



Republic of Macedonia

ECONOMIC REFORM PROGRAMME

2017

January 2017

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ABBREVIATIONS

BC	border crossing
BEER	behavioural equilibrium exchange rate
CBA	Cost benefit analysis
CEB	Council of Europe Development Bank
CEFTA	Central European Free Agreement
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EFTA	European Free Trade Association
EIB	European Investment Bank
ENER	National Electronic Registry of Regulations
ERD	Equal regional development
ERP	Economic Reform Program
ESA	European System of Accounts
ESARM	Employment Service Agency of the Republic of Macedonia
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FDI	Foreign Direct Investment
FITD	Fund for Innovations and Technology Development
GDP	Gross domestic products
GS	Government Securities
ha	hectare
IEP	Individual Employment Plan
IIP	International Investment Position
IMF	International Monetary Fund
IPA	Instrument for pre-accession assistance
IPA TAIB	IPA Transition Assistance and Institution Building Component
IPARD	Instrument for pre-accession assistance for Rural Development
IT	Information Technology
KfW	Kreditanstalt für Wiederaufbau – German Development Bank
km	Kilometer
MAFWE	Ministry of Agriculture, Forestry and Water Economy
MEPSO	Electricity Transmission System Operator
MISA	Ministry of Information Society and Administration
MoF	Ministry of Finance
MR	Macedonian Railways
MTBF	Medium- Term budgetary framework
MTEF	Medium-Term expenditure framework
NBRM	National Bank of Republic of Macedonia
NEER	Nominal Effective Exchange Rate
NQF	National Qualifications Framework
NTTO	National for Technology Transfer Office
OECD	Organisation for Economic Co-operation and Development
OTC	Over the counter
PEFA	Public Expenditure and Financial Accountability
PFM	Public Finance Management
pp	percentage point
REER	Real Effective Exchange Rate
RIA	Regulatory Impact Assessment
RM	Republic of Macedonia
ROE	Return on equity
ROA	Return on assets
SEE	Southeast Europe
SIGMA	Support for Improvement in Governance and Management
SMEs	Small and medium-sized enterprises
SS	Substation
SSO	State Statistical Office
TFP	Total factor productivity
TIDZ	Technological Industrial Development Zones
UNIDO	United Nations Industrial Development Organization
VAT	Value Added Tax
VET	Vocational Education and Training
WB	World Bank
WBIF	Western Balkans Investment Framework
WTO	World Trade Organization

INTRODUCTION

As a candidate country, Republic of Macedonia has prepared a total of 9 programs so far, 7 Pre-Accession Economic Programmes and 2 Economic Reform Programmes.

The European Union introduced a new approach to the economic governance in the Enlargement Strategy as of October 2013, becoming the key pillar in the enlargement process. Main objective of this approach is to help the enlargement countries tackle the economic fundamentals first and meet the economic accession criteria.

New approach to the economic governance in the enlargement process is inspired by the European Semester process at EU level. This approach means a significant change in the dialogue on the economic policies and better reporting to the end of providing clearer instructions for the reforms necessary for supporting long-term economic growth and competitiveness. As of 2015, the Western Balkan countries, among which the Republic of Macedonia as well, have been invited to improve their economic policies and economic governance by preparing annual Economic Reform Programmes (ERP).

Economic Reforms Programme 2017 is the third document of this type prepared in line with the instructions given by the European Commission (EC). The Programme presents the medium-term macroeconomic and fiscal framework, as well as the sectoral structural reforms for promoting both competitiveness and growth.

The programme is prepared in line with the 2014-2018 Programme on Government Operations of the Republic of Macedonia, as well as the other national strategic documents, such as the National Programme for Adoption of the Acquis Communautaire, the Stabilisation and Association Agreement and the national sectoral strategies, such as Innovation Strategy 2012-2020, Competitiveness Strategy 2016-2020, as well as the adopted midterm Fiscal Strategy for the period 2017-2019, and the annual 2017 Budget of the Republic of Macedonia.

In addition, the Programme is in line with the EU Strategy for fast, sustainable and comprehensive economic development "Europe 2020", as well as the SEE 2020 Strategy of the Council for Regional Cooperation, called "Jobs and Prosperity in a European Perspective", which closely follows the vision of the "Europe 2020" Strategy.

EC recommendations indicated in the 2016 Progress Report on the Republic of Macedonia, as well as the specific recommendations of the Ministerial Dialogue as of May 25th 2016, based upon the EC's Economic Reform Programme 2016-2018 assessment, were also taken into consideration during the Programme preparation.

Ministry of Finance coordinated the entire document preparation process together with the relevant state institutions. The draft sectoral structural reforms were also shared with the social partners and the business community via the Ministry of Finance's website and the consultative meeting held for providing opinions and suggestions. There was continuous cooperation with the EC and OECD during the preparation of the ERP, such as missions and workshops in order to improve the quality of ERP and build capacity of institutions for prioritisation and coordination of economic policies.

1. OVERALL POLICY FRAMEWORK AND OBJECTIVES

Macroeconomic Policy 2017 - 2019 provides conditions for intensified economic activity through sustainable fiscal policy, which, in coordination with the monetary policy, will contribute to achieving sustainability of the external position of the country and ensuring inflation level to underpin the economic activity.

According to the Fiscal Strategy 2017-2019, fiscal consolidation in accordance with the Maastricht criteria remains the main priority in the coming medium-term period. In the period 2017-2019, gradual reduction of the deficit level is envisaged: 3% of GDP in 2017, 2.6% of GDP in 2018 and 2.2% of GDP in 2019. Moderate and contained increase of government debt up to 44.0% of

GDP is expected at the end of 2019, while public debt is expected to account for 56.0% of GDP during the same period.

Global economy in the period 2017 - 2019 is envisaged to experience moderate growth rates. EU economy is expected to be affected by the Great Britain referendum outcome. Increased uncertainty and reduced investors' confidence are envisaged to adversely affect the growth and to slow down the recovery of the European economy. Taking into account the expectations for increase of foreign effective demand, in particular for higher value added goods, share of which increases in the structure of domestic industry, as well as the structural reforms aimed at boosting country's competitiveness and the active fiscal policy in this medium-term period, favourable economic trends are expected to continue in the country.

On the basis of the above-mentioned assumptions, real GDP growth is expected to be 3% in 2017, 3.5% in 2018 and 4% in 2019.

Export of goods and services is envisaged to be the main driving force of economic growth, and resolving the political crisis in the country will have positive effects on the expectations and the confidence of the economic entities on the medium run, reflecting on increased investments, which is also a positive signal for the potential foreign investors. Analyzed by activity, growth will be driven by construction, followed by services, industry and agriculture.

Projected growth of economic activity in the period 2017 - 2019 is expected to be accompanied by increased demand on the labour market, by job creation in the free economic zones and as a result of realisation of publicly funded infrastructure projects, and, together with the active employment measures and programmes, will result in further decline of the unemployment rate to around 21% in 2019.

In the next three year period monetary policy will remain oriented at maintaining price stability by keeping a stable exchange rate of the Denar against the euro.

Global factors of inflation point to a moderate acceleration of domestic inflation in the medium run, after its low level in 2016, in line with the general downward trend of global prices of primary commodities. In 2017, the inflation is expected to be 1.3%, while in 2018 and 2019 it is expected to slowly come closer to the historical average of about 2%.

The latest estimates of the external sector for the next three years suggest moderate current account deficit of around 2% of GDP.

In the upcoming mid-term period Republic of Macedonia will remain committed to creating a functional and competitive market economy. Structural reforms will be aimed at strengthening human capital, stimulating innovation and creativity, improving competitiveness of the service and agriculture sectors, further improving transport and energy infrastructure, facilitating trade and attracting foreign direct investment. Implementation of these measures complemented by active labor market measures, should contribute to increase of the competitiveness of the economy, creating jobs and reducing unemployment.

1.1. MEASURES TAKEN TO IMPLEMENT THE TARGETED POLICY GUIDELINES ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE OF MAY 2016

G 1/2016: Underpin fiscal consolidation by identifying concrete revenue and expenditure measures; move towards a better targeting of transfer spending and improve the growth-friendliness of public finance, in particular by fully executing planned priority public investment spending. Protect against fiscal risks by using any excess revenue to create fiscal buffer.

Fiscal consolidation remains to be the main priority in the medium-term period under the new 2017-2019 Fiscal Strategy. As for the period 2017-2019, budget deficit is envisaged to gradually reduce, as follows: 3% of GDP in 2017; 2.6 of GDP in 2018 and 2.2% of GDP in 2019. Ministry of Finance continuously monitors the performance of revenues and other inflows, expenditures and other outflows of the Budget of the Republic of Macedonia, thereby undertaking appropriate measures to meet the fiscal target and provide room for realising the priority infrastructure investments.

In the coming medium-term period, expenditure side of the Budget will be aimed at realising two components: development component aimed at supporting the growth of the Macedonian economy by investing in major infrastructure projects, and social component aimed at maintaining social stability and improving the living standard of the citizens, above all the

<p>vulnerable categories of citizens.</p> <p>Thereby, disciplined budget spending will continue to be implemented, with an emphasis to restrictiveness and rigorous control over less productive costs, on one hand and increase of investments in capital projects on the other.</p>
<p>G 2/2016: Improve fiscal transparency and budget planning capacity by the swift introduction of a medium-term expenditure framework; by providing multi-annual projections of detailed revenue and expenditure components in the medium-term strategy as well as by comprehensive reporting of extra-budgetary expenditure in the consolidated fiscal reports. Inform systematically about payments arrears.</p>
<p>Improvement of public finance management system, by improving both the medium-term budget framework and the transparency, will remain to be the key priority in the next medium-term period.</p> <p>Implementation of the Project on Strengthening Medium-Term Budgeting for Efficient Public Finance Management commenced in December 2015 through IPA TAIB 2011, the main activities of which will be aimed at determining the programme classification of expenditures, strengthening the capacities for medium-term planning and reporting in line with the ESA Methodology. Apart from the programme classification, what is expected from the Project is for medium-term budgetary expenditure framework to be prepared, whereby the concept for implementation of medium-term budgetary framework (MTBF) and medium-term expenditure framework (MTEF) will be appropriately defined, and respective legal amendments, manuals and bylaws will be prepared accordingly.</p> <p>In fact, series of expert missions within the Project took place in the past period, focusing on the preconditions and the elements of an effective medium-term budget framework, fiscal risks: how fiscal risks should be described and presented, for instance, in the Fiscal Strategy, and contents of the Fiscal Strategy and the medium-term budget framework: what the Fiscal Strategy should include so as to best underpin the medium-term budget framework and what changes are to be made in the budget calendar.</p> <p>One of the Project objectives is to improve the capacities for both budget planning and fiscal transparency. Preparation of guidelines to provide for all additional information to be systematised and presented accordingly in the overall budget documentation is one of the Project outcomes.</p> <p>The fact that all activities related to medium-term budget planning and fiscal transparency are additionally processed within the Sector Planning Document on PFM and the Public Finance Management Reform Programme speaks in favour of project activities being implemented.</p>
<p>G 3/2016: Develop comprehensive strategies involving all relevant stakeholders in order to both further foster the resolution of non-performing loans by banks and further promote the use of the local currency with a view to reducing risks to financial stability and the real economy. There would be a case for a gradual removal of the central bank's accommodative monetary policy stance to the extent that authorities' sanguine macroeconomic scenario is realised (including through its impact on inflation expectations and on the output gap).</p>
<p><i>Non-performing loans in the banking system</i> of the Republic of Macedonia rose since the beginning of the global financial crisis, but were still preserved at a moderate and relatively stable level of about 11% in the period 2013-2015. The National Bank has been monitoring the movement of non-performing loans, not only to preserve financial stability of the country, but also to prevent any damage to the credit channel. In this context, the central bank has been undertaking activities to identify the reasons of the high persistency of existing non-performing loans, but also of the emergence of new non-performing loans (banks' analyzes and surveys). Thus, in 2013, regulatory amendments were made to support loan restructuring by banks.</p> <p>The NBRM analyzes indicate a high concentration of non-performing loan portfolio of legal entities, where the 50 largest non-performing loans account for nearly 60% of the total non-performing loans to legal entities. More than half of the non-performing loans are fully provisioned. Banks' surveys indicate that they take standard measures to manage non-performing loans (increased personal contact with customers, adjusting the credit standards to the current financial difficulties), and do not write-off claims as long as there is the slightest possibility of recovery. In this context, the collateral for the non-performing claims is often considered a reason that deters banks to implement quick and extensive write-off of claims. Under such circumstances, in December 2015, the NBRM amended the Decision on credit risk management, requiring from banks, as of 30 June 2016, to write-off all claims that have been fully provisioned for more than two years. In addition, banks are still allowed and required to take actions to collect these claims, although they are written off. Consequently, in September 2016, as a result of write-offs, the share of non-performing loans dropped to 7.4%.</p> <p>During 2016, the NBRM took further actions aimed to explore possibilities and obstacles to efficient settlement of banks' bad claims. In fact, an analysis was made of the legal possibilities and obstacles for more efficient collection of bad claims, sale of bad claims, sale of foreclosed property. A comprehensive questionnaire was sent to all banks in the Republic of Macedonia about their views regarding all these issues. Responses from banks will help to identify possible obstacles in this area, and the relevant institutions will make coordinated efforts to reduce or remove them.</p> <p>In the period from mid-2009 to 2015, there was a trend of intensive <i>denarization</i> on both sides of the banks' balance sheet, which was mainly driven by the denarization on the liabilities side, followed by the denarization on the assets side. During this period, the share of deposits with foreign currency component in the total deposits declined by about 18 p.p., while the share of loans with foreign currency component in the total loans decreased by about 12 p.p.. The change in currency preferences of entities towards increased share of denar deposits can be explained by several factors. Besides conducting credible macroeconomic policies aiming at preserving macroeconomic stability, as well as safe and sound banking sector, there are also other factors, such as: strengthened fundamentals of the domestic economy, higher yield on domestic currency instruments, crisis in the euro area, efforts for developing domestic financial markets, and wide range of macro-</p>

prudential measures taken by the NBRM in this period aimed at promoting domestic currency.

The NBRM significantly supported the process of denarization mainly through changes in reserve requirement, which in this period has been actively used as a macroprudential tool and instrument to support denarization. Thus, this period registered further differentiation of the reserve requirement rates by currency (reduction in the reserve requirement rate on denar liabilities and increase in this rate on foreign currency liabilities) and introduction of a zero rate of reserve requirement on household deposits with contractual maturity of over 2 years and denar household deposits with contractual maturity of over 1 year. These measures encouraged banks to influence saving decisions of the private sector through active approach and appropriate interest rate policy, contributing to currency and maturity restructuring of banks' balance sheets in favor of denar savings in the longer run. Uncertainty about the political situation and speculations on the exchange rate and the banking system stability during the second quarter of 2016 interrupted the positive trend. Yet, the share of deposits with foreign currency component slightly increased (1.5 p.p.), and then stabilized in the third quarter. The set of measures for dealing with the situation, among other things, included a measure for maintaining the denarization process (by increasing the reserve requirement rate on denar deposits with FX clause). In this context, it is worth mentioning that the benefits of the multiyear process of denarization were maintained despite the external and internal shocks. Also, during 2016, the NBRM developed a list of draft measures to further support the process of denarization in the economy and together with other competent institutions in the country to define strategy including concrete measures and activities in this area.

As for the *monetary policy*, in May 2016, the policy rate was increased, complemented by tightening through some of the other monetary instruments. These changes were a response to non-economic factors, i.e. the impact of political uncertainty and the speculative attack on the exchange rate and the banking system, which affected the expectations of economic entities, whereby the pressures mainly reflected on the movements on the currency exchange market and household deposits with banks (in April -May). As a result of the NBRM measures and the partial easing of political tensions later, the movements stabilized during the third quarter, which also continued in the last quarter of the year. Such favorable developments, combined with the assessment of stable economic fundamentals and mitigated political risks, created a room for gradual adjustment of the policy rate, which in December was reduced, however still remaining above the level prior May. The NBRM will continue to carefully monitor the developments, internal and external risks, and will remain ready to adequately respond to maintain price and financial stability in the economy.

G 4/2016: Adopt a credible public finance management reform programme. Prioritise public investments against clear policy objectives and identify the needs to which they respond. Increase the transparency on the selection criteria for the investments and on their impact on economic growth and on the fiscal path.

Improvement of public finance management system, by improving both the medium-term budget framework and the transparency, will remain to be the key priority in the next medium-term period.

Working group on management of public finances has been established therefore, with participants from all relevant institutions, the activities of which are aimed at preparing programme documents on provision of support to the Public finance management (PFM) sub-sector, as part of the economic governance within IPA 2 instrument.

In the past period, the Working Group on management of public finances together with the EU Delegation and SIGMA experts, engaged by EC, intensively worked on preparation of the Public Finance Management Reform Programme, as a main strategic document, as well as the IPA Sector Planning Document on PFM.

The Programme envisages improvement in several segments within public finance area such as: strengthening and implementation of medium term budget framework including budget planning, introducing integrated information system for PFM, improving compliance, efficiency and effectiveness of public procurement system, modernizing tax system and improving revenue collection, increasing quality of customs procedures and services, further improvement of public internal financial control and of external audit efficiency.

G 5/2016: Ensure a reliable and predictable regulatory environment for businesses by reducing the use of the urgency procedure for legislation, ensuring proper consultation of the stakeholders and reinforcing the independence of commercial courts.

Constitution of the Republic of Macedonia and the Law on Courts govern the basic principles on independence of both the judicial power and the courts in the Republic of Macedonia.

Judicial power rests with the courts in the Republic of Macedonia, which are independent state bodies.

The courts try and adopt their decisions on the basis of the Constitution, the laws and the international agreements ratified in line with the Constitution, in a procedure stipulated by law.

The judges protect human rights and freedoms when applying the law.

Citizens and other legal entities are guaranteed court protection in terms of legality of the acts adopted by the state administration bodies or organization and other bodies exercising public authorization. Everyone has the right to equal access to the court in terms of protection of his rights and legally established interests. When being decided on citizens' rights and obligations and on criminal liability, everyone has the right to fair and public trial within a reasonable period by an independent and impartial court established by law.

The judge decides impartially by applying the law on the basis of free assessment of evidence. At the same time, any form of influence on independence, impartiality and autonomy of the judge when performing the judiciary function on whatever basis and by whichever entity is forbidden.

Specialized court units, to act upon certain types of disputes, are mandatorily established within the basic courts with

extended jurisdiction.

Primary courts with basic jurisdiction, besides dealing as first instance courts upon civil disputes, can also deal with property disputes and civil legal relationships of natural and legal persons, the value of which is up to EUR 50,000 in Denar equivalent, unless the law envisages jurisdiction of another court.

Primary courts with extended jurisdiction are competent, besides the jurisdiction determined for the areas they are established for, to decide upon civil disputes, as well as disputes on

- property disputes and civil legal relationships of natural and legal persons, the value of which exceeds EUR 50,000 in Denar equivalent, unless the law envisages jurisdiction of another court,
- commercial disputes in which both parties are legal persons or state bodies, as well as disputes in copyrights and other related rights and industrial property rights,
- disputes between domestic and foreign legal persons arising from their mutual business, i.e. commercial relations.

There are specialized court units in the concerned courts with extended jurisdiction to deal with certain types of disputes in the commercial area, i.e. commercial disputes.

Regulatory Impact Assessment (RIA) is a process of systematically identifying and estimating the expected effects of proposals of a regulation, using consistent analytical methods. RIA is a comparative process based on defining the goals to be achieved by the proposal of a regulation, as well as on finding possible ways to achieve them based on selection of the most effective and the most efficient manner of attaining the goals.

Legal framework, through which quality process of preparing laws, bylaws and strategic documents should be ensured, comprises the following bylaws and documents: Rules of Procedure of the Government of the Republic of Macedonia, Methodology on Strategic Planning and Preparation of Annual Operational Programme of the Government, Methodology on Analysis of Policies and Coordination, Methodology on Regulatory Impact Assessment, Decision on the Form and the Contents of the Report on Regulatory Impact Assessment, Manual on the Manner of Operations of Ministries in the Process of Carrying Out Regulatory Impact Assessment.

According to the Rules of Procedure of the Government, RIA is carried out for all proposals of laws submitted to the Government to be considered and determined, except for the following:

- laws which are proposed to be adopted by applying the urgency procedure;
- laws on ratification of international agreements;
- laws related to terminology harmonisation with other laws;
- Budget of the Republic of Macedonia;
- Law on Execution of the Budget of the Republic of Macedonia, and
- laws on borrowing by the Republic of Macedonia and laws on guarantee by the Republic of Macedonia.

According to the Methodology on Regulatory Impact Assessment, the process includes the following steps:

- planning the process of carrying out RIA;
- carrying out the process of RIA;
- preparing the Report on RIA;
- consultations with the stakeholders, and
- obtaining an opinion from the Ministry of Information Society and Administration (MISA).

According to the Manual on the Manner of Operations of Ministries in the Process of Carrying Out Regulatory Impact Assessment, Annual Plan on Carrying Out RIA is prepared at the same time when the initiatives for the draft Annual Operational Programme of the Government of the Republic of Macedonia are prepared, and it is uploaded on ENER (Single National Electronic Registry of Regulations) 15 days at the latest following the adoption of the Annual Operational Programme of the Government of the Republic of Macedonia.

According to the Rules of Procedure of the Government of the Republic of Macedonia, MISA gives opinion on the regulatory proposal, subject to RIA. Such opinion is prepared on the basis of a draft Report on RIA submitted by the competent ministry.

The General Secretariat plays an important role in this process which, pursuant to the Rules of Procedure of the Government, makes sure that laws submitted to the Government includes regulatory impact assessment, and it cooperates with, and coordinates, the ministries as regards this issue.

ENER is a very important mean in improving the implementation of the consultations phase in the RIA process. All proposals of laws submitted to the Government are uploaded on ENER so as for the stakeholders to give their comments. New ENER was fully put into operation in 2015, which provided for its integration with the multi-platform system for cooperation with e-Government, the objective of which was to prevent submission of proposals of laws to be considered by the Government if not being uploaded on ENER, thus fully adhering to the Rules of Procedure of the Government of the Republic of Macedonia.

In addition, as of June 2014, the section "Cooperation" on the ENER provides information arising from "Mirror of the Government" Project, implemented by Macedonian Center for International Cooperation since 2012. Under this Project, the ENER is monitored, thus providing for assessment of the involvement of the public in the early stage of preparation of laws published in quarterly reports. Goal of these issues/uploads is to make the public more informed and to stimulate civil society organizations and other stakeholders to participate in the early stages of preparation of laws.

In order to improve the RIA process, MISA organizes meetings, seminars, training, counseling with civil servants at the

ministries. Hence, in the period 2012 – 2015, total of 674 persons, involved in the RIA process from the public and the private sector, were trained through basic, advanced and specialized training. In addition, Regulatory Reform Department provides, on continuous basis and upon request by the ministries, information on the application of the RIA process, the act regulating RIA and analytical tools to carry out RIA.

G 6/2016: Strengthen the provision of activation measures especially for vulnerable youth, women and long-term unemployed and further improve the capacity of the Employment Service Agency for profiling and personalised counseling of job seekers.

The new tool being introduced in the working process of ESARM is intended for persons in a disadvantaged position on the labour market and should ensure they get the most appropriate combination of employment services and programmes available under the Annual Operational Plans on Employment Services and Active Programmes and Measures on the Labour Market. This new approach strengthens the trust and the cooperation between the unemployed person and ESARM, as an agency providing service to the citizens, since all activities are adjusted to the actual needs of the unemployed person to be employed. On the other hand, financial resources spent for implementation of services, programmes and measures will be mainly directed towards the category of unemployed persons who are the most in need of help during the employment process.

Human resources are one of the essential preconditions for successful performance of the functions of ESARM. Therefore, it is indispensable for human resources to be continuously strengthened both in quantitative and qualitative terms. Rational allocation of financial resources, alignment of the job demands with the individual abilities of the employees, quality human resources management are of great importance, all to the end of improving the efficiency of the operations. Taking into account the limited resources for new employments, i.e. quantitative strengthening of human resources, Employment Service Agency has been paying special attention on qualitative strengthening of human resources in the course of 2016 as well, all to the end of bringing the services closer to the citizens through a small, but efficient and modern expert service. This is mainly implemented by ensuring continuous development, strengthening and upgrading human capacities through taking part in various seminars, trainings, workshops and lectures.

Capacities regarding physical and human resources of the Employment Service Agency and their constant improvement, upgrade and modernization are essential for successful implementation of employment policies and measures (passive and active) and achieving the desired results and effects in the labour market in general. During 2016, 12 local employment centers were reconstructed, thus improving the conditions for preparation of Individual employment plans, but this caused a certain delay in implementation in 2016. ESARM launched the implementation of this measure in January 2016 as a pilot - activity. As of 31.10.2016, the profiling of employability is done for 4.869 active job seekers, of which 1.893 are classified as unemployed with significant difficulties in hiring. Out of these, an IPV 2 is prepared for 1,635 persons.

2. MACROECONOMIC FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS

International Economic Environment. Growth rate is expected to amount to 3.0% in 2016 at global level and to surge to 3.4% in 2017 and 3.5% in 2018. Global economy in 2016 will experience the lowest growth rate following 2009, as a result of the slowed-down growth of many developed economies outside the EU. Economic activity in the USA is expected to recover in the second half of 2016, continuing with a stable pace in 2017, while such recovery is expected to decelerate in 2018. Fast-growing economies as a whole will gradually strengthen in 2016, following the slowdown in 2015. Chinese economy is expected to experience 6% growth by 2018, assuming that macroeconomic policies will be aimed at supporting the growth, while the ongoing financial weaknesses will remain under control. Still, expectation on global growth remain to be significantly affected by the downside risks.

