company responsible for the operation of passenger and freight services.

The financial and operational performance of municipal utility companies is mixed as collection rates are low by regional standards, there is weak cost control and substantial network losses are common among the smaller communities. The level of tariffs for water and heating is generally low, but some municipal utilities manage to cover operational costs through tariffs. The transition challenges are still substantial and linked to effective tariff reforms based on transparent methodology and regulation and contractual arrangement, in

particular outside the capital in order to foster further commercialisation of municipal services throughout the country.

**Further Strengthening of the Financial Sector to Improve SMEs Access to Finance:** There has been a significant reform of the banking sector in recent years. The new banking law aims to strengthen the stability of the banking system by raising the minimum capital requirement for establishing a bank from EUR 3.5 million to EUR 5 million. The new law has strengthened the NBRM's supervisory authority and the banking sector is now well regulated. However, commercial banks still face problems with regard to the enforcement of financial collateral and the court procedures. The banking sector is characterised by a high concentration, with the biggest three banks controlling roughly two thirds of banking assets. Banks with majority foreign ownership have increased their market share to more than 85 per cent of total assets.

Despite expanding rapidly, the Macedonian banking system remains small compared to the region, with credit to the private sector accounting for only 43 per cent of GDP. Up to 57 per cent of credit to the private sector is either denominated in foreign currency, mostly Euro, or has a foreign currency clause. While the direct impact of the global financial crisis on the banking system has remained limited so far, lending has become more restricted as a result of the crisis and the enterprise sector – and SMEs in particular – sees poor access to credit as a major problem. The MBDP, some commercial banks and international donors (including KfW) provide microcredit lines; the level of lending to the MSME sector is still low. The first license for the management of voluntary pension fund was issued in April 2009. The additional voluntary pension insurance (third pension pillar) thus started functioning and will enable the harmonisation of Macedonian social insurance system with the EU regulations.

Building on this strong record of reform in recent years, the main transition challenges for the coming Strategy period include:

- *Further improvement in the general business environment including the effective implementation of legal and administrative changes.* Corruption and judicial shortcomings are identified by enterprises as major constraints on their activities and the lack of effective rule of law and the uncertainty of property rights undermine investments. Cumbersome enforcement procedures and administrative bottlenecks in the bankruptcy process continue to cause difficulties for businesses and investors.
- *Modernisation of infrastructure.* The policy of gradually increasing electricity prices to market-based cost recovery levels must continue. The transition challenges are still substantial and linked to effective tariff reforms based on transparent methodology and regulation to stimulate greater energy efficiency and justify investments in new generating capacity. Introduction of another significant generator or the privatisation of generation assets would introduce competitive pressure for greater supply-side efficiency. In transport, the main challenges are (i) further upgrade of the regional and local road networks, including the development of motorway concessions; (ii) sound implementation of the airport concession system; and (iii) addressing railway border-crossing bottlenecks and increasing the competitiveness of the railway operations.

*Further strengthening of the financial sector to improve private companies' access to finance.* Bank lending has become more restricted as a result of the crisis. Companies see poor access to credit as a major problem.

### **2.3. Access to Capital**

Access to domestic sources of capital improved in the past few years, driven by growing competition in the banking sector. Domestic credit to private sector in 2008 was around 43 per cent of GDP, which is considerably higher compared to the previous years, but still significantly lower compared to other countries in the region. However, the effects of the global crisis had a negative impact on the banks' lending activities. As domestic companies, especially exporters have started to face difficulties, banks tightened their credit approval and therefore the funding sources for the real economy are insufficient. Against this background, as one of the main anti-crisis measures the government took a EUR 100 million sovereign loan from the EIB to be channelled through nine local banks. This loan will be solely used by domestic SMEs for financing investment projects and working capital.

The country's investment needs are still considerable. While the government has an ambitious programme of capital investments across various sectors, implementation is likely to be constrained by the need to maintain budget discipline. Although FDI in FYR Macedonia are amongst the lowest in the region, the annual investments have grown rapidly from USD 331 million in 2007 to USD 598 million in 2008, reflecting the government's efforts to improve the business climate. As a result of the crisis, in the first six months of 2009 FDI inflows slowed down to USD 141 million.

Remittances account for around 15-17 per cent of GDP and were constantly increasing in the last few years and reached a level of USD 1.4 billion at the end of 2008. The economic downturn in the main host countries for emigrant workers from FYR Macedonia (Germany, Switzerland, Turkey, Italy, USA, and Australia) resulted in a decrease of remittance transfers to USD 532 million until the end of July 2009.

On the stock exchange, after the record year in 2007, with total trading of EUR 682 million, the global financial crisis had impact on the domestic and foreign investors' behaviour, leading to significant decrease of trading volumes (2008: EUR 131 million). During 2009, trading volume has further decreased despite some positive movements in the second half of the year, an indication that domestic investors interest in the domestic stocks is possibly starting to recover.

FYR Macedonia is rated BB+ by both S&P and Fitch. In September 2009 S&P has upgraded the country's outlook to Neutral from Negative. S&P improved rating is based on a positive assessment with regard to the country's fiscal position, with the lowest fiscal deficit in the region, as well as its improved liquidity position following the issuing of a Eurobond for EUR 175 million, inflows from SDR allocations and loans from the EIB and the WB. The country does not have an existing arrangement with the IMF since the last Stand-By Arrangement expired in August 2008.

## **3. STRATEGIC ORIENTATIONS**

### **3.1. Bank's Priorities for the Strategy Period**

The Bank will continue to support the efforts of the Government to implement its reform agenda and improve the country's business environment in favour of local private sector development and further inflows of FDI, while continuing to build and modernise key infrastructure on a sustainable basis. The Bank's operational priorities will support the

development of the private sector, further strengthening the financial sector and the rehabilitation of the country's transport (airports and road networks), energy and municipal infrastructure (in particular water supply and waste water treatment), including through policy dialogue and technical assistance.

Despite the negative impact of the global financial crisis, FYR Macedonia continues to perform relatively well compared to other countries of Bank's operations. Nevertheless, during the Strategy period, the Bank will need to have a strong and meaningful post crisis response and support the recovery process when the country will experience further slowdown in the already limited levels of FDIs, as well as reduced lending activities from local banks. Development of SMEs and MSMEs is of crucial importance for the continued long-term growth of the economy. Therefore, the Bank will continue to finance the growth of local SMEs and MSMEs both through providing financing to local banks and through direct investments in the private sector. Given the small average size of local companies, LEF will remain the key instrument for direct financing of the private sector.

## **3.2. Sector Challenges and Bank's Objectives <sup>2</sup>**

### **3.2.1. Enterprise Sector**

**Transition Goals:** Further improve the business environment through effective implementation of legal and administrative reforms. Accelerate implementation of the legal framework for corporate governance. Strengthen the independence and professionalism of the judiciary and increase efficiency of courts to improve contract enforcement. Improve access to bank credits for SMEs and MSMEs as well as to the rural sector, including through increased commercialisation of land titles. Support the expansion of the market for modern commercial property and promote innovative construction technologies. In telecoms, further competition in the fixed-line market is necessary and to support the use of broadband internet. Upgrade quality and hygiene standards to the European level in the agribusiness sector.

### **Operational Priorities**

FYR Macedonia has made significant progress with privatisation and restructuring in the enterprise sector, although this is yet to be reflected in improved competitiveness. Support to the real economy will be the priority of the next strategic period to address the financing needs in response to the crisis, and promote economic diversification, competition, competitiveness and energy efficiency.

Also as a result of the crisis, despite the government's efforts, FDI still lag behind expectations and neighbouring countries. The Bank will provide debt and equity to the corporate sector to improve competitiveness, foster growth and strengthen corporate governance.

Following the EC recommendations of October 2009 the Bank will continue to work with the government, the business community and the financial sector to move transition further to support the accession process.

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<sup>2</sup> A more detailed assessment of transition goals / remaining transition challenges per sub-sector can be found in Annex 3.

The current crisis will require even stronger co-operation and risk sharing with the local banking system to support local enterprises. Facilitating continued trade flows through the trade finance program and ensuring adequate access to working capital will also be needed. New and existing clients will require refinancing and restructuring support.

Financing SMEs and MSMEs through framework lending schemes with financial intermediaries and through LEF will remain the key instrument to address the needs of the real economy. The Bank will support industrial energy efficiency projects through the WeBSEDFP or with local banks through products such as the Medium Size Co-Financing Facility (MCFF) and the Western Balkans Sustainable Energy Credit Line Facility (WeBSECF). To foster the local SMEs and MSMEs competitiveness, the Bank will provide long-term funding to local commercial banks through the new SME Competitiveness Support Financing Facility. Assistance to local enterprises will also be provided through the TAM/BAS programmes.

In the Agribusiness sector, the Bank will continue to provide debt and equity financing to support the retail, food and beverage sectors in consolidation and restructuring.

In the commercial real estate and hotel developments, where large transitions gaps remain, the Bank will focus on projects which support the development of the retail sector and offices development as well as selected tourism investments with strong operators.

In the Telecommunications sector, the Bank will look for opportunities to help rolling-out 3G and WiMAX networks. The Bank will also continue to finance projects that can further improve competition and help increase the broadband penetration to help bridging the digital divide. To support the development of a knowledge based economy, the Bank will finance projects by co-investing with specialised equity funds.

### **3.2.2. Financial Sector**

**Transition Goals:** In light of the impact of the global financial crisis on the banking system, the Bank will provide appropriate policy and funding responses to the banks, will improve the availability of risk capital and long term funding for private businesses, in particular to the SME and MSME sector. Improve bankruptcy procedures and their consistent enforcement. Support the development of the private equity market. Upgrade insurance legislation and regulation to the level of International Association of Insurance Supervisors (IAIS) standards. Expand the insurance sector and develop non-bank financial institutions, including through the recently established private pension funds.

### **Operational Priorities**

In response of the crisis the Bank will continue to focus on (i) providing banks with long term funding and institutional support to help them to compensate the impact of the global crisis; (ii) assisting the banks to develop new products (including risk sharing, co-financing, energy efficiency and SME competitiveness support), grow their business on a sustainable basis, and improve corporate governance; and (iii) channelling more funding to SMEs and MSMEs through commercial banks and micro-lending institutions. The Bank will also provide additional equity or quasi-equity funding to existing partner banks to counter any asset deterioration as a result of the crisis impact.

While the Bank will continue to support the Macedonian financial sector to weather the current difficult market conditions, it will explore possible exit routes from the matured investments in the local banks. In parallel, the Bank will continue to promote the strengthening of the banking sector through growing competition by attracting further foreign investments.

The Bank will also continue to promote its TFP by expanding the number of participating banks and encouraging active utilisation of TFP lines by the existing participants.

To support the growth and development of local SMEs and MSMEs, the Bank will provide the much needed long-term funding to commercial banks and microfinance institutions through the existing financing facilities, and the new SME Competitiveness Support Financing Facility. The bank will continue to work with donors to mobilise TC funds to support the banks' institution building, improve their corporate governance, and assist in developing new products and improving banks' risk assessment policies and procedures.

The Bank will explore the possibilities to contribute to the development of the non-banking financial sector, including insurance and leasing companies, subject to further regulatory and legal framework improvements in these sectors.

### ***3.2.3. Infrastructure and Energy***

**Transition Goals:** In the power sector, increase competition through increased private sector participation. Further improve the quality of institutions, including the regulatory authority. Support reform of electricity tariffs in order to reduce quasi-fiscal losses and facilitate further opening of the market. On the basis of the new Energy Law, provide incentives (including adequate price signals) to use energy efficiently and to invest in Renewable Energy Sources (RES) based on the established feed-in tariff mechanism. Support the implementation of the national action plan for energy efficiency. In transport, develop further the involvement of the private sector in road management issues and support the government in developing motorway concessions and the sound implementation of the airport concession. In the MEI sector, promote effective implementation of a transparent tariff setting methodology and improvements in regulation and contractual arrangements to foster further commercialisation of municipal services throughout the country.

### **Operational Priorities**

**Energy:** FYR Macedonia has an important position in the regional transmission network, located across the dominant North-South flow of energy. It therefore has a key role to play in the ongoing development of a regional power market, both physically through the implementation of further interconnections with its neighbours and commercially through participation in regional coordination of transmission capacity sales. FYR Macedonia also has excellent potential for small hydropower and possibly wind-power together with a supportive feed-in tariff. Exploitation of this potential requires a focus on the remaining barriers to investment.

The Bank will focus on (i) investments in new and rehabilitated generation capacity to alleviate growing capacity problems and improve the efficiency and environmental performance of the existing infrastructure, in particular projects which introduce private sector investors, including by way of public-private-partnerships; (ii) investments in renewable and sustainable energy to address the current high carbon intensity and make use of the existing regulatory regime



supporting such projects, including through the WeBSEDF; and (iii) energy projects that fit the regional energy market development and integration including regional electricity and gas interconnections. In these areas the Bank will particularly seek opportunities to support private investors and new entrants in order to support the development of a more diverse energy sector.

**Transport:** The Bank will continue to provide support for the development of the road network, with the emphasis on the key regional links (Corridors VIII and X). The Bank will work with the other IFIs, in particular with the EIB and the WB, to develop these links. The Bank will continue to support the commercialisation of the road sector, with the main focus on ensuring a predictable and stable flow of funds and further improvement of road maintenance.

FYR Macedonia has active program for the development of transport infrastructure through the PPP model. At present, the PPP model is used for the development of **the Macedonian Airports concession**, motorway network of 800 km and the road tolling project. The Bank remains ready to provide financing to preferred bidders, providing that projects are bankable and the concession award process is consistent with the Bank's guidelines.

Following the completion of the first phase of restructuring, the railway company was institutionally separated into infrastructure and operating companies. The Bank will seek to provide financing for further development of the Macedonian railways with investments focusing on the key corridors and rolling stock. The Bank will also support further restructuring with the focus on establishing adequate legal framework that would facilitate third party operators to use the Macedonian railway network.

The Bank's strategic priorities in the Transport sector will focus on (i) promoting transport networks in the country and their regional interconnection; (ii) the support to Macedonian Airports concession; (iii) restructuring of the road maintenance sector; and (iv) support to the regional railway's links. The Bank will continue to promote introduction of private investors in the transport infrastructure including through public-private-partnerships.

**Municipal and Environmental Infrastructure:** In the Municipal infrastructure the Bank will be supporting municipal or sovereign guaranteed investments in the water supply, wastewater treatment, district heating and public transport. Efforts will be made to promote commercialisation of utilities both in Skopje and other regional centers.

Following the adoption of the fiscal decentralisation legislation, the Bank will continue to support the implementation of the fiscal decentralisation reform at local level. In addition, the Bank will continue the policy dialogue with central and local governments to encourage the commercialisation of the municipal utility companies through reform in the corporate governance, tariff reform, introduction of service standards and management performance. Financing of municipal infrastructure could be facilitated and commercialised if loans are extended directly to municipal companies (e.g. water or district heating companies) backed by a guarantee from the relevant city, thus making the municipal company more responsible and accountable thus leading to better management and financial performance.

To achieve these objectives, in cooperation with the central government, the Bank will seek to develop a pilot project with a municipality or municipal utility without a sovereign guarantee. Such investment will be made with principal reliance on the city budget and will be

accompanied by substantial institution-building technical assistance for municipal financial management.

#### **3.2.4. Policy Dialogue**

The bank will maintain active dialogue with the government, the NBRM, IFIs and key donors, as well as with the business community to further strengthen Macedonian institutions, the rule of law and improve business environment. This could include the effective implementation of legal and administrative changes as well as further progress in judicial reforms that would enhance the country's attractiveness for FDI.