Global trade is expected to strengthen gradually in the coming period, following the weak performance in 2016 caused by the weaknesses on the markets in fast-growing economies and the unexpected decline of import demand in the developed economies.

Present weakness of global trade outside the EU affects the export from the Eurozone despite the trade elasticity inside the Eurozone. In addition, future trade between the Great Britain and the EU is uncertain, which is expected to lead to a reduced volume of trade in the coming years. Export growth is expected to slow down from 1.8% in 2016 to 1.6% in 2017, to gradually intensify to 1.8% in 2018. Stronger growth of import than export from the EU is expected, whereby contribution of net export to GDP growth in the Eurozone will be negative until 2018.

Real **GDP** growth in the Eurozone is expected to remain almost unchanged, i.e. 1.7% in 2016, 1.5% in 2017 and 1.7% in 2018. Employment increase is expected to have positive effects on private consumption, thus neutralizing the negative influence of inflation growth on the purchasing

power of households. There are preconditions for stronger growth of investment activity, however increased uncertainty may have opposite effects at the same time. Weak global trade and decline of export to Great Britain, accompanied by British pound depreciation, are a limiting factor to export growth in the Eurozone. Unemployment rates are expected to drop, while inflation is expected to pick up as windfall gain from low oil prices has been largely consumed.

Table 2.1. Macroeconomic indicators in the Euro zone and EU

	GDP			Inflation			Unemployment rate		
Year	2016	2017	2018	2016	2017	2018	2016	2017	2018
Euro zone	1.7	1.5	1.7	0.3	1.4	1.4	10.1	9.7	9.2
EU	1.8	1.6	1.8	0.3	1.6	1.7	8.6	8.3	7.9

Source: European Commission, European Economic Forecast (Autumn 2016)

Recovery of the **labour market** in the EU is solid and employment in the EU and the Eurozone is expected to pick up by 1.4% in 2016, being the highest growth since 2008. Job creation is expected to continue, as a result of the expansion led by the domestic demand, moderate increase of wages, as well as the fiscal measures and the structural reforms implemented in some member states. Employment growth in the Eurozone is expected to remain at a relatively stable level. In the EU, on the other hand, employment increase will be weaker due to the slowdown of the British economy. Despite the expectations for labour force growth intensification in 2016, due to the increased participation and the gradual integration of refugees in the labour market, unemployment rate in the Eurozone is expected to decline relatively fast, from 10.1% in 2016 to 9.7% in 2017 and 9.2% in 2018. Unemployment rate in the EU is expected to account for 8.6% in 2016, 8.3% in 2017 and 7.9% in 2018.

Inflation rate in the EU and the Eurozone is expected to account for 0.3% in 2016 as a result of the effects from low prices of energy sources. Inflation is expected to be under strong influence of the positive effects from energy inflation by the second half of 2017. Taking into account that import prices and producers' prices are expected to stabilise, nominal wages to increase, output gap to further narrow and profit margins to slightly increase, it is estimated that these factor will reflect on increase of core inflation. Inflation rate in the Eurozone is expected to amount to 1.4% in 2017 and 2018. Inflation in the EU is expected to reach to 1.6% in 2017 and 1.7% in 2018.

Risks regarding the expectations in both the EU and the Eurozone are predominantly downside. Domestic risks arise from the Brexit, inherited problems (high share of non-performing loans) from the European debt crisis, as well as the postponement of the structural reforms, while external risks are a result of the aggravating geopolitical conflicts, the challenges China faces in its attempt to structurally rebalance the growth and the U.S. monetary policy normalisation.

Recent economic developments in the Republic of Macedonia.

Gross domestic product. GDP in the first three quarters of 2016 grew by 2.7% in real terms, amid intensified political instability in the country. Construction sector, experiencing 15.0% growth, had a significant contribution to economic growth in this period, as well as in the past years. Agriculture in this period experienced 6.1% growth, while growth in the services sector amounted to 2.6%, as a result of the growth in several activities (information and communications, financial activities, trade, transport and food and accommodation, etc.).

Industrial production¹ in the period January – September 2016 experienced 5.4% growth as a result of the intensified growth registered in Manufacturing (8.6%), whereby significant growth was seen at manufacture of motor vehicles (70.8%), manufacture of machinery and equipment (27.3%) and manufacture of electrical equipment (19.5%), industrial branches which part of the companies operating in the free economic zones belong to. Solid production growth was also seen in the segment of traditional industrial sector.

¹ According to monthly data

Analyzed according to the expenditure side of GDP, economic growth in the first three quarters of 2016 was driven by export and consumption. Growth of export of goods and services amounted to 10.9% in real terms, as a result of the growth of export by the capacities in the free economic zones, in conditions of favourable trends of the external demand, i.e. the sound growth of economic activity in the EU, as the most important destination to export the Macedonian products. Export growth was accompanied by improved export structure by increasing the share of higher value added goods, in conditions of increase of export of machinery and transport equipment by 22.4% and of chemical products by 12.2%. Import of goods and services in this period experienced lower growth than export, amounting to 8.7%.

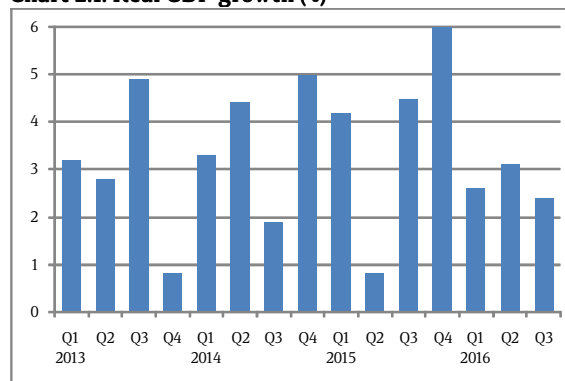
Final consumption in the first three quarters of 2016 grew by 3.3% in real terms, being a result of the increase of both private and public consumption. Private consumption experienced 3.8% growth in real terms as a result, above all, of the increase of household disposable income, in conditions of increase of employment and wages. Public consumption grew by 0.9% in real terms. Gross investments, experiencing 0.8% real growth in conditions of boosted activity in the construction sector, contributed positively to the economic activity in this period.

Labour market. Positive trends on the labour market continued in 2016. According to the Labour Force Survey, employment rate is continuously increasing and reached 43.4% in Q3 2016, being higher by 1.0 p.p. compared to the same quarter in 2015. In the first three quarters of 2016 employment rate amounts to 43.0%, being higher by 1.1 p.p. compared to the same period last year. The number of employed persons in the first three quarters in 2016 was higher by 2.6% compared to the same period in the previous year. Increase of employment is mainly due to the realisation of active measures and policies aimed at unemployment reduction, mainly "Macedonia employs", as well as due to the activities of companies in the free economic zones and the public infrastructure investment. The majority of jobs created were in trade, industry and construction.

Employment growth was accompanied by drop of the number of unemployed persons, decreasing by 10.6% in the first three quarters of 2016 compared to the same period last year. Such trends on the labour market caused for the unemployment rate in Q3 2016 to reduce to 23.4%, i.e. to drop by 2.1 p.p. compared to the same quarter of the previous year. In fact, in Q3 2016, unemployment was at the lowest level since the independence of the country until today. In the first three quarters of 2016 the unemployment rate amounts to 23.9%, being lower by 2.6 p.p. compared to the same period in 2015. Active population in the first three quarters of 2016 accounted for 56.5% of total working-age population.

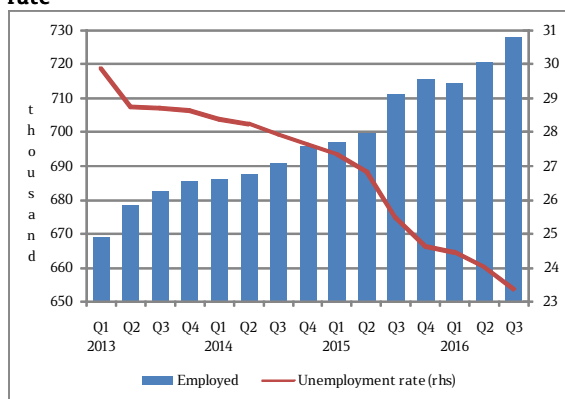
Average net/gross wage in the first nine months of 2016 was higher by 2.0% in nominal terms and by 2.3% in real terms in relation to the same period in 2015.

Chart 2.1. Real GDP growth (%)



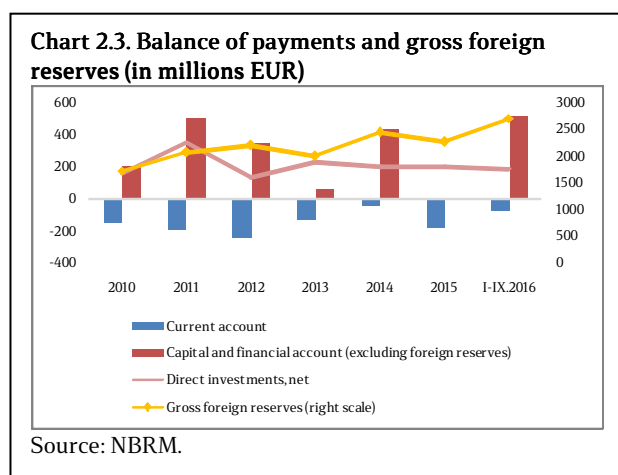
Source: SSO

Chart 2.2. Number of employees and unemployment rate



Source: SSO

External Sector. The developments in the current account of the balance of payments in the first nine months of 2016 reflect the increased positive effects of the new production facilities on total exports, the movement of world prices of primary commodities, as well as the moderate economic growth (amid limited effects of the political crisis). Cumulatively, in January-September 2016, the current account registered a moderate deficit of Euro 70.1 million, which is by Euro 25 million higher compared to the same period last year². Current account deficit widened mainly due to the



widening of trade deficit, amid small deterioration in the net inflows of secondary income and primary income deficit, which was partially offset by the larger surplus in services. Within the secondary income, the net purchase on the currency exchange market was lower by only 1.5% compared to the same period last year, mainly reflecting lower net purchase in the second quarter due to the growing political uncertainty and speculative pressures.

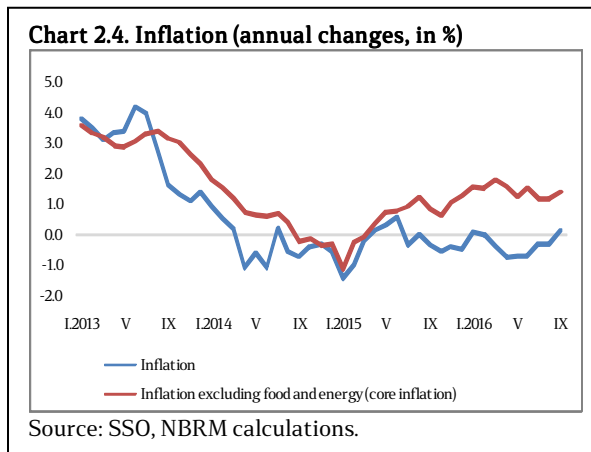
In the first nine months of 2016, inflows of the new government Eurobond (issued in July)

and FDIs made upmost to the financial account inflows. In the period January-September 2016, net FDIs amounted to Euro 183 million, which is by 39% more relative to the same period last year. Most of them (nearly 82%) are inflows in the form of equity and reinvested earnings, and less are intercompany borrowings. At the end of September 2016, the gross foreign reserves amounted to Euro 2,699 million, which is an increase of 19% compared to the end of 2015, mainly due to transactions on behalf of the government, and less to foreign currency deposits of banks with the NBRM (see section on Monetary policy and exchange rate). Foreign reserves have been maintained at an adequate level, providing over four months average import of the next year coverage ratio.

Inflation. The average annual inflation in January-September 2016 was -0.3%, with a trend of deceleration of the negative changes in the third quarter of the year. Low average inflation is mainly due to lower prices of food and fuel, in line with their downward movements in world markets. The average annual core inflation that excludes variable categories (food and energy) equals 1.5%, remaining mostly stable during the year.

Monetary Developments and Exchange Rate.

The environment for conducting monetary policy in the first three quarters of 2016 was primarily marked by uncertainty related to the domestic political situation and its influence on expectations. Adverse effects were mainly present in the period from April to May and primarily affected the movements on the currency exchange market and household deposits with banks. In such circumstances, monetary policy was tightened at the beginning of May 2016 by raising the policy rate and making corresponding changes in some other instruments that, along with net sales in the foreign exchange market and strengthened communication with the public, stabilized the expectations for the rest of the year.

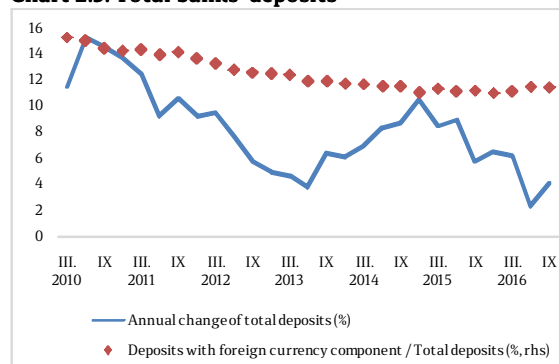


² In September 2016, a regular annual review of the balance of payments in 2015 was done, with the revisions mainly referring on categories of primary income in the current account (greater negative balance) and higher net inflows of trade credits and foreign direct investment (reinvested profit).

Amid sluggish economic activity and worsening expectations due to the political uncertainty, the annual growth of broad money M4 moderately slowed down to 4% in September 2016 (6.8% at the end of 2015). Total private sector deposits that were higher by 4% on an annual basis in September 2016, also slowed down (6.5% at the end of 2015). Sector-by-sector analysis shows that this is mainly due to the slowdown in household deposits. Namely, influenced by uncertainty and speculations on the exchange rate and the banking system, the growth of household deposits in the second quarter of 2016 slowed down to 0.2% (4.1% at end 2015). Positive spillover effects of the measures taken by the NBRM and partial appeasement of domestic political turmoil halted the withdrawal of deposits by non-financial entities during the third quarter. At the end of September 2016, total household and corporate deposits increased annually by 1.2% and 11.3%, respectively, where two-thirds of the annual growth of total deposits were driven by the growth of corporate deposits.

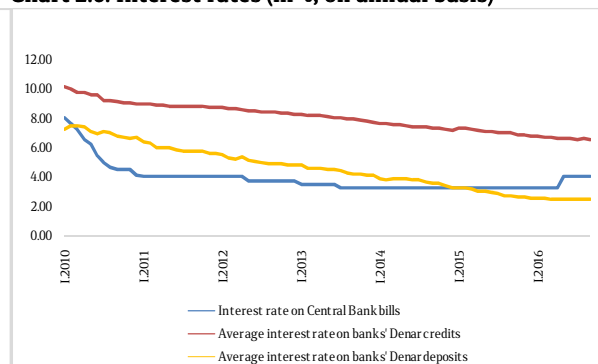
Moreover, in 2016, influenced by political uncertainty, as well as the speculations on the exchange rate and the banking system, currency preferences have changed. At the end of September 2016, foreign currency deposits registered faster annual growth (6.9%) compared to the growth in denar deposits (2%), with the growth of denar deposits making up about one-third of the annual growth of total deposits. Consequently, despite the multiyear trend of reducing the average share of deposits with currency component in total deposits that started in 2009 onwards, in September 2016 their share slightly increased to 42.6% (41.6% in September 2015), which is still significantly lower compared to the level at the beginning of the global crisis.

Chart 2.5. Total banks' deposits



Source: NBRM.

Chart 2.6. Interest rates (in %, on annual basis)



Source: NBRM.

In January-September 2016, bank loans to private sector registered favorable developments, and since the mid-year, the annual changes were influenced by the NBRM measure that required from banks to transfer non-performing loans that are fully covered for more than two years to off-balance sheet evidence. At the end of September 2016, loans registered an annual growth of 2.5%, while adjusted for write-offs their growth equals 7.7%. Amid slower deposit growth, in the first three quarters of the year, loan/deposit ratio was maintained at a moderately higher level (of about 95% on average, corrected for the effect of written-offs loans, compared to the average for the same period last year of about 91%). By sector, adjusted for the effect of the write-offs, loans to households registered a stronger annual increase (11.1%) compared to the growth of corporate loans (5.3%). By currency, credit growth remains largely (about three quarters) driven by the growth of denar loans.

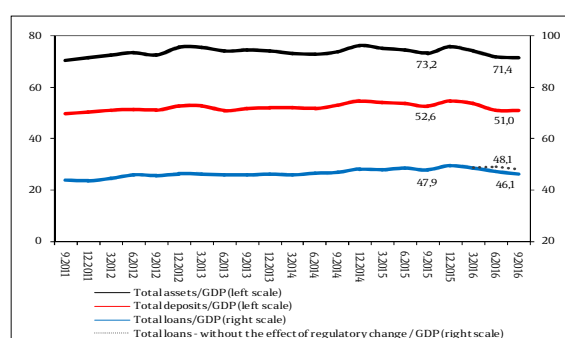
Interest rates in the banking sector were moderately cut. Average weighted interest rate on total denar loans was 6.6% p.a. in September 2016, and decreased by 0.2 p.p. compared to the end of 2015. Simultaneously, average deposit interest rate decreased by 0.1 p.p. and in September 2016 was 2.5% p.a. It is worth mentioning that denar interest rates of banks underwent changes in the first few months of the year, but once the monetary policy tightened, they remained unchanged. Given the greater cut in lending interest rate, compared to the end of 2015, interest rate spread has narrowed by 0.1 p.p., to 4.1 p.p.. In September 2016, interest rates on foreign currency loans and deposits equalled 5.4% and 1%, respectively, which is a decrease of 0.3 p.p. and 0.1 p.p., respectively,

since the beginning of the year. Consequently, the interest rate differential between denar and foreign currency deposit interest rate remained unchanged, at 1.5 p.p..

Banking System. Banks are the dominant institutional segment, making up about 86% of the total assets of the financial system at the end of 2015, whose stability is crucial for the stability of the overall financial system. There are fifteen banks and three savings houses in the Republic of Macedonia. Foreign capital prevails (mainly from the EU countries), composing around three quarters of the total capital of the banking system. Eleven banks are predominantly owned by foreign shareholders and six of them are subsidiaries of foreign banks.

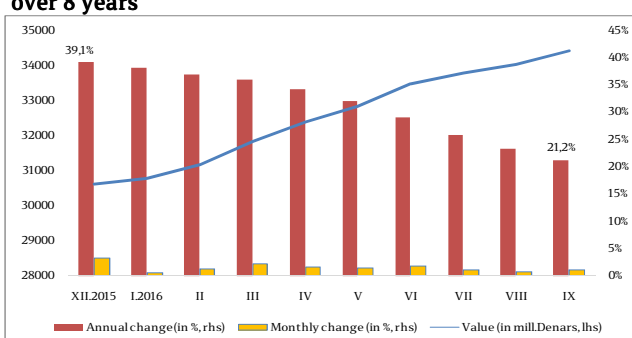
In the first nine months of 2016, despite all the challenges, the banking system remained stable and proved to be resilient to shocks from domestic and external environment. Against the backdrop of domestic political instability and lower rates of economic growth than initially expected, in the third quarter of 2016, total assets of banks in the Republic of Macedonia continued to grow, but at a slower pace compared to the same period last year. Domestic political turmoil and speculation on the banks' stability and deposits, prompted deposit withdrawals from the banking system, particularly by households, which was most pronounced in the second half of April and May 2016. Positive spillover effects of the NBRM measures and partial appeasement of domestic political turmoil in the summer, halted the decline in bank deposits. However, in the third quarter of 2016, banks' deposits to GDP ratio was 51%, decreased by 1.6 p.p. compared to the same period of 2015.

Chart 2.7. Financial intermediation (in %)



Source: NBRM, SSO.

Chart 2.8. Consumer loans with contractual maturity of and over 8 years



Source: NBRM, SSO.

Shares of total assets and loans of the banking system in GDP since mid-2016 have been affected by write-offs of non-performing loans, fully provisioned for more than two years, so that after correcting this effect, these indicators suggest a relatively stable level of financial intermediation by banks. Consequently, reduction of deposits in the banking system had no significant spillover effects on bank lending (excluding the effects of write-offs). The NBRM Lending Survey for the first three quarters of 2016 indicated continued net easing of standards for approving corporate loans in terms of interest rate, non-interest income, requirements related to the size of loan or line of credit, and less in terms of collateral requirements and loan maturity. Also, there is continued net easing of standards for approving households loans, mainly in terms of interest rate and non-interest expenses for housing and consumer loans. With these changes, banks facilitate the access to finance for the private sector. In this context, one should emphasize the gradual improvement in the assessment of access to finance, as part of the assessment of the competitiveness of the economy³.

Corporate and household debt. In 2015, the debt of the Macedonian corporate sector⁴ registered a faster growth compared to 2014, with structural changes related to the increase of the external debt component. The total corporate debt grew annually by 10%, which is faster growth compared to the past five years. Corporate debt to GDP ratio continues to grow, accounting for nearly two-

³ WEF Global Competitiveness Report, 2016-17, ranks Macedonia at the 45th position by access to finance (improvement by 51 position compared to 2011, and by 11 positions compared to 2015), where the score for this criterion increased from 2.4 in 2011 to 4.3 in 2016 (7 being the highest score).

⁴ Latest available data.

thirds. Liabilities of domestic companies to non-resident creditors made the largest contribution to the growth of total debt of the corporate sector in 2015 that include intercompany loans and trade credits (taking into account the claims on non-resident parent companies and trade partners, which reduce the indebtedness). Domestic debt funding sources of corporate activities are mainly in the form of contractual funding by financial institutions, mainly domestic banks, with minor share of non-banking financial institutions. In 2015, household debt recorded the highest growth rate in the past five years, due to the further strengthening of credit support from the banking system. Thus, the level of household indebtedness in the Republic of Macedonia, measured as debt to GDP ratio was 22.4% (21% in 2014). However, the solid creditworthiness of the sector and the volume of its financial assets leave room for further borrowing. Banks remain the most significant creditor of households, accounting for 94% of the household debt.

Credit risk. Credit risk is the most significant inherent risk in banks' balance sheets. In the first nine months of 2016, non-performing loans recorded a significant decline, mainly due to the amendments to the regulation of the National Bank, requiring from banks to transfer (and to continue transferring) all claims that have been fully provisioned for more than two years to off-balance sheets, by 30 June 2016. The mandatory "cleansing" of loan portfolios from old and completely written-off non-performing loans improved the quality indicators of the banks' credit exposure, reducing the non-performing to total loans ratio to 7.4%. However, if we exclude the effects of the transfer of part of fully provisioned non-performing loans to the banks' off-balance sheets, credit portfolio quality remains at the usual level (at around 11%), mainly determined by corporate loans. The threat to the banks' own funds from materialization of the credit risk arising from non-performing loans is not high due to their high coverage with impairment, but also because of the satisfactory volume and quality of banks' own funds.

In December 2015, the NBRM increased the capital requirement for consumer loans with contractual maturity equal to or longer than 8 years. This measure aims to slowdown the growth of these loans and had a moderate effect that was expected, given that it applies only to new loans.

Profitability of the banking system has been improving, given that in recent years, banks have been almost constantly increasing rates of return on equity and assets. At the end of the third quarter of 2016, the rates of return on assets and equity rose to 1.6% and 13.9%, respectively. Several years in a row, improved profitability is due to the cut in interest expenses.

Table 2.2. Basic bank risks indicators (in %)

	2014 Q4	2015 Q4	2016 Q2	2016 Q3
Capital adequacy				
Capital adequacy ratio	15.7	15.5	15.6	15.7
Asset quality				
Non-performing loans / gross loans (non-financial entities)	11.3	10.8	7.5	7.4
Total provisions to Non-Performing Loans (non-financial entities)	104.7	108.4	111.3	108.8
Profitability				
ROAA	0.8	1.1	1.4	1.6
ROAE	7.4	10.4	12.2	13.9
Liquidity risk				
Liquid assets / total assets	33.2	31.4	28.7	29.7
Liquid assets to total short-term liabilities	59.2	54.9	51.2	52.9

Source: NBRM.

The **solvency** of the banking system is high and relatively stable. Capital adequacy ratio in the third quarter of 2016 was 15.7%. In October 2016, amendments were adopted to the Banking Law that introduced capital conservation buffers under Basel III and the European regulations, which will further strengthen banks' solvency.

Deposit withdrawal in April and May affected the volume of liquid assets that was the main pillar that made banks smoothly service any payment demand. The higher amount of previously accumulated liquid assets and the NBRM instruments to create liquidity successfully offset this crisis episode in the domestic banking system and even ensured sound credit growth rates. Despite the reduction of liquidity in the second quarter of 2016, the banking system **liquidity**

stabilized and approached the level prior the period April-May. Thus, in the third quarter of 2016, liquid assets still accounted for nearly 30% of total banks' assets and covered about 53% of total short-term liabilities and 57% of total household deposits, which is satisfactory and allows banks' smooth operations.

The resilience of the banking system to shocks is confirmed by **sensitivity tests** that are conducted on a regular quarterly basis. The results of the stress test simulations that assume a certain percentage of increase of non-performing credit exposures have significantly improved, mostly due to the transfer of fully provisioned non-performing loans to the off-balance sheets in the second quarter of 2016, as required by the recent amendments to the credit risk management regulations. Simulations show that only amid extremely high growth of non-performing credit exposure to non-financial entities (of 143.2%), the capital adequacy of the banking system would drop to the minimum capital requirement of 8%.

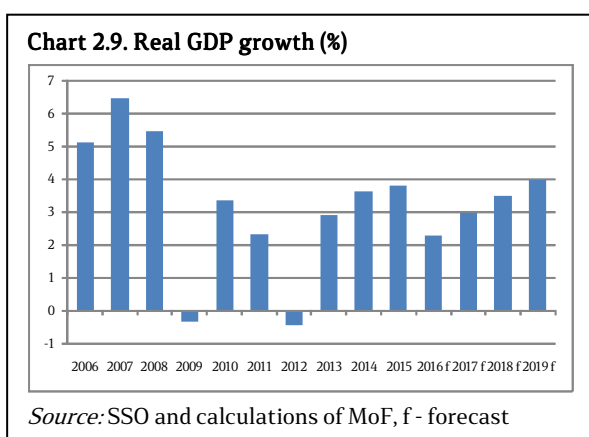
2.2. MEDIUM-TERM MACROECONOMIC SCENARIO

Macroeconomic policy of the Republic of Macedonia in the coming period is aimed at fulfilling the strategic commitments to long-term and sustainable economic growth, boosting competitiveness of the economy and job creation, as well as better living standard of the population.

Macroeconomic Policy 2017 - 2019 provides conditions for intensified economic activity through sustainable fiscal policy, which, in coordination with the monetary policy, will contribute to achieving sustainability of the external position of the country and ensuring inflation level to underpin the economic activity.

Global economy in the period 2017 - 2019 is envisaged to experience moderate growth rates. EU economy is expected to be affected by the Great Britain referendum outcome. Increased uncertainty and reduced investors' confidence are envisaged to adversely affect the growth and to slow down the recovery of the European economy. Taking into account the expectations for increase of foreign effective demand, in particular higher value added goods, share of which increases in the structure of domestic industry, as well as the structural reforms aimed at boosting country's competitiveness and the active fiscal policy in this medium-term period, favourable economic trends are expected to continue in the country.

Gross Domestic Product. On the basis of above-mention assumptions, real GDP growth is expected to be 3% in 2017, 3.5% in 2018 and 4% in 2019.



Export of goods and services in this medium-term period is envisaged to be the main driving force of economic growth, which is expected to experience 6.7% real growth in average. Growth of export is mostly related to further increase of export from the free economic zones, in conditions of entrance of new export capacities and gradual increase of external demand. Favourable effects on export are also expected from the envisaged gradual increase of prices of metals on the medium term.

Resolving the political crisis in the country will have positive effects on the expectations and the confidence of the economic entities on the medium run, reflecting on increased investments, which means a positive signal for the potential foreign investors. Planned investments by the public sector, as the main driving force of infrastructure investments, are also expected to have positive contribution on investment growth. As for public investments, investment projects aimed at improvement of the transportation network are envisaged to be realised, as well as capital expenditures aimed at improving the energy and the utilities infrastructure, improving the conditions in the education,

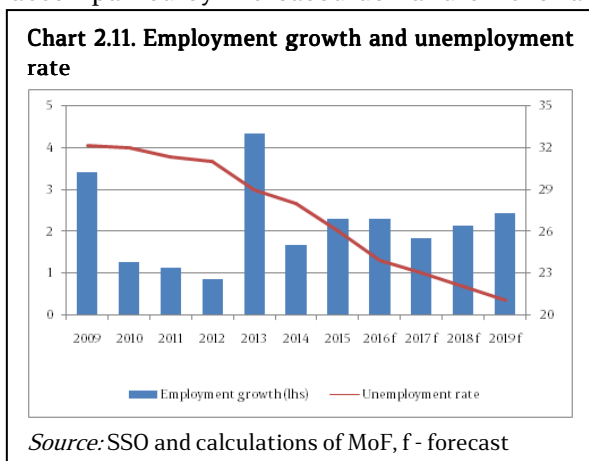
social and health system, which are to boost the competitiveness of the country in the longer run. Growth of gross investments in the period 2017 - 2019 is projected at 5.8% in real terms in average.

In the period 2017 - 2019, private consumption is expected to experience real growth of 2.5% in average, mostly as a result of the expected increase of disposable income of households, in conditions of projected increase in the number of employees and wages, supported by the expected growth of crediting to households. Growth of public consumption is projected at 1.3% in this period.

Projected growth of domestic demand and export activity provides for growth of import of goods and services which, in this period, is expected to experience 5.5% real growth in average.

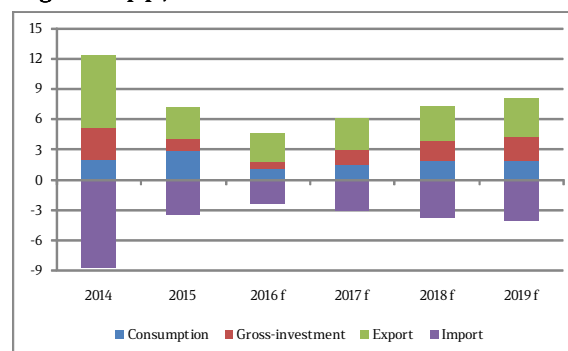
Analyzed by activity, in the period 2017 - 2019, construction is expected to achieve average growth rate of 5.7% in real terms, mainly as a result of realisation of the planned publicly funded infrastructure projects and the expected investments in the free economic zones. Services sector is expected to experience average growth rate of 3.2% in real terms this period, whereby trade and transport activity are envisaged to significantly contribute to growth. Real growth of the industry is expected to range between 2% and 4% in this period, with prospects for a certain intensified growth, in line with the envisaged trends in external demand and the expected increase of the production potential of the country. Agriculture sector is expected to experience 2.4% real growth in average in this period. Real growth rates by years and sectors are shown in Table 1e in Annex 1.

Labour Market. Envisaged growth of economic activity in the period 2017 - 2019 is expected to be accompanied by increased demand on the labour market, by job creation in the free economic



trends on the labour market will provide for the unemployment rate to drop to around 21% in 2019. Average increase of net wage in this period is expected to amount to 2.4% in nominal terms, i.e. 1% in real terms.

Chart 2.10. GDP by expenditure method (contribution to growth, p.p.)



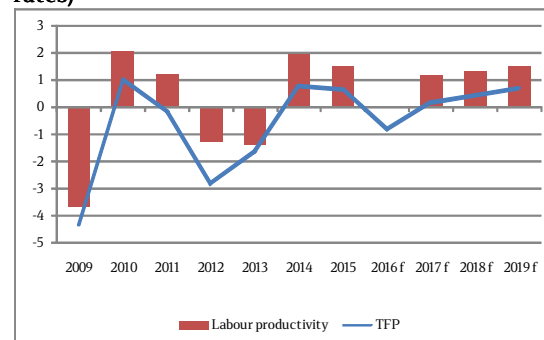
Source: MoF calculations and projections, f - forecast

zones and as a result of realisation of publicly funded infrastructure projects, and, together with the active employment measures and programmes, they will result in further decline of the unemployment rate.

According to the projections, average annual increase of about 2% in the number of employed persons is expected in this period, leading to a drop in the number of unemployed persons by 3.2% in average in this medium-term period. Increase of demand in this period is expected to also reflect on the labour supply, projected to increase by approximately 1% in average. Such

Sources of Growth. Total Factor Productivity (TFP)⁵ is envisaged to have negative contribution to the economic growth in 2016, in conditions of expected low increase of investments in fixed assets and strong growth in the number of employees. Chart 4. shows the growth of both labour productivity and TFP in the period 2009-2019. In the period 2017 – 2019, growth of productivity of production factors is expected to shift to the positive zone. However, TFP contribution to growth in this period is relatively low and accounts for 12.8% in average. Labour is expected to contribute to economic growth with 39%. Physical capital, according to the projections on investment growth, is expected to grow by 4.7% in average in the analysed period, contributing with 48.2% to total economic growth.

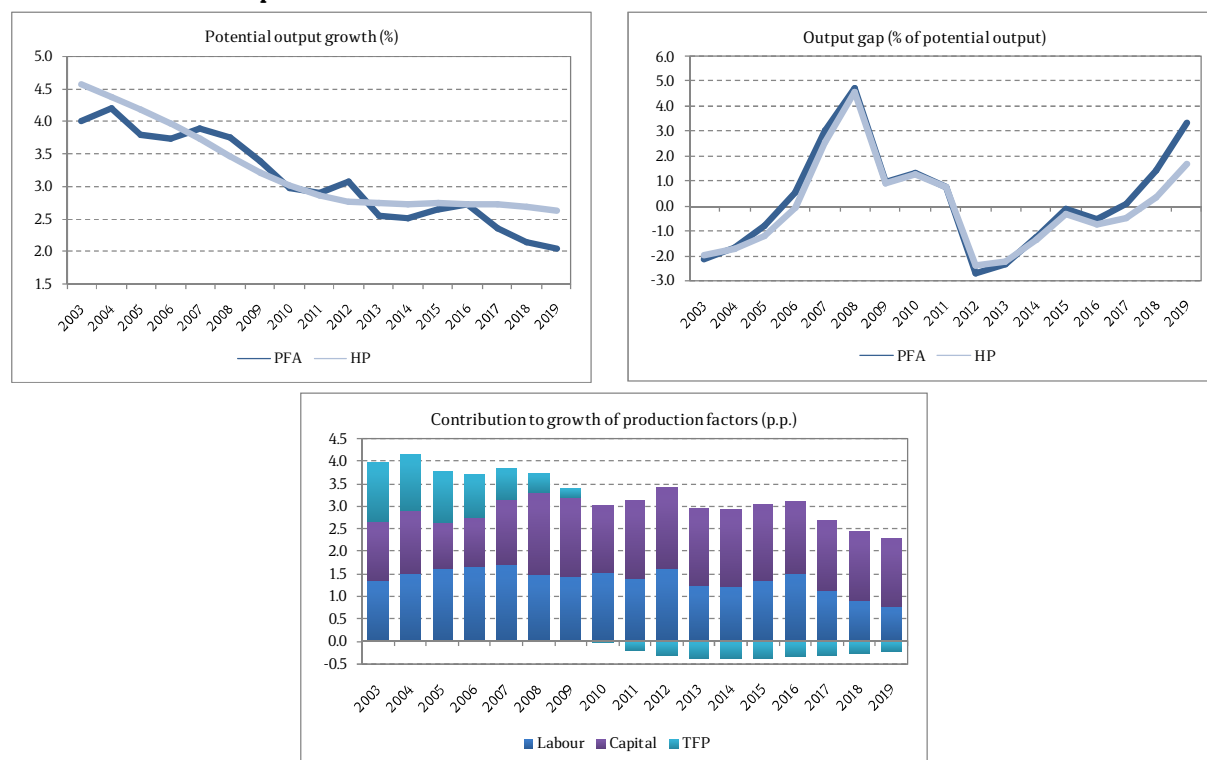
Chart 2.12. Labour productivity and TFP (growth rates)



Source: SSO and calculations of MoF, f - forecast

Potential Growth. Calculation of potential output is a basis for estimating the cyclical position of economy. Two methods are used to calculate the potential output. According to the first method, Hodrick-Prescott (HP) filter, which belongs to the statistical approaches group (a-theoretical) and is based only on historical data on GDP⁶, potential GDP growth is estimated at 3.3%. According to the Production Function Approach (PFA), applied by the European Commission⁷, potential GDP growth is estimated at 3.1% in the analysed period. Results from the calculation of potential output are presented in the charts below, as well as in Table 5 in Annex 1.

Chart 2.13. Potential output



Source: MoF calculations

⁵TFP is residual of growth of other factors to economic growth, labour and capital. As regards the calculation of physical capital, the so-called perpetual inventory method has been applied (see Berlemaun and Wesselhöft, *Estimating Aggregate Capital Stocks Using the Perpetual Inventory Method*, 2014), by applying 4% depreciation rate to the accumulated capital. Average value of the share of income from capital is estimated at 36%, while the remainder of the income is from labour.

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

⁷Based on the study of Havik et al, *The Production Function Methodology for Calculating Potential Growth Rates & Output Gaps*, 2014.

According to the projections on production growth in the coming medium-term period and the estimations on the trends of the potential output, cyclical component of output is in the negative zone in 2016. In 2017, output gap is expected to be closed according to the calculations based on the Production Function Approach, while according to the Hodrick-Prescott filter, output gap will remain negative, however, narrowed compared to 2016. In 2018, output gap is expected to shift to the positive zone and to remain positive in 2019.

Monetary and exchange rate policies. Monetary policy is oriented towards preserving price stability by maintaining a stable exchange rate of the denar against the euro. The environment for conducting monetary policy in 2016 was influenced by political uncertainty and speculations on exchange rate and banking system. Adverse effects of the domestic political situation and speculative attacks on the exchange rate and the banking system stability, mainly affected the movements on the currency exchange market and household deposits with banks in the period from April to May. In response to these non-economic factors, besides the sale of foreign currency on the foreign exchange market, at the beginning of May 2016, the NBRM increased the policy rate from 3.25% to 4% (first change since mid-2013). The reserve requirement for denar deposits with FX clause was also increased (from 20% to 50%) in order to support deeuroization and to maintain low propensity of economic agents to hold this type of deposits. In addition, auctions of banks' foreign currency deposits with the NBRM were reactivated, at favorable interest rates compared to the current negative interest rates on the international markets, which increased the interest from the banks and, consequently, boost foreign reserves. Following these measures, the situation was stabilized, thus during the third quarter there were positive movements in deposits and on the currency exchange market, as well as net purchase by the NBRM on the foreign exchange market. In late October, the auctions of foreign currency deposits were halted, and the placed deposits will gradually be released as they fall due.

Stabilization of the developments continued during the last quarter of the year. Such favorable developments, combined with the assessment of stable economic fundamentals and mitigated political risks, created a room for gradual adjustment of the policy rate, which in December was reduced to 3.75%.

The National Bank conducts ongoing monitoring of the movements in the currency structure of deposits and loans, as well as in the interest differential for instruments in domestic and foreign currency. In this regard, multiple changes have been made in reserve requirement rates in recent years, generally towards cutting reserve requirement rates on denar liabilities (and on a longer run). Potentially, the cost reductions would accordingly affect the interest rate differential in favor of denar deposits. Political instability and speculative attacks in the period April-May 2016 were estimated to have had limited adverse effects on the deposit currency structure (a small growth in the share of deposits with FX component of 1.5 p.p., and stabilization in the third quarter). These effects were limited by the set of measures aimed at stabilizing household expectations, further complemented by the gradual, partial calming of the political situation. The last increase in reserve requirement of deposits with FX clause in May 2016 was aimed at maintaining favorable deeuroization trends in recent years, which in turn, increases the credibility of monetary policy based on stability of the denar exchange rate against the euro.

The measure that released banks from reserve requirements on loans to export and energy sector, which has been in effect since early 2013 and has supported credit growth, continued in 2016. In 2015, about a quarter of the annual growth of corporate loans was to net exporters. Due to the positive effects on bank lending, at the end of 2015, this non-standard measure was extended to the end of 2017. Consequently, banks are expected to continue their active credit support to companies in these sectors by offering new loan products and favorable credit conditions.

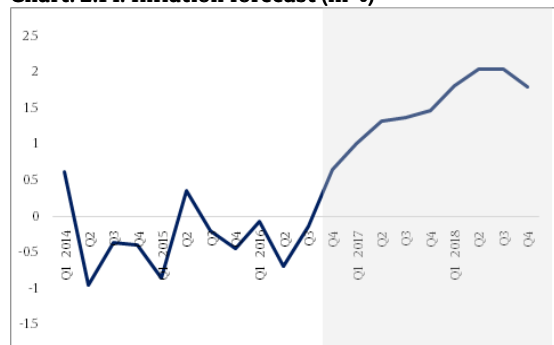
In the next three years, the monetary policy will remain oriented towards preserving price stability by maintaining a stable exchange rate of the denar against the euro. The results of the

models for evaluation of equilibrium denar real effective exchange rate⁸ as of the last quarter of 2015 do not indicate major deviations from equilibrium, which maintained within acceptable limits of +/- 3% in the period 2003-2015, and suggest moderate exchange rate underestimation during 2015⁹. Regarding the conduct of monetary policy, it is important to mention the results of the monetary transmission models that, with the latest update as of 2015, indicate improvement in the interest rate transmission channel from the policy rate to banks' interest rates (improvement in the transmission on lending and deposit interest rates amid higher transmission effect on deposit rates).

In the recent period of turbulent external environment, the monetary policy confirmed its flexibility and appropriately adjusted its monetary instruments, in order to encourage credit growth, strengthen the denar deposit base in a long run, while achieving its primary and intermediary monetary goal. In this context, the monetary policy provided sufficient incentive and revived the credit growth, and some of the measures are expected to produce effects in the next period. In 2016, the monetary policy showed readiness to properly deal with the aftermath of the domestic political shock whose effects were short-lived. In 2016, the inflation remained low, under the dominant influence of global factors on the supply side, amid moderately positive core inflation. According to the forecast of the other economic segments, in the next three years, we can expect moderate inflation movements and generally favorable movements in the foreign exchange market, although accompanied by risks. Fiscal policy, and in particular the way of financing the budget deficit and the implementation of the announced fiscal consolidation in the period ahead, remains a significant factor for the environment for monetary policy implementation, which also emphasizes the importance of monetary and fiscal coordination. External sector developments, import structure and their effects on the foreign exchange market and foreign reserves, will be crucial for the monetary setup in future. In addition, there will be regular monitoring of the pace and structure of credit growth in terms of consumer lending vis-a-vis investment lending, and of the movement of deposits and interest rate spreads. Monetary authorities remain ready to take appropriate measures, if necessary, to maintain price and financial stability in the economy.

Inflation. Global factors of inflation point to a moderate acceleration of domestic inflation in the medium run, after its low level in 2016, in line with the general downward trend of global prices of primary commodities. Foreign effective inflation¹⁰ in 2016 is estimated at 0% (which is significantly lower compared to last year's scenario). In 2017 and 2018, foreign inflation is

Chart. 2.14. Inflation forecast (in %)



Source: SSO, NBRM, October forecast for the period 2016-18

expected to increase moderately to 1.3% and 1.6%. Global prices of primary commodities are also expected to increase.

In the last quarter of 2016, the average annual inflation rate in the Macedonian economy is expected to remain low. Consequently, the average inflation rate in 2016 is expected to be around 0%. Analyzing the components, unchanged average price level relative to the previous year reflects negative changes in energy prices (in line with the fall in world fuel prices) and food prices, as opposed to the core

⁸ According to the BEER (behavioral equilibrium exchange rate) approach for assessment of the equilibrium denar exchange rate, which is based on a narrower definition of the real effective exchange rate and is designed on the basis of the five major EU trading partners of the Republic of Macedonia. Models (established by different specification and evaluated by various techniques) include productivity differential, trade openness, public consumption and total net foreign assets, as independent variables.

⁹ IMF's analyses also indicate no significant deviation in the real exchange rate (IMF Staff Report 2016 Article IV Consultation, November 2016, p.37).

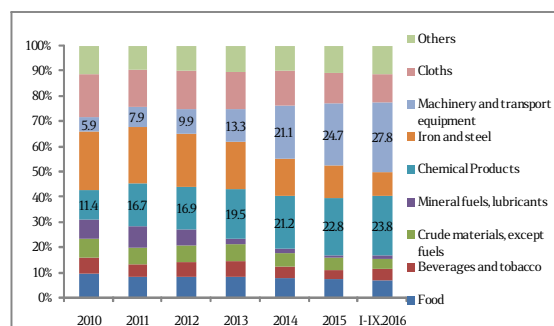
¹⁰ The calculation of effective foreign inflation is derived from a weighted sum of the consumer price indices of nine countries that are the most important exporters of products for personal consumption in the Republic of Macedonia. Weighted structure is based on normalized shares of nominal imports from each country in the total nominal imports in the period 2010-2012.

inflation that remained moderate and as expected. Compared with last year's scenario that expected inflation rate of about 1.5%, the inflation in 2016 in this scenario is estimated to be significantly lower, mainly due to the lower global prices of oil and food compared to the expectations at that time.

In 2017, the inflation is expected to gradually increase to about 1.3%. The growth of prices in the next year is in line with the movement of import prices, especially with the expectations for higher oil prices, amid expectations for faster inflation in trading partners. From a structural perspective, for 2017, there are expectations for upward movements in both food and energy component, amid relatively stable core inflation. Positive effect on inflation is also expected from the domestic demand, amid gradual strengthening of the economic activity, with the output gap being estimated as moderately positive. The acceleration of the inflation is expected to continue in 2018 and 2019, when it is expected to slowly come closer to the historical average of about 2%. Risks to the forecast inflation trajectory are mainly attributable to the uncertainty about the movements in the prices of global primary commodities.

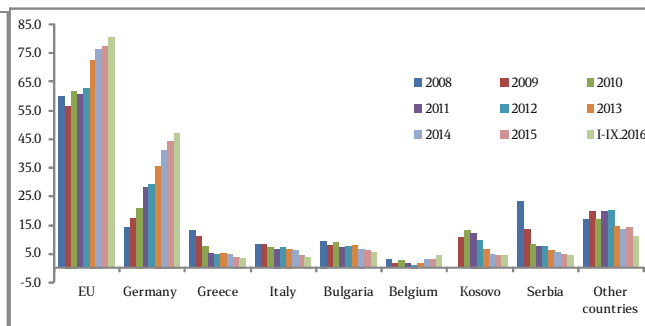
External Sector and Its Medium-Term Sustainability. The movements in the current account of the balance of payments of the Republic of Macedonia further reflect the structural changes in the economy in recent years that strengthened the export sector and improved the current account balance. The current account deficit in the last six years (2010-2015) averaged 2% of GDP (compared to the previous six-year average of about 6%). According to the trends and estimates for the last quarter of 2016, the current account deficit for 2016 was estimated at 2.1% of GDP, which is unchanged compared to the previous year. The estimated deficit for 2016 is slightly higher than expected in last year's macroeconomic scenario (close to 2% of GDP).

Chart. 2.15.
Export structure by products (in %)



Source: SSO.

Chart. 2.16.
Geographical breakdown of the export (% of total export)



Source: SSO.

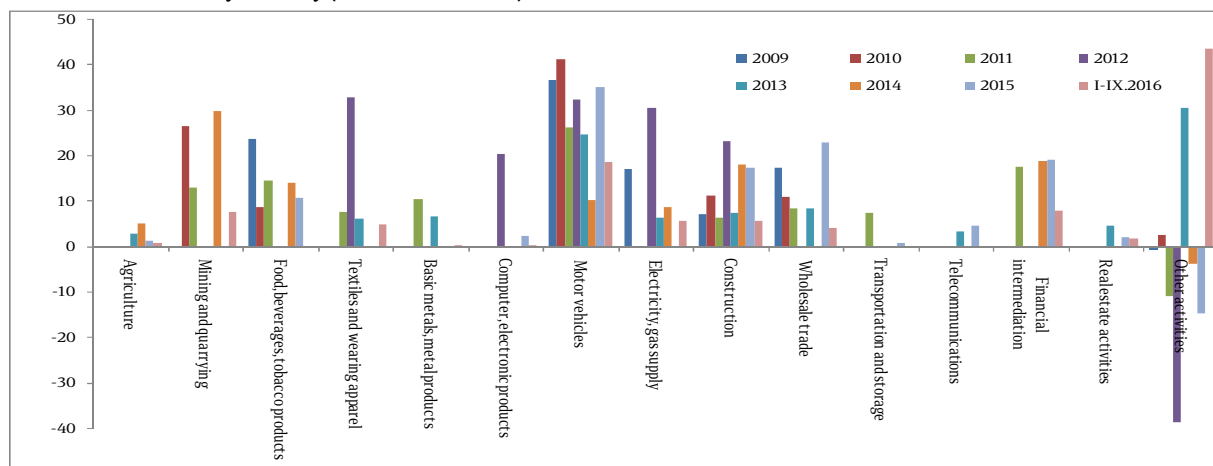
In the period January-September 2016¹¹, trade deficit is by 7% higher compared to the same period last year, amid export growth of 6.1% and higher import of goods of 6.3%. The increased exports mainly reflect higher export of machinery and transport equipment, and chemicals, mainly due to the effect of the new production facilities in the technological industrial development zones. Additionally, positive contribution was also made by some traditional sectors (food, beverages and tobacco). The increased imports mainly reflect higher imports of raw materials and equipment, in line with the dynamics of economic activity and investment consumption, with moderate contribution of the increased imports of vehicles and manufactured goods, as opposed to the lower import of fuel (amid significant price effect) and lower import of ores. In January-September 2016, trade with Great Britain registered the highest deficit in goods, while significant surplus was registered in the trade with Germany.

Analyzing the structure, as a result of the new capacities in the economy, the export structure significantly improved. It is due to the gradual increase in the share of higher value-added products in exports, mainly chemicals, and machinery and transport equipment that reached 51.6% at the end of September 2016. Changes in export structure correspond with the foreign

¹¹ According to foreign trade statistics, where imports are presented on CIF basis.

direct investments, which in the recent years, were mainly concentrated in these sectors. In the period 2009-2015, on average, about 63% of the new foreign capital was invested in the tradable sector, where one can expect its further contribution to greater export diversification. On the other hand, there is a decrease in the share of traditional export products - iron and steel, and textile products (smaller reduction in textiles and more significant decline in iron and steel), from dominant 40% in 2010 to about 20% at the end of September 2016, confirming the export diversification and modernization of the export structure. It should be noted that the unfavorable trends in export of iron and steel in recent years have been influenced by the unfavorable movements in the international market of metals and the fall in their prices. Share of exports of mineral fuels and lubricants in total exports have reduced in recent years, mainly reflecting the switch in the business orientation of the oil refinery (that had an effect on both sides of the trade).