In the energy sector, the Bank will continue its policy dialogue with all players including the regulatory authorities and the Energy Community Secretariat in order to assist in resolving the current tensions within the sector. The Bank will also continue to work with the Macedonian regulator and the transmission system operator MEPSO to facilitate the latter's participation in the development of the Coordinated Auction Office for regional transmission capacity as a key step towards the implementation of a functioning regional power market.

The Bank will engage in policy dialogue to ensure sound implementation of motorway and airport concessions as well as the creation and implementation of the legal framework that will facilitate further development of the railway sector and its faster regional integration.

The policy dialogue in the municipal sector will focus on effective implementation of a transparent tariff setting methodology and improvements in regulation and contractual arrangements to foster further commercialisation of municipal services.

In the financial sector, policy dialogue may help to ensure independence of the insurance regulator, further strengthen corporate governance standards and disclosure requirements.

#### **4. COOPERATION WITH DONORS AND OTHER IFIs**

The Bank works closely with other IFIs and donors to promote its Strategy in FYR Macedonia. Cooperation has been strong on both infrastructure and private sector projects. Bank's partners have included the WB and the EIB, and bilateral donors such as the EU and the governments of Italy, Germany, Netherlands, Japan, Switzerland and Sweden.

Led by the WB and the EU, in 2008 the Government started a process of closer IFI and donor coordination through the Program Based Approach (PBA). The objective is to further improve the effectiveness of external partners' assistance through a significantly strengthened government-led coordination mechanism driven by the EU accession process and focussing on the following five critical sectors for the country's development: (i) Business Environment, Competitiveness and Innovation; (ii) Human Capital (Education, Social Policy, Health); (iii) Agriculture; (iv) Environment; and (v) Governance.

The Bank already has a close collaboration with the WB through the parallel financing of the Regional and Local Roads Project and with the EIB on the Skopje Bypass Project. Going forward the cooperation should be further strengthened to co-finance other infrastructure projects on either sovereign or PPP basis.

Donor funding, including from EU, CEI and other bilateral donors, has been particularly important to support specific project related TC in both preparation and implementation phase, as well as TAM/BAS initiatives.

IFI cooperation will benefit further from the creation of the WBIF, which aims to consolidate IFI financial instruments and resources available to pre-accession countries in the Western Balkans. The framework provides for a much improved co-operation among European donors, based on transparent sharing of respective pipeline, joint programming missions to countries, share of decision on priority projects eligible to receive IFI and donor financing, and joint/parallel financing from participating IFIs.

TC, grants and official co-financing will remain crucial for project preparation and institution building, particularly promoting smaller scale local enterprises and for public sector operations. In line with the Bank's priorities for the next years, the following specific objectives will be pursued:

- (i) Implement the WBIF through co-financed projects in FYR Macedonia and the pulling of grant resources to support them;
- (ii) Maintain close co-operation with WBIF participants, the World Bank and other institutions in continuing a policy dialogue with the government on issues concerning the improvement of the investment climate. The Bank will also work with the business community to identify the existing impediments to private sector and especially SME and MSME development and to gain direct feedback on government policy and actions;
- (iii) Co-ordinate with the World Bank/IFC, EIB and EU, as well as with other agencies actively involved in the dialogue to promote private investment in developing and operating infrastructure and working to assist sector reforms;
- (iv) Continue co-operation with the IFI where appropriate in the banking sector and to support important large FDI; and
- (v) Continue co-operation and coordination with the World Bank, EIB and bilateral donors in particular in the transport (road concessions and tolling, airport and railways), energy efficiency / renewable energy and the municipal infrastructure sectors.

Details on IFIs and bilateral donors' activities in FYR Macedonia are presented in Annex 10.

### **III. ANNEXES**

#### **ANNEX 1: POLITICAL ASSESSMENT**

FYR Macedonia is committed to and applying the principles of multiparty democracy, pluralism and market economics in accordance with the conditions specified in Article 1 of the Agreement establishing the Bank.

FYR Macedonia acquired formal status of an EU candidate country in December 2005 and has since made further progress on key reforms, geared towards integration into the EU. Democratic institutions in FYR Macedonia are robust, with the functioning separation of powers and checks and balances in the political system. Elections are generally conducted in a manner deemed by the OSCE and the Council of Europe to be free and largely in line with international standards, although they are sometimes marred by various irregularities.

The implementation of the Ohrid Framework Agreement, which ended the armed inter-ethnic conflict in 2001, has contributed to the consolidation of democracy and the rule of law and continues to support political stability in the country. Political stability has further increased due to the relatively high level of popular support enjoyed by the ruling political party, pro-reform centre-right VMRO-DPMNE, which has governed since 2006 and which further consolidated its power after the early parliamentary elections in 2008 and the presidential and local elections in 2009. The global financial crisis has not so far eroded popular support for the government's overall pro-reform course. Certain inter-ethnic tensions persist on the local level, but the reshuffled governing coalition, which since 2008 includes as a junior coalition partner the strongest ethnic Albanian minority political party, DUI, functions reasonably well. There has been some progress of late in political dialogue between the government and the opposition, which was lacking in the past drawing criticism from EU.

#### **Political Accountability**

The existing legal framework enables a sound basis for democratic elections, provided the authorities and political parties exercise sufficient will to implement it. The legal framework benefited from amendments, adopted in 2006 and 2008, which, inter alia, took on board several recommendations put forward by the OSCE after the last general elections. Almost all elections in the country, which have since 1996 been observed by OSCE Office for Democratic Institutions and Human Rights (ODIHR), usually in cooperation with the Parliamentary Assembly of the Council of Europe, were assessed as free and fair. However, the qualities of the elections administration and electoral behaviour have been uneven over the years. Among recurring procedural irregularities is the so-called 'proxy' (family) voting, particularly present in the ethnic Albanian-populated regions of the country where this phenomenon represents a long-term challenge, as well as occasional allegations of pressure on or intimidation of citizens.

Several elections in the past were marred by electoral violence, which was particularly disturbing during the 2008 early general elections, when the international election observation mission issued its toughest assessment of FYR Macedonia's elections in recent history, concluding that the elections did not meet key international standards. However, the authorities and the main political actors demonstrated that they are able of conducting elections in a much better fashion. The ODIHR-led international Election Observation Mission, which was deployed to monitor presidential and local elections in March-April 2009, assessed that these

elections ‘met most OSCE commitments and other international standards for democratic elections’. These latest elections marked significant progress. Some procedural irregularities persisted, but the administration and the overall conduct improved. Both rounds of these elections went in a peaceful and incident-free atmosphere. Political parties made efforts to use measured rhetoric, while the police, unlike sometimes in the past, played a constructive role in ensuring a calm atmosphere.

FYR Macedonia has a satisfactory legal framework for civil society organisations. NGO representatives have been involved in the preparations of a Strategy for cooperation between the government and civil society for 2007-2011. The NGOs are particularly active in the social field, including protection of vulnerable groups, and in election observation.

### **Rule of Law**

The legal system for a functioning market economy in FYR Macedonia is largely in place. In the past few years the authorities made further progress in legislative alignment with the EU acquis and in comprehensive judicial reform in accordance with a long-term strategy adopted in 2004 ahead of the country’s bid for EU membership. This included adoption of new legislation, administrative strengthening of the Court system, and improvement in training of judges and prosecutors, as well as police. Several years of police reform, which has been one of the most sensitive issues ever since the 2001 inter-ethnic conflict when the enforcement agencies were seriously tested, have started to bear fruit. The efficiency of the police has strengthened, and its new territorial organisation better reflects the needs of the country, including specifics of its ethnic composition.

Significant progress has been achieved in the integrated border management, where the authorities actively cooperate both with the EU and their regional neighbours, on issues of migration, asylum, and visa policy. **The Council of EU decided to grant visa free travel to and throughout the Schengen area for citizens of FYR Macedonia starting from 19 December 2009.** However, there is still a need to increase the independence and professionalism of the judiciary and of the public service in general. Establishing a stable, professional and merit-based civil service and further progress in reform of public administration remain among top priorities of the authorities and a key requirement for further progress in EU integration. Another area where further efforts will be needed is reducing a still sizeable informal sector of economy.

Although corruption is still perceived by Macedonian citizens as a wide spread phenomenon and a serious problem, the authorities have made progress over the last years in implementing their anti-corruption policy. The government adopted special Action Plans for fighting corruption and for preventing conflict of interest. Sustained efforts led to some results in the fight against organized crime and in preventing and prosecuting corruption, including a few convictions in high-level corruption cases. In the Transparency International’s Corruption Perception Index 2009, FYR Macedonia was ranked 71<sup>st</sup> out of 180 countries, which places it in a better position than most of its regional Western Balkans neighbours. Establishing a ‘one-stop-shop’ for enterprise creation and comprehensive regulatory reforms of the last years, including dealing with registration of businesses and property, construction permits and investors’ protection not only has made it easier to do business in FYR Macedonia, but also contributed to improving transparency and the overall integrity atmosphere.

## **Protection of Civic and Human Rights**

FYR Macedonia is a signatory to all major international human rights instruments, including the European Convention on Human Rights and Fundamental Freedoms. The Constitution and relevant laws prohibit discrimination on grounds of sex, race, language, religion, national or social origin, property or social status. The Constitution guarantees the basic freedoms and rights of citizens recognized in international law, while international treaties are directly enforceable by domestic courts and their status superior to the domestic law. The constitutional guarantees of freedom of thought, conscience and religion are generally respected.

The country has been assessed in the **recent** reports by Freedom House as regards political rights and liberties on par with most other Western Balkan countries. The same applies to the media, which are largely free from state interference. State electronic media faces strong competition from private channels and stations. Foreign ownership in media is significant. There is growing number of media and broadcasts in the languages of ethnic minorities.

By regional standards women have impressive representation in the national Parliament (39 out of 120 MPs), and there are a few female members of the Cabinet. During recent presidential elections the first woman ran for the President, and although she did not make it into the second round, this was a breakthrough in terms of some previous gender prejudice. On the local level, however, the situation is not as good. There were only 3.6 per cent women among mayoral candidates during the last municipal elections, and none of them were elected.

The situation with human trafficking in FYR Macedonia is comparable to that in other countries of the region. FYR Macedonia is mainly a transit and destination country for women and girls trafficked for forced prostitution, and, to a lesser extent, also a source for human trafficking. The government is making efforts to combat trafficking and forced prostitution, as well as to protect the victims. However, some problems still have to be addressed, including additional efforts to effectively prosecute traffickers.

## **Inter-Ethnic Issues**

The country has a complex ethnic composition and a history of ethnic tensions (according to the latest census, ethnic Macedonians are 64.2%, ethnic Albanians 25.2%, ethnic Turks 3.9%, Roma 2.7%, ethnic Serbs 1.8%, ethnic Bosnians 0.8%, and Vlachs 0.5%). However, it has made progress since the 2001 armed inter-ethnic conflict in addressing both the roots and the effects of this conflict. These efforts included legislative reform and practical measures designed to ensure equitable representation of minority communities in public administration and their integration into society and promotion of inter-ethnic reconciliation. The interests of minority communities are protected at different levels, starting with basic constitutional guarantees (ethnic communities are explicitly mentioned in the constitution) to the special mechanism ensuring protection of their interests in the Parliament and measures to protect their cultural, linguistic and religious identities. The most tangible results in this respect have been achieved in protecting the interests and ensuring equitable representation of the largest ethnic minority, Albanian, which lives compactly in the western and northern regions of the country. More remains to be done to protect smaller ethnic minorities, particularly the most vulnerable Roma community.

Despite the above-mentioned progress, inter-ethnic tensions and certain lack of mutual trust persist, especially on the local level. Political parties are largely divided along ethnic lines. The

latest elections witnessed campaigning by the candidates almost exclusively among their own ethnic communities. The only discernable effort to campaign across ethnic lines was made by the presidential candidate Imer Selmani of the newly established largely ethnic Albanian supported political party New Democracy. The implementation of the Ohrid Framework Agreement remains indispensable in order to preserve stability in the country.

### **EU Approximation and Euro-Atlantic Integration**

Euro-Atlantic integration remains both the key priority of the government and, objectively, the main external anchor for continuing reforms and for stability in FYR Macedonia. The commitment to EU reform agenda and to the objective of Euro-Atlantic integration remains high and there is a strong consensus on this issue among all mainstream political parties and among the citizens. Support for both EU and NATO membership steadily exceeds 80 per cent.

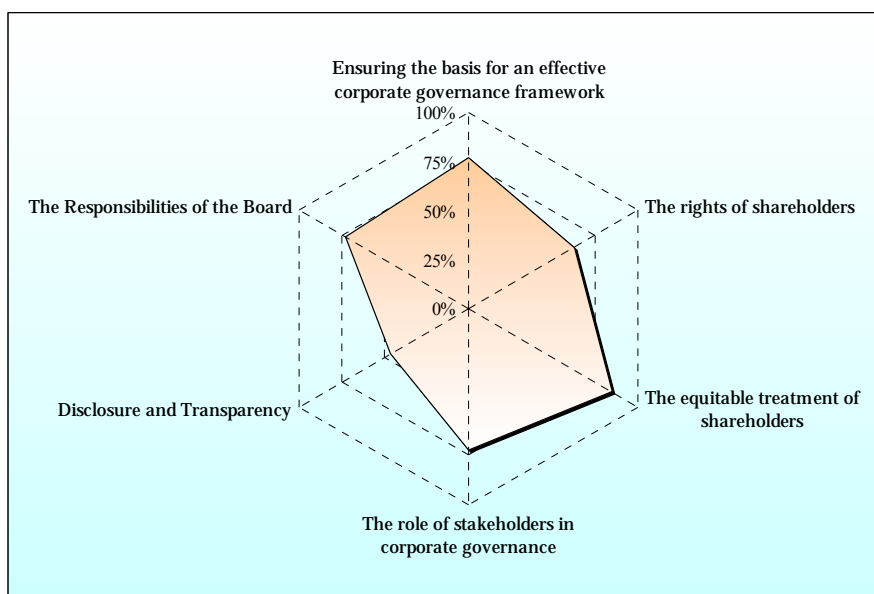
The country received the status of an official EU candidate country – the only in the Western Balkans apart from Croatia – in December 2005. After several years, during which the country was scrutinized for further progress in meeting specific benchmarks, the European Commission in October 2009 made its recommendation to the Council of the EU to begin accession negotiations with FYR Macedonia. However, no decision has been made yet about the date for the opening of these negotiations. The unresolved dispute over the country's official name has become an additional obstacle for further progress in the integration into the EU, as well as for obtaining NATO membership.

## ANNEX 2: COMMERCIAL LAWS OF FYR MACEDONIA

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws “on the books” (also referred to as “extensiveness”) and the actual implementation of such laws (also referred to as “effectiveness”). All available results of these assessments can be found at [www.ebrd.com/law](http://www.ebrd.com/law). This annex presents a summary of the results for FYR Macedonia, accompanied by critical comments of the Bank’s legal experts who have conducted the assessments.

### Company Law and Corporate Governance

The principal legislation on corporate governance in FYR Macedonia is entrusted in the Law on Trade Companies issued in 2004 (as amended). In addition, the “Corporate Governance Code for Companies listed on the Macedonian Stock Exchange”<sup>3</sup> was approved by the Macedonian Stock Exchange in January 2006. The Code is voluntary, but listed companies are required to take the Code’s recommendations into consideration according to the so-called “comply or explain” mechanism.