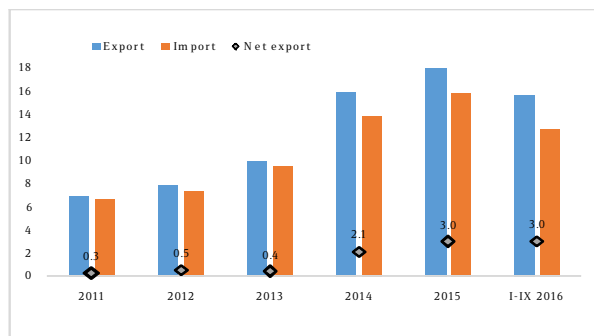
Chart 2.17. FDI net, by activity (% of the total FDI)



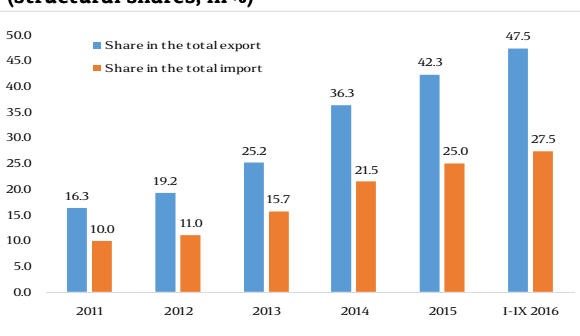
Source: NBRM.

Trade of new companies in foreign ownership can be analyzed in detail using foreign trade statistics, which shows that these companies register positive value added, which has accelerated in the last three years. Namely, in 2014 and 2015, net exports of these companies averaged 2.5% of GDP. The share of exports of these companies in total exports of goods in the economy has grown steadily, reaching nearly 50% of total exports in the first nine months of 2016. Thus, export growth of new companies is a major generator of growth of the overall export activity of the country, against the background of relatively low (or negative) contribution of other traditional export sectors. On the other hand, given that these companies import raw materials and equipment, the share of imports of these facilities in total import of goods also continued growing, but at a slower pace than the growth of exports (27.5% in first nine months of 2016).¹²

Chart 2.18. Trade exchange of new companies (% of GDP) **Chart 2.19 Export and import of new companies (structural shares, in %)**



Source: NBRM calculations.



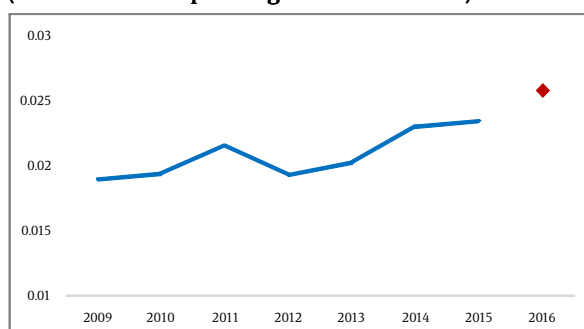
Source: NBRM calculations.

¹² Source: NBRM Quarterly Report, August 2016 (Appendix2). Charts are based on foreign trade statistics (customs declarations), where the export of goods is presented on f.o.b. basis, while imports of goods is on c.i.f. basis. The analysis includes 15 new large foreign capital companies. The results show that in the period 2009-2015, current transactions of these companies registered net inflows of about 2.4% of GDP, and net inflows of financial transactions of 2.7% of GDP on a cumulative basis. In summary, the effect of current and financial transactions of 15 new companies indicates creation of net foreign exchange inflows in the domestic economy of 5.1% of GDP.

Besides the direct effects on exports and employment, FDIs in the tradable sector have multiple positive effects in the economy. It mainly implies possibilities of transfer of new technologies, modernization of the production structure, and increased demand for raw materials from local companies that improves the quality of local suppliers¹³ (particularly by forcing implementation of standards in their businesses). This gradually increases the second-round effects of FDIs on the economy.

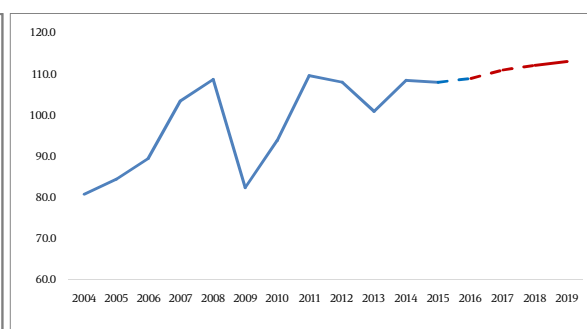
The analysis of the geographic distribution of Macedonian export proved that the EU is a major destination of about 80% of the Macedonian export in January-September 2016. Analyzing the EU, the share of exports to Germany has seen an annual growth (there are positive trends in the exports to Belgium and Spain, amid low initial shares, and an ongoing decrease in the share of exports to Greece, Italy and Bulgaria). Total trade between Macedonia and the EU in the period January-September 2016 constitutes about 70% of the total trade of the Republic of Macedonia, and given the faster growth of exports than imports, the deficit with the EU narrowed by around 15% annually.

Chart 2.20. Export market share
(% of the world export of goods and services)



Source: IMF and NBRM, forecast for 2016.

Chart 2.21. Export and import / GDP (in %)



Source: SSO and NBRM forecast for the period 2016-2019.

In the period January-September 2016, the denar real effective exchange rate (REER)¹⁴ deflated by consumer price index appreciated by 1.4% annually. Amid favorable domestic to foreign price ratio, it mainly arises from the denar nominal effective exchange rate that appreciated given the fluctuations of the currencies of some major trade partners. If we exclude primary commodities from the calculation (as commodities with variable prices) REER deflated by the same price index would register smaller appreciation of 0.3%. Nominal unit labor cost registered a moderate growth of 1.7% in the first three quarters of 2016, which amid modest productivity growth is due to the faster growth of wages.

Export market share of the economy in the world export, after increasing in 2013 and 2014, in 2015 remained relatively stable. In 2016, the export market share in world exports of goods and services is expected to accelerate again, given the acceleration of the Macedonian export of goods and services at almost unchanged level of world export of goods and services. The level of trade openness of the Macedonian economy is generally high, and in the period 2014-2016, it stabilized at about 108%. The level of trade openness of the economy is expected to gradually increase in the next three years.

International investment position and external debt. At the end of the third quarter of 2016, the negative international investment position (IIP) increased by 8% compared to the end of 2015, amid higher (absolute) increase in external liabilities compared to the increase of assets. The widening of the negative IIP arises from the growing negative net position of the government¹⁵ reflecting new Eurobonds issuance, which to a large extent was offset by the increase of positive IIP of the monetary authority. Additionally, the depository institutions and

¹³The WEF Global Competitiveness Report, 2016-17, ranks Macedonia at the 89th position by FDI and technology transfer (improvement of 24 positions compared to 2011) and at 47th position by quality of local suppliers (improvement of 44 positions compared to 2011).

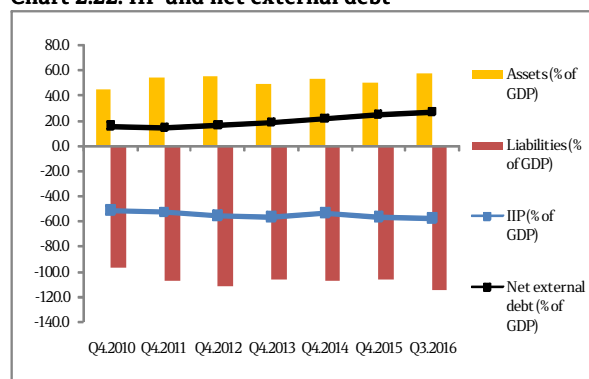
¹⁴Within the REER, the calculation of nominal effective exchange rate and relative prices includes 15 major trade partners of the Republic of Macedonia by their share in foreign trade in the period 2010-2012 and the base period 2010.

¹⁵Government sector includes: central government, local government and social security funds.

the other sectors (amid higher net liabilities mainly based on direct investments) also contributed towards widening of the negative IIP. In September 2016, the negative IIP was 57.1% of estimated GDP, and compared to the end of 2015, it is higher by 1 p.p. of GDP.

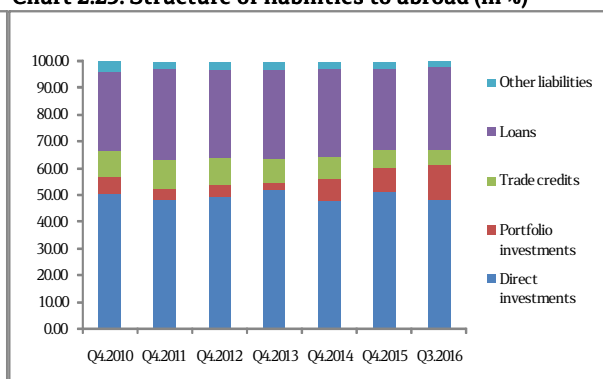
Given the significant share of foreign direct investment as external liabilities (about 50% in recent years), typical for the converging countries, the analysis of external position also needs to consider other variables, such as net external debt, which includes only net debt instruments. At the end of the third quarter of 2016, the net external debt of the Republic of Macedonia was 26.9% of GDP, or by 2.1 p.p. of GDP more compared to the end of 2015 (amid increased net debt of both the public sector and private sector by 1.8 p.p. and 0.2 p.p. of GDP, respectively).

Chart 2.22. IIP and net external debt



Source: NBRM and SSO.

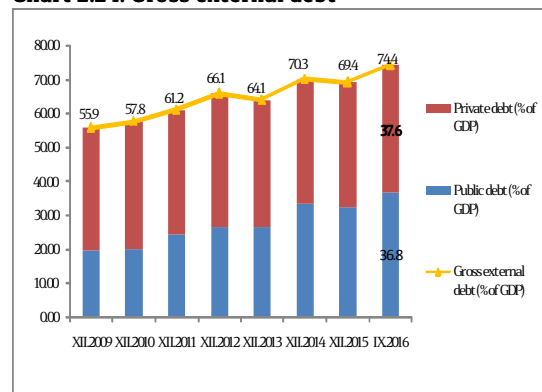
Chart 2.23. Structure of liabilities to abroad (in %)



Source: NBRM.

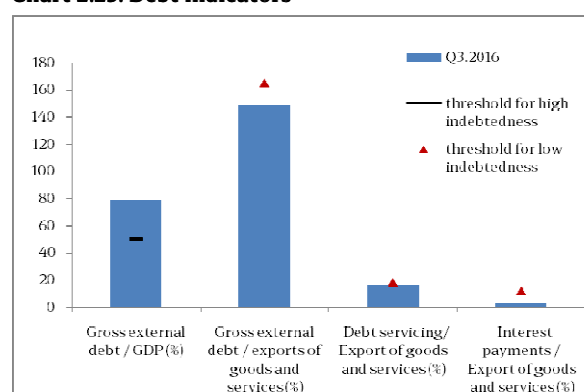
At the end of the third quarter of 2016, the gross external debt was Euro 7,151 million (without NBRM repo transactions, which appear in almost the same amount on the sides of liabilities to and claims on non-residents). The gross debt is 74.4% of GDP and relative to the end of 2015 it is higher by 5 p.p. of GDP. This increase was mainly due to the public debt (contribution by 4.4 p.p.), while private debt contribution was smaller (0.6 p.p.). Long-term debt with nearly 75%, still dominates the debt structure.

Chart 2.24. Gross external debt



Source: NBRM

Chart 2.25. Debt indicators



Source: NBRM calculations

At the end of the third quarter of 2016, the coverage of short-term debt by remaining maturity with foreign reserves was 1, indicating solid liquidity relative to external payments. The analysis of foreign debt¹⁶ of the Republic of Macedonia indicates low indebtedness by three ratios (gross external debt, debt servicing and repayment of interest, individually, to export of goods and services), while only gross debt to GDP ratio indicates high debt. The forecast of the balance of payments' financial account for the period 2017-2019 expects the three debt indicators, calculated as ratios to the export of goods and services, to improve or remain stable in the next three years,

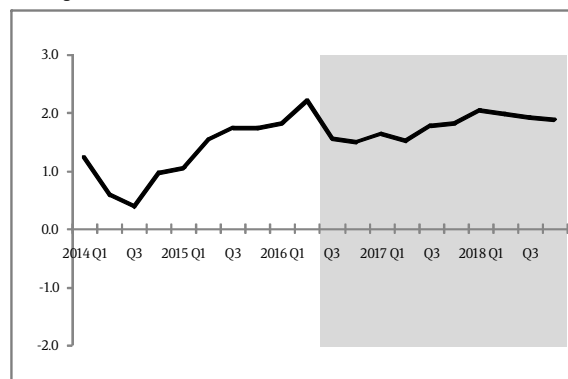
¹⁶ According to the World Bank approach, where the calculation of indicators uses three-year moving averages of GDP and exports of goods and services, as denominators. This method also defines indebtedness criteria, as reference values for the level of indebtedness.

given the expectations for moderate acceleration of exports, mainly due to the new foreign owned companies. Observing maturity structure, long-term debt is expected to remain dominant. Debt sustainability analysis is given in Annex 3 of the document.

Balance of Payments Forecasts. Global economy is expected to continue recovering in the next years. In this context, it is estimated that the annual foreign effective demand for Macedonian products¹⁷ in 2016 accelerated, recording a growth of 1.8%, which is more than expected in last year's scenario. In 2017, the economic activity in some trading partners is expected to face with adverse economic effects from the Brexit, amid assessments of slightly slower growth of external demand of 1.7%, while in 2018 it will increase by 2%.

The latest estimates of the external sector for the next three years suggest moderate current account deficit of around 2% of GDP. In the next three years, the needs for external funding are expected to be covered by borrowings and direct investments. It is expected that capital inflows will ensure maintenance of adequate level of foreign reserves of about four-month coverage of the import of the next year.

Chart. 2.26. Foreign effective demand (annual changes in %)



Source: NBRM, October forecast for the period 2016-18.

The gradual stabilization of foreign demand, along with the further positive effect of the existing foreign capital companies, and those pending to be established and start operating, in the next three years, export of goods and services is expected to continue increasing. In the next three years, imports would be driven by increased imports for the needs of export production, as well as by imports for the increased investment consumption. Thus, part of the new FDI inflows at the establishment of new capacities reflects with the increased import of machinery and equipment. At the same time, some medium-term public

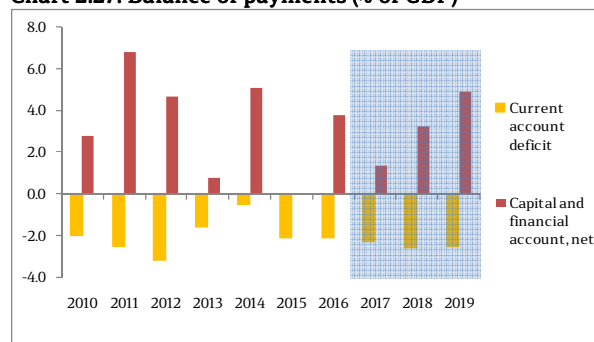
infrastructure works are expected to increase outflows for services. For 2016, trade deficit in goods and services is estimated to moderately narrow to 15.3% of GDP (16.3% of GDP in 2015). This assessment largely relies upon the increased export of goods (especially of the new facilities), narrowed energy trade balance, and increased surplus in trade of services. In terms of trade of services, it is worth mentioning that the improved performances over the last period of 2016 mainly result from the contribution of telecommunications and computer services, transport and construction services abroad, which indicate enhanced export perspectives of the services sector in future. The estimated deficit in goods and services in 2016 is lower than expected in the last year's scenario (16.5% of GDP) given the improved energy balance, mainly due to the price effect on fuel, and improved services balance. In the period 2017-2018, trade deficit in goods and services is expected to stabilize at about 15% of GDP, and to slightly decrease in 2019. Within this framework, the growth of market prices of crude oil on world markets is expected to moderately deteriorate the energy trade balance, which is expected to be offset through further positive developments in the non-energy trade deficit and the balance of services.

A significant part of the trade deficit will continue to be financed by inflows of secondary income (which includes net purchase on the currency exchange market as the main component of private transfers). One of the main segments that suffered from the political crisis in 2016 was the currency exchange market that reported increased demand for foreign currency in the second quarter. However, the effects were short-lived, and the net inflows of secondary income for 2016 are estimated at 16.3% of GDP (17.4% of GDP in 2015), which is a similar pace of slowdown as in

¹⁷The calculation of external demand takes into account the growth rates of GDP (Consensus Forecast) of the ten most important trading partners, according to their share in the Macedonian exports in the period 2010-2012.

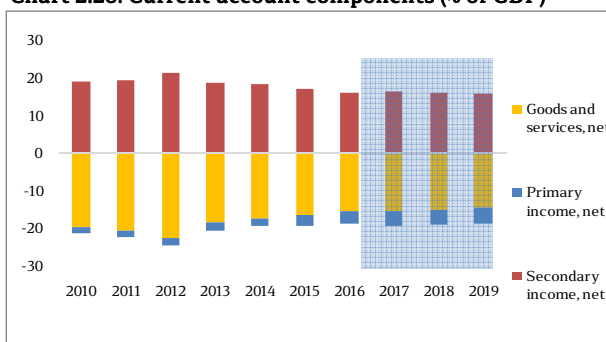
previous years when this category normalized after the excessive levels at the peak of the global crisis (in 2011-2012). After the recovery of net inflows of secondary income in 2017, they are expected to continue normalizing at a moderate pace in the next two years, and to reach 16% of GDP in 2019. The primary income deficit for 2016 is estimated at 3.2% of GDP, while in the next three years, it is expected to increase moderately and to be maintained at about 4% of GDP.

Chart 2.27. Balance of payments (% of GDP)



Source: NBRM. Estimate for 2016 and forecast for 2017-2019

Chart 2.28. Current account components (% of GDP)



Source: NBRM. Estimate for 2016 and forecast for 2017-2019

Amid such forecast of the current account movements, the current account deficit is estimated to be 2.1% of GDP for 2016, and to remain relatively stable at about 2% in the next three years (about 2.5% of GDP in 2018-2019). Moreover, despite relatively stable deficit in goods and services and its slight narrowing in 2019, the primary income deficit is expected to moderately widen, amid further moderate reduction in inflows of private transfers. The stabilization of the deficit in goods and services at around 15% of GDP is in line with the expected medium-term effects of FDI inflows in recent years in the tradable sector that have already changed the structure of the economy, contributed to greater export diversification, and consequently, given the strengthening of their export potential and favorable external environment, stabilized and narrowed the trade deficit (for comparison, the trade deficit in goods and services in 2009 was 22.7% of GDP).

In 2016 and the next three years, capital inflows will mainly result from the expected FDIs and the expected external public and private debt. The growth of domestic economy and the improvement of global environment are expected to contribute to maintaining positive perceptions among investors. In 2016, the foreign direct investments were estimated at 2.6% of GDP and in the next three years, they are expected to gradually grow and to reach 3.2% of GDP in 2019. This forecast is similar to last year's scenario and is due to the continuous inflows of FDIs (including in 2016 which was marked by internal political crisis), and the announcements for entry of new FDIs. Total net inflows on the financial account in 2016 would be nearly 4% of GDP (amid solid net government borrowing), lower in 2017, and in the next two years, they are expected to increase and to reach nearly 5% of GDP in 2019. Cumulatively, the expected movements in the current and financial account are estimated to ensure additional accumulation of foreign reserves in the next three years and further maintenance of relatively stable and adequate coverage of the average imports of each coming year.

Financial sector. In 2016, there are assessments for significant slowdown in deposits growth of 2.6% (from 6.3% in 2015), mainly reflecting larger withdrawal of deposits from the banking system due to the speculations on the Denar devaluation and the banking system stability primarily in the second quarter as well as shaken confidence of economic agents due to the uncertain domestic political environment. However, once the situation stabilizes, withdrawn deposits are expected to be gradually returned to the system. This, along with the expected favorable trends in the domestic economy will enable faster accumulation of deposits in the banking system, which are expected to grow at a solid rate of around 7.5% in the next two years.

In 2016, banks' credit support for the private sector remained solid, and credit growth, without write-offs, is estimated to be 5.6% by the end of 2016. In the next two years, it is expected to further strengthen to 6%-7% annually. Credit activity is expected to enhance given the positive trends on the demand and the supply sides. The intensification of economic activity in the coming

years is expected to improve the creditworthiness of economic agents. Moreover, given the higher private consumption and investment, there will be a greater need and willingness for lending to the private sector. At the same time, there is a basis for growth of the supply of bank loans, taking into account expectations for solid growth in the deposit base in the coming years and stronger competition within the banking sector, amid estimates for the absence of major risks in the economy relevant for the banking sector. In addition, the measures undertaken by the NBRM are still expected to produce favorable effects on the savings and lending activity.

Main priorities in the area of the financial system remain to be the maintenance of financial system stability, its further development, as well as enhancing intermediation. Therefore, the following activities will be undertaken:

- In the period 2017-2019, new Banking Law will be adopted, by which, banking regulations will be further aligned with the Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment companies and Regulation (EU) No. 575/2013 on prudential requirements for credit institutions and investment companies. The new Law, besides terminological harmonization, will provide for strengthening the banks' corporate management, primarily in terms of the rewarding policies and practices of banks and strengthening of the function of the Risk Management Committee. All this will provide for strengthening the banks' capacity for adequate risk management related to their operations, as well as for loss absorption, which can occur during the business operations.

- During the same period, what is also envisaged is adoption of the Law on Bank Recovery and Resolution by implementing 2014/59/EU Bank Recovery and Resolution Directive, thus creating conditions for quick response by the supervisory bodies in case of problems in the banks' operations.

- By the end of 2017, new Law on Payment Services and Systems will be adopted, transposing the Payment Services Directive (2007/64/EC), the Electronic Money Directive (2009/110/EC) and Settlement Finality Directive (98/26/EC). Draft Law on Payment Services and Systems has been prepared through the Project „Further Harmonisation with the EU Acquis in the Field of Movement of Capital and Payments and Financial Services - Securities Markets and Investment Services“, financed from IPA 2010, which lasted for 18 months and was completed in August 2016. Adoption of the Law on Payment Services and Systems will provide for the following:

- opening the payment services market for payment services providers other than banks, as well as for new issuers of e-money and increasing the competition in this segment of the payment system;
- establishing aligned prudent regime for giving authorisations to payment services providers other than banks, as well as for new issuers of e-money, for the purpose of providing adequate level of safety to the users of payment services and
- introducing harmonised operational manuals to be applied on all payment services providers and issuers of e-money for the purpose of providing equal access to the market of payment services.

- The two new laws in the field of capital market - Law on Financial Instruments and Law on Securities Prospectus and Issuers' Transparency Requirements – will be adopted by the end of 2017. Laws will be prepared through the Project „Further Harmonisation with the EU Acquis in the Field of Movement of Capital and Payments and Financial Services - Securities Markets and Investment Services“, financed from IPA 2010. New legal solutions will be fully aligned with the EU Acquis in the field of capital market, thus providing for greater transparency of the companies, introducing new financial instruments, new investment services and new markets to trade the financial instruments, establishing higher level of protection against market abuse and increasing the authorisations of the Securities and Exchange Commission as supervisory body in the field of capital market.

- New Insurance Law will be adopted in 2018, transposing the Solvency II Directive (2009/138/EC). Insurance Law will be prepared through the Project „Further Harmonisation with EU in the Field of Insurance and Increase of Market Operations“, within the National Programme for IPA Component 1 - TAIB for 2012-2013. The Project commenced in March 2016 and was completed in 18 months. Adoption of the new Insurance Law is expected to contribute to increasing reliability and stability of the insurance industry and strengthening the insurers' protection. Hence, capital requirements as regards establishment and operations of insurance undertaking will be aligned with and supervisory measures, adequate to the detected irregularities in the undertakings' operations, as well as procedures to implement them, will be prescribed.

During this period preparatory activities will start for the transposition of the Directive on Payment Services 2 and Payment Accounts Directive, aimed at further harmonization with the EU acquis in the field of payment services.

2.3. ALTERNATIVE SCENARIO AND RISKS

Alternative Scenarios. Two alternative scenarios will be elaborated on below. The first alternative macroeconomic scenario is based on the assumption for lower economic growth in the EU and other trade partners to the country in the forecasting period. According to this scenario, real GDP growth in 2017 is projected at 2.4%, at 2.6% in 2018 and at 3.0% in 2019.

Such scenario implies weaker external demand and unfavourable effects on the domestic exporters, i.e. lower growth of export activity and of industrial production. According to this scenario, real export growth is projected at 5% in average annually in the forecasting period.

Such scenario also assumes unfavourable effects on the inflow of capital in the country in the form of direct investments, implying slower growth of gross investments in the medium term, as a result of the lower growth of investments in the construction sector and of import of investment goods (equipment, machines, etc.). As a result, real growth of gross investments is projected at 4.3% in average annually in the forecasting period. Lower growth of gross investments in relation to the baseline scenario is mainly due to the slower growth of private investments, and to a lesser extent to the growth of public investments.

Effects on the consumption are expected to be smaller in relation to the other components. Hence, real growth of public consumption is around 1% in average annually in the forecasting period. Real growth of private consumption is projected at 1.8% in 2017 and 2% in the following two years. Lower growth of both export and domestic demand implies slower growth of import which, in the analysed period, is envisaged to surge by 4.2% in average annually.

The second alternative macroeconomic scenario is related to the risk of protracted domestic political crisis into 2017¹⁸. Such uncertain environment will adversely affect the confidence of the economic agents and will reflect on foreign investors restraining from making new investments and on households restraining from spending more. As a result, real growth of gross investments is projected at 2.6%, at the same time expecting for the public investments to increase, while growth of private consumption is expected to be 1.4%. Such scenario does not envisage any greater downward adjustment of export growth compared to the baseline scenario, i.e. growth is projected at 5.7% in real terms. In conditions of projected real growth of import of 4%, net import is expected to have a slight positive contribution to economic growth. Hence, according to this scenario, growth of economic activity in 2017 is envisaged to be 2.2%.

As regards labour market, sluggish economic growth implies slower growth of the number of employees and slower pace of reduction of unemployment rate compared to the baseline scenario. Hence, according to the first alternative scenario, average annual increase in the number of employees is expected to be 1.6%, resulting in drop of the number of unemployed persons by 2.4% in average in the forecasting period, assuming that projected growth rates of

¹⁸ Assumptions on international environment are in line with the baseline scenario.

changes in inactive population remain the same in relation to the baseline scenario. Such trends on the labour market will cause for the unemployment rate at the end of 2019 to drop to 21.7% and employment rate to surge to almost 45%. According to the second alternative scenario, growth of employment in 2017 is projected to be 1.3%, resulting in decline of unemployment rate to 23.2%.

As regards inflation rate, it is assumed that trends of primary commodity prices on the global stock markets remain unchanged in relation to the baseline scenario, i.e. we assume similar projections as regards the developments on the supply side and the level of foreign prices. Slower economic growth, according to the first alternative scenario, implies that no inflationary pressures by the demand are expected, taking into account that output gap is projected to remain in the negative zone until 2018, while lower positive output gap is estimated in 2019.

Effects of the alternative scenarios on the budget deficit are presented in point 3.6. Sensitivity Analysis.

Risks. Risks as regards projected economic growth rates are generally related to the global economic trends, mainly with the pace of growth of the economy in the EU, amid uncertainty related to the duration, the size and the scope of the effects pertaining to the UK exit from the EU. Thus, weaker economic performance in the EU and of the other trade partners of the country could reflect unfavourably on the export activity and the investment demand, hence on the economic growth of the national economy.

As regards the domestic environment, risk of protracted domestic political crisis is the highest, although the so-far effects from the domestic political instability on the economy are limited. On the other hand, resolving the political crisis provides for stable domestic environment, increased confidence by the economic agents which, in conditions of macroeconomic stability, might result in higher growth of investments, consumption and accordingly the economic activity than the projected one.

Main risks to the external sector scenario in period ahead in part still arise from the global surrounding, particularly the rate of global recovery and its influence on the growth of domestic economy and investor perceptions. Any weaker external demand may have adverse effects on the presence of domestic exporters in foreign markets. Amid heightened volatility in global financial markets, there is a possibility of greater risk aversion of investors and consequently, risks of lower capital inflows of non-debt financing or possible capital outflows to fund parent companies. It is estimated that the direct effects of Brexit on the Macedonian economy would be small, while potential risk is the indirect transmission effect through the EU, as our major trading partner. In addition, the movement of world prices is accompanied by uncertainty, with possible effects on domestic inflation and export prices. Possible continuation of unfavorable conjuncture in world metal markets (versus expectations for positive developments in 2017) may affect the growth and export prospects of the domestic metal industry as traditional export sector, although with significantly reduced share in recent years (in the context of structural changes in the economy and already dominant share of higher value-added industries).

The assessment and extent of the effects of new export capacities in the economy is crucial for the trade balance forecast. The number of export capacities in the economy has been increasing, and once they establish their production process, they start contributing to the country's exports. Trade deficit in the last three years was lower than expected in the scenarios, largely a result of the new export companies, which points to an upward risk (potential in the future, too). In this context, it should be noted that the current scenario incorporates an expectation of maximum capacity utilization of part of the existing companies, but the upward risk remains, especially with regard to new companies. In the medium run, changes in the production structure are expected to further diversify exports and improve export performance, which goes in favor of strengthening the resilience of the economy to external shocks. Given the growing number of new production facilities in the economy, and the expected improvement of the global environment, the expectations in this regard are justified. Moreover, the forecast of net inflows of secondary income (and within their frameworks, of net cash purchased on the currency exchange

market) that expects gradual slowdown of their share in GDP, can generally be assessed as conservative, thus reducing the downward risks to the this category and leaving room to offset any downward risks in the current account trade balance.

Risks to the inflation forecast are mainly conditioned upon the assumptions about the movements in prices of primary commodities, the potential changes in regulated prices and the possible second-round effect on other prices in the economy. In the light of conditionality of inflation mainly upon exogenous factors on the supply side (output gap would register small positive changes), risks to the forecast inflation trajectory in the medium run are difficult to assess.

Observing the expected banks' credit growth, the pace of global recovery, in the context of its influence on the domestic economic growth and the loan portfolio quality, as before, would affect the banks' risk perceptions and consequently, lending. Risks arising from the business strategies of foreign banking groups, and changes in the regulatory requirements, could also affect the operations of their subsidiaries in the country.

It is worth mentioning that the overall macroeconomic scenario largely depends on the implementation of the fiscal strategy for the next three years. Additionally, in 2015 and 2016 in particular, political risks were more pronounced, but with limited impact on the economy. Any continuation of these risks in the period ahead may increase the restraint of economic entities, even though the economy has already shown some vitality in this regard. The aforementioned risks to the macroeconomic scenario for the next three years indicate a need for constant monitoring of the changes in the external and domestic economic environment in the period ahead and a need for the policy makers to take timely and adequate measures.

3. FISCAL FRAMEWORK

3.1. FISCAL STRATEGY¹⁹ AND MEDIUM-TERM OBJECTIVES

Fiscal policy in the coming medium-term period will be focused on maintaining macroeconomic stability and encouraging economic activity through capital expenditures and investments in infrastructure and improving the doing business conditions to stimulate the potential of the private sector for growth and job creation.

In the coming medium-term period, attention will be focused on the commitment to gradually consolidate public finances, which envisages significant reduction of the budget deficit below the Maastricht criterion of 3% of GDP.

Projected revenues of the consolidated general government budget in the next three-year period decline relatively, as a share of GDP, from 32.7% of GDP in 2017 to 31.6% in 2019. As a result of continuity in implementing disciplined budget policy and strengthened consolidation of public spending, in the period 2017-2019, total expenditures will also decline from 35.7% in 2017 to 33.8% in 2019.

Set basic postulates of the fiscal policy in the coming period provide for gradual reduction of the deficit level and its positioning at a level of around 2.6% of the projected GDP in 2018 and 2.2% of GDP in 2019.

Table 3.1. Consolidated general government budget (Denar million)

	2017	2018	2019
Consolidated general government budget - Revenues	199,254	209,355	216,965
% of GDP	32.7	32.4	31.6
Consolidated general government budget - Expenditures	217,861	226,359	232,380
% of GDP	35.7	35.1	33.8
Consolidated general government budget - Deficit	-18,607	-17,004	-15,416

¹⁹ Fiscal Strategy 2017-2019 has been published on the website of the Ministry of Finance http://finance.gov.mk/files/u6/Fiskalna%20Strategija%20na%20RM%202017-2019_EN_1-1.pdf

% of GDP	-3.0	-2.6	-2.2
Central Budget - Revenues	115,724	122,700	127,433
% of GDP	19.0	19.0	18.5
Central Budget - Expenditures	134,443	139,460	142,533
% of GDP	22.0	21.6	20.7
Central Budget - Deficit	-18,719	-16,759	-15,100
% of GDP	-3.0	-2.6	-2.2
Budget Funds - Revenues	53,571	56,194	58,942
% of GDP	8.8	8.7	8.6
Budget Funds - Expenditures	53,459	56,193	58,941
% of GDP	8.8	8.7	8.6
Budget Funds - Deficit	112	0	0
% of GDP	0.0	0.0	0.0
Local Government Budget - Revenues	29,959	30,461	30,590
% of GDP	4.9	4.7	4.5
Local Government Budget - Expenditures	29,959	30,706	30,906
% of GDP	4.9	4.8	4.5
Local Government Budget - Deficit	0	-245	-316
% of GDP	0.0	0.0	0.0

Source: Ministry of Finance

3.2. BUDGET IMPLEMENTATION IN 2016

Budget revenue and inflow performance is within the expectations for this period of the year, while expenditures are executed on regular and timely basis. In the period January - September 2016, total revenues were collected in the amount of Denar 125,821 million, i.e. collection was higher by 7.1% in relation to the revenue collection in the analysed period last year. Denar 75,016 million out of this amount are tax revenues, being higher by Denar 6,432 million or by 9.4% more compared to last year. VAT revenues experienced the biggest increase, the collection of which amounted to Denar 34,956 million, being higher by Denar 4,333 million or 14.1% compared to the same period in 2015, predominating in the structure of tax revenues with 46.5%. Excise revenues were also higher than the projections. During the first nine months of 2016, they reached Denar 16,712 million, being higher by Denar 2,191 million or by 15.1% more than last year. On the other hand, Profit tax revenues collection of was by 14.2% lower compared to the analysed period in 2015, i.e. they reached Denar 8,234 million.

Revenues on the basis of social contributions were collected in the amount of Denar 36,874 million. This was by Denar 1,917 or 5.5% more compared to the same period in 2015. Denar 24,779 million was collected on the basis of pension insurance, while revenues collected on the basis of health insurance contributions amounted to Denar 10,519 million. Revenues performance corresponded to the positive trends in the real sector and the growth of economic activity respectively.

During the first nine months of 2016, non-tax revenues were collected in the amount of Denar 9,540 million, which compared to the same period in 2015, they were higher by Denar 189 million, i.e. by 2%. Capital revenues were collected in the amount of Denar 1,695 million, being generated from sale of construction land and social flats. Budget users generated Denar 2,441 million on the basis of donations from international multilateral and bilateral cooperation.

Expenditures in the period January-September 2016 were executed in the amount of Denar 134,915 million, i.e. by Denar 3,596 million or 2.7% higher compared to the same period last year. During this period, all liabilities of the budget users and the due liabilities towards domestic and foreign creditors were settled on time.

Within this framework, current expenditures were executed in the amount of Denar 124,044 million. During this period, Denar 19,378 million was paid for salaries and allowances to the employees with the institutions that are budget users, while expenditures related to goods and services were executed in the amount of Denar 11,134 million.

Transfers-related expenditures accounted for the most in the current expenditures, amounting to Denar 88,736 million in this period. Government liabilities on the basis of payments related to

exercising the rights to guaranteed social protection of the citizens (pecuniary allowances to vulnerable categories of citizens, as well as child allowance and parenting payments) were settled on regular basis, accounting for Denar 5,413 million. Increase of social welfare benefits by 5% was realized within these expenditures with the payments made in July. As regards regular payment of pensions, Denar 35,923 million was allocated therefore, with respect to financing health services and benefits, Denar 19,160 million was paid, while Denar 674 million was allocated for payment of unemployment benefits through the Employment Agency. Denar 11,096 million was transferred from the Budget of the Republic of Macedonia to the municipalities, as block grants for financing the transferred competences, as well as earmarked grants for financing the operating costs in local public institutions. In addition, Denar 1,443 million was transferred on the basis of VAT revenues. During this period, agricultural subsidies were paid on continuous and regular basis, aimed at improving the quality and the competitiveness of the sector.

Table 3.2. Budget of the Republic of Macedonia 2016

(Denar million)	Budget 2016	Realisation in the period January-September 2016
1. Total revenues	174,291	125,821
1.1. Tax revenues and contributions	149,597	111,890
1.1.1 Tax revenues	99,452	75,016
1.1.2 Contributions	50,145	36,874
1.2. Non-tax revenues	16,576	9,540
1.3. Capital revenues	2,329	1,695
1.4. Donations and other revenues	5,789	2,696
2. Total expenditures	197,410	134,915
2.1. Current expenditures	175,079	124,044
2.1.1 Salaries and allowances	26,520	19,378
2.1.2 Goods and services	21,621	11,134
2.1.3 Transfers	120,044	88,736
2.1.4 Interest	6,894	4,796
2.2. Capital expenditures	22,331	10,871
3. Deficit	-23,119	-9,094
4. Deficit financing	23,119	9,094
4.1 Inflow	44,573	15,456
4.1.1 Other inflows	54	60
4.1.2 External sources	31,657	30,357
4.1.3 Domestic sources	8,405	4,795
4.1.4 Deposits/Additional sources	4,423	-19,767
4.1.5 Revenues on the basis of sale of shares	34	11
4.2 Outflow	21,454	6,362
4.2.1 Repayment upon foreign borrowing	12,273	2,391
4.2.2 Repayment upon domestic borrowing	9,181	3,971

Source: Ministry of Finance

Transfers-related expenditures accounted for the most in the current expenditures, amounting to Denar 88,736 million in this period. Government liabilities on the basis of payments related to exercising the rights to guaranteed social protection of the citizens (pecuniary allowances to vulnerable categories of citizens, as well as child allowance and parenting payments) were settled on regular basis, accounting for Denar 5,413 million. Increase of social welfare benefits by 5% was realized within these expenditures with the payments made in July. As regards regular payment of pensions, Denar 35,923 million was allocated therefore, with respect to financing health services and benefits, Denar 19,160 million was paid, while Denar 674 million was allocated for payment of unemployment benefits through the Employment Agency. Denar 11,096 million was transferred from the Budget of the Republic of Macedonia to the municipalities, as block grants for financing the transferred competences, as well as earmarked grants for financing the operating costs in local public institutions. In addition, Denar 1,443 million was transferred on the basis of VAT revenues. During this period, agricultural subsidies were paid on continuous and regular basis, aimed at improving the quality and the competitiveness of the sector.

Denar 4,796 million was allocated for regular servicing of liabilities on the basis of interest, according to the repayment schedules on domestic and foreign borrowing. Denar 2,960 million out of this amount was allocated for payment of interest on foreign borrowing.

In the period January - September 2016, capital expenditures were executed in the amount of Denar 10,871 million. In this period of the year, activities for realization of major infrastructure projects were intensified, such as the construction of Corridor 10 highway and investments in reconstruction and construction of the railway infrastructure. At the same time, many projects were realised, aimed at improving the infrastructure in education sector, health sector and utilities infrastructure, by constructing schools, sports facilities, playgrounds, water supply and sewerage network, as well as reconstruction of health facilities.

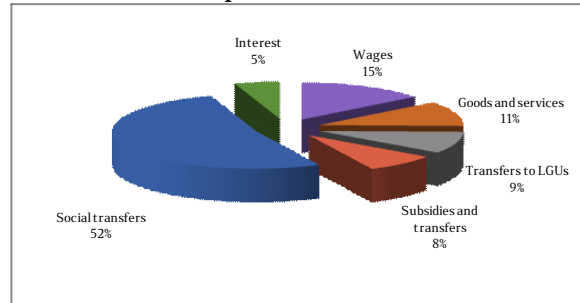
During this period, budget deficit amounted to Denar 9,094 million, being by Denar 4,780 million or by 34.5% less compared to the respective budget deficit in 2015. Inflows to the Budget provided for regular and early repayment of principal, amounting to Denar 6,362 million.

3.3. MEDIUM-TERM BUDGETARY OUTLOOK

Total genuine revenues of the Budget of the Republic of Macedonia (central government) for the period 2017-2019 are projected to around 30.4% of GDP, whereby their share in GDP by years is reduced in conditions of keeping low tax rates and low tax burden on the business sector. Thereby, tax revenues account for around 58.2% of the projected revenues, followed by revenues on the basis of social contributions accounting for around 27.7%, non-tax revenues and capital revenues accounting for around 10.7%, while the rest of the revenues are expected to be generated from IPA Funds and other donations. With respect to tax revenues, most revenues will be generated on the basis of VAT, personal income tax and excises.

In the next medium-term period, projections for social contributions, which are genuine revenues of the Pension and Disability Insurance Fund, Health Insurance Fund and the Employment Agency, are based on the expected positive economic trends, which will accordingly reflect on the growth rates of both employment and salaries. Non-tax revenues in the next medium-term period account for around 9.5% of the total revenues, wherein revenues on the basis of administrative fees and other non-tax revenues the budget users generate on their own accounts account for the most.

Chart 3.1. Current expenditure structure



Source: Ministry of Finance

In the coming period, budget revenue projections with regard to foreign donations include the donations the budget users will realise for specific projects, as well as disbursements from the EU pre-accession funds.

In the coming medium-term period, expenditure side of the Budget will be aimed at realisation of two components: development component aimed at supporting the growth of the Macedonian economy by investing in major infrastructure projects, and social component aimed at maintaining social stability and improving the living standard of the citizens, above all the vulnerable categories of citizens.

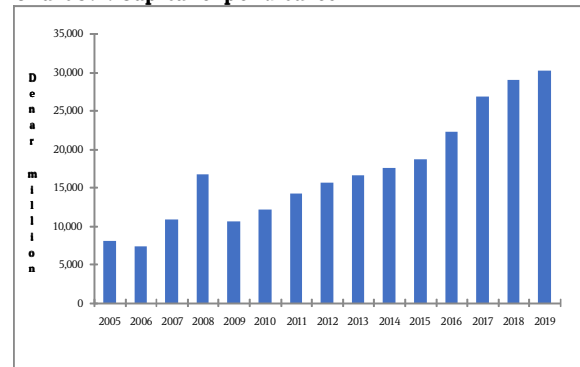
Thereby, disciplined budget spending will continue to be implemented, with an emphasis to restrictiveness and rigorous control over less productive costs, on one hand, and increase of investments in capital projects on the other. Average share of expenditures in the Budget of the Republic of Macedonia in the period 2017-2019 is around 33% of GDP.

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

- As regards expenditures related to wages and salaries and allowances, continuation of strict control over new employments;
- Timely payment of pensions and social benefits, for the purpose of ensuring the well being of the beneficiaries of these rights. Medium-term projections also include regular servicing of liabilities on the basis of social benefits for socially most vulnerable families as social assistance, child allowance, allowances on the basis of rights of disabled persons, war invalids and civilian invalids and asylum seekers. The Conditional Cash Transfers Project will continue, financed with a World Bank loan, aimed at reducing poverty of vulnerable groups by conditioning the existing pecuniary allowances;
- Further provision of significant amounts for payment of agricultural subsidies, to the end of strengthening and supporting this sector;
- Improvement of the quality of university education and vocational education, as well as public financial support for stimulating innovations in Macedonian companies. To that end, implementation of the Skills Development and Innovation Support Project, funded with a World Bank loan, will continue in 2017.
- In order to improve the innovation capacity of the companies by better access to skills, knowledge and technology, Fund for Innovations and Technological Development will continue the activities aimed at better access to skills, knowledge and technology through its new instruments in the form of co-financed grants and conditional loans, as well as significant technical assistance.

In the coming medium-term period, fiscal policy will focus on ensuring substantial public investments, being a precondition for improvement of economic perspectives, as well as better and more quality life of the citizens. To the end of realizing and maintaining positive economic growth rates, in the coming three-year period significant amount from the Budget is expected to be intended for public investments, as a development component of the fiscal policy. Denar 26,954 million is envisaged for capital investments in 2017 Budget.

Chart 3.2. Capital expenditures



Source: Ministry of Finance

Regarding the budget funds allocated for capital expenditures, significant investments are envisaged:

- road infrastructure will be improved through ongoing construction of motorway section Demir Kapija – Smokvica along Corridor X, being 28.18 km long, thus completing the main axis of Corridor X passing through the Republic of Macedonia. Construction of this section is financed with loans from EBRD and EIB, grants under the IPA and Budget funds;
- at the same time, substantial investments in road infrastructure, financed with World Bank and Export – Import Bank of China loans, are ongoing through the Public Enterprise for State Roads, aimed at rehabilitation, upgrade and development a number of road sections;
- activities envisaged under the National Roads Program, funded with EBRD loan, will be intensified in the coming period, envisaging construction of new road sections;
- finalisation of the Rail Corridor X Project, financed with EBRD loan, encompassing overhaul of several sections along Corridor X, the total length of which is around 53 km.
- implementation of the Project for Completion of Rail Corridor VIII, being aimed at connecting the Black Sea with the Ionian Sea. Construction of the eastern part of Rail Corridor VIII, i.e. the part towards Bulgaria, will be carried out in 3 phases, out of which the first two are financed with EBRD loans, while the third phase is planned to be financed with grant funds under the IPA and

loans from international financial institutions. The drafting of the main project with the tender documentation for the construction of the western part of the railway Corridor VIII will be carried out with grant funds under the IPA;

- implementation of the “Macedonian Railways Fleet Renewal Project”, financed with EBRD loan in the amount of EUR 50 million, will continue;
- continuing the construction of the other sections of the national gasification system, financed with a loan from Deutsche Bank and Erste Group Bank;
- “Water Supply and Waste Water Collection Project”, focused on rural areas, financed with EIB loan, will continue to be implemented in the coming period;
- finalising of the “Project for Rehabilitation of Health Provider Institutions in the Republic of Macedonia – Phase I”, funded by Council of Europe Development Bank (CEB), which envisages construction/reconstruction of 24 health provider institutions;
- construction of the Regional Clinical Hospital in Stip will continue, while construction of the Clinical Centre “Mother Teresa” in Skopje will commence in 2017, both financed with a CEB loan;
- the “Project for Building Physical Education Facilities in Secondary Schools”, financed with CEB loan and contribution of the Republic of Macedonia, will continue to be implemented, as well as renovation of several secondary schools;
- the Project for Building Physical Education Facilities in Primary Schools and Rehabilitation of Primary and Secondary Schools in the Republic of Macedonia, financed with CEB loan and contribution of the Republic of Macedonia, will continue to be implemented;
- implementation of the second and the third phases of the “Zletovica Water Basin Utilisation Improvement Project” is planned to commence in 2017 with a support by EIB, providing irrigation for 4,570 ha net area, as well as construction of small hydro power plants along the flow of Zletovica River;
- second phase of the “Irrigation Program Southern Vardar Valley”, is to continue in 2017 as well, financed with a KfW loan. This phase, covering rehabilitation and modernisation of the irrigation systems in the Southeastern region of the Republic of Macedonia, will contribute to achieving both increased productivity and sustainable development of the agricultural production in this region;
- “Project for Reconstruction of Houses of Correction”, financed with the Council of Europe Development Bank loan, will continue to be implemented, including construction, reconstruction, renovation and extension of 4 houses of correction, thus implementing the standards set in the international and European prison rules;
- the “Project for Housing of Vulnerable Groups”, funded with a CEB loan will continue in 2017 as well, by constructing flats for low-income persons.

Projected Deficit and Its Financing. As for the period 2017-2019, budget deficit is envisaged to gradually reduce, as follows: 3% of GDP in 2017, 2.6 of GDP in 2018 and 2.2% of GDP in 2019.

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

Foreign borrowing, as source of financing, will be used by budget users for realization of specific projects.

As for the borrowing on the domestic market, Ministry of Finance will continue to issue government securities in the next period as well. The purpose is, by regular issuance of government securities, to provide for more efficient financing of budget needs in the short and long run, reducing the financing costs, as well as encouraging the further development of financial market in the Republic of Macedonia.

In the coming period, Ministry of Finance will continue extending the maturity structure of government securities portfolio by issuing long-term securities, i.e. by issuing 2-, 3-, 5-, 10- and 15-year government bonds. Pension funds, as well as commercial banks and insurance companies, are expected to, in particular, show interest in investing in long-term securities issued by the Republic of Macedonia.

Table 3.3 Projected deficit and sources of its financing.

	2017	2018	2019
Budget balance	-18,607	-16,760	-15,099
Deficit financing	18,607	16,760	15,099
Inflows	37,133	39,754	29,165
External sources	17,634	14,096	18,924
Domestic sources	17,834	21,010	16,408
Deposits	1,665	4,648	-6,167
Outflows	18,526	22,994	14,066
Repayment upon foreign borrowing	9,232	10,520	6,339
Repayment upon domestic borrowing	9,294	12,474	7,727

Source: Ministry of Finance

Local Government Budget. In the course of 2016, as well as in the medium run, it is expected for the municipalities to continue the trend of strengthened collection of own revenues, strengthening the capacities for development of policies for financing the municipalities and enhancing the capacities for financial management.

For the purpose of realizing the strategic commitments, strong commitment to encouraging sustainable local development, good local governance and creating conditions for more active, more effective and more innovative role of the local authorities in attaining the national objectives for growth and development, will continue in the coming period as well.

Additional revenues are allocated to the municipalities from the state budget on the basis VAT grant (general grant), in the amount of 4.5% of VAT collected in the previous year.

New revenues are provided by allocating funds from lease of state-owned agricultural land to the municipalities, the proportion of which is 50% for the Budget of the Republic of Macedonia and 50% for the municipalities and the municipalities in the City of Skopje, to be distributed from 2018 (this ratio will be 70%:30% in 2017), depending on the location of the agricultural land being under lease, provided that revenue performance on the basis of tax on real estate exceeds 80% in relation to the projected ones. The municipalities are also allocated additional revenues from the fee collected by issuing concession for usage of water resources for electricity generation (50% for the central government budget and 50% for the local authorities), depending on which area the concession activity is performed.

Performance of own revenues of municipalities, in particular revenues collected on the basis of taxes on real estate, as a result of fully including the real estate of natural persons and legal entities and re-assessment of the value of real estate, will continue to increase in the next medium-term period. At the same time, part of the municipalities generated higher revenues on the basis of property taxes as a result of the higher rate of calculation and collection of property tax within the set spread pursuant to the Law on Property Taxes. Higher revenues are also expected by applying the improved elements of calculation in the Methodology on Determining Market Value of Real Estate, as well as the improved quality assessment of the value of real estate, thus providing the municipalities the legal possibility to employ an expert – an evaluator or to use the services of licensed evaluators.