Quality of corporate governance legislation – FYR Macedonia (2007)

Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the ‘web’, the more closely the corporate governance laws of the country approximate these principles

Source: EBRD Corporate Governance Sector Assessment, 2007 assessment

According to the results of the EBRD’s 2007 Corporate Governance Sector Assessment<sup>4</sup> (see chart above) under which the quality of corporate governance legislation in force in November 2007 was assessed, FYR Macedonia was found to be in “medium compliance” with the OECD Principles of Corporate Governance. The framework, which is very close to the high compliance category, showed some flaws in the “disclosure and transparency” category. When considering the effectiveness of corporate governance legislation, the EBRD’s 2005 Legal

<sup>3</sup> The Code is available at <http://www.ebrd.com/country/sector/law/corpgov/codes/index.htm>

<sup>4</sup> For more information on the EBRD’s 2007 Corporate Governance Sector Assessment see: <http://www.ebrd.com/country/sector/law/corpgov/assess/index.htm>



Indicator Survey<sup>5</sup> revealed that judicial procedures can be lengthy, burdensome and judgements difficult to enforce. Company books are generally of good quality but minority shareholders can find it difficult to gain access to them. Finally, the competence and experience of courts in corporate law cases should be enhanced.

### Concessions

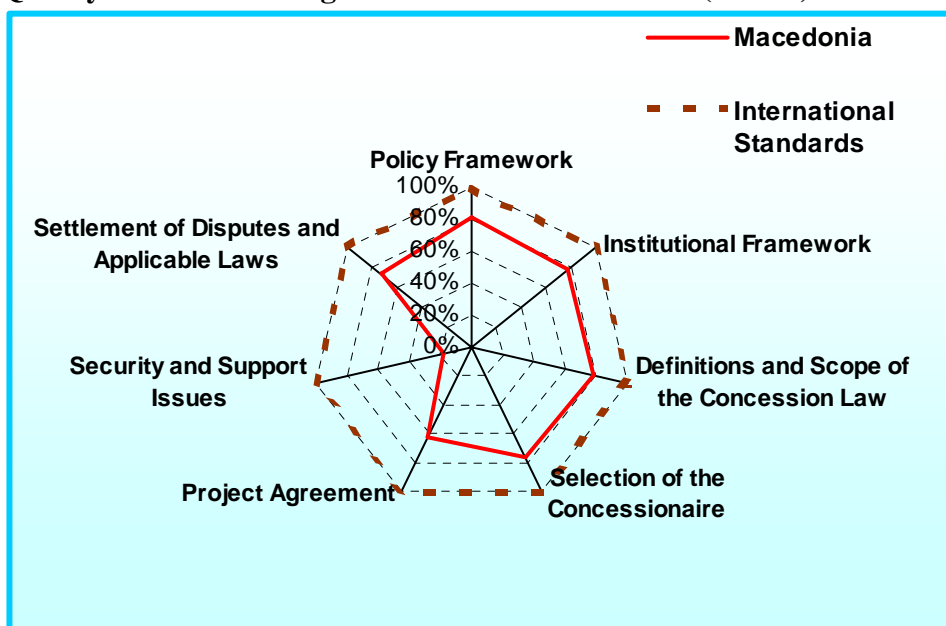
There is no evidence of the existence of a clear general policy framework for improving the legal environment and promoting PPP in FYR Macedonia.

A new Law for Concessions and Other Types of Public Partnerships was adopted in 2008 (the Concession Law). Being a recent piece of legislation the Concession Law is influenced by modern ideas and international best practices. It clearly defines its scope of application, regulates the selection procedure (publication, pre-selection and procedure for requesting proposals, publication of concession award, possibility of review procedures) and provides for a flexible framework for the project agreement (with reference to termination/compensation, tariff setting/service standards, etc).

Among its shortcomings, the Concession Law refers to "the possessions of common interest", an ambiguous term which relies heavily on sector law for implementation purposes. In addition, the Concession Law contains no clear provisions concerning government support and financial security, and the possibility of international arbitration remains questionable.

Overall, the Concession Law is one of the best laws in the region and constitutes a solid basis for the development of public-private partnerships in the country, provided the financing and arbitration issues can be solved in accordance with best international practice. The Concession Law is, however, quite a recent development and its implementation is still to be verified in practice.

### Quality of concession legislation – FYR Macedonia (2007/8)



Note: the extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide or Privately Financed Infrastructure projects. The fuller the 'web', the more closely concessions laws of the country approximate these standards.

Source: EBRD Concessions Sector Assessment 2007/8

The 2007/8

<sup>5</sup> For more information on the EBRD's 2005 Corporate Governance Legal Indicator Survey see: <http://www.ebrd.com/country/sector/law/corpgov/lis/index.htm>

Assessment of Concession Laws which assessed legislation as it appeared on the books, found the laws of FYR Macedonia to be in “medium compliance” with international standards in the area. As can be seen from the graph, nearly all the core dimensions of the environment are fairly extensively regulated, with the exception of the availability of financial instruments and state support rules that still need to be significantly improved in order to meet the requirements of a modern legal framework facilitating private sector participation.

## **Insolvency**

The principal law that governs the liquidation of insolvent enterprises in FYR Macedonia is the Law on Bankruptcy (the “Bankruptcy Law”). The Bankruptcy Law came into force in March 2006 and was amended in 2006 and 2008. The EBRD Insolvency Sector Assessment conducted in 2009 rated the Bankruptcy Law as “high” in terms of its compliance with international standards. This shows an improvement from the previous Bankruptcy Law.

The EBRD Insolvency Sector Assessment indicated that the Bankruptcy Law is strong in most assessed areas. Thus it contains clearly defined commencement criteria allowing the debtor and the creditor to initiate insolvency proceedings; the commencement process is fairly quick; the stay on most claims is automatic upon commencement and an insolvency practitioner is immediately appointed to administer the process. However, the proceedings may not be initiated based on balance sheet test or future inability of the debtor to pay its debts, only current cash flow shortages constitute sufficient grounds for commencement. This may prevent the debtor from seeking bankruptcy protection to regain strength before a potential distress.

The Bankruptcy Law spells out the assets forming insolvency estate and envisages sufficient protection for the secured creditors. The rules on avoidance of transactions are clear and well defined ensuring the fairness of insolvency proceedings. The process of recovery of assets of the debtor is aided by the duty imposed on the debtor to provide all relevant information and deliver the assets. This process may however prove inefficient due to the lack of a similar duty on third parties who may have information about debtor’s assets.

As regarding treatment of creditors in insolvency proceedings the Bankruptcy Law provides for set-off, disclosure of information, creditors’ participation, administrative costs sharing and appropriate claims ranking. Somewhat problematic may be the fact that creditors are not specifically notified about their rights to file the claims whereas the time for filing such claims is limited and definite.

The Bankruptcy Law envisages the reorganisation/restructuring of the debtor within the insolvency proceedings. There are clear provisions on the components of the plan, approval process, sufficient disclosure of information to the creditors and independent analysis of the plan. However, legal provisions in this area are deficient on some points, including full discretion of the court to approve or not the plan despite the approval by the creditors. In addition, the plan cannot be changed after the court approval. Another impediment to recovery may be the fact that there is no mechanism for post-commencement financing and the continuity of essential contracts is not ensured.

## **Secured Transactions**

Over the last decade, the legal regime applicable to secured transactions has markedly improved the conditions by which security over movable assets can be created and enforced.

In particular, the 2003 Law on Contractual Pledge (developed with World Bank's support) introduced a number of positive features. As of today, a charge can be granted over all types of movable property (as opposed to real estate), tangible assets, securities, claims and other rights. The charge can be either possessory (i.e. requiring transfer of the collateral to the lender) or non-possessory. Registration in the pledge registry is compulsory for non-possessory pledges and optional for possessory pledges.

The 2003 Law on Contractual Pledge has removed previous limitations as to the assets which could be given as collateral – previous legislation prohibited enforcement over assets used for the business activities of the debtor. Enforcement has been strengthened, especially by allowing self-help and out-of-court realisation of assets based on a notarised charging agreement. The Registry of Pledges on Movable Property and Rights is part of a system of electronic registries administratively combined into the Central Registry of Macedonia. The registry's principal office is located in Skopje and it has 31 local offices across Macedonia. Registration is made by submitting an application form which must include all details of the parties and the pledge, together with supporting documentation, and which must be signed by the applicant, the pledgor and the pledgee (or their representative(s)).

Some problems, however, remain: the secured claim still need to be precisely identified in the charging agreement and in the registration statement, which may limit flexibility (such as for an overdraft facility). The registration agreement still requires specific description of the charged assets, making the charging of future assets very difficult. This weakens the overall commercial effectiveness of the system.

This weakness is also illustrated by a recent reform aimed at introducing into Macedonian law the substantive contents of the EU Financial Collateral Directive. By doing so, ambiguity was introduced into the legal framework as to the way pledges over bank accounts granted by corporations to financial institutions were to operate (in particular, the scope of the pledge regarding monies transferred onto the account *after* the creation of the pledge). The EBRD is aware of such problems and recommends further evaluation of the framework to clarify or adjust specifically identified points. This should allow Macedonia to be equipped with a truly legally efficient and market oriented legal regime for pledges.

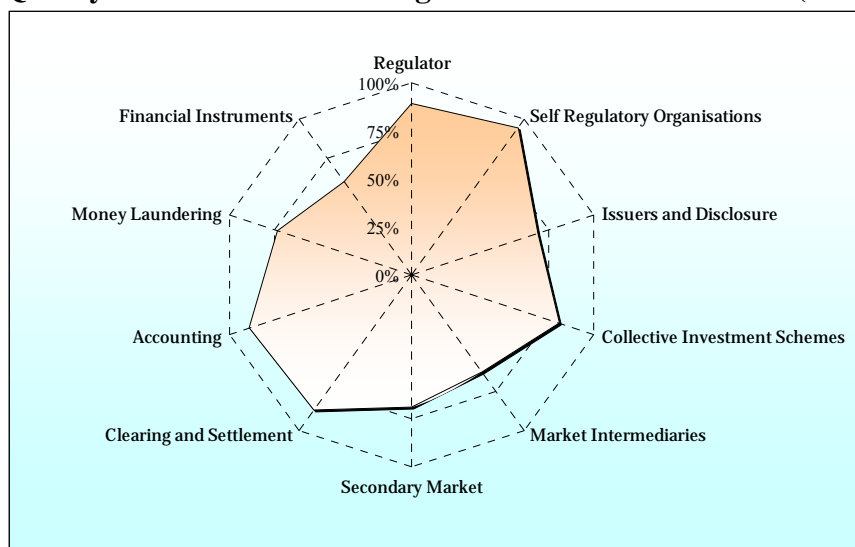
## **Securities Markets**

In FYR Macedonia the basic legislation on securities markets is entrusted in the Securities Law (2005, as amended), in the Law on Takeover of joint stock companies (2002, as amended) and in the Law on Investment Funds (2000, as amended). The Securities Law regulates the conditions for issuance, trading, registration, clearance and settlement of securities; the requirements for the functioning of the market; disclosure obligations of issuers; prohibited conducts with respect to operations with securities and the status and authorities of the Stock Exchange and Securities Commission of FYR Macedonia. The Law on Takeover of joint stock companies regulates the procedure for purchase of control shareholding in joint stock companies. The Law on Investment Funds regulates the conditions for incorporation, supervision and management of investment funds and investment fund management companies and their depository bank.

The Securities and Exchange Commission is the national securities markets regulator. It was established in 1992 and is in charge for the supervision of the securities markets. The Agency

for Supervision of Fully Funded Pension Insurance is in charge of the supervision of pension funds while the National Bank of FYR Macedonia is responsible for the banking sector.

### Quality of securities market legislation – FYR Macedonia (2007)



*Note:* The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in IOSCO’s *Objectives and Principles for Securities Regulations*. The fuller the ‘web’, the closer the relevant securities market legislation of the country approximates these principles.

*Source:* EBRD Securities Market Legislation Assessment 2007

In 2007, the EBRD benchmarked the securities markets legislation in FYR Macedonia against the “Objectives and Principles of Securities Regulation” published by IOSCO, showing a framework in “medium compliance” with international standards, but very close to the high compliance category (see chart above).<sup>6</sup> In order to understand how securities markets legislation works in practice, in the same year the EBRD undertook a Legal Indicator Survey asking practitioners in the region to comment on a hypothetical case study.<sup>7</sup> The Survey concentrated on effectiveness of prospectus disclosure requirements, private and public enforcement mechanisms and authority of the market regulator. The Survey revealed that international public offerings and underwriting practices are not common in FYR Macedonia. Securities are issued either through a private offer or a public offer with a prospectus merely created to satisfy the formal requirements of the regulator rather than to induce a wide spectrum of investors to purchase securities. Further, prospectuses lack information on delicate issues as insider ownership and related party transactions and beneficial ownership is not subject to disclosure requirement. Private enforcement mechanisms allow for some course of action but they might be burdensome. The competence and experience of courts in complex securities law cases need to be improved.

### Telecommunications

The primary legislation regulating the electronic communications sector in FYR Macedonia is the Electronic Communications Law, 2005 (the “EC Law”), based on the European Union 2003 regulatory framework. The EC Law establishes the national regulatory authority, the Agency for Electronic Communications (AEC), defining its responsibilities, along with those of the government and Ministry of Transport and Communications (the “Ministry”). The Ministry is responsible for drawing up policy and drafting sector legislation. AEC was

<sup>6</sup> For more information on the EBRD’s 2007 Securities Markets Legislation Assessment see: <http://www.ebrd.com/country/sector/law/capital/assess/index.htm>

<sup>7</sup> For more information on the EBRD’s 2007 Securities Markets Legal Indicator Survey see: <http://www.ebrd.com/country/sector/law/capital/survey/index.htm>

established in July 2005 as an autonomous, independent authority responsible for carrying out regulatory tasks defined under the EC Law, including adoption and administration of implementing legislation within its competencies, managing of frequency spectrum and numbering resources, carrying out analysis of the relevant electronic communications markets and imposing regulatory obligations on undertakings designated as having Significant Market Power (SMP).

The EC Law establishes an EU compliant regime whereby network and services can be provided on the basis of a general authorisation, with a notification submitted to AEC before the start of activities. AEC is required to provide a written confirmation of the registration of the notification within 15 days of its receipt. Individual licences are still issued by AEC for the rights of use of the radio frequency spectrum. The EC Law specifies the market analysis procedures, definition of relevant markets, SMP designations and imposition of remedies on SMP operators based on the principles of the Law on Competition and the EU 2003 regulatory framework. The following competitive safeguards foreseen under the EU 1998 regulatory framework are in place in FYR Macedonia: carrier selection/pre-selection in fixed network; reference interconnection offers of the fixed incumbent and mobile operators; reference unbundling offer of MakTel; regulated fixed interconnection and local loop unbundling (LLU) charges; and, fixed and mobile number portability.

The main priorities for AEC going forward are the full practical implementation of competitive safeguards, in particular LLU, number portability and RIOs for the mobile operators with SMP. Other issues include finalisation of the market analysis procedure, effective enforcement of regulatory obligations and implementation of a modern universal service framework.

In a 2008 Communications Sector Assessment undertaken by EBRD, FYR Macedonia was assessed as having “full compliance” when measured against benchmarks of international best practice, scoring low in all categories assessed.

### ANNEX 3: TRANSITION CHALLENGES

The table below provides an overall Assessment of Transition Challenges rating for 2009 based on individual ratings for market structure and market-supporting institutions and policies. Scores range from negligible, small, medium and large. “Negligible” means that the remaining challenges are minor and that the sector is well advanced in moving towards a well-functioning market economy. “Large” means that the remaining challenges are major and that this dimension of the sector is at an early stage of reform.

#### Summary Sector Gaps

	Structure and extent of markets	Market-supporting institutions and policies	Overall rating (2009)
<b>FINANCIAL INSTITUTIONS</b>			
<b>Banking</b>	Medium	Medium	Medium
<b>Insurance and financial services</b>	Medium	Medium	Medium
<b>MSMEs</b>	Medium	Medium	Medium
<b>Private equity and capital markets</b>	Large	Large	Large
<b>ENTERPRISE SECTOR</b>			
<b>Agribusiness</b>	Medium	Large	Medium
<b>General industry</b>	Medium	Medium	Medium
<b>Property/Tourism</b>	Large	Medium	Medium
<b>Telecoms</b>	Medium	Small	Medium
<b>ENERGY &amp; INFRASTRUCTURE</b>			
<b>Sustainable energy</b>	Large	Medium	Medium
<b>MEI</b>	Medium	Large	Medium
<b>Natural resources</b>	Medium	Large	Medium
<b>Power</b>	Medium	Medium	Medium
<b>Transport</b>	Medium	Medium	Medium

FYR Macedonia faces a number of important transition challenges in all sectors. The assessment below is based on the 2009 Assessment of Transition Challenges.

#### Corporate Sector

**General industry:** FYR Macedonia has made progress with privatisation and restructuring in the enterprise sector over the last few years, although this is yet to be reflected in improved efficiency and productivity. Progress was made regarding the introduction of low and simplified taxation, the “regulatory guillotine” (the process of eliminating and simplifying regulations quickly), customs reform and the process of issuing building permits. The authorities took steps to improve the legislation on the “one-stop shop” system, reducing the time required to register a business. Progress was also made on the draft of a new law on the property cadastre, which will encourage the use of land as loan collateral and should ultimately help to lower borrowing costs. Legislative changes introduced in 2007 to allow foreign individuals and legal entities to own construction land are expected to encourage increased FDI. The key challenge for the sector is to improve the general business environment including the effective implementation of legal and administrative changes.

**Agribusiness:** The country gradually reduced trade protection under the umbrella of the EU’s SAA agreement signed in 2001, the WTO agreement signed in 2003 and CEFTA signed in 2006. Around 80% of arable land is under secure ownership by private farmers, but the land

market functions poorly (despite ongoing cadastral reforms land holdings continue to be small and fragmented and there are problems with the land registration system since cadastral records and tradable titles need updating). Most of the agro-processors have been privatised, but are still in severe financial difficulty due to outdated plant and equipment, excess labour and poor management. FDI into the sector has been low. The institutional framework related to building a warehouse and registering property needs further improvements. Quality and hygiene standards need significant upgrading. There has been continued reform of the commercial banking sector, and microfinance banks have been established, but the rural sector still has limited access to bank credit.

**Property and Tourism:** The property market is at relatively early stages of development, including the introduction of new products and financing methods. Market penetration of innovative construction technologies is low, and there is a lack of supply for modern commercial property in all segments. The mortgage market remains underdeveloped. Progress has been made in improving the business environment for real estate development, including the introduction of a new law on real estate cadastre, but inefficiencies remain with respect to dealing with construction permits. There is little state interference in the sector (subsidies etc.), but the lack of effective rule of law and the uncertainty of property rights undermine investment and development in the sector. Tradability of land is limited de jure.

**Telecommunications:** Although alternative operators have been able to compete since 1st January 2005, competition only started in February 2007 because of a delay in implementing the new regulatory framework. MakTel, fixed-line incumbent continues to dominate the market, with the Voice over Internet Protocol (VoIP) providers accounting for about 10 per cent of the fixed-line market by end 2007. However, since May 2008 MakTel has agreed 28 ISDN-based commercial network access agreements with alternative VoIP providers, and fixed number portability is expected to be in operation in 2009. Mobile market is well-developed, and mobile number portability is effective since September 2008. The Internet market is at a relatively early stage, but the increased competition from On.Net has forced MakTel to make significant changes to its broadband services, and broadband Internet should become more widely available once the regional and national wireless data transmission (WiMAX) licenses issued in 2007 become operational.

## **Energy and Infrastructure**

**Power Sector:** Progress has been achieved in improving the market structure of the Macedonian power sector. Notably, the unbundling of the sector has been completed along the lines of generation, transmission, and distribution. In addition, the monopolist power distribution and supply company established during the unbundling process was privatised in 2006. The power generation segment is still dominated by the state-owned AD Elektrani na Makedonija (ELEM) which owns substantially all the generating capacity other than Negotino TPP, which is held separately directly by the state. Liberalisation of the sector is still at an early stage and competition is very limited. Several attempts to tender for private participation in new generation projects have failed. The quality of institutions needs to be further strengthened. A regulatory authority is operating but it is still perceived to be subject to political pressure. Further development of the sector is hindered by disputes between the privately-owned distribution company EVN Macedonia, and the government and ELEM. Despite improvements in the tariff methodology, electricity tariffs are still below costs recovery and cross-subsidies are significant, with household prices being kept artificially low.

A feed-in tariff mechanism to support renewable energy is in place but there has been limited progress in taking advantage of this because of shortfalls in the wider concessions framework.

**MEI Sector:** Local infrastructure has been transferred to municipalities. However, there is still political interference into the water sector and local infrastructure operators are normally not fully converted into joint stock companies. The overall financial and operational performance of municipal utility companies is mixed as collection rates are low by regional standards, cost control is weak and substantial network losses are common among the smaller communities. Utility companies in the capital are operating fairly well. The district heating company in Skopje is private and partly floated on the local stock exchange. There is also substantial private sector participation in the urban bus services, particularly in the country's capital.

Tariffs for water are set by the municipalities based on methodology issued by the Ministry of Transport. However, the tariff setting process is often subject to political influence. Cross subsidies between consumer groups are still widespread. Although the level of tariffs for water and heating is generally low, some municipal utilities manage to cover operational costs through tariffs. The transition challenges are still substantial and linked to effective implementation of a transparent tariff setting methodology and improvements in regulation and contractual arrangements to foster further commercialisation of municipal services throughout the country.

**Natural Resource Sector:** FYR Macedonia has large deposits of low-quality coal and lead-zinc ores, as well as copper and chromium. However, mining and quarrying make a very small contribution to value added, and account for less than 0.5 per cent of GDP. There are no domestic sources for production of natural gas, which is used by industrial customers and for district heat generation. Oil is imported from Greece and processed at the Okta refinery, which is majority owned by Hellenic Petroleum. Although some progress has been made in the area of the internal energy market, the activities of the natural gas transmission system operator and the natural gas distribution system operator are not unbundled and are performed by the same company. The ownership of the gas system has still not been resolved. The mining sector has attracted some private interest (Solvaj purchased Macedonia's largest lead and zinc mine in 2005), but most of the coal (lignite) reserves are being managed by state-owned electricity generation companies with no clear separation of accounts. A strategy for the long-term development of the energy sector is still to be completed. The Grid Code for transmission of natural gas distribution was adopted in the first half of 2008. In relation to energy networks, progress was made with implementation of the Energy Community Treaty. The Energy Regulatory Commission (ERC) regulates electricity, natural gas, district heating, oil and oil derivatives and the geothermal energy sector. Its administrative capacity is low and independence should be further strengthened.

**Sustainable Energy:** The Energy Law (amended in 2007) includes provisions in support of sustainable energy, but does not set concrete targets. In the field of energy efficiency, it envisages, among other issues, standards and labelling of household appliances. However, electricity tariffs are still not cost reflective (in particular for households, hence cross-subsidies are widespread) and do not include environmental costs. Therefore price signals do not provide incentives to use energy efficiently and to invest in RES projects. The support system for RES was strengthened in 2007, when the Energy Regulatory Commission approved the Rulebooks on the method and procedures for establishing and approving the use of feed-in tariffs for purchase of electricity produced from small hydropower plants, wind power and biomass. FYR Macedonia ratified the UNFCCC and Kyoto protocol where it holds the status of the Non-Annex



1 Party. A national action plan for energy efficiency has been adopted but implementation remains a challenge.

**Transport:** In the railway sector, the government started a reform process in 2005. The first phase of restructuring has been completed, which resulted in the institutional separation of the railway into infrastructure and operating companies. There have been significant labour adjustments and tariff reforms. The institutional mechanisms for the introduction of Public Service Obligations (PSO) and access charges are under development. In the road sector, the Agency for state roads (ASR) was created as an independent state-owned entity responsible for the operation and maintenance of the main road networks. For the time being, road maintenance is contracted out to one state enterprise (without competition), but the authorities are committed to introduce fair competition as well as best practice maintenance contracts. The government is interested in developing motorway concessions, and international consultants are presently assisting with this task. The airport concession was awarded to TAV Havalimanlari Holding, a Turkish based company, following an open tender undertaken by the government in 2008.

## **Financial Institutions**

**Banking Sector:** The financial sector reforms continued in the recent years, and the sector is reasonably well regulated. In May 2007 the parliament adopted a new banking law, which strengthens banks' governance, tightens provisions on connected lending and establishes a framework for consolidated supervision. The central bank has also upgraded the credit registry in mid-2008. Despite these improvements, commercial banks still face problems with regard to the enforcement of financial collateral and the cumbersome, albeit improving, court procedures.

The banking system remains relatively small, with the total banking assets accounting for 62 per cent of GDP, well below other countries in the region. Still, a low loan to deposit ratio underpinned the sector's resilience in the face of the international financial crisis. Following the rapid though not excessive growth in recent years, the slowdown of lending growth in 2009 has been less precipitous than in other countries. The sector remains highly concentrated, with the biggest three banks (Komeracijalna banka, NLB Tutunska banka and Stopanska banka) controlling two thirds of total banking assets. 11 out of 18 commercial banks have foreign investors as majority shareholders. The solvency of the banks remains relatively high and the capital adequacy ratio remained at above 16 per cent at the end of 2008, twice the legally required minimum.

**Insurance and Financial Services:** Insurance legislation and regulation fall short of the International Association of Insurance Supervisors (IAIS) standards in a number of areas, notably with respect to the independence of the regulator, corporate governance standards and information disclosure requirements. Insurance market remains relatively small. **In 2009, the voluntary pension system ("third pillar") became optional, completing a seven-year pension reform intended to harmonise the social insurance legislation with that of the EU.** The Law on Leasing was adopted in 2002 and amended several times subsequently. Out of 13 authorised firms, 6 are currently active on the financial leasing market.

**MSMEs:** There is limited lending from commercial banks to the MSME sector as MSMEs find it hard to meet the rigid collateral requirements of commercial banks. Some businesses access credit through microfinance institutions, albeit with high fees and interest rates.

Improved bankruptcy procedures and their consistent enforcement would surely help reduce risk perceptions. EBRD projects with the Export & Credit Bank (ECB) and Procredit Bank have left these banks with a recognised strong focus on the micro and SME market. A registration system for moveable assets is in place for legal and physical persons and can be accessed on request for a fee. Information services on loans issued to physical and legal persons are available only to financial institutions.

***Private Equity Fund Sector:*** FYR Macedonia showed high compliance with the International Organisation of Security Commissions (IOSCO) principles, and relatively high effectiveness in applying the laws and regulations. However, the securities market regulator may not be in a position to pursue all cases. A commercial private equity sector is yet to develop and to date the country has not attracted significant interest of international private equity funds. A challenging business environment, limited investment opportunities and poor exit prospects all conspire against this sector. While the domestic equity market has a sizable capitalisation, turnover is low, deterring investors, and limiting the attractiveness of public equity issuance as a source of capital.

## ANNEX 4: SELECTED MACROECONOMIC INDICATORS

	2003	2004	2005	2006	2007	2008 <i>Estimate</i>	2009 <i>Projection</i>
<b>Output and expenditure</b> <i>(Percentage change in real terms)</i>							
GDP	2.8	4.1	4.1	4.0	5.9	4.9	-1.6
Industrial gross output	6.6	-2.1	7.0	3.6	3.7	5.5	na
Agricultural gross output	4.8	6.2	0.2	4.6	-2.0	3.5	na
<b>Employment</b> <i>(Percentage change)</i>							
Labour force (end-year)	4.4	-3.3	4.4	2.6	1.7	1.4	na
Employment (end-year)	-2.8	-4.1	4.3	4.6	3.5	3.2	na
<i>(In per cent of labour force)</i>							
Unemployment (end-year)	36.7	37.2	37.3	36.0	34.9	33.8	na
<b>Prices and wages</b> <i>(Percentage change)</i>							
Consumer prices (annual average)	1.2	-0.4	0.5	3.2	2.3	8.3	-0.4
Consumer prices (end-year)	2.6	-1.9	1.2	2.9	6.1	4.1	-1.0
Producer prices (annual average)	-0.3	0.9	3.2	4.5	2.5	10.3	na
Producer prices (end-year)	-0.2	1.3	4.0	3.2	4.2	-1.8	na
Gross average monthly earnings in economy (annual average)	4.9	4.1	2.7	8.0	4.8	8.7	na
<b>Government sector</b> <i>(In per cent of GDP)</i>							
General government balance	-0.6	0.4	0.3	-0.5	0.6	-1.0	-2.8
General government expenditure	34.5	33.2	34.9	34.0	33.1	35.2	na
General government debt	39.0	36.6	39.5	32.9	24.7	21.3	na
<b>Monetary sector</b> <i>(Percentage change)</i>							
Broad money (M2, end-year)	18.1	17.1	15.5	24.8	28.1	7.1	na
Domestic credit (end-year)	7.0	27.5	3.7	27.4	67.1	39.4	na
<i>(In per cent of GDP)</i>							
Broad money (M2, end-year)	30.7	34.1	36.5	41.9	47.1	44.9	na
<b>Interest and exchange rates</b> <i>(In per cent per annum, end-year)</i>							
Basic rate of the National Bank	7.0	6.5	6.5	6.5	6.5	6.5	na
Interbank interest rate	6.2	10.0	8.5	5.7	4.8	6.5	na
Deposit rate	6.7	6.5	5.6	4.4	5.3	5.7	na
Lending rate	14.5	12.0	12.1	10.7	9.9	9.7	na
<i>(Denars per US dollar)</i>							
Exchange rate (end-year)	49.1	45.1	51.7	46.5	41.7	43.7	na
Exchange rate (annual average)	54.3	49.4	49.3	48.8	44.7	41.9	na
<b>External sector</b> <i>(In millions of US dollars)</i>							
Current account	-184.1	-452.8	-157.9	-56.4	-596.8	-1,209.6	-1,155.0
Trade balance	-851.0	-1,139.0	-1,063.0	-1,285.0	-1,629.8	-2,551.8	-2,000.0
Merchandise exports	1,362.7	1,674.9	2,040.6	2,396.3	3,349.5	3,970.9	2,300.0
Merchandise imports	2,213.7	2,813.8	3,103.6	3,681.2	4,979.2	6,522.7	4,300.0
Foreign direct investment, net	117.5	321.9	94.2	424.0	700.2	612.0	300.0
Gross reserves, excluding gold (end-year)	897.7	905.0	1,228.5	1,750.6	2,082.3	1,920.3	na
External debt stock	1,840.5	2,816.9	2,970.6	3,284.4	4,160.8	4,678.3	na
<i>(In months of imports of goods and services)</i>							
Gross reserves, excluding gold (end-year)	4.1	3.3	4.0	4.9	4.5	3.2	na
<i>(In per cent of exports of goods and services)</i>							
Debt service	19.7	12.4	10.2	18.8	15.5	na	na
<b>Memorandum items</b> <i>(Denominations as indicated)</i>							
Population (end-year, million)	2.0	2.0	2.0	2.0	2.0	2.1	na
GDP (in billions of denars)	251.5	265.3	286.6	310.9	354.3	398.6	407.0
GDP per capita (in US dollars)	2,285.6	2,645.2	2,854.0	3,119.4	3,868.1	4,633.1	na
Share of industry in GDP (in per cent)	20.8	19.5	19.6	20.2	21.9	22.3	na
Share of agriculture in GDP (in per cent)	11.4	11.3	10.8	10.8	9.4	9.4	na
Current account/GDP (in per cent)	-4.0	-8.4	-2.7	-0.9	-7.5	-12.7	-11.9
External debt - reserves (in US\$ million)	942.8	1,911.9	1,742.1	1,533.8	2,078.6	2,758.0	na
External debt/GDP (in per cent)	39.7	52.4	51.1	51.5	52.5	49.1	na
External debt/exports of goods and services (in per cent)	105.6	132.4	116.2	109.6	105.4	102.4	na

## **ANNEX 5: ENVIRONMENTAL and SOCIAL ISSUES**

### **5.1. Environment**

FYR Macedonia is located in southeastern Europe in the central Balkan Peninsula. Landlocked, it is bordered by Albania to the west, Bulgaria to the east, Serbia and Kosovo to the north and Greece to the south, representing a major transportation corridor from western and central Europe to the Aegean Sea and from Southern Europe to Western Europe. FYR Macedonia is a member of the United Nations and the Council of Europe; it has been a candidate for European Union membership since December 2005 and has applied to join the NATO. In the environmental arena, although good progress is apparent within horizontal legislation, improvement is still needed in enforcement and administration capacity as the country faces important institutional challenges associated with accession reforms, and significant environmental and social challenges associated with economic growth, namely deforestation, biodiversity conservation and water management.