In the coming period, higher revenues are expected to be generated by determining the real market value of the real estate after completing the procedure on treatment of illegally built facilities on construction and agricultural land.

In the coming medium term, municipalities will continue performing the transferred competences for management of construction land and treatment of illegally built facilities and

agricultural land, the respective sources of revenues therefore being determined in municipal budget are determined.

Government of the Republic of Macedonia will continue to carry out the activities aimed at equal regional development and enhancement of all regions in the country in the next period as well. Implementation of the 2009 – 2019 Strategy for Equal Regional Development of the Republic of Macedonia in the eight planning regions (Vardar, Eastern, Southwestern, Southeastern, Pelagonija, Polog, Northeastern and Skopje regions), by better vertical and horizontal coordination between the national and the local policies and through the integrated development projects adjusted to the local needs, will provide for more balanced local development throughout the country. Council for Equal Regional Development will continue to play significant role as promoter of partnership between the regions/the municipalities and the Government, coordinating the usage of funds from all sectoral programs intended for the planning regions and the municipalities. Special efforts will be put in supporting municipalities by encouraging local development via supporting the local projects and harmonizing them with the national ones.

Realisation of series of infrastructure projects related to improvement of the quality of life will accordingly improve the regional development and the active integration of regions in the economy. To that end, series of projects will be undertaken aimed at improving the overall road and communal infrastructure, as well as urbanization of villages to the end of development and support of rural tourism and recreational centers.

Implementation of “Municipal Services Improvement Project”, supported by the World Bank will continue in 2017 as well. The loan proceeds are intended for financing infrastructure investment projects in the field of water supply and wastewater drainage, management of solid waste and other investments in municipal services, having potential to generate revenues, i.e. to make savings, or being of high priority for the municipalities. IPA funds are additionally provided for this Project, which the municipalities can use, as grants, by 2019 so as to finance their priority projects.

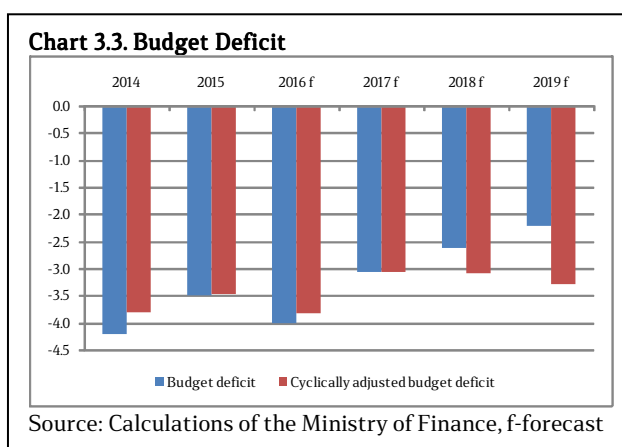
At the same time, pursuant to the legal regulations, municipalities fulfilling the legal criteria to borrow, will be able, in the coming period, to finance their projects by borrowing on the basis of concluding loan agreements at domestic or foreign creditors or on the basis of issuing municipal bonds.

Government will continue to successfully implement this process within the fully established legal and institutional framework of local government, with developed, responsible and functional local government units and increased level of local democracy that will bring the citizens closer, as much as possible, to the local government institutions.

3.4. STRUCTURAL DEFICIT

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

Calculations point out that cyclically adjusted budget deficit accounted for 3.8% in



2016, and it was lower than the projected budget deficit in the respective year, taking into account that the cyclical budget component has a negative value, as a result of the estimated negative output gap.

In 2017, taking into account that projected GDP is expected to be the same with the potential one, cyclical budgetary component is neutral, i.e. cyclically adjusted budget deficit is the same as the projected one, which accounts for 3% of GDP. In 2018 and 2019, in conditions of positive output gap, estimated cyclically adjusted deficit is higher than the projected budget deficit, i.e. it amounts to 3.1% in 2018 and 3.3% in 2019. During the analysed period, cyclically adjusted primary budget deficit accounts for 1.7% in average (see Table 3.4).

Table 3.4. Aggregate fiscal indicators and production gap

	2016	2017	2018	2019
Total budget balance	-4.0%	-3.0%	-2.6%	-2.2%
Primary budget balance	-2.8%	-1.7%	-1.1%	-0.7%
Production gap	-0.5%	0.1%	1.4%	3.3%
Cyclical component of the budget	-0.2%	0%	0.5%	1.1%
Cyclically adjusted total budget balance	-3.8%	-3.0%	-3.1%	-3.3%
Cyclically adjusted primary budget balance	-2.6%	-1.7%	-1.6%	-1.7%

Source: Calculations of the Ministry of Finance

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

3.5. DEBT LEVELS AND DEVELOPMENTS, ANALYSIS OF BELOW-THE-LINE OPERATIONS AND STOCK-FLOW ADJUSTMENTS

At the end of Q3 in 2016, government debt of the Republic of Macedonia²⁰ amounted to EUR 3,964.0 million, i.e. 41.9% of GDP. At the end of Q3, total public debt²¹, which includes both the government debt and the guaranteed debt, amounted to EUR 4,759.3 million, accounting for 50.6% of GDP. During the analysed period, domestic government debt accounted for 35.1% in the total government debt, while the external government debt accounted for 64.9%. Share of external government debt increased by 4.2 p.p. compared to the end of 2015, above all as a result of the issuance of the Eurobond amounting to EUR 450 million. From interest structure point of view, fixed interest rate debt increased by 5.7 p.p. compared to end-2015, by which the ratio between fixed interest rate debt and variable interest rate debt was 74.1% to 25.9% respectively. Such increase of fixed interest rate debt was a result of the issued government Eurobond with fixed interest rate of 5.625%. As for the currency structure of foreign currency debt, share of euro-denominated debt in the foreign currency debt portfolio accounted for 86.8% and, compared to end-2015, it increased by 3 p.p..

Table 3.5. Public debt stock (EUR million)

	2011	2012	2013	2014	2015	30.09.2016
External Public Debt	1882.0	1941.2	2078.7	2725.1	2847.5	3535.9
Government Debt	1582.1	1615.9	1597.5	2092.2	2096.7	2561.8
Guaranteed debt	299.9	325.3	481.2	633.0	750.8	792.1
Domestic Public Debt	532.9	967.6	1202.7	1196.2	1379.7	1405.4
Government Debt	510.8	938.6	1174.1	1170.3	1356.6	1384.2
Guaranteed debt	22.1	29.0	28.6	25.9	23.2	21.1
Total Public Debt according Public Debt Law	2414.9	2908.8	3281.4	3921.3	4227.2	4759.2
Total Public Debt as % GDP	32.0	38.3	40.3	45.8	46.7	50.6
Total Government Debt	2092.9	2554.5	2771.6	3262.5	3453.3	3946.0
Total Government Debt as % GDP	27.7	33.7	34.0	38.1	38.1	41.9
Guaranteed Debt	322.0	354.3	509.8	658.9	774.0	813.2
Guaranteed Debt as % of GDP	4.3	4.7	6.3	7.7	8.5	8.7

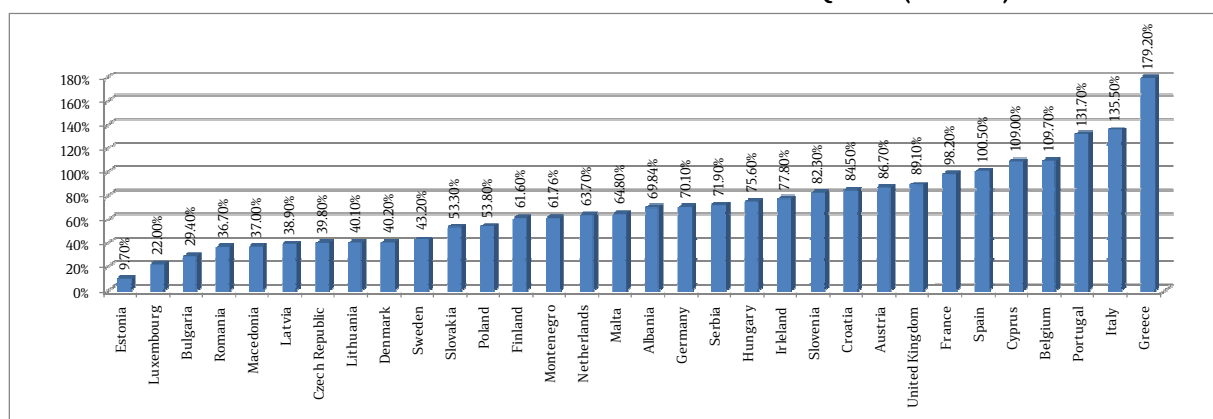
Source: MoF and NBRM

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

²¹ Public debt comprises the government debt and the guaranteed debt of public enterprises and state-owned joint stock companies.

Medium-Term Fiscal Strategy, covering 3-year period, is the framework determining the public debt management policy in the Republic of Macedonia.

Chart 3.4. Government debt of EU Member States and candidate countries in Q2 2016 (% of GDP)



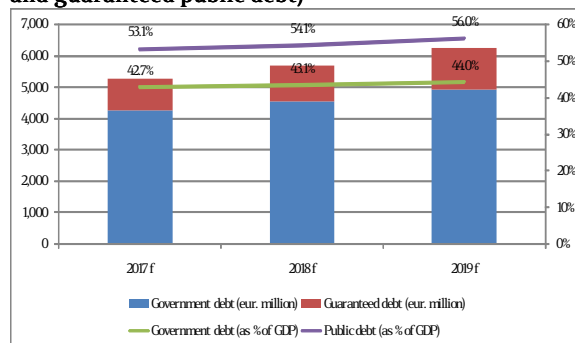
Source: Ministry of Finance, Eurostat, October 2016

Investments launched in the past period in the field of road and rail infrastructure, water supply and sewerage, sports facilities, education, health, energy, construction of the National Gasification System, as well as other projects that are in line with the Programme of the Government of the Republic of Macedonia, are expected to continue realizing in the period 2017 - 2019. The projects, co-financed with foreign loans, will be implemented by the state administration bodies, strongly committed not to jeopardize the long-term sustainability of the debt level of the country. According to the Fiscal Strategy, moderate and contained increase of government debt up to 44.0% of GDP is expected at the end of 2019, while public debt is expected to account for 56.0% of GDP during the same period. The Fiscal Strategy is submitted to the Parliament of the Republic of Macedonia, whereby the legislative authority has insight in the public debt management policy.

In order to reduce the exchange rate risk, currency limits are set in the Fiscal Strategy, whereby the minimal share of euro-denominated debt in the foreign currency debt portfolio should account for 80%. In addition, interest limit on government debt is also set in the Fiscal Strategy, i.e. the fixed interest rate debt should account for at least 50% in the total debt portfolio.

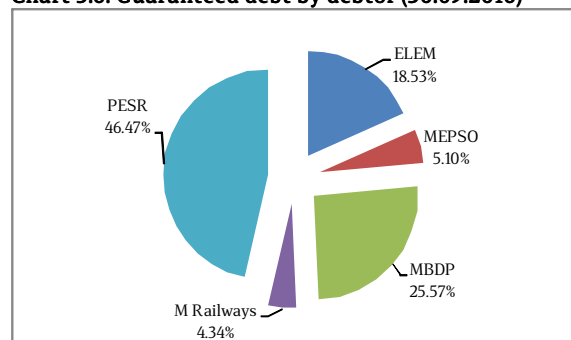
In order to protect central government debt portfolio against the refinancing risk, minimum level of the “average time to maturity” indicator in 2017 should be 3 years. In order to protect central government debt portfolio against the interest rate risk, minimum level of the “average time to refixing” indicator in 2017 should be 2 years.

Chart 3.5. Forecast of total public debt (government and guaranteed public debt)



Source: Ministry of Finance

Chart 3.6. Guaranteed debt by debtor (30.09.2016)



Source: Ministry of Finance

Republic of Macedonia remains to be moderately indebted country as a result of the cautious and successfully managed fiscal policy in the past years.

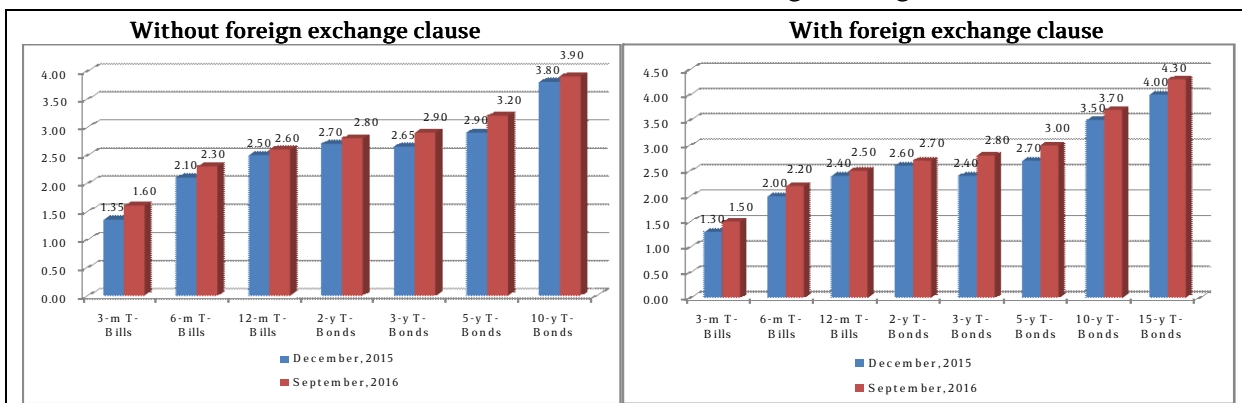
Moderate growth of investment activity is projected in the course of 2017, by using credit support from abroad. In addition, in the period 2017 – 2019, investments are expected to be carried out in the field of road and railway infrastructure, water supply and sewerage

network, construction of social flats, as well as investments in the field of education and health aimed at increasing productivity, i.e. boosting the competitiveness of the economy in the long run. Guaranteed debt in relation to GDP is expected to experience a moderate increase, as a result of the new planned projects in the field of road infrastructure and energy sector for which the state will issue guarantees.

However, as for the new borrowings, account is taken of the long-term sustainability of debt, whereby the process of issuing new guarantees is strictly regulated and subject to the borrowing procedure prescribed in the Public Debt Law, according to which the public debt issuers should fulfill certain criteria so as for the country to be able to issue guarantee. As of 30th September 2016 inclusive, issued sovereign guarantees amounted to EUR 813.2 million, accounting for 8.7% of GDP (included in the public debt which accounted for 50.6% of GDP).

Primary Government Securities Market. According to the Calendar for Issuance of Government Securities (GS) on the Domestic Market, in the period January - September 2016, Ministry of Finance issued 3-, 6- and 12-month treasury bills on regular basis, as well as 10- and 15-year government bonds. In this period, total of 81 auctions of GS were carried out, i.e. 52 auctions of treasury bills and 29 auctions of government bonds. Total amount offered for sale at the auctions was Denar 44,230.86 million, demand was Denar 41,121.53 million and amount realised accounted for Denar 41,007.81 million.

Chart 3.7. Interest rates of Government Securities without and with foreign exchange clause

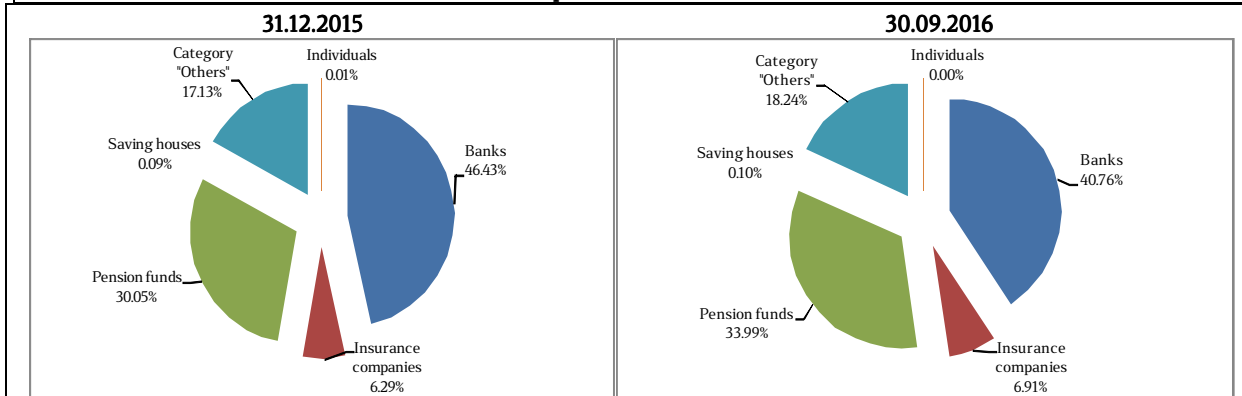


Source: Ministry of Finance

Interest rates on government securities in the period December 2015 – September 2016 are shown in Chart 3.7. In January 2016 the Ministry of Finance raised the interest rates on government securities at an average of 0.20 p.p. and as of September 2016, interest rates on government securities remained at the same level.

As of September 2016 inclusive, stock of outstanding government securities amounted to Denar 80,125.90 million, Denar 37,263.97 million out of which as treasury bills and Denar 42,861.93 million as government bonds.

Chart 3.8. Government securities market ownership structure



Source: Ministry of Finance

Despite the reduced share of banks in the ownership structure of outstanding government securities, trends of their dominant share in ownership structure of government securities continued in the course of 2016 as well (Chart 3.8.). In the period January - September 2016, except for the banks, saving houses and individuals, share of other categories of market participants in the ownership structure increased. During the analysed period, share of banks dropped by 5.67 p.p. in relation to the share of other market participants. As of September 2016 inclusive, ratio between banks and other market entities was 40.76% to 59.24% respectively.

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

In the period January - September 2016, only trading in government denationalisation bonds was recorded at the Macedonian Stock Exchange. Total volume of trading during this period amounted to Denar 649.54 million, surging by Denar 63.04 million compared to the same period last year.

During the same period, 24 transactions with government securities, pertaining to treasury bills, and 7 transactions with government securities, pertaining to government bonds, were realised on the OTC market. Total nominal trading amount amounted to Denar 2,950.00 million. Compared to the trading in the same period last year, it can be concluded that larger number of transactions with government securities were realised in 2016, while total nominal amount of trading was higher by Denar 1,482.14 million.

International Capital Market. In July 2016, Republic of Macedonia issued the fifth Eurobond on the international capital market, intended for financing the budget needs and refinancing the liabilities falling due in 2016 and 2017 on the basis of previously issued public debt. The Eurobond was issued in the amount of EUR 450 million, with a coupon interest rate of 5.625% annually and 7-year maturity, and it is traded on the Irish Stock Exchange. The ownership structure of Eurobond is mainly distributed between hedge and asset funds, insurance companies and banks from the USA and Continental Europe. In the course of 2016, Eurobonds issued by the Republic of Macedonia, falling due in 2020, 2021 and 2023, were traded on the international capital market. As of September 2016 inclusive, yield to maturity as regards the Eurobond falling due in 2020 is 3.19%, while as regards the Eurobond falling due in 2021 and the Eurobond falling due in 2023, yield to maturity is 3.30% and 4.31% respectively.

Credit Rating of the Republic of Macedonia. On 19th August 2016, “Fitch” Credit Rating Agency announced that it downgraded Macedonia’s Long-Term Foreign and Local Ratings to ‘BB’ from ‘BB+’, with a negative outlook. The Agency noted that the degraded rating was based on the political crisis in Macedonia, increased economic uncertainty and the negative pressure on public finances.

On 30th September 2016, “Standard & Poor’s” Credit Rating Agency affirmed the previously awarded ‘BB-’ long- and short-term foreign and local currency sovereign credit rating of the Republic of Macedonia, at the same time affirming the stable outlook of the country.

3.6. SENSITIVITY ANALYSIS

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

Taking into account that medium-term fiscal scenario is based on macroeconomic assumptions, we consider them as factor with potential effect on the fiscal trends. Hence, the first scenario assumes lower economic growth, according to the alternative scenarios elaborated on in point 2.3. In fact, the baseline scenario, which budget revenue and expenditure projections are based on, envisages real GDP growth of 3% in 2017, 3.5% in 2018 and 4% in 2019. According to the first

alternative scenario, real GDP growth is projected at 2.4% in 2017, at 2.6% in 2018 and at 3% in 2019. Lower economic growth projections result in higher budget deficit compared to the baseline scenario, in particular by 0.3 p.p. in 2017, 0.5 p.p. in 2018 and 0.7 p.p. in 2019. According to the second alternative scenario, real GDP growth is projected at 2.2% in 2017, implying lower increase of budget revenues and respectively higher budget deficit in relation to the baseline scenario, which would account for 3.5% of GDP. Table 3.6. shows the budget deficit in the analysed period according to both the baseline and the alternative scenarios.

Table 3.6. Sensitivity analysis of budget deficit

	2017	2018	2019
GDP, real growth rate	3.0	3.5	4.0
Budget revenues, growth rate	7.6	5.3	3.9
Budget expenditures, growth rate	4.5	3.9	2.8
Budget deficit (% of GDP)			
Baseline Scenario	-3.0	-2.6	-2.2
Scenario 1a. Lower GDP growth rate in the analysed period according to the first alternative scenario	-3.4	-3.1	-2.9
Scenario 1b. Lower GDP growth rate in 2017 according to the second alternative scenario	-3.5	-2.7	-2.2
Scenario 2. Lower growth rate of revenues by 1/5 in the analyzed period	-3.5	-3.3	-3.1
Scenario 3. Higher growth rate of expenditures by 1/4 in 2017 and 2018	-3.4	-3.3	-2.8

Source: Calculations of the Ministry of Finance

As a second scenario, we assume for economic agents to restrain from spending, and the result thereof would be reduction of the annual growth rate of total budget revenues by 20% in the analysed period in relation to the initially projected rates, presented in Table 3.6. Hence, by assuming for growth of budget revenues to account for around 6% in 2017, 4.3% in 2018 and around 3% in 2019, budget deficit would increase by 0.7 p.p. in average annually above the level projected in the baseline scenario.

Under the third scenario, growth rate of budget expenditures is assumed to be higher by 25% in 2017 and 2018 in relation to the projected growth rate in the baseline scenario. As a result thereof, i.e. increase of budget expenditures by 5.6% and almost 5% in 2017 and 2018 respectively, budget deficit accounts for 3.4% of GDP in 2017 and 3.3% of GDP in 2018. Should projections for increase of both budget revenues and expenditures in 2019 remain unchanged, effects from the previous two years spill over to 2019 as well, hence budget deficit is by 0.6 p.p. higher compared to the baseline scenario projections.

Government of the Republic of Macedonia is prepared, should any of the presented scenarios occur, to respond appropriately, by adjusting the public spending, i.e. the budget expenditures, to a level necessary to retain the projected budget deficit rates.

Public Debt Risks. Uncertainty arising from the future trends of macroeconomic variables on the international capital market significantly affects the decision making for efficient management of debt portfolio of the country. In conditions of large oscillations of economic variables, need arises to actively manage risks which public debt portfolio in the Republic of Macedonia is exposed to. Main risks identified when managing this portfolio are re-financing risk, market risk, including interest rate risk and exchange rate risk, risk associated with contingent liabilities and operational risk.

Public Debt Sensitivity. To the end of assessing sensitivity of public debt portfolio to exposure to market risk, i.e. interest rate risk and exchange rate risk, effects from variation of interest rates and the exchange rate on the external government debt were analysed. Sensitivity analysis is based upon the following assumptions: by changing one variable, all other variables remain unchanged, i.e. ceteris paribus, in conditions of possible currency movements in relation to the euro, Denar exchange rate in relation to the euro retains the stable value, and non-correlation between interest rate movements and exchange rate movements.

The analysis covers the period 2017-2019, being based upon scenarios of increase of interest rate by 1 p.p. and by 2 p.p. compared to the baseline scenario, as well as increase of euro appreciation and depreciation by 10% compared to the other currencies.

Table 3.7. Sensitivity analysis of servicing-related costs of the external government debt where there is change in both the interest rates and the foreign exchange rates

	2017	2018	2019
Baseline scenario	100.0	100.0	100.0
Scenario 1: increase of respective interest rates by 1 pp.	105.4	105.5	105.2
Scenario 2: increase of respective interest rates by 2 pp.	110.8	111.0	110.5
Scenario 3: appreciation of other currencies of the portfolio in relation to the euro by 10%	101.3	101.2	101.5
Scenario 4: depreciation of other currencies of the portfolio in relation to the euro by 10%	98.7	98.8	98.5

Source: Calculations of the Ministry of Finance

Main conclusions under this analysis are the following:

- servicing-related costs on the basis of interest on external general government debt are sensitive to the interest rate movements. Should the interest rates in the period 2017 - 2019 increase by 1 p.p., it would cause increase of the interest-related costs by 5.4% at the most, as a result of the exposure of the debt portfolio to the interest rate risk, being a result of the share of the debt with variable interest rates.
- in this period, possible unfavourable movements at exchange rates of other currencies in relation to the euro will not cause any more significant increase of the servicing-related costs, due to the fact that most of the external general government debt is denominated in euros. Therefore, future euro appreciation, i.e. depreciation, in relation to the other currencies in the portfolio (US dollar, Japanese yen and special drawing rights) by 10% will cause an increase, i.e. decrease, of servicing-related costs by 1.3% in 2017, 1.2% in 2018 and 1.5% in 2019 at the most. In addition, due to the de facto fixed Denar exchange rate regime in relation to the euro, this risk is minimised, i.e. sensitivity of public debt portfolio is at lower level.