#### **5.1.1. Environmental and Social Legislation, Policies and International Commitments**

The Macedonian Ministry of Environment and Physical Planning (MoEPP) oversees a comprehensive range of activities related to the safeguard of the flora and fauna and regulation of national parks, bio and geo diversity; the protection of waters, soil and air from pollution; the regulation of waste management, noise and radiation levels, use and ownership of land. The 2000 Law on Organization and Work of the Administrative Bodies arranges the MoEPP into four departments: Regulation and Standardization, Sustainable Development, European Integration and Environmental Information Centre. In charge of technical cooperation, project management and the implementation of bilateral and international agreements, and to ensure FYR Macedonia is aligned with international environmental standards, the MoEPP coordinates the activities of other several state offices namely the State Environmental Inspectorate, the Agency of Environment and the Fund for Environment and Nature Protection and Promotion. Together with the Ministry of Health and the Ministry of Agriculture, Forestry and Water Economy Management, the MoEPP is responsible for the protection of the environment with respect to management of toxic chemicals and their residues, and for drafting relevant legislation, aided by a Committee of Ministries encompassing the Ministry of Foreign Affairs, the Ministry of Finance, the Ministry of Economy and the Ministry of Transport and Communications. The Committee, supported by a technical coordination group, also decides on the allocation of aid according to sectoral strategies and priorities, collecting information for program implementation.

The environmental management process is ruled by both the National Environmental Action Plan (NEAP) and the National Plan for Approximation to the Acquis. The initial NEAP (to cover the period 1997-2001) had identified a series of environmental goals in the areas of institutional enhancement, air and water quality, biodiversity conservation, and forest regeneration. The general environmental National Plan for Approximation to the Acquis (NPAA) was drafted in 2001, and with further sector-specific National Plans being prepared on an annual basis since then, it allowed for an accelerated process of development of an overall Acquis-compliant regulatory framework. The Stabilisation and Association Agreement (SAA) was signed in 2001, though coming into force only in 2004. Immediately after, a National Program for the Approximation of the Legislation (NPAL) was adopted, developing a specific Action Plan for Environmental Legislation Harmonisation to address the transposition of environmental law into domestic laws, enabling municipalities to gradually incorporate

environmental management responsibilities. The NPAL, updated annually, serves as a control mechanism in the legal approximation process identifying progress made. However, even though this process helped significantly to build vertical and horizontal structures for the broad implementation of national and international environmental legislation, it is still imperative that such structures are strengthened and institutional capacity enhanced if international standards are to be met and best practices to be encouraged. The institutional framework is well developed to include inter-ministerial coordination schemes like committees, boards and commissions; although cooperation and distribution of responsibilities between the institutions should be further strengthened.

FYR Macedonia applied for European membership in 2004 and was granted the status of Accession Country in November 2005. At the same time, five major laws were passed aiming at transposing the requirements of EU environmental legislation: (i) the Law on Environment, (ii) the Law on Ambient Air, (iii) the Law on Nature Protection, (iv) the Law on Waste Management and (v) the Law on Water Management. Following on this, subsidiary regulations still need to be developed for a thorough improvement.

Following on the 1997-2001 NEAP, the National Strategy for Sustainable Development (NSSD) was developed in 2008, setting the framework for an economically, socially and environmentally balanced development. On 26<sup>th</sup> May 2009 the NSSD Project Team held a workshop specifically for the Macedonian Media with the objective to present to the public the National Strategy for Sustainable Development, its implications, objectives and consequences. Providing an umbrella for policies and strategies across a variety of fields, the document sets as short-term priorities for the environmental sector the implementation of environmental legislation and the development of environmental investment strategies paired with the strengthening of execution and enforcement institutions. For medium and long term objectives, the alignment of the legislative framework to international standards takes precedence, with the commitment to integrate environmental protection requirements into sector-specific policies and increase environmental infrastructure investments, especially in the area of waste water management, drinking water supplies and air pollution. The National Strategy for Environmental Approximation (NSEA) and the National Waste Management Plan for 2006-2012 are examples of the country's initiative to incorporate international practice into its national environmental legislation through the rationalisation of the process of policy development and the implementation of planning frameworks such as the Millennium Development Goals (MDG). FYR Macedonia's first report on the MDG was launched in June 2005; the government, supported by UNDP and under the lead of the State Statistical Office – responsible for the country's data provision and analysis- developed a strategic institutional framework for monitoring, analysis and reporting on progress towards the achievement of MDGs. Despite these early signs of progress, coordination with civil society still requires significant improvement.

FYR Macedonia is member of international and regional organisations such as the IMF (1992), WHO (1993), Central European Initiative (1993), Council of Europe (1995), OSCE (1995), SECI (1996), WTO (2003), CEFTA (since 2006) and La Francophonie (2001). On the 2008 Bucharest NATO summit the country failed to gain an invitation because Greece vetoed the move after a dispute over its name issue, dispute which is still ongoing.

Regarding international agreements, FYR Macedonia is party to:

- *Air Pollution*: Protocol to the 1979 Convention on Long-Range Transboundary Air Pollution Concerning the Control of Emissions of Nitrogen Oxides or Their Transboundary Fluxes
- *Biodiversity*: Convention on Biological Diversity
- *Climate Change*: UN Framework Convention on Climate Change
- *Climate Change-Kyoto Protocol*: Kyoto Protocol to UN Framework Convention on Climate Change
- *Endangered Species*: Convention on International Trade in Endangered Species of Wild Flora and Fauna (CITES)
- *Hazardous Wastes*: Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal
- *Law of the Sea*: United Nations Convention on the Law of the Sea (LOS)
- *Organic Pollutants*: Stockholm Convention on Persistent Organic Pollutants.
- *Ozone Layer Protection*: Montreal Protocol on Substances That Deplete the Ozone Layer
- *Wetlands*: Convention on Wetlands of International Importance as Waterfowl Habitat (Ramsar)

Other state offices with environmental implications in FYR Macedonia are the Department for Physical Information System, the Administration for Cadastre and Registration of Property, the State Office for Geodesy Affairs with activities related to the measure, cadastre and registering real estates. The Water Economy Department, the Department for Hydro-meteorological Affairs, the State Agriculture Inspectorate, the State Forestry and Hunting Inspectorate, the Port Captaincy, the State Inspectorate for Transport, the State Inspectorate for Civil Engineering and Urbanism and the State Communal Inspectorate all encompass environment-related responsibilities and cooperate closely with the activities of the MoEPP.

### **5.1.2. General Environmental Setting**

#### **Physical**

FYR Macedonia is located in Southern Europe, taking up the central part of the Balkan Peninsula with an approximate area of 25,713km<sup>2</sup> encompassing 25,433 km<sup>2</sup> of land and 280 km<sup>2</sup> of water. A transit path for freight shipment from Greece through the Balkans towards Europe and from Bulgaria to the East, FYR Macedonia depicts a diverse relief structure to include mountains, hills, plateaus, ravines and river valleys. The country's largest ravine is Pelagonia featuring a plain area stretching over 1,570 km<sup>2</sup> but with approximately 45 peaks standing over 2000masl, the Macedonian landscape is predominantly mountainous: its highest point being the Golem Korab (Maja e Korabit) at 2,764masl and the lowest sitting in the Vardar River at 50masl.

Waters constitute approximately two percent of the territory of FYR Macedonia, categorised in (i) underground waters, (ii) river flows, (iii) natural and artificial lakes. Although the country counts with something like 35 rivers and just over 50 lakes (both natural and artificial), water sources are not evenly distributed throughout the country, with the western parts benefiting from bigger supplies. There are two regional water supply systems: Studencica and Lukar. The average daily water consumption is 0.25m<sup>3</sup>/0.35m<sup>3</sup> per inhabitant, although in certain regions consumption needs are not met as the water supply system in FYR Macedonia is still outdated, inefficiency measured with reported losses in volume ranging from 18% to 46%.

The river network belongs to three main flow areas: the Aegean, the Adriatic and the Black Sea. The Aegean is the most important one, feeding major watercourses such as the Vardar and the Strumica rivers. Approximately 6.63bn m<sup>3</sup> of water flow into the river basins at roughly 100 litres per second, with the highest levels occurring in Spring and Autumn. The Hydro-Meteorological Institute is responsible for monitoring water resources, with recent data indicating a significant decrease in rainfall volume: as a result, a shortage in water supply constitutes the biggest concern for water resources together with the industrial pollution of riverbeds. FYR Macedonia is signatory to the Barcelona Convention for Protection of the Mediterranean Sea from Pollution (1976), though enforcement still has a long way to go. The pollution of River Vardar is especially high in Skopje and Veles, mainly from urban sewage systems and industrial plants.

FYR Macedonia features over 50 lakes, both natural and artificial. The three major ones from the tectonic era, the Lake Ohrid, the Lake Prespa and the Dojran Lake, lie on the southern borders and are shared with Albania and Greece. The biggest and most important one is Lake Ohrid, covering an area of 348km<sup>2</sup> (plus 118.9km<sup>2</sup> belonging to Albania) it has a maximum depth of 294m and is considered one of the oldest lakes and biotopes in the world. The second in size is Lake Prespa stretching across 275km<sup>2</sup> (plus 49.4km<sup>2</sup> belonging to Albania and 47.8km<sup>2</sup> to Greece) it has its deepest point at 54m. The third one, Lake Dojran, covers an area of 43km<sup>2</sup>, with the southern portion going across the Greek border. Apart from these tectonic lakes, a number of natural glacier-originated water groups can be found on the mountains, namely the Livadicko Lake, the Bogovinsko and the Karanikolicko on Sar Mountain. The biggest example of artificial waterbeds is the Tikves Lake, with an area of 14km<sup>2</sup>.

Approximately 80% of the country's territory consists of hills and mountains, with an average altitude of 850masl and belonging to two different mountain ranges: the Šar Mountains that stretch to the West Vardar/Pelagonia group, also known as the Dinaric range, with peaks such as the Baba Mountain at 2601masl, the Nidže at 2521masl, and the Jakupica at 2540masl; and the Osogovo/Belasica mountain chain, also known as the Rhodope range. The Šar Mountains and the West Vardar/Pelagonia range are younger and higher than the older mountains that are part of the Osogovo-Belasica group.

According to the WDPA, 8.07% of Macedonia is designated protected area, including three national parks: Galicica, Pelister and Mavrovo, two protected natural areas: Ezerani and Jasen, 14 eco-reserves and 48 natural monuments. The Galičica National Park stretches over 227 KmSq and sits between the two biggest lakes: Lake Ohrid and Lake Prespa, housing a diversity of flora and fauna and many significant cultural monuments, churches and monasteries such as the monasteries of St Naum, St Bogorodica Pestanska, St Stefan and the basilica St. Gorgia. The Pelister National Park is reknown for its uniquely rich in flora and fauna. The Mavrovo National Park, also a popular ski resort has the Mavrovo lake at its epicentre; lieing at an altitude of 1220m, with 12km long and 3km wide, the lake's coast stretches across 24km and measures 48m at its deepest point.

There is one designated UNESCO site in FYR Macedonia: the Natural and Cultural Heritage of the Ohrid Region. Situated on the shores of the namesake lake, the town of Ohrid is one of the oldest human settlements in Europe. Built mainly between the 7th and 19th centuries, it has the oldest Slav monastery (St Pantelejmon) and more than 800 Byzantine-style icons dating from the 11th to the end of the 14th century. After those of the Tretiakov Gallery in Moscow, this is considered to be the most important collection of icons in the world. Submitted to the

tentative list, but yet to be decided, are the Cave Slatinski, Markovi Kuli, and Archaeo-astronomical Site Kokino.

## **Biological**

According to the World Wildlife Federation (WWF), FYR Macedonia belongs to the Illyrian province of the Circumboreal Region within the Boreal Kingdom, and is subdivided into four ecoregions: the Pindus Mountains mixed forests, Balkan mixed forests, Rhodopes mixed forests and Aegean sclerophyllous mixed forests. As a general rule, FYR Macedonia has a rich and diverse flora and fauna, with about 3,700 species of plants, 55 species of fish, 78 species of mammals and 330 species of birds, thanks to its diversity in habitats ranging from forests to fresh waterbeds and plains.

There are 71 Natura 2000 sites identified in the entire country: 25 in Eastern Macedonia, 33 in Central Macedonia, 13 in Western Macedonia. Forests take up an area of approximately 1.000.000ha or 37% of its total territory of the country, consisting specifically of 550,000ha of oak and beech forest, 83,000ha of evergreen forests (Austrian and Scottish pine), 288,000ha of mixed deciduous forests, 8,000 ha of mixed evergreen forest and 47,000ha of mixed deciduous and evergreen forests. Of the 300 types of trees found in this region, 16% are endemic, including very rare ones such as the *Astragalus Cernjavski*, the *Tulipa Marianae*, the *Slavia Jurisicii*, the *Ferulago Macedonica* and the *Sambucus Deborensis*. According to statistics provided by the Ministry of Agriculture, Forestry and Water Management, 9.8% of deciduous forests have dried, especially affected was the oak forest. Similarly, rates for evergreen forests go up to 18%, with special concerns for the white and black pine. The floral life is represented by over 1000 species, of which 11 cannot be found anywhere else in the world. The Pelister National Park is one of the few areas in the world to house the five-needle pine molica (or *Pinus peuce*); other examples are the Pelister pine, the oak, the chestnut. A pathogenic mushroom endangers the survival of the chestnut and so far no measures have been implemented to resolve this issue. Mavrovo National Park has 50 types of vegetation registered and 100 rare species, with sub-mediterranean thermo - xerophilic forests as well as black forests and bushes. The highlands have sub-alp oak forests.

**The RAMSAR Convention on Wetlands came into force in FYR Macedonia in 1991, with currently 2 designated sites with a total surface of 82,062ha.** The Dojran Lake (Dojransko Ezero) is a shallow eutrophic lake in the southeast shared with Greece. The local community employs a unique and ancient fish hunting practice, with its own implements and traditions using birds and reed traps. The lake hosts several endemic species and subspecies of fish as well as 11 endemic invertebrates and many protected bird species: over 100 individual *Pelecanus crispus* are supported every year in the period from November till March. A decreasing water level from over-abstraction is perceived as a potential threat. The **Lake Prespa is a strictly Protected Nature Reserve and Ornithological Reserve.** A Pliocene Lake (2-3 million years old) providing important feeding areas for large numbers of the Pelicans that breed nearby in Greece, the site includes cultivated land, meadows, pastures, reedbeds, and forests. Commercial and recreational fishing and conservation education are the only human activities here, administrated by a functioning visitors' centre.

As far as biodiversity is concerned, FYR Macedonia houses a large number of animal species thanks to its landscape and climate. According to the Law on Hunting, the fauna is diverse, with over 200 species of birds and 45 species of mammals, amongst which the eagle Cruiser, the grey eagle, the forest owl, the meadow owl, the bear, the wild goat, the wild cat, the roe



deer, wolves, chamois, wild boars, rabbits, several species of eagles, partridges, redbilled jackdaws, and the endemic Macedonian Pelagonia trout are worth noting. From all the national parks, Galicica is the area housing the most of the wild life in FYR Macedonia: it features 100 species of animals or 97.1% of the total wild life in the country. Regarding birds, the most dominant families are those of eagles and hawks, with over 15 species, as well as geese swans and ducks, with over 12 species; after that, ravens, storks, and owls follow suit. Most of the forest wild life is now protected, with about 4,000ha designated for breeding wildlife. A total of 64 species (8 furry, 56 feathery species) are protected, amongst which can be found the deer, the roebuck, the chamois, the wild boar, the bear, the wild rabbit, the partridge, the kamewarka partridge, and the pheasant. Amongst wild birds, protection has been granted to the white stork, the black sork, the owl and the cuckoo.

As a general rule, FYR Macedonia features warm, dry summers and autumns and relatively cold winters with heavy snowfall. Natural disasters also occur: the region is seismically active with a tracked history of destructive earthquakes, the last significant one in 1963 when Skopje was heavily damaged by a major quake leaving a toll of over 1,000 deaths. Macedonia's most impending environmental issue is air pollution from metallurgical plants, and in a minor but nonetheless important scale attention should be paid to deforestation, soil erosion and sensitive biodiversity.

## **Human**

FYR Macedonia has a population of over 2m people, of which approximately 20% are under 14 years of age and 10% are 65 or over, with life expectancy reaching 74 years and 1.58 children born per woman. Population density is of 80 inhabitants per square metre, with 67% of the total living in urban areas. The net migration rate is of -0.52 migrant per 1,000 people, as an estimate for 2009.

Ethnic Macedonians form a majority (64.2%), with other ethnic groups to include Albanian (25.2%), Turkish (3.9%), Roma Gypsy (2.7%), Serb (1.8%), other (2.2%). Religious beliefs are equally varied, with statistics indicating Macedonian Orthodox 64.7%, Muslim 33.3%, other Christian 0.37%, other and unspecified 1.63%.

The official and most widely spoken language is Macedonian, which belongs to the Eastern branch of the South Slavic language group, and closely related to and mutually intelligible with Standard Bulgarian. Although it is the only language explicitly designated as an official national language in the constitution, in municipalities where at least 20% of the population is part of another ethnic minority, their individual languages are used for official purposes in local government, alongside Macedonian. The language breakdown shows: Macedonian 66.5%, Albanian 25.1%, Turkish 3.5%, Romani 1.9%, Serbian 1.2%, other 1.8% Turkish, Aromanian, Adyghe and Greek.

## **Climate change**

FYR Macedonia has a transitional climate from Mediterranean to continental, with hot, dry summers and moderately cold winters. The average annual precipitation ranges from 1,700mm in the western mountainous area to 500mm in the eastern area. Three main climatic zones are found: temperate Mediterranean, mountainous and mildly Continental. Along the valleys of the Vardar and Strumica rivers, in the regions of Gevgelija, Valandovo, Dojran, Strumica and Radoviš the climate is temperate Mediterranean. The warmest regions are Demir Kapija and

Gevgelija, with summer temperatures above 40 °C. The mountainous regions feature long, snowy winters and short, cold summers. There are 30 main and regular weather stations in the country.

In early 2009, the World Bank and the government of FYR Macedonia, with grant funds from the Energy Sector Management Assistance Program and the Trust Fund for Environmentally and Socially Sustainable Development, also organised a series of workshops on climate change and the vulnerabilities of the energy sector to consider options for adaptation mechanisms, their costs and benefits. The Climate Change Mitigation Study is a part of the project for preparation of the Second National Communication under the United Nations Convention on Climate Change (UNFCCC). The Research was carried out by team of experts of the Research Center for Energy, Informatics and Materials (ICEIM-MANU) together with experts from other institutions and with coordination of Ministry of Environment and Physical Planning (MoEPP). The Study was conducted with financial support from the Global Environmental Facility (GEF) through the United Nations Development Programme (UNDP).

The conclusions of the document are indicative, concerning the country's mitigation potential, and should be permanently revised taking into account all the relevant occurrences in the national economy. A strategic document of primary importance is the National Strategy for Clean Development Mechanism (CDM) for the first commitment period of the Kyoto Protocol 2008 – 2012. The goal of National CDM Strategy is to facilitate transfer of investment and technologies through CDM for implementation of projects that reduce GHG emissions and contribute to FYR Macedonia's national sustainable development priorities. Despite recent progress in mainstreaming climate change issues, the need to bring it into national planning and policy still stands strong. It is imperative to address adaptation, mainly in the most vulnerable sectors such as water resources, air and water pollution.

The future scenario for FYR Macedonia regarding climate change includes rising average temperatures, increased risk of heat waves, random heavy downpours as well as decreased rates of annual average precipitation, reduction of water resources and pollution of air and water.

### **5.1.3. Areas of Environmental Concern and Priorities**

FYR Macedonia's EU harmonisation program on environmental legislation could become a useful tool to channel reform in order to accelerate improvements, specifically through mechanisms for regular assessment of environmental progress such as the annual updates of the sector-specific national policies. Priority areas include:

*Air quality:* especially in urban areas where pollution is notoriously high. There is no clear sustainable long-term policy for air pollution within government. Existing legislation on industrial pollution is poor and enforcement remains weak.

*Biodiversity conservation and protection:* unstructured urbanisation is adversely affecting ecosystems, further implementation of international agreements and stronger legislation are required to decrease the rate of loss of biodiversity and protect endangered species.

*Institutional Capacity Building:* further efforts are required to strengthen administrative capacity of environmental policy making and enforcement, together with inter-institutional cooperation and coordination.

*Waste Management:* limited progress has been evident on waste management, current disposal methods represent significant environmental and health hazards, and modern systems of waste collection, disposal and recycling processes still do not exist.

*Water Management and Conservation:* although general access to drinking water and water supply systems has improved, surface waters are severely affected by urban, domestic and industrial pollution. Water supplies and sanitation schemes remain seriously outdated.

#### 5.1.4. Environmental Issues Associated with Macedonian Operational Priorities

The Country Strategy identifies four high-level operational priorities of Bank’s activities in FYR Macedonia for the strategic period 2009-2012. The table below identifies in a non-exhaustive manner some potential environmental and social issues associated with each of these priorities:

<i>Priority</i>	<i>Potential Environmental and Social Issues</i>
<i>Infrastructure, energy generation and environmental projects</i>	<ul style="list-style-type: none"> <li>○ <i>Water resource management</i></li> <li>○ <i>Potential biodiversity impacts, with particular focus on fragile areas (mountains)</i></li> <li>○ <i>Lack of capacity to manage land acquisition</i></li> <li>○ <i>Increase in tariffs for basic municipal services and associated affordability issues for the poorest in the population</i></li> <li>○ <i>Undeveloped occupational safety culture</i></li> <li>○ <i>Possible political interferences in public consultation</i></li> <li>○ <i>Lack of participation of ethnic minorities in public consultation and decision making</i></li> <li>○ <i>Inadequate grievance processing mechanisms</i></li> </ul>
<i>Financial sector consolidation/restructuring (TFPs).</i>	<ul style="list-style-type: none"> <li>○ <i>Labour issues such as child labour and minimum wages</i></li> <li>○ <i>Biodiversity loss</i></li> <li>○ <i>Occupational Health and Safety</i></li> <li>○ <i>Gender issues</i></li> <li>○ <i>Lack of capacity in FIs and SMEs to manage environmental, social and labour issues</i></li> </ul>
<i>Direct finance for foreign/local enterprises (SMEs - FDI)</i>	<ul style="list-style-type: none"> <li>○ <i>Lack of capacity in FIs and SMEs to manage environmental, social and labour issues</i></li> <li>○ <i>Biodiversity loss</i></li> <li>○ <i>Occupational Health and Safety</i></li> <li>○ <i>Land acquisition/displacement</i></li> <li>○ <i>Retrenchment in the public services sector</i></li> </ul>
<i>Policy dialogue (new Government to address regulatory, infrastructure shortcomings)</i>	<ul style="list-style-type: none"> <li>○ <i>Strengthening of National Action Plans (eg. Biodiversity, Natural Disaster, Spills Response etc.)</i></li> <li>○ <i>Consultation with civil society, practical implementation of the Aarhus convention.</i></li> </ul>

The Bank will continue to work across a variety of sectors, and where applicable identify areas for environmental enhancement and development opportunities that are in line with the Bank’s priorities. For example EBRD is currently working on a programme of upgrade and rehabilitation for both the regional roads (Tranche 1) and local roads (Tranche 2), with the overall aim of providing urgently needed access to parts of the FYR Macedonia.

All EBRD operations in FYR Macedonia are subject to the Bank’s Environmental and Social Policy (2008) and incorporate, where appropriate, Environmental and Social Action Plans into the legal documentation in order to address issues raised during due diligence, in line with the

Bank's mandate to actively support environmentally sound and sustainable development through its investment projects.

## 5.2. Social Issues

**Human Development, Migration and Poverty.** In the 2007/08 Human Development Report the country is ranked 69<sup>th</sup> out of 177 countries, which is below Bulgaria (56<sup>th</sup>), Romania (62<sup>nd</sup>) and Serbia (65<sup>th</sup>) and on par with Albania (69<sup>th</sup>). The average life expectancy at birth is 72 years for males and 77 years for females, with an average of 74.7 years, around 4 years below the EU average (Source: 2009 CIA World Fact Book). Living standards remain far below those in the EU. In terms of purchasing power parity, GDP per capita is only 25 per cent of the EU average. It has also relatively high regional disparities, with GDP in the capital city Skopje at almost 50 per cent of the EU average, far above the rest of the country. With a gross national income per capita of around USD 4,120 in 2008, the country is classified as a lower middle-income country according to the OECD-DAC classification. The population is relatively young, with an average age of 34.6 years, but the number of elderly persons is increasing.

FYR Macedonia has a relatively significant and longstanding diaspora. Around 370,000 Macedonians are living abroad, which represents roughly 18 per cent of the population (International Organization for Migration, 2007). Main countries of destination are Australia, Switzerland, USA and Germany. Remittances constitute an increasing source of revenue for many families in FYR Macedonia. In fact, according to the OECD the FYR Macedonia is among the top 30 developing countries with respect to the highest remittances received as a percentage of GDP (11th) and with the highest remittances per capita (14th). According to official central bank data, private transfers, which include workers remittances, compensation of employees and migrant transfers (cash exchange), account for around 14 per cent of GDP. According to the World Bank remittances sent through informal channels could add at least 50 per cent to the official estimate. The data on internal migration (movement within the borders of the same region) shows that rural-urban migration within FYR Macedonia is significant, with at least a quarter of the population now living in the capital Skopje.

Social exclusion and poverty are severe problems. According to State Statistical Office data, in 2008 28.7 per cent of the total population lived below the national poverty threshold, defined as having an income lower than 60 per cent of the average revenue of households. According to a recent survey conducted jointly by the UNDP and the South East European University SEEU (*“People-Centred Analyses: Regional Development, Local Governance and the Quality of Life in FYR Macedonia”*, March 2009), the most vulnerable ethnic group are the Roma, with 64 per cent of Roma households living below the income-based poverty line. Analyzed by profiles, the most vulnerable groups are big size households, taking into account that 57.7 per cent of the poor live in households with five and more members. Education is another important determinant of poverty: 56.6 per cent of the poor live in households where the head of the household does not have, or has not completed, primary education. The poverty rate for unemployed people is 38.4 per cent.

**Labour Issues:** The 2005 Law on Labour Relations provides the main statutory framework for employment and labour relations in FYR Macedonia. There is also a 2007 law on occupational health and safety. The Labour Inspectorate is in charge of supervising and enforcing compliance with labour and OHS regulations. Although the number of inspectors was recently increased from 96 to 129, the Labour Inspectorate capacity to ensure proper implementation of

the law remains weak (EU, 2008). Amendments made to the Labour Relations Law in 2008 have met with significant criticism from trade unions, who consider that the amendments provide greater flexibility for employers at the expense of workers' rights, particularly in relation to termination, annual leave and working time (Business Week, 2008). Further legislative reforms are envisaged in relation to the ongoing process of alignment of FYR Macedonia's labour legislation with EU directives; e.g. anti-discrimination law. According to the 2008 EU Progress Report, Macedonian labour law does not effectively regulate all forms of employment. The Slovak Republic is currently providing assistance to FYR Macedonia to harmonise its labour legislation with the *acquis communautaire*. Workers freely exercise their right to form and join trade unions of their choice (US Dept of State, 2008). However, in practice, the social partners are described as weak and lacking of capacity (EU, 2007).

The unemployment rate in the country, at 32.7 per cent, is one of the highest in Europe, even though it has declined in recent years. The unemployment figures are however open to question as they may be inflated by inclusion of people registering as unemployed to get benefits of the health insurance. Among the unemployed, the largest groups are the people with educational level up to primary school (54 per cent) and secondary education (33 per cent), whereas 6 per cent of the unemployed lack a complete primary education (UNDP, 2008). About 20 per cent of the unemployed are between 15 and 24 years old. Ethnic minorities (especially Roma) can mostly be found in the informal economy in low-paid jobs where they do not benefit from the protection of labour legislation. When they do access the labour market they face both discriminatory working conditions and rates of pay (Amnesty, 2008). Unemployment in the Roma community is estimated at more than 70 per cent, reaching 95 per cent in some areas (ERRC, 2006).

There is a persistent gender wage gap across all sectors: on average, men earn 25 per cent more than women (World Bank, 2008). Labour force participation rates among women are amongst the lowest in the ECA region and female rates have remained flat since 2004 at around 56 per cent (World Bank, 2008). Among the reasons for female inactivity, household responsibilities are the most important. However, this proportion varies by educational level. In fact, 68 per cent of women having primary or less education are out of the labour force due to household responsibilities, while the same share is only 21 per cent among women having higher of university education. Rural women and ethnic minority women (Roma and Albanians) are particularly vulnerable, facing discrimination on the grounds of both gender and ethnicity (CEDAW, 2006). According to an ERRC survey (2008), nearly half of all Romani women experienced open discrimination when applying for jobs. Child labour is still an issue, especially in the Vardarski region, where child labour rates are considerably higher than in the rest of the country (15 per cent).