3.7. FISCAL GOVERNANCE AND BUDGETARY FRAMEWORKS

Public finance management is a strong commitment and a challenge requiring continuous adjustments, reforms and improvement, particularly in conditions of unpredictable and turbulent economic surrounding. Efficient public finance management and establishing stable fiscal position in the long run provides for solvency as regards the assumed liabilities and the payment of expenditures.

Improvement of public finance management system, by improving both the medium-term budget framework and the transparency, will remain to be the key priority in the next medium-term period.

Working group on management of public finances has been established therefore, with participants from all relevant institutions, the activities of which are aimed at preparing programme documents to the public finance management (PFM) sub-sector, as a part of the Public administration reform sector, within the IPA 2 instrument.

In the past period, the Working Group on management of public finances together with the EU Delegation and SIGMA experts, engaged by EC, worked intensively on preparation of the Sector Planning Document on PFM, as well as the Public Finance Management Reform Programme.

Within IPA TAIB 2011, Twinning Project "Strengthening the Medium-Term Budgeting for Effective Public Financial Management" commenced to be implemented in November 2015. Main activities of the Project for Strengthening the Medium-Term Budgeting for Effective Public Financial Management will be focused on determining a programme expenditure classification, enhancing the capacities for medium-term planning and reporting in line with ESA Methodology, all to the end of improving the quality of public expenditures. Main Project objective is improving the public finance management, the central focus being placed on medium-term budget planning as a main precondition for sound public finances and maintenance of stable fiscal position. Expected results from the Project, apart from the programme classification, are also preparation

of medium-term fiscal framework, whereby the concept for implementation of MTEF and MTBF will be appropriately defined, and respective legal amendments, manuals and bylaws will be prepared accordingly.

Funds have been provided under IPA 2011 Technical Assistance Facility Envelope for implementation of the Project “Development of Proposals for Implementation of Modern Integrated Financial Management Information System”. Under the Project, Ministry of Finance engaged experts who are preparing a Study, together with an analysis and assessment of the state of play of the financial management information systems of the Ministry of Finance, including draft solutions for establishing a modern integrated financial management information system.

3.8. SUSTAINABILITY OF PUBLIC FINANCES

Calculations for long-term sustainability of public finances²² are based upon the following assumptions:

- average labour productivity growth of approximately 2%;
- increase of male participation rate from 77.5% in 2015 to 88.7% in 2060;
- more intensive increase of female participation rate (from 52% in 2015 to 74% in 2060), by which share of female population in the total active population is expected to reach 45.5% in 2060;
- reduction of unemployment rate with higher intensity by 2030, projected at 12.4% in 2030, and with lower intensity in the remaining 30 years, whereby unemployment rate is projected to account for 4.8% in 2060;
- Gradual increase of the share of population above 65 years of age, reaching around 12% in 2060.

In addition, it is assumed that non-tax budget revenues, as % of GDP, will not be changed. On the basis of the above-mentioned assumptions, as well as the employment growth projections, certain increase of the share of revenues on the basis of pension insurance contributions is envisaged from 5.8% of GDP in 2015 to 6.3% in 2030 and stabilisation at slightly below 6% in the remaining analysed period. As for pension-related expenditures, it is worth mentioning that those of the Pension and Disability Insurance Fund are taken into account, while expenditures of the private pension insurance funds are not taken into account. Thus, share of pension-related expenditures in GDP in the period by 2030 is expected to account for 9.7%, while, in the coming period, the share is envisaged to gradually reduce, if one takes into account that share of pensioners, having been paid their pensions in full from the first pillar, will decline, and share of the pensioners, to be paid part of their pensions from the second pillar, will rise. Public expenditures for health protection as percentage of GDP are projected to gradually increase from 5% in 2020 to 5.5% in 2060. Such projected increase of expenditures was partially a result of the effects of population aging. Education-related expenditures as percentage of GDP are envisaged to range between 5.2% and 5.5% during the analysed period. Interest-related costs are expected to increase to approximately 2% of GDP in 2030, while in 2060, it is expected for the share to reduce to a level of slightly above 1%, in line with the projected trend of budget balance, i.e. government debt.

4. STRUCTURAL REFORM PRIORITIES 2017-2019

4.1. IDENTIFICATIONS OF KEY OBSTACLES TO COMPETITIVENESS AND INCLUSIVE GROWTH

Macedonia relies to a great extent on exports as main growth driver, having in mind that internal market is not sufficiently big to ensure high economic growth rates in long term. In the period 2010-2015 the export of goods reached an average annual growth of nearly 14%, and the participation of goods with higher technological value such as machinery, equipment and chemical products is significantly increased on the account of decreased participation in the

²² See Table 7 in Annex 1.

export of goods with lower processing level like iron, steel and raw materials. Also, the structure of industrial production notices increase of participation of sectors involving the companies in the free economic zones like Manufacture of motor vehicles, Manufacture of machinery and equipment, Manufacture of electrical equipment, etc.

The Government strategy for attracting foreign direct investments led to a number of established foreign companies in Macedonia as a result of simplification of the business environment, investments in the free economic zones and fiscal incentives. The country's legal and regulatory framework is conducive to business sector and in global terms, the country ranks 10th out of 189 countries according to Doing Business report 2017 and is ranked better than its regional peers.

Still, economic performance of the country could be much improved. Macedonia still faces high unemployment rate, as last available statistical data show that 23.4% of population is unemployed, though compared to 2008, it is lower by nearly 10 pp. Though the government has invested much efforts in attracting FDIs which resulted in about 17,000 new jobs, foreign companies are facing constraints posed by shortages of skilled labour across sectors. Improvements have been noticeable over the last few years, especially with regard to better learning outcomes at the primary level and the effect of compulsory enrolment in secondary education. However, automotive firms, for example, continue to have difficulty filling not only management and technical positions, but also lower-skills positions.²³

The youth unemployment is decreasing as level of education is increasing, yet it is twice as higher than the average, 48.2%. In 2014 25.2% of youth between 15 and 24 years of age were neither included in the educational system nor were employed. Forty percent of youth in Macedonia find a job in 1 to 3 years after exiting the educational system, and average transition time from education to employment is 6 years.²⁴

This challenge of matching skills with labour market needs has been noted in the Inventory and Analysis Report of existing qualification that has been prepared within National Qualification Framework Referencing Process according to the European Qualification Framework. The report states that reformed qualification in 3-years VET based on learning outcomes and existing qualification in non-formal education are partially based on learning outcomes and that there is a need for modernisation of 4 -year qualification in TVET, post-secondary education and Higher Education.

Educated and skilled workforce contributes to the increase in productivity of enterprises which is especially important for small and medium-sized enterprises (SMEs) as major contributors to job creation and inclusive economic growth in the country. Growth-oriented SMEs integrated into global value chains are key to boosting productivity, innovation and competitiveness. In Macedonia, SMEs represent majority of firms, account for 3/4 of total employment and contribute to over 70% of total private sector value added.

Creating innovation and technology driven economy is key challenge. According to European Innovation Scoreboard, Macedonia is modest innovator. The R&D expenditure accounted for only 0.44 percent of GDP in 2014²⁵, which is far below the EU 28 average of 2.03% in 2014.²⁶

The established Fund for Innovation and Technology Development provides opportunities to companies, yet capacities needs to be developed for absorption of RDI grants, enhance business-academia cooperation and increase investment readiness. This should lead towards expanding the economy's productive capacity, job creation and economic growth.

The OECD SME Policy Index Report 2016 on SEE²⁷ finds that Macedonia is one of the most advanced economies in the region in promoting its SME sector. Its institutional framework and

²³ http://www.imf.org/external/pubs/ft/scr/2015/cr15243_p.12.pdf

²⁴ <http://www.mtsp.gov.mk/content/pdf/strategii/Nacionalna%20Strategija%20za%20Vrabotuvane%20na%20Republika%20Makedonija%20za%20Vlada%2016102015.pdf>

²⁵ <http://www.stat.gov.mk/Dokumenti/strategii/Evropa2020strategija.htm>

²⁶ <http://ec.europa.eu/eurostat/web/europe-2020-indicators/europe-2020-strategy>

²⁷ <http://www.keepeek.com/Digital-Asset-Management/oecd/development/sme-policy-index-western-balkans-and-turkey-2016>

operational environment continues to have a high level of EU SME policy convergence. Although it has fairly solid policy framework in place, it needs to make further efforts to ensure the proper delivery of services meeting the needs of SMEs.

Though the digitalization of the country has advanced, the private sector and wider community in general cannot still bear the fruits of consistent application for delivery of different government e-services that will simplify the way of getting needed information and decrease time spent and uncertainty while searching individual institutions' portals. On the other side, there is also lack of consistent information on efficiency and effectiveness of implementation of different policies affecting the improvement of local and regional competitiveness. Proper monitoring and evaluation of how policies are being implemented and their costs should strengthen and streamline the collaboration between central and local governments and improve funds allocation on local level.

Further efforts are needed for improving managerial and entrepreneurial capacities of the SMEs in order to increase their productivity and economic limits, especially in sectors such as ICT, tourism, food, etc., in which the country has potential for creation of products with higher added value. Having in mind that the global information technology development actually presents the forth industrial revolution, establishing linkages used for networks and consortium building initiatives for accessing new and bigger tenders, markets and clients by Macedonian companies is important for enabling them to become part of the global supply chains and significantly contribute to increase the country's export.

What needs to be improved is collaboration between industry and universities which is very limited and the level of technology transfer is very low. Companies are more directed towards buying new technology or innovative solution instead of having their own commercially oriented researches. This may be in close relation to previously mentioned challenge of educational outcomes, i.e. how much the graduated students are equipped with practical knowledge, entrepreneurial skills, and possibilities to research and innovate. Also, it can directly contribute to increase the cooperation between domestic and foreign companies, having in mind that currently around 500 domestic companies cooperates with foreign ones, the value of cooperation being about EUR 50 million during 2015, but is far lower than the value of imported goods by the FDIs that is around EUR 1.2 billion. Improving their productive capacities provides companies with opportunity to increase their share in export and in the global market.

Expecting export to be the key driver of the long-term economic growth, improvement of the transport infrastructure is critical for Macedonia. Hence, large investment projects in road infrastructure are either ongoing or in final phase, and also activities have started for improving the railway transport. The improvement of railroads needs to be stepped up on both corridors, especially east-west one, to diminish the consequences of frequent disruption at the south border-crossing having negative impact on costs for some of the exporting companies by forcing them to look for more expensive alternative routes and often environmentally not friendly (roads).

Improving the performance of the energy sector is crucial to sustaining economic development and improving competitiveness in South East Europe (SEE)²⁸. Power supply in the region is projected to tighten significantly during the next few years, which will constrain economic activity and affect the quality of life of the citizens if not addressed in a timely fashion. Thus, it is essential the integration of Macedonia into the regional power market by investments in power transmission and institutional development that would support market participation.

Also, efforts need to continue to facilitate cross-border economic activities. According the OECD Competitiveness Report 2016 for SEE countries, Macedonia leads the region in trade policy and facilitation. Still, there is a room for improvement in transport and logistics considering the fact

²⁸World Bank - Macedonia Partnership Country Program Snapshot April 2016

that two corridors are crossing the country, north-south Corridor 10 and east-west Corridor VIII. According to the report, transport and logistics can boost the trade performance by making the delivery of goods easier, faster and safer. Therefore, cross-border bottlenecks need to be overcome to reduce the costs and time of transport thus contributing directly to companies' competitiveness.

Agriculture export accounted for 11.1% and import 10.6% of the overall exports and imports of the country in 2015. The agriculture sector is not utilized to its potential as the sector is fragmented, weakly equipped and with relatively obsolete technology. The climate changes impose another important issue of land irrigation. Dealing with these issues will have direct impact on production of higher processed products, increasing yields and physical volume of agricultural production and should lead towards increased share in export.

Tackling above mentioned challenges will influence positively on job creation. However, having unemployment rate of about 24% points to another aspect of the problem of employability. The share of early school leavers of population aged 18-24 is 11.4% in 2014 according to SSO data²⁹. It is close to EU 27 average of 11.2% in the same year³⁰, however needs to be decreased especially among the Roma population. The target according to Europe 2020 is this share to be under 10%.

Also, there is a need to activate people with a risk of difficult employability in the labour market by improving their skills as unemployment is mostly structural and reflects the shortage of skilled labour. Accent should be put on those that have more difficulties to enter the labour market, especially youth and women.

In line with above overview of main obstacles to competitiveness and inclusive growth, number of measures are identified across sectors, as listed under section 4.2.

4.2. SUMMARY OF REFORM PRIORITIES

Public Finance Management (PFM)
Measure 1: Public Finance Management Reform Programme – this measure is linked to the fourth policy guidance from the Joint Conclusions of the Economic and Financial Dialogue from May 2016 "Adopt a credible public finance management reform programme."
Measure 2: System (IT platform) for co-ordination, management, monitoring and evaluation of funds on regional and local level (SiReRa)
Energy, transport and telecom markets
Measure 3: Joint border railway station Macedonia - Serbia
Measure 4: Upgrading and rehabilitation of transport Corridor X
Measure 5: Upgrading and rehabilitation of transport Corridor VIII
Measure 6: Construction of 400kV Overhead Transmission Line SS Bitola 2 to Macedonia-Albania border and SS 400/110 kV Ohrid
Measure 7: Revitalisation and modernization of the transmission network and power system management
Agriculture sector development
Measure 8: Improvement of Irrigation Systems
Measure 9: Consolidation and defragmentation of agricultural land
Measure 10: Agricultural cooperatives
Sectoral development – Services sector
Measure 11: Increasing competitiveness in Tourism & Hospitality Sector
Measure 12: Increasing competitiveness in Creative Industries Sector
Business environment and reduction of the informal economy
Measure 13: Development of National Portal for e-services
Measure 14: Adoption of a National Strategy for SMEs (2017-2022) with an Action plan (2018-2020)
Research and innovation
Measure 15: Improvement of the infrastructure and the access to funding for research, development, and innovations

²⁹ <http://www.stat.gov.mk/Dokumenti/strategii/Evropa2020strategija.htm>

³⁰ <http://ec.europa.eu/eurostat/web/europe-2020-indicators/europe-2020-strategy>

Measure 16: Triple Helix Partnership
External trade and investment facilitation
Measure 17: Upgrading the customs clearance facilities of road border crossings Tabanovce (IPA 2012) and Kafasan (IPA 2013)
Education and skills
Measure 18: Further development of the qualification system
Employment and labour markets
Measure 19. Profiling of unemployed persons and designing an Individual Employment Plan 2 - this measure is linked to the sixth policy guidance from the Joint Conclusions of the Economic and Financial Dialogue from May 2016 "Strengthen the provision of activation measures especially for vulnerable youth, women and long-term unemployed and further improve the capacity of the Employment Service Agency for profiling and personalised counseling of job seekers."

4.3. ANALYSIS BY AREA AND STRUCTURAL REFORM PRIORITIES

4.3.1. PUBLIC FINANCE MANAGEMENT

Good public finance management (PFM) is vital for preserving macro-economic stability, effective use of country's resources and poverty reduction. PFM covers all components of the budget process: strategic planning, medium term expenditure framework, annual budgeting, revenue management, public procurement, control, accounting, reporting, auditing and oversight.

Macedonia weathered well the double deep recession supported by expansionary fiscal policy. The expansionary fiscal policy revealed some PFM weaknesses such as missing of fiscal targets for four years in a row and underperforming of capital expenditures. Public debt is expected to rise further having in mind the planned investment projects.

A slow-down of the EU and the global economy growth and increased uncertainty imposes the need for strengthening the public finance management, creating enough fiscal space for dealing with future unforeseen challenges and improve public investment efficiency by supporting projects that contribute for increasing the country competitiveness and economic growth.

In relation to above said, The European Commission (EC) in its Country assessment³¹ of the Economic Reform Programme 2016-2018 (ERP) points out that the authorities have not yet adopted a comprehensive Public Finance Management Programme. The policy guidance³² adopted at the Economic and Financial Dialogue in May 2016 were partially implemented. The EC notes that although the fiscal deficit has declined significantly (from 4.2% in 2014 to 3.5% in 2015), the fiscal target for 2015 was missed again. The Government remains committed to fiscal consolidation, but does not identify concrete supporting measures. Efficiency of public spending remains impeded by weaknesses in budget planning and there is again capital investments underperformance (in 2015 capital expenditure implementation was 84%, the percentage being close to those in previous two years). Additionally, the EC points out to lack of clear prioritisation among number of projects financed either by donors or national budget, and of regular and timely information on the state of their implementation, which could have a major impact on economic growth. On the other side, prioritization of investment projects will contribute to avoid debt stabilisation risks.

The Public Expenditure Financial Accountability (PEFA) report from 2015, notes that a good PFM system is the one in which revenues are maximized, so as to provide resources for delivery of public services, and in which available funds are spent as efficiently and effectively as possible for the delivery of those services. According to the PEFA report, maximizing tax revenues should be considered, given the structure and rates of tax, for which there is a need to upgrade the electronic systems used for tax management and linked in a new integrated system. In relation to efficiency and effectiveness, although there is some improvement in medium-term fiscal and budgetary planning in the preparation of three year fiscal strategy and the national Economic

³¹ http://ec.europa.eu/economy_finance/publications/eeip/pdf/ip028_en.pdf

³² <http://www.consilium.europa.eu/en/press/press-releases/2016/05/25-conclusions-dialogue-eu-western-balkans-turkey/>

Reform Programme 2015-2017, these documents look only at fiscal aggregates, and do not include detailed plans for the development of particular areas. Public investments are heavily dependent on external finance from International Finance Institutions, and are subject to rigorous cost-benefit analysis (CBA). Yet, there is no procedure to ensure that investments are subjected to CBA before being undertaken, or to keep track of their performance during and after project implementation. The Public Procurement Bureau does not keep records of the extent to which contracts are modified during their execution, and there has been no reporting of the returns actually achieved. The development of a new integrated Financial Management Information System is already a priority for the country. The Budget and Treasury systems that only operate within the Ministry of Finance, are not fully integrated and budget users do not make any direct input during the budget preparation and execution. A new system should as well ensure that all the necessary financial control procedures as established under the Public Internal Financial Control (PIFC) legislation, have been implemented. Also, the report notes that steady progress is being made in the implementation of PIFC on the EU model, and efforts should continue to extend the coverage, while current internal and external audit work should focus more on identifying ways to improve the delivery of services, rather than simply checking on whether regulations are being correctly followed.³³

Regarding regional development, although progress has been made, national and regional partner institutions are not yet in position to fully implement the new regional development policy according to EU requirements. The biggest challenge that still exists is distribution of budget funds for equal regional development (ERD). The horizontal and vertical coordination in the area of ERD is still not efficient, and there is lack of inter-institutional coordination during the preparation and execution of national programmes supporting ERD. There is a lack of appropriate mechanism for identifying expenditures of supported project and distribution of finances for planned projects in different planning regions³⁴ (there are 8 planning regions in the country). In same direction goes the EC statement in the 2015 Progress Report where it is noted that "distribution of capital funds to municipalities needs to be carried out in a more transparent and coordinated manner".

Measure 1: Public Finance Management Reform Programme

Short description of the measure

Public Finance Management Reform Programme covering the period till 2020 is currently being drafted. It is based on recommendations provided within Public Expenditure Financial Accountability report, Sigma report on the Principles of public administration baseline measurement including public finance management³⁵, WB Public Expenditure Review³⁶ and IMF Article IV report³⁷.

The Programme envisages improvement in several segments within public finance area such as: strengthening and implementation of medium term budget framework including budget planning, introducing integrated information system for PFM, improving compliance, efficiency and effectiveness of the public procurement system, modernizing the tax system and improving revenue collection, increasing quality of customs procedures and services, further improvement of public internal financial control and of external audit efficiency.

Implementation of activities within the above mentioned priorities is planned to be supported by IPA 2 funds.

Activities per year

³³ <https://pefa.org/en/assessment/mk-decl5-pfmp-public-en>

³⁴ <http://www.vicpremier-ekonomija.gov.mk/?q=node/667>

³⁵ <http://www.oecd-ilibrary.org/docserver/download/5jm0xw47v6f7-en.pdf?expires=1482240711&id=id&accname=guest&checksum=1C97E0A6161202E211BFA2CADF076D90>

³⁶ <http://documents.worldbank.org/curated/en/895641468269982851/pdf/Macedonia-PER-2015-Revised-for-Submission-Final-clean.pdf>

³⁷ <https://www.imf.org/external/pubs/ft/scr/2015/cr15242.pdf>

2017: Adoption of Public Finance Management Reform Programme 2017-2020

Budgetary impact /

Expected impact on competitiveness

The Programme will be a base for implementation of measures which will contribute to strengthening institutional capacities for preparation and execution of mutual coordinated economic policies that should tackle key structural challenges for increasing economic growth and job creation.

Potential risks

Programme not to be adopted due to prolonged political crisis.

Measure 2: System (IT platform) for co-ordination, management, monitoring and evaluation of public funds on regional and local level (SiReRa)

Short description of the measure

In 2014 a feasibility study was developed on the organizational, legal, technical, financial and procedural framework for establishing the SiReRa System. The System will be an IT platform which will integrate all development projects in the country and will provide a comprehensive picture of public investment in different regions. The structure of the system consists of four components:

- 1) Systematic data for all development planning documents (current and old archived) at national, regional and local level,
- 2) Database of professionals employed in state and local administration whose work involved or may be involved in activities for development at local, regional and national level,
- 3) Database of foreign professionals (experts and associates) whose work involved or may be involved in activities supporting development at local, regional and national level,
- 4) Financial matrix providing smoothness in the allocation of funds.

The System includes:

- Database of relevant documentation for national, regional and local development, including strategies, programs, projects with development component within several areas: regional development, transport, agriculture, health, education, environment etc. This database will be supporting a platform for the process of adjustment of programs and measures according to the current situation.
- Database with municipal projects (realized, in phase of implementation and ready for funding that can use funds from the IPA instrument), primarily large infrastructure projects.
- Statistical monitoring and overview of the development level of regions at any time based on the level of implementation of the programs and projects with developing character in every moment. This is very important for the policy making process, program design and funding of projects for balanced regional development.

Activities per year

2017: Establishing legal, organizational and technical environment for functioning of the system

2018: Functional electronic system on national level (phase I)

2019: Functional electronic system on local (municipal) level (phase II).

Budgetary impact

The establishment of the system is 3,5 millions EUR.

Expected impact on competitiveness

The establishment of the system will contribute to continuous monitoring of the level of development of regions in order to have timely and efficient adjustment of the programs and measures for regional development leading to increase in regions' economic potential.

Expected social outcomes

Increased economic potential of the regions is closely linked to creating new jobs and improve living standards of the population.

Potential risks

Inadequate skills and capabilities of the institutions for operation with IT systems.

Insufficient cooperation between institutions at local, regional and national level.

4.3.2. ENERGY, TRANSPORT AND TELECOMS MARKETS

Republic of Macedonia has a strong need for improvements in its transport infrastructure³⁸. Good connectivity with the rest of the world and within the country is critical for a small, open and land-locked economy, where exports are expected to play an important role in driving long-term economic growth. During 2010–15, net exports contributed on average to 0.04% in annual GDP growth, indicating significant room for increase in that share. As a landlocked country, Macedonia is particularly dependent on a well-developed transport network to reduce the economic distance to export markets and to lower the costs of transportation arising from poor road conditions³⁹. Key elements of this network are also extensions to the core trans-European transport network, specifically the Orient/East-Mediterranean Corridor (north-south connection [Corridor X] from Austria to Turkey, and east-west connection [Corridor VIII], which connects Albania to the Black Sea ports in Bulgaria). The road transport network plays a particularly critical role in the development of the economy, as it carries the bulk of the country's exports and goods (in 2014, 93% of freight was carried on roads).

However, Macedonian road network is worse than in most countries with a similar income level. The World Bank's Logistics Performance Index shows that Macedonia's logistics and infrastructure scores rank is among the lowest in the region. Road quality is below average in the region according to the World Economic Forum's Global Competitiveness Report. Road density in Macedonia is not low by regional standards, but the share of paved roads is among the lowest according to the World Bank World Development Indicators. A recent IMF report (IMF, 2015) on Western Balkan countries also identifies improving infrastructure as one of the top five priorities in Macedonia.

The energy infrastructure of the Republic of Macedonia enables exploitation of domestic energy resources, import and export of energy, processing of primary energy and production of final energy, transport and distribution of energy. The energy infrastructure of the Republic of Macedonia comprises of coal, oil and oil products, natural gas, electricity sector and sector for heat production.

Republic of Macedonia has started the process of liberalization of the electricity market and at this point there is a regulated and liberalized electricity market for large customers (companies). In 2015 the government delayed the full opening of the electricity market, i.e. for small businesses and households. Full liberalization of the electricity market is expected to be completed by 2020.

Greater utilization of renewable energy sources (RES) and improving energy efficiency are one of the major strategic objectives in the energy sector for the Government of Macedonia. This is very important for energy security and environmentally clean energy supply for the country, and for creating the conditions for sustainable energy development in Macedonia and in the region.

In order to create conditions for reliable operation of the network, data transmission for remote regulation and video surveillance of all objects connected to the transmission network

³⁸ REPUBLIC OF MACEDONIA SELECTED ISSUES, International Monetary Fund, November 2016

³⁹ World Bank - Macedonia Partnership Country Program Snapshot April 2016

revitalisation and modernisation of the transmission network is needed. Also in order to overcome “bottlenecks” in the network that restrict access of generators to the regional market of electricity, interconnection between Macedonia and Albania brings significant benefits. This reduces the production costs, both in national systems and on regional level. Additionally, both systems will benefit from reduction of imported energy and reduce the overflow reservoirs (final effect means “liberation” of existing “green energy”).

Improving the performance of the energy sector is crucial to sustaining economic development and improving competitiveness in South East Europe (SEE). Power supply in the region is projected to tighten significantly during the next few years⁴⁰, which will constrain economic activity and will affect the quality of life of the citizens if not addressed in a timely fashion. Thus, essential is the integration of Macedonia into the regional power market by investments in power transmission and institutional development that would support market participation.

It is necessary to intensify/continue with activities for rehabilitation and modernization of existing and construction of new modern infrastructure for production and use of energy, as well as to improve efficiency in production, distribution and use of energy. Optimal utilization of domestic resources for electricity production is of particular importance as well as increasing the use of renewable energy sources.

Communications accounted for approximately 3.4% of Macedonia’s GDP in 2015. The Macedonian telecommunications market is developing rapidly. There are currently two mobile carriers and ten fixed-line operators, all privately owned.

The Law on Electronic Communications, introduced in 2005, has provided stable and consistent regulation of the communication sector. It has been harmonised with the EU legal regulatory framework package since 2002, thus enabling full liberalisation of the market.

The Government of the Republic of Macedonia has supported the development and liberalisation of electronic communications services to ensure these services are available at affordable prices in an effort to achieve mass broadband internet usage. Increased competition in the telecommunications sector established the necessary infrastructure for efficient, safe and timely delivery of high quality digital content and services.

According to data from the State Statistical Office in Macedonia, in January 2016, approximately 92.5% of the enterprises were connected to broadband internet.

Measure 3: Joint railway border station Macedonia - Serbia

Short description of the measure

The construction of a joint railway border station Tabanovce between Macedonia and Serbia will provide for efficient and fast passage of passenger and freight traffic at border crossings by reducing the control procedures performed by officials of the two countries. The controls will be made from a single “one stop shop” during the movement of the train. Pursuant to Directive 2012/34 of the European Parliament and the Council of 21 November 2012 for establishing a single European railway area, in February 2015 Agreement was concluded for establishing border procedures between both countries by the Ministers of Transport, and in June 2016 protocols were concluded between the relevant authorities of Macedonia and Serbia (police, customs, inspection services, etc.).

Activities per year

2017: Preparation of feasibility studies, main design and tender documentation and submission of application to WBIF for investment grant

2018: Selection of a construction company, concluding the contract and commencement with construction works

⁴⁰World Bank - Macedonia Partnership Country Program Snapshot April 2016

2019: Construction works

Budgetary impact:

Project preparation: EUR 380.000, WBIF

Construction: around EUR 3.5 million WBIF Investment grant

Expected impact on competitiveness:

The objective of the Project is to improve the international rail transport between the railway networks of the two neighbouring countries, and to establish and implement the legal and institutional framework for a gradual market opening of the rail transport in South East Europe, based on gradual achievement.

The measure will contribute to reducing delays at borders by streamlining and shortening of the border-crossing procedures via Single window method of providing services and to increasing competitiveness of the rail sector compared to other transport sectors.

Expected social outcomes

The measure will contribute for facilitating transport of passengers at this border crossing.

Potential risks

Untimely completion of construction works

Measure 4: Upgrading and rehabilitation of the transport Corridor X

Short description of the measure:

By upgrading and rehabilitation of Corridor X the entire road Corridor X will be completed at a highway level and together with the rehabilitation of sections along Corridor X the capacity and overall efficiency of the E-75 North - South road will improve. Upgrading and modernization of railway Corridor X is also envisaged.

Activities per year:

The following activities are envisaged regarding road and railway infrastructure:

2017

- Construction of the road section Demir Kapija-Smokvica - length of 28.3 km.
- Rehabilitation and upgrading of the section Smokvica-Gevgelija - length of 10.15 km.
- Rehabilitation and upgrading of the left section of Kumanovo-Miladinovci highway- length of 22.5 km.
- Renewal of railway section Negotino-Nogaevci- length of 30 km.
- Modernization of 10 railway stations along Corridor X.

2018

- Rehabilitation and upgrading of the right section of the Kumanovo-Miladinovci highway- length of 22.5 km.
- Procurement and installation of equipment for automatic regulation of the speed of trains (ETCS) and the radio stations controller (GSMR) along Corridor X Tabanovce – Gevgelija.

2019

- Construction of road A1 and Pan-European Corridor Xd Gradsko – Prilep-First section - length of 10.2 km, second section - length of 15 km.

Budgetary impact

Section Demir Kapija – Smokvica = EUR 210 million (IPA, EBRD, EIB and Budget of RM)

Section Smokvica-Gevgelija = EUR 4.153 million construction + EUR 0.518 million Contract for supervision (85% IPA, 15% budget support)

Section Gradsko – Prilep = EUR 31.8 million (EBRD) and EUR 41 million (IPA 2)(assumed value)

Kumanovo - Miladinovci = EUR 5.1 million construction + EUR 0.60 million Contract for supervision. (85% IPA, 15% budget support)

Negotino - Nogaevci = EUR 10 million - loan from the European Bank for Reconstruction and Development (EBRD)

Railway stations = EUR 2.4 million (85% IPA, 15% budget support)

Procurement and installation of equipment for automatic regulation of the speed of trains = 0.5 MEUR, radio stations controller = EUR 0.3 million (WBIF).

Expected impact on competitiveness

With the construction and rehabilitation of these sections, the entire Corridor X will be built at a highway level. This will significantly improve the competitiveness of the country in terms of increasing traffic, increase traffic safety and reduce travel time. The effect will be to improve the transport of goods for domestic and transit carriers as well as reduce travel time. It will also provide a stronger integration with the markets of the region and connecting with the common EU market.

By restoring the sections of the railway line will allow increasing the speed limit to 120 km/h, which will reduce the time and cost of travel and will improve the competitiveness of passenger and freight rail versus road transport on Corridor X. It will also reduce the time and cost of moving goods and passengers around train stations by setting up separate entrances for passengers and cargo. The improved control of movement of trains will enable the safe and secure use of rail transport, both for transporting passengers and freight traffic.

Expected social impact

In the short term there will be significant improvement in the employment of local population in the regions associated with the construction and rehabilitation of the sections. The employment effects of the project Demir Kapija -Smokvica are presented as number of jobs as following: Number of jobs directly created during implementation phase is 4.165 persons with average duration of these jobs of 48 months. During operational phase 87 persons will be employed with average duration of these jobs of 276 months.⁴¹

In the long term this project will affect a better geographical connection, it will accelerate the transport of passengers and goods in this section both for domestic and for transit carriers. The project will contribute to improving the safety and security of passengers.

The renewal of the sections will significantly improve passenger safety in passenger rail transport. Railway stations will be modernized according to EU best practices in order to meet the demands and needs of passengers including passengers with special needs. The improved control of movement of trains will enable the safe and secure use of railway transport, both for transporting passengers and goods.

Potential risks

Untimely completion of construction works

Measure 5: Upgrading and rehabilitation of the transport Corridor VIII

Short description of the measure

Upgrading and rehabilitation of road and railway Corridor VIII.

Activities per year

The following activities are envisaged regarding road and rail infrastructure:

2017

- Construction of highway A2 section Kicevo – Ohrid (57 km).
- Reconstruction of the railway section from Kumanovo to Beljakovce (30.8 km).

⁴¹ CBA of the Project for Construction of the section Demir Kapija - Smokvica

- Construction of new and reconstruction of the existing railway section from Beljakovce to Kriva Palanka (34 km).
- Preparation of main design with tender documentation for construction of new railway section from Kriva Palanka to Deve Bair, border with Bulgaria.
- Preparation of the main design with tender documentation for construction of new railway section from Kicevo to Lin, border with Albania length of 62.6 km.

2018

- Construction of highway A2 section Kicevo – Ohrid.
- Reconstruction of the railway section from Kumanovo to Beljakovce.
- Construction of new and reconstruction of the existing railway section from Beljakovce to Kriva Palanka.

2019

- Construction of highway A2, section Trebenishta – Struga- length of 8.5 km.
- Construction of expressway A2, section Rankovce – KrivaPalanka – length of 23 km.
- Reconstruction of the railway section from Kumanovo to Beljakovce.
- Construction of new and reconstruction of the existing railway section from Beljakovce to Kriva Palanka.

Budgetary impact

Kumanovo-Beljakovce: construction works - loan from EBRD: EUR 46,4 million, supervision of the construction: EUR 2.5 million by a WBIF grant, preparation of main documentation EUR 1.5 million WBIF grant.

Beljakovce-Kriva Palanka: construction works-loan from EBRD EUR 145 million, supervision of the construction: EUR 3.0 million WBIF grant and EUR 4 million from the loan, preparation of main documentation EUR 2.7 million WBIF grant.

Kriva Palanka-Deve Bair border with Bulgaria, preparation of the main design with tender documentation EUR 3.0 million grant funds through IPA.

Kicevo-Lin, border with Albania, for preparation of the main design with tender documentation EUR 8.0 million IPA grant.

Construction of highway A2, section Kicevo - Ohrid: EUR 374 million (90% EXIM Bank and 10% Public Enterprise for State Roads).

Construction of highway A2, section Trebenishte - Struga: EUR 45 million EBRD loan.

Construction of expressway A2, section Rankovce-Kriva Palanka: EUR 78 million World Bank loan.

Construction of the expressway A2 section Kriva Palanka - border with Bulgaria: EUR 30 million EBRD loan.

Expected effects on competitiveness

By the construction and completion of the railway Corridor VIII travel time between Skopje and Sofia by rail will be reduced for about 1 hour in relation to the current travel time compared to road traffic. The time of regional travel between Kumanovo and Kriva Palanka by rail will be reduced for approximately 35 minutes from the current travel time of approximately 50 minutes by road. The rail link between Macedonia and the Black Sea will be shortened for approximately 200 km, while the one between Macedonia and Istanbul for approximately 150 km. The capacity for transporting cargo will be increased by obtaining capacity for crossing of 10 freight trains in each direction, which is equivalent to 400 road trucks. The measure will provide direct rail route between Macedonia and Bulgaria, avoiding the need to pass through Serbia, as well as facilitation of trade with Bulgaria.

The construction of the road sections along Corridor VIII will significantly improve the competitiveness of the country in terms of improved connectivity of this region of Macedonia and integration of this region with the entire trans-European network. It will provide efficient access to ports in Bulgaria and Albania, as well as access to potential markets in the East and connection of the TRACECA Corridor⁴².

Trade exchange between Bulgaria, Macedonia and Albania will be facilitated and better connections with the regional district of inclusion of Corridor VIII to the main southern Italian ports and this area will be provided.

Expected social impact

In the short term, new jobs will be created during the phase of construction of the road and railway sections along the entire road Corridor VIII. In the long term it will provide better geographical connectivity, thus accelerating the transport of passengers and goods for both domestic and transit carriers. The measure will contribute to improving the safety and security of passengers.

Potential risks

Untimely completion of construction works and submission of project documentation.

Measure 6: Construction of 400 kV Overhead Transmission Line SS Bitola 2 to Macedonia-Albania border and SS 400/110 kV Ohrid

Short description of the measure

This project is a part of an initiative to establish a major East - West electricity transmission corridor between Bulgaria, Macedonia, Albania and potentially Italy (via a planned submarine cable). This section (Bitola to Macedonia - Albanian border, with substation at Ohrid) is part of the Macedonia/Albania section of that corridor. The overall objective of the project is the construction of a high voltage 400 kV electricity transmission line between Sub Station Bitola 2 and Macedonia - Albanian border, with the construction of a new 400/110 kV substation near Ohrid. This project, which has been identified as a priority for the creation of the regional electricity market in SEE, and will contribute to the stability and security of the electricity system of the Balkans, not only for the two countries directly concerned, but also for the electricity systems of the region by closing a 400 kV ring between Albania, Greece and Macedonia.

Activities per year for the following components of the project: Overhead Transmission Line Bitola 2 SS to Ohrid SS, Ohrid SS, Extension of Bitola 2 SS and Smart Grid Improvement

2017: Starting of tendering process

2018: Starting construction works

2019: Proceed with construction works

Budgetary impact

The total cost of the implementation is 49 MEUR. The project is financed by MEPSO and does not impact the annual budget of Macedonia.

Expected impact on competitiveness

Direct benefits⁴³ for MEPSO from construction of this interconnection are reflected by revenues from: reduced electricity losses (approximately EUR 1.9 million/year), decrease of undelivered electricity (approximately EUR 1,500/year), increased production of electricity (average of EUR 700,000/year), efficient dispatching and balancing generators (average EUR 400,000/year), increased transmission capacity and greater transit of electricity (approximately EUR 70,000/year). Electricity interconnection between Macedonia and Albania brings significant

⁴²TRACECA is an abbreviation of Transport Corridor Europe-Caucasus-Asia

⁴³Feasibility Study and ESIA for Elbasan (AL) -Bitola (MK) 400 kV Transmission Line, COWI – IPF Consortium, January 2013.

benefits to overcome “bottlenecks“ in the network that restrict access of generators to the regional market of electricity. This reduces the production cost, both in national systems and on regional level. Additionally, both systems will benefit from reduction of imported energy and reduce the overflow reservoirs (final effect means "liberation" of existing "green energy").

In terms of the project impact on the national and regional transmission network, we can expect the following effects:

- creating 400 kV contour Albania - Macedonia - Greece,
- increased transmission capacity of the network to support the forecasted load growth and transit of electricity and connection of new production capacities,
- improved reliability of the regional network, security of supply and stability of the transmission system,
- reduction of technical losses in electricity transmission system,
- improved quality of power supply (normalizing the voltage profile, stabilize the flow of power and frequency fluctuations, etc.)
- support the development of a regional electricity market in South East Europe and creating opportunities for trade with Bulgaria and Italy and
- reducing the costs for providing spare capacity and enabling support in emergency situations.

In the feasibility study⁴⁴ the impact for Macedonian economy is estimated at EUR 37,8 million on a 15 year perspective.

Expected social outcomes

Due to a significant number of preparatory and construction works the Project will engage local companies. Also the outcome of this Project is to improve the electricity supply quality and this will create better environment for doing business and increase employment.

Potential risks

Problems with land acquisition.

Measure 7: Rehabilitation and modernization of the transmission network and power system management

Short description of the measure

A significant part of the Macedonian 110 kV transmission network was built during the 60's and 70's. Most of the lines and the equipment in substations are approaching the end of their lifecycle. Transmission lines and other equipment, which are estimated to have diminished performance, operational reliability and safety (technical faults, frequent outages, and deteriorated condition) need to be rehabilitated.

The investment for revitalization and modernization of the transmission network and power system management consists of four components:

- Revitalization of seven 110 kV transmission lines (SS Bitola 1- SS Prilep 1, SS Oslomej - SS Kicevo, Skopje 1 - SS Miladinovci, SS Veles - SS Ovce Pole, SS Skopje 4 - SS Veles, SS Stip - SS Ovce Pole and SS Stip - SS Probitip),
- New equipment for substations,
- Complete closure of the optical ring transmission network and
- Installation of systems for monitoring and management of substations.

Activities per year

⁴⁴ Feasibility Study and ESIA for Elbasan (AL) - Bitola (MK) 400 kV Transmission Line – Europe Aid/128073/C/SER/MULTI WB4bis-REG-ENE-01: 2013

2017: Equipment for SS's: Rehabilitation of Substations, High Voltage Equipment and Relay Protection

Optical loop: Supply and Installation Optical Ground Wire and Equipment and Construction of Underground Installation for Optical Connection

2018: The activities will be determined next year

2019: The activities will be determined next year

Budgetary impact

The total cost of the implementation is EUR 40,5 million. The project is financed by MEPSO and does not impact the annual budget of Macedonia.

Expected impact on competitiveness

The revitalisation and modernisation of the transmission network will contribute to accurate and reliable operation of the network, data transmission will be provided between the National dispatching center and power facilities, data transfer in the fields of business and financial operations, data transmission for remote regulation and video surveillance of all objects connected to the transmission network. Also, it will enable connectivity with neighbouring telecommunication networks for data transmission of Serbia, Bulgaria, Greece and Albania through existing and new interconnecting lines, meeting the requirements of the European Network of Transmission System Operators ENTSO-E to provide digital electronic connection with at least two neighbouring transmission system operators for data exchange, being of vital importance for the system management and supply stability in the region.

Expected social outcomes

Due to a significant number of preparatory and construction works the Project will engage local companies. Also the outcome of this Project is to improve the electricity supply quality and this will create better environment for doing business and increase employment.

Potential risks

Problems with land acquisition.

4.3.3. SECTORAL DEVELOPMENT

4.3.3.1. Agriculture sector development

Agriculture in Macedonia has a significant share in GDP, employs a large number of persons and has a high contribution to foreign trade. Despite its overall importance for Macedonia's economy, the sector is fragmented, poorly equipped and with relatively outdated technology, having implications on growth. The fragmented production and lack of mechanization makes it difficult for farmers to achieve economies of scale in production and produce the quantities required for certain markets, constraining agricultural growth. Also, spending more resources on irrigation will be critical to increase production of high-value added crops.

Progress on land consolidation and development of a functioning land market would also be important to make the sector more productive. Agriculture is one of the sectors directly harmed by a climate changes. Both water scarcity and water demand for irrigation are predicted to rise in near future. Irrigation systems are already insufficient and poorly designed for small farms. Many farms depend on local wells and unsustainable extracted groundwater, which is neither regulated nor priced.

According to the World Bank publication "Reducing the Vulnerability of Macedonia's Agricultural Systems to Climate Change", agriculture is one of the most climate-sensitive economic sector, and without a clear plan for aligning agricultural policies with climate change, the livelihoods of rural populations are at risk. Over the next 40 years climate change will grow more severe and will hamper agriculture conditions. Temperature increases are projected to be higher, and precipitation declines greater, during the crucial summer growing period. By predicting water supply and demand under climate changes, substantial water shortages in the future are expected, meaning that there will be insufficient water available to irrigate all crops.

This could lead to losses for farmers of 50% or more for most crops under the medium (moderate) impact scenario if nothing is done to adapt.

The total irrigation capacity installed can provide irrigation of 163,693 ha agriculture land or 144,984 ha in an average dry year. Irrigated areas in 2014 are estimated at 20,575 ha or only 4% of arable land. The percentage of irrigated agricultural land is under the EU 27 average (about 5%). Irrigated area is well below the average of countries with a Mediterranean climate where Macedonia belongs (for example: Greece 31%, Malta - 27%, Cyprus - 21%, Italy - 21%, Spain - 10%).

According to the National Strategy for Agriculture and Rural Development 2014-2020: "Rehabilitation and construction of irrigation systems is a policy priority, especially in terms of the expected adverse effects of the climate change that will mostly affect the reduction of the available amount of water for irrigation and increase the needs for irrigation. Hence, the ultimate goal is to increase the current irrigated areas in the country to the level of installed capacity (144,000 ha), and gradually expand hydro-systems to reach the objective for irrigated area at half of the arable area (around 250 thousand ha). Specifically, most of the large capital investment in new hydro-systems and investments for expansion and reconstruction of existing hydro-systems in the country should commence in the upcoming period. These investments will have a direct impact on increasing yields and physical volume of agricultural production. Future phases of designing the systems will be in accordance with the analysis of the future impact of climate change, for the purposes of proper adjustment of the technical parameters".

Cost-effectiveness of the new investments in irrigation can be achieved if implemented in parallel with the land consolidation projects.

High fragmentation of agricultural land (small and fragmented land parcels) has adverse effects on productivity and efficiency of the agriculture production, and hence the competitiveness of Macedonian agricultural products. Without any changes towards the improvement of the existing land structure, the agricultural sector potential will remain underutilised.

The average parcel size of agriculture land is below 0.2 ha (high frequency of parcels below 0.2 ha) and with significant presence of borders in between or dispersed small plots of unorganized agricultural space.

Out of 190.000 farms, major part (around 80%) are individual agricultural holdings - family farms with average farm size of 1.7 ha. Around 440.000 household members are working on individual agricultural holdings and 141.000 seasonal engaged people. Small sized farms produce limited market quantities of agricultural products with diverse quality due to they are in subordinated position on the market without negotiation power in regards to buyers and processors. A sustainable model for farmer organization is essential.

Some of the key features which will determine development of the farmers' cooperatives and associations are related to the changes that are occurring such as adjusting production to the global distribution of competitiveness, changing the structure of producers and increasing yields, problems they face, such as inclusion of small-scale farmers into the modern market chain and the changes they are going to face (customs liberalization, changes in consumer habits, ways of trade etc).

Measure 8. Improvement of Irrigation Systems

Short description of the measure

In order to ensure continuous and long-term investments in infrastructure for irrigation and drainage, a ten-year planning document "Investment Plan for the Water Management Master Infrastructure for the period 2015-2025" is prepared. This plan includes: Rehabilitation and reconstruction of installed infrastructure for irrigation and drainage in order to achieve their sustainability and water conservation; Upgrading and expansion of the existing hydro-system in order to increase the irrigated area in the country; and Construction of new major facilities in the Macedonian hydro-system.

This measure comprises the following capital investments:

- **Construction of Rechani dam on Orizarska River** - for irrigation of agricultural land of approximately 1,500 ha and producing electricity through construction 2 hydropower plants with a capacity of 2,852 KW.
- **Construction of Konsko dam near Gevgelija** - for water supply of the region, irrigation of approximately 4,200 ha agricultural land with a system of drip irrigation, generation of electricity and provision of additional quantities of water for the hydro system "Rescue of Dojran Lake".
- **Construction of main supply pipeline within the project Raven-Rechica** – for irrigation of about 6,000 ha of agricultural land.
- **Construction of a dam on the river Slupchanska** - for water supply of the region and irrigation of approximately 7,800 ha of agricultural land.
- **Second and third phases of the “Zletovica Water Basin Utilisation Improvement Project”** - for irrigation for 4,570 ha agricultural land. Phase 3 of this project is construction of 3 small hydropower plants along the river Zletovica with installed capacity of 15 MW and a projected annual electricity production of 48 GWh.
- **Second phase of the “Irrigation Program Southern Vardar Valley”** - rehabilitation and modernisation of the irrigation systems in the South-eastern region covering 3,900 ha agricultural land.
- **Second phase of construction of the HS "Lisiche"** - for irrigation of about 4,100 ha agricultural land.
- **Construction of small scale community irrigation systems (up to 300 ha).** - Tender dossiers should be finished until August, 2019.

Activities per year

2017:

- Starting with construction of Orizarska dam.
- Starting construction works on Konsko dam and irrigation system Raven – Rechica.
- Construction activities for building an access road to the Rechani dam.
- Prepare technical documentation for the dam on the Slupchanska River.
- Develop infrastructure project, detailed design and environmental impact elaborate for HS "Lisiche".
- Implementation of the Second phase of the “Irrigation Program Southern Vardar Valley”.
- Implementation of the Second phase of construction of the HS "Lisiche".

2018 and 2019:

Continuing construction works according to signed agreements.

Budgetary impact

Complete implementation of the measure for the period 2017-2019 amount to EUR 96,000,000. The annual budget for 2017 under the programme for rural development is EUR 4,560,261.

- Construction of Rechani dam on Orizarska River EUR 39,200,000 Budget funds under Program for rural development.
- Construction of Konsko dam EUR 40,640,000 Budget funds under Program for rural development.
- HMS Raven-Rechica EUR 15,030,000 Budget funds under Program for rural development.
- Construction of a dam on the Slupchanska River EUR 19,500,000 Budget funds under Program for rural development.

- Second and third phases of the “Zletovica Water Basin Utilisation Improvement Project” EUR 1,000,000 Grant from the European Investment Bank (EIB).
- Second phase of the “Irrigation Program Southern Vardar Valley” EUR 10,250,000 loan from the KFW.
- Start of construction works of second phase of Irrigation Program Southern Vardar Valley.
- The second phase of construction of the HS "Lisiche" EUR 37,750,000.
- Construction of small scale community irrigation systems (up to 300 ha) EUR 5,000,000 IPA 2015 – 2017 - Tender dossiers should be finished until August 2019.
- Investments in irrigation infrastructure EUR 3,000,000 in 2017.

Expected effects on competitiveness

The implementation of the measure will increase the proportion of irrigated agricultural land from the current 4% to approximately 6% (from 20,575 to 20,575+11.700) and will also improve the existing irrigation systems. With implementation of those capital investment projects, farmers in those regions will have available irrigation water for irrigation of agricultural land and possibilities for increasing of agricultural crops yields. The measure will enable production of electricity through construction of hydropower plants, as well as provision of additional quantities of water for the hydro system "Rescue of Dojran Lake".

Access to farmers to regular irrigation is expected to increase competitiveness by adoption of new varieties, diversification to higher value crops and higher yields.

Sustainable management of irrigation and drainage systems, through investments in irrigation and drainage infrastructure.

Expected social outcomes

Building of dams will provide access to drinking water of people in those areas, flooding control downstream and industrial developments of the region through increased production of electricity leading to creation of new jobs. Improved farming will result in increased agricultural irrigation. Facilitating community small scale irrigation systems shall promote sustainability of rural households.

Potential risks

Untimely completion of construction works

Measure 9. Consolidation and defragmentation of agricultural land

Short description of the measure

According to the National Strategy for Agriculture and Rural Development 2014-2020: “Re-parcelisation projects and consolidation of land will be carried