**Education.** FYR Macedonia has accomplished much in the realm of primary school enrolment. In 2005, its net enrolment ratio (NER) was 92 per cent, which is higher than all the countries in the Caucasus and the third highest in South-eastern Europe after Albania and Bulgaria. Its gross enrolment ratio (GER) is 98 per cent. FYR Macedonia has achieved gender parity in primary school enrolment, making it one of the three countries in the CEE/CIS region to have done so. However, the government has not been as successful in increasing enrolments in pre-primary, secondary and tertiary education. The net attendance rate for pre-primary school is 11 per cent, which is among the lowest in the region and comparable to enrolment rates in Central Asia and the Caucasus. Only 3 per cent of the population is enrolled in tertiary education and this figure has not changed since 1999. Despite high national averages, there are large gaps in educational access and enrolment between sub-national groups. The most notable

differences are between the country's richest and poorest income quintiles, between those living in urban and rural areas and between Macedonian and Roma ethnicity groups. In primary school, ethnic inequities are the most pronounced, with Macedonian children two thirds more likely to attend than Roma children.

The current government has pledged to increase total expenditure, and as of 2009, total expenditure in the sector is close to 6 per cent of GDP, which is an increase from the 2005 rate of 3 per cent and higher than the regional average. Education is one of the four strategic priorities stated in the National Programme for the Work of the Government, 2008-2012. Initiatives supported by the government include measures such as (i) extending the duration of compulsory primary education from eight to nine years for all children from 6 to 15 years of age, (ii) implementing "computer for every child" project; (iii) constructing new schools and physically rehabilitating old schools; (iv) introducing matura exams at the end of secondary education; and (v) introducing religious education/history of religions as optional subjects in grade six and ethics as a compulsory subject in grade six. FYR Macedonia inherited from Yugoslavia two universities, one in Skopje and one in Bitola, both with a wide range of departments. In February 2004 the Tetovo University was legalised, which means that the university which offers tuition exclusively in the Albanian language now receives state funding along with the Macedonian-language universities in Skopje, Bitola **and Stip. The latter was founded in March 2007 as the fourth state university. It includes 13 Faculties with 500 members of staff, academics and teaching assistants, serving more than 9000 students.**

**Health.** In the 1980s the state had provided a guaranteed and comprehensive healthcare service, which on paper continues. But, in reality, the quality of healthcare has deteriorated since independence due to an acute lack of funds and shortages of medical supplies. Compared with the private sector, the medical service is seriously underpaid, and free health insurance for the unemployed plays a central role in explaining the high share of non-active jobseekers among registered unemployed. In recent years, however, advances were made in strengthening the finances and operations of the Health Insurance Fund and Ministry of Health. According to the World Bank, health system revenues rose by around 18 per cent from 2003 to 2007, and the obligations of the public health sector fell from 1.7 per cent of GDP at end-2005 to 0.5 per cent in September 2008.

The country is on track to achieve the MDGs in regard to health. There is a positive trend with regard to reducing child mortality (the under-five mortality rate is 17 per 1,000 live births) and the maternal mortality rate is decreasing, but most health-related indicators are still far below the EU average. The adult HIV prevalence rate remains below 0.1 per cent – the lowest reported number in South Eastern Europe. However, disparities in access to basic primary health care services remain wide between urban and rural areas and among different socio-economic and ethnic groups, with very limited access among the Roma population. Also, the country has the highest perinatal mortality (defined as still births and newborn deaths occurring within first 7 days after delivery) in Europe, with 16.8 per 1,000 births against the European Union average of six.

## ANNEX 6: BANK'S TECHNICAL COOPERATION PROJECTS 2006 – 2009

Commitment Name	Euro Committed	Euro Disbursed	Fund Approved	Commit. Stage	Sector
Skopje Water/Wastewater Rehabilitation Project	141,950	141,950	07/02/06	Closed	Local Authority Services
Republic of Macedonia: MEAP -Supervising Engineer and Project Manager	113,633	113,633	09/05/06	Closed	Local Authority Services
Social Protection against Energy Poverty	140,212	140,212	31/05/06	Closed	Energy
FYR Macedonia: Consulting Services for Implementation of Management and Financial Procedures and Systems for Air Navigation System	248,750	235,814	18/08/06	Disbursing	Transport, Storage
TAM - Ading AD	8,428	8,428	30/11/06	Closed	Manufacturing
TAM - IGM Trade	2,443	2,443	20/12/06	Closed	Manufacturing
TAM - Tikves	8,040	8,040	14/02/07	Closed	Manufacturing
EAR Visibility Event in FYR Macedonia	20,401	20,379	14/02/07	Disbursing	Manufacturing
TAM - Ting Doool	76,116	59,834	14/02/07	Disbursing	Manufacturing
TAM - Mlin Stojcev AD	64,116	58,934	14/02/07	Disbursing	Manufacturing
TAM - 11 Oktomvri	58,116	45,343	15/02/07	Disbursing	Manufacturing
Macedonia Regional Roads Project : Lender's Monitoring Consultant	99,750	87,359	20/02/07	Disbursing	Construction
MEAP-Supervising Engineer and Project Manager	39,917	39,917	05/06/07	Closed	Local Authority Services
TAM - INEX Gorica A.D.	43,116	40,903	12/07/07	Disbursing	Manufacturing
TAM - Dekon AD	35,316	34,705	18/07/07	Disbursing	Manufacturing
TAM - PI BLAGOJ GJOREV AD	59,116	47,736	18/07/07	Disbursing	Manufacturing
TAM - EAR FYR Macedonia Conferences and Seminars	21,025	19,961	20/07/07	Disbursing	Manufacturing
TAM - Fatina	49,116	47,269	31/07/07	Disbursing	Manufacturing
TAM - Mebel Injenering	24,116	21,757	31/07/07	Disbursing	Manufacturing
TAM - Rade Koncar Contractors & Relays	49,116	46,480	31/07/07	Disbursing	Manufacturing
TAM - MZT Pumpi	56,616	49,328	16/08/07	Disbursing	Manufacturing
TAM - Mlekara Zdravje Radovo	32,316	30,486	24/08/07	Disbursing	Manufacturing
TAM - S & V Shoes	41,304	37,855	18/09/07	Disbursing	Manufacturing
TAM - Frotirka	49,116	40,682	06/12/07	Disbursing	Manufacturing
MEAP - Implementation Assistance for Wastewater Treatment Plant in Kumanova	49,690	49,690	20/03/08	Closed	Local Authority Services
FYR Macedonia: Training for TFP Factoring	35,000	0	23/04/08	Committed	Finance, Business
TAM - Vitalia	49,960	23,640	05/08/08	Committed	Manufacturing
Continuation of the BAS Programme in FYR Macedonia	465,794	194,523	19/09/08	Disbursing	Manufacturing

Commitment Name	Euro Committed	Euro Disbursed	Fund Approved	Commit. Stage	Sector
FYR Macedonia: Environmental and Social Analysis for ASR	48,405	0	10/12/08	Committed	Transport, Storage
TTK - Institution Building - EXTENSION	195,000	0	04/03/09	Committed	Finance, Business
TTK - Institution Building - EXTENSION	195,000	0	04/03/09	Committed	Finance, Business
Bitola TPP - Technical Audit and Project Review for Rehabilitation and Performance	49,990	0	11/03/09	Committed	Energy
Implementation and Supervision consultant for the Regional and Local Roads - SSF portion	750,000	0	12/05/09	Committed	Transport, Storage
Assistance to ASR for implementation of the new Law on roads	750,000	0	12/05/09	Committed	Transport, Storage
Implementation and Supervision consultant for the Regional and Local Roads - WEBF Portion	750,000	0	13/05/09	Committed	Transport, Storage
Assistance to ASR for implementation of the new Law on roads - WEBF Portion	750,000	0	13/05/09	Committed	Transport, Storage
<b>TOTAL:</b>	<b>5,570,984</b>	<b>1,647,301</b>			
<b>Number of Commitments:</b>	<b>41</b>				

Commitment by sector	EUR committed	EUR disbursed
Local Authority Services	345,190	345,190
Finance, Business	425,000	0
Construction	99,750	87,359
Manufacturing	1,213,687	838,726
Transport, Storage	3,297,155	235,814
Energy	190,202	140,212
<b>TOTAL:</b>	<b>5,570,984</b>	<b>1,647,301</b>



## **ANNEX 7: MULTILATERAL and BILATERAL ASSISTANCE**

### **1. MULTILATERAL ASSISTANCE**

#### **European Union**

Over the past decade, The EU has delivered substantial support to FYR Macedonia through various programmes such as European Commission Humanitarian Aid (ECHO), Obnova, Programme of Community aid to the countries of Central and Eastern Europe (PHARE), the Emergency Response Programme and the Community Assistance for Reconstruction, Development and Stabilisation (CARDS). The EU also involved macro-financial assistance in the form of balance-of-payments support. The total assistance of the EU to the country since 1992 amounts to more than EUR 870 million. The CARDS programme has been based on a strategic approach in support to the Stabilisation and Association process.

#### CARDS

The EU's main institution for managing assistance in the region – the European Agency for Reconstruction (EAR) has been efficiently delivering substantial amount of assistance since the start of its operations in 2002. The EU assistance portfolio managed by the Agency in the country amounts to some EUR 326 million. By the end of 2007, more than 97 per cent of this amount has been contracted and more than 83 per cent disbursed. EU assistance has been delivered within four priority areas: Democracy and the rule of law, Economic and social development, Justice and home affairs and Environment and natural resources.

Assistance in the area of democracy and the rule of law has contributed to sound implementation of the Ohrid Framework Agreement, which stipulates equitable representation of the country's ethnic communities in the public administration and aims at transferring responsibilities to local self government units. EU support to the public finance and harmonisation of administrative structure has improved the public accountability and its planning capacities.

In the field of economic and social development, pre-accession assistance through capacity-building in key institutions and the substantial support to SME sector helped to improve the investment climate. Assistance to the rural sector has led to improved capacities within the administration regarding policy development. Through infrastructure projects water supply and sewage systems were improved, while roads and border crossing were upgraded.

In the field of justice and home affairs, EU assistance contributed to strengthening the judiciary capacities and structures. CARDS assistance resulted in an enhanced police reform process, improved policing capacities as well as increased border security.

EU assistance in the area of environment resulted in further approximation of national legislation to EU standards. Environmental investments in the water and waste water management reduced pollution.

#### Instrument for Pre-Accession Assistance (IPA)

The IPA 2007 National Programme on transition assistance and institution building aims at supporting the acceleration process in the field of democracy and the rule of law. The

programme provides support to the police reform, as well as the revision and implementation of the Public Administration Reform Strategy. It will also provide support to the Judicial Reform and further capacity building for decentralised management of EU funds. Local infrastructure support is also envisaged with the programme to improve long term development prospects and social cohesion in the country.

With the Acquis related activities, substantial support will be given to the tax administration and the regulatory bodies, in particular in the insurance and the energy sector. Activities will also be undertaken to improve statistics in line with the EU standards, to align national customs legislation with the Acquis and reinforcement of border control.

Under IPA Component II, assistance to Cross Border Cooperation is granted within the multi-annual programme.

For the period 2007 – 2013, assistance will be provided through a new single instrument for Pre-Accession Assistance (IPA), covering five components: 1) Institution Building; 2) Cross-border Cooperation; 3) Regional Development; 4) Human Resource Development and 5) Rural Development. The Commission has planned EUR 210.4 million for the period 2007-2009. In addition, the country will benefit from the IPA multi-beneficiary programme. IPA management will be assumed by the European Commission (EC) with the essential role to be played locally by the Mission and the country's authorities.

In February 2009, EU and the Macedonian government signed the following three financing agreements. The National Programme for 2008 under IPA, Transition Assistance and Institution Building Component aims at providing assistance for political and socio-economic criteria, ability to assume the obligations of the EU membership and support to programming and participation in community programmes and agencies. The maximum amount of EU contribution shall be EUR 37.1 million. The global objective of the Cross-Border Programme with Greece is to enhance convergence in the border area by promoting sustainable local development. The programme will also devote resources to common actions of actors of both sides of the border for the protection and promotion of environmental resources and the natural and cultural potential. For the first three years of the programme, the EU has allocated EUR 3.6 million for projects in certain regions of FYR Macedonia. The Multilateral Cooperation within SEE Region programme has twofold objectives: to support the participation of partners from candidate / potential candidate countries in joint trans-national cooperation activities with partners from EU member states and to familiarise potential candidate countries with territorial cooperation programmes under the EU Structural Funds in view of their implementation upon accession. The entire territory of FYR Macedonia is eligible to this programme with fixed funding for 2008 of EUR 453 thousand.

The EC is one of the largest donors to the TAM / BAS programmes.

### **The World Bank Group / IFC**

FYR Macedonia has been a member of the World Bank Group (WB) since 1993. To date, the WB has granted loans to FYR Macedonia totalling USD 1 billion and mobilised grants totalling USD 170 million. The largest portion of investments was made in the Transport sector. The WB and the Bank co-financed the Regional and Local Roads Rehabilitation Project with EUR 70 million and EUR 50 million invested respectively. With the Railway Reform Project, The WB supported the restructuring of the railway sector, including separation of

Macedonian railways into operating and track companies and establishment of a transparent process to provide public subsidies for uneconomical passenger routes. The second Trade and Transport Facilitation in SEE Project aims at improving trade with the neighbouring countries in SEE, through removal of selected border-zone bottlenecks. It also aims to improve the efficiency and quality of road and rail services along the Corridor X.

Other sectors financed by the WB in FYR Macedonia include Agriculture, Social sector, Health, Education, Energy and Business Environment. The WB lending programs in the country focus on competitiveness, business environment, infrastructure and human development.

The WB financing for the Energy sector is focused on strengthening transmission and dispatch as well as improving the efficiency of the Macedonia transmission company MEPSO. Another project in this sector is the Sustainable Energy Project financed by GEF that assists in developing a sustainable market for energy efficiency and renewable energy through the development of an enabling framework, institutional capacity and financing mechanisms.

With its other active programmes in the country, the WB has engaged in policy dialogue focused on public sector reform agenda and business environment; supports the completion of the real estate cadastre and securing the land and real estate titles; improving enforcement of commercial legislation and upgrading court infrastructure; improving business entry, operations and exit and enhancing the competitiveness of the enterprise sector; as well as aims at improving the delivery of government assistance to the agricultural sector in a manner consistent with the EU's pre-accession requirements.

### *IFC*

To date, the International Finance Corporation (IFC) had invested USD 69 million in FYR Macedonia. Most of the investments were made alongside the Bank. In 2008, the Bank and the IFC co-financed the loan to EVN Macedonia with EUR 35 million each.

In addition to its investments, IFC has several ongoing advisory services programs. The Alternative Dispute Resolution Program aims at reducing the contract enforcement time, providing improved access to justice, increased trust in judiciary, improved business environment and investment climate.

IFC also has a programme in the solid waste management, which aims to develop and implement environmentally sound PPP projects in solid waste disposal and management. The program's objective is to support municipalities in designing economically profitable, environmentally and socially responsible projects that would attract the private sector.

The Corporate Governance Program has an objective to improve corporate governance practices and contribute towards creation of corporate governance culture.

The International Standards and Regulatory Program aims at improving public awareness build local consultants' skills and introduce the International Technical Standards and Regulations in selected export oriented companies.

## **European Investment Bank**

The European Investment Bank (EIB) started its operations in FYR Macedonia in 1998 with the signing of the Protocol for financial cooperation, according to which EIB started granting credits to FYR Macedonia on a sovereign basis.

As of 15 September 2009, EIB's has signed exposure to FYR Macedonia amounts to EUR 239 million in the transport (road), energy (transmission) and SMEs (through selected financial intermediaries).

Most recently, in June 2009, EIB approved a EUR 100 million loan to the Macedonian Bank for Development Promotion to support SMEs and large companies in the fields of knowledge economy, energy and environment protection.

Over the past Strategy period, EIB also provided two loans to NLB Tutunska Banka of EUR 10 million each, one in November 2006 and one in August 2008.

EIB's target sectors for the future include transport, energy, health, SMEs and municipal financing with possible commitments in the range of EUR 150 – 200 million.

## **International Monetary Fund**

FYR Macedonia joined the International Monetary Fund (IMF) in December 1992. Since the adoption of the last EBRD country strategy in July 2006, FYR Macedonia did not have a new arrangement with the IMF. The last Stand-by arrangement approved in August 2005 was finished in August 2008.

The IMF currently does not have an arrangement with FYR Macedonia. As such, there are no committed funds. The IMF supports several ongoing technical assistance projects, among which projects on revenue collection (with the Public Revenue Office) and public financial management (with the Ministry of Finance). In addition, the IMF stands ready to support the government, requested.

## **2. BILATERAL ASSISTANCE**

### **USAID**

FYR Macedonia is an important strategic partner to the United States. Since 1993, USAID has worked with the Government, the private sector, and educational institutions to further FYR Macedonia's transition to a stable and prosperous democracy. Through USAID, the US has invested nearly \$500 million in programs that have reduced corruption, created new jobs, and improved the quality of education.

The following priority areas are in the focus of the support through the USAID Program:

- *Accelerated Economic Growth* (The strategy is two-fold – to work on the macroeconomic level to improve the business environment and investment policy, while assisting industry sectors with increasing their competitiveness and productivity);
- *Democracy and Good Governance* (The focus of the USAID democracy assistance, as the country moves forward, is on helping Macedonia to prepare for the EU and NATO accession. In more recent years efforts are put into combating corruption, enhancing

democratic political competition, supporting government decentralization and promoting rule of law);

- *Education for a modern society* (The main goal is improving the quality of education, to ensure that youth are equipped with knowledge and skills that will help foster economic growth and improve the country's prospects for EU membership. The programs address all levels of the educational system.), and
- *Peace and Security*.

## **Germany**

The development cooperation between FYR Macedonia and the Federal Republic of Germany began in 1992. In 2007, Germany pledged EUR 14.5 million for a two-year period, of which EUR 10 million for financial cooperation and EUR 4.5 million for technical cooperation. The use of funds was focused on the following priority areas: drinking water supply, waste water treatment and waste disposal; democracy and civil society and sustainable economic development.

Germany also supports the EU's IPA to promote modernisation of FYR Macedonia and assist it in its accession to the EU.

The main focus of the sustainable economic development programme is on promoting SMEs by providing long-term funding through the MBDP.

The bilateral and multilateral development cooperation of the Federal Republic of Germany is also provided through the German Development Bank (KfW), responsible for the financial cooperation and the German Investment and Development Company (DEG), which promotes private enterprise initiatives in developing and transition countries and GTZ, that is responsible for the technical development cooperation.

### KfW

To date, KfW provided financial and technical support to FYR Macedonia with total amount of EUR 111.4 million. KfW's financial support to FYR Macedonia focuses on democratisation, environmental protection and the promotion of SMEs. In the period 2000 to 2007, KfW extended EUR 22 million funding to MSMEs through local banks. In addition, KfW provided TC for training local banks totalling EUR 3.1 million.

KfW is also active in the energy sector. in advanced stage of preparation of the project for the Rehabilitation of Six Power Plants, where the investment would be about EUR 27 million.

### GTZ

FYR Macedonia is a priority partner country of the German Development Cooperation. The GTZ's role in FYR Macedonia focuses on the following priority areas: (1) economic reform and development of the market system; and (2) promotion of democracy and civil society. Within these priority areas, GTZ has financed provided technical cooperation to support the FYR Macedonian government in harmonising laws with the EU legislation, provide supporting the Secretariat for European Affairs, investment and export promotion, build up PPP knowledge and experience, and harmonising the technical standards in the country with those of the EU.

## **Italy**

The Italian Development Cooperation (IDC) has been present in FYR Macedonia since 1999. Total development aid provided up to 2008 was approximately EUR 50 million.

The focus of the IDC in FYR Macedonia was on sectors with significant economic and social importance, such as:

- health (modernization of the health system and equipment, rehabilitation of hospitals, prevention from drug abuse);
- water and environmental protection (water supply, waste water and municipal waste management, environmental protection of Radika River valley, support to the Ministry of Environment);
- agriculture (credit line through the IFAD for the food supply chain actors);
- decentralization (particularly in the field of culture and education) and
- support to SMEs (credit line for commodities and services from Italy, promotion of trade and business cooperation between Italian and FYR Macedonian companies).

In 2009, the Italian government provided EUR 4.3 million for the development cooperation with FYR Macedonia with the focus remaining on the same sectors.

In the period 2010 to 2012, the Italian government bilateral cooperation with FYR Macedonia will include two environmental projects.

## **Japan**

With the aim of supporting the EU accession process of FYR Macedonia, there are three priority areas of assistance from Japan: (1) Support for Transition to a Market Economy; (2) Peace Consolidation and Human Security; and (3) Environmental Preservation.

*The Embassy of Japan* mainly provides assistance in the area of Peace Consolidation and Human Security through a scheme of “Grant Assistance for Grassroots Human Security Projects (GGP or AGRP)”. GGP Assistance provides small fund for local-self government units, NGOs, schools and hospitals to implement projects such as purchasing equipment, refurbishing/renovation or construction of new premises.

*The Japan International Cooperation Agency (JICA)* mainly supports two areas through several schemes: Support for Transition to a Market Economy, particularly Private Sector Development, and Environment Conservation Preservation (Water and land pollution control and improving the water supply and wastewater treatment). Technical Cooperation in these assistance areas will continue for next few years as well as organizing training courses in Japan.

Following the merger between JICA and JBIC in October 2008, the Yen-Loan assistance is now incorporated into the JICA scheme. The ongoing Zletovica Basin Water Utilization Improvement Project is now a part of the Environment priority area.

## **The Kingdom of the Netherlands**

The Netherlands has maintained close relations with Macedonia since Macedonia's independence in the early 90's, as one of the biggest donors in the country. Until 2008, the Netherlands has donated EUR 195 million, of which EUR 102 million were for the macro support.

An intensive development cooperation program with FYR Macedonia has existed since 1994, but is currently being phased out since the country graduated from being an ODA (Official Development Assistance) eligible partner to a middle income country with which the Netherlands will have a broad relationship using non-ODA financial means. The development cooperation will end on December 31<sup>st</sup>, 2010.

The cooperation will continue with the Dutch bilateral EU pre-accession funds and Dutch constituency funds. The future partnership will be focused on strengthening good governance in the field of democratisation, rule of law, public finance management and gender, trade and economy, defence and public diplomacy and culture.

The remaining ODA budget for 2009-2010 for Macedonia is approximately 15 mil euros, which is allocated for ongoing programmes and projects in the field of good governance, education, private sector development, gender issues and culture.

The Kingdom of Netherlands is an important donor to the TAM/ BAS programmes.

## **Switzerland**

Switzerland assistance programmes implemented since 1992 by both the Swiss Agency for Development and Cooperation (SDC) and the State Secretariat for Economic Affairs (SECO) have contributed to the transition process of FYR Macedonia. Cooperation Strategy 2009-2012 is focused on two main domains of intervention: i) the Rule of Law and Democracy and ii) Water and Environment.

The assistance in the Rule of Law and Democracy domain are targeting: democracy (strengthening the accountability to citizen and civil society) and policy (work with national and local authorities). Contributions to dialogue and networking (interethnic, inter-municipal, international) raise the outreach of the programme.

Switzerland has been very active and will continue to be active in water and waste water management. Assistance in these domains targets the policy formulation and investment, both material and human, to implement policies. Education and awareness building activities aim at ensuring the sustainability of results achieved.

The principles of good governance (accountability, participation, transparency, non-discrimination and efficiency), including interethnic relations, are taken into account at the level of planning and monitoring of all projects and programmes.

A key principle in relation to gender is addressing structural inequalities and unequal power relations.

## **ANNEX 8: TAM/BAS in FYR MACEDONIA**

The Turn Around Management (TAM) and Business Advisory Services (BAS) Programmes are two EBRD's complementary schemes aimed at helping enterprises adapt to the demands of market economy, develop local MSME and business advisory services sectors.

While TAM has a broad approach focusing on substantial managerial and structural changes within companies, BAS supports more narrowly defined projects with a rapid payback. Generally, areas of TAM/BAS assistance include restructuring of businesses, improving products, reducing operating costs, advising on local and export markets and helping to develop business planning skills of management. Hence, TAM/BAS promotes economic transition by combining direct, targeted assistance to the private sector with systemic market development interventions. Thereby TAM/BAS works towards enterprise and management change as well as the development of a sustainable infrastructure of business advisory services.

The overall planning, programming and implementation of the TAM/BAS Programme is managed and controlled by the TAM/BAS Programme Team, a unit of the Banking Department, based in EBRD's London headquarters.

### **TAM/BAS in FYR Macedonia**

Since inception, TAM has undertaken a total of 37 projects in FYR Macedonia, one of which is still in progress, with four enterprises at the evaluation stage. TAM has worked with enterprises of varying size, but especially with medium-sized enterprises, many with a large turnover. There has been a wide geographic dispersion of projects, with almost two in three projects being undertaken outside the capital, Skopje. Of projects fully completed, 93% have been rated satisfactory or better. What has been identified as a key factor for TAM project success has been the degree of willingness and eagerness of the staff of assisted enterprises to learn from the TAM team.

Since inception in June 2002, BAS in FYR Macedonia has undertaken a total of 393 projects, engaging 174 consultants – 92% of which were local. From the completed projects, 270 have been internally evaluated by the BAS Team in FYR Macedonia. The evaluation analysis shows that 95% of the evaluated projects were rated as “Highly successful” or “Successful”. These projects have encompassed a wide range of industries, with a focus on Food/Beverages, and Construction/Engineering. More than half of the projects have been carried out outside the main cities. The projects are individually tailored for each company but most have targeted Quality Management & Certification and Engineering Studies. The most common cross-cutting objective has related to environmental issues and energy efficiency.

### **TAM/BAS Linkages with Banking**

Some of the TAM/BAS assisted projects go on to become EBRD investments. As TAM/BAS usually works with MSMEs, not all of them can absorb the EBRD minimum investment amount. However, a TAM intervention often helps to grow companies and acquire the professionalism in management as well as corporate and business planning that is necessary to attract external finance.

MSMEs in need of finance with local financial institutions can be supported by the Western Balkans and Croatia SME Finance Facility and LEF LEF. This strengthens the Bank's impact



in the enterprise sector and in the financial sector, as outlined in this Strategy. To date, 7 TAM/BAS assisted companies in FYR Macedonia have attracted investments of EUR 26.4 million from the EBRD of which EUR 11 million through the EBRD Local Enterprise Facility.

### **The MSME and the Consulting Sector in FYR Macedonia**

MSMEs operate in an improving, yet challenging business environment. There are very few large enterprises in FYR Macedonia. Micro and small businesses are often family owned and managed. They lack a sufficient capital base and management experience, which makes them rather vulnerable and hardly suitable for business and employment growth. MSMEs are concentrated in the capital, Skopje. The MSME sector is characterised by low export penetration and low business sophistication.

There is a strong need for business advisory services yet a lack of awareness of the potential benefits. A change in attitude vis-à-vis external advice would be beneficial for Macedonian businesses in order to become more competitive. Introduction of quality and environmental standards is already well advanced, due to legislation making ISO 9000 (quality management system), ISO 14000 (environmental management system), HACCP (food) and IPPC (environment) compulsory. Capacity building is particularly important in the ‘non compulsory’ areas of commercial partner search, HR management, management and marketing skills and long-term planning. In terms of sectors, external advice is particularly important in the export-oriented sectors, food processing, tourism, pharmaceuticals and IT.

### **TAM/BAS future activities in FYR Macedonia**

The main impediments faced by Macedonian MSMEs, which will be addressed in the Strategy period by the TAM, relate to poor management skills (operational, organizational, human resources, marketing), deficiencies in long term business planning, and a lack of exposure to international best practices.

In terms of sectors, textiles, food processing, automotive and car-parts industry, metals, construction and pharmaceuticals would benefit from international industrial expertise, especially when it comes to technological know-how. Companies especially need assistance with export promotion and quality management and certifications. TAM will continue its regional scope beyond the capital Skopje where management advisory services are not available.

The main impediments faced by Macedonian MSMEs, which could be addressed in the Strategy period by BAS, relate to: basic business skills in order to ease access to finance (business planning, presenting financials), management culture (need for HR management, general corporate governance and integrated management systems more advanced than ISO), partner search, foreign investment consulting, marketing (packaging, labeling), and long term strategic planning.

BAS grant support will remain a key component of BAS assistance, thus helping financially constrained enterprises to access consultancy services. A Grant Guideline Matrix will be used to prioritise intervention and avoid duplication of efforts from international donors. Grants will be used based on the following principles: (i) *Size of enterprise*: with smaller enterprises receiving a higher proportion of grants comparing to bigger enterprises’, (ii) *Type of advisory service*: Higher grants will be given to support projects involving consultancy services where

market supply is less mature, particularly in the areas of environmental management and food safety (HACCP, Euro Gap, ISO 22000), and (iii) *Cross-cutting issues*: Higher grants will be allocated to enterprises in rural areas and those with a high percentage of women in their labour force.

TAM/BAS assistance will also be complemented by strengthened market development activities to (i) increase its visibility and promote its activities and outcomes,; disseminating information on business advisory services and best practices via booklets and other publications; (ii) focus SME and consultancy training on capacity building for consultants, including by extending their skills into new product areas and establish their track record with the help of initial BAS projects; and (iii) support and develop existing local institutions through, inter alia, formal to international accreditation schemes for consultants.

There is a potential need for TAM to concentrate on measures that increase energy efficiency and environmental management given that enterprises need to comply with the EU IPPC Directive (Integrated Pollution Prevention and Control) by 2014. Beyond mere compliance with directives and standards, there is need for BAS to furthermore encourage long term strategic planning and development taking into account EU environmental standards and regulations.

Reaching areas outside of the capital should remain a high priority for TAM/BAS. Rural development initiatives have the potential to further both development outside Skopje and to exploit FYR Macedonia's potential in industries related to agriculture (especially food-processing). MSMEs in regions in the East, where the textile industry is concentrated, appear to be in need of donor assistance to improve quality, promote exports and compete with imports. In the West, where industrial activities tend to gather, enterprises need assistance with meeting international requirements for export and pollution and in promoting their products as exports.

TAM/BAS also has a role in devoting efforts to supporting women entrepreneurs and encouraging women's access to middle management and executive positions primarily by the continuation of targeted initiatives.

### **TAM/BAS contribution to EBRD policy dialogue**

TAM/BAS also has a role in strengthening the EBRD's policy dialogue toolkit. Future challenges for the government (among others) are identified as enhancing the protection of investors, implementing intellectual property rights, reducing burdensome social contributions for employers, reducing the grey economy, improving infrastructure and enhancing inter-ministerial cooperation as well as dialogue between the government and businesses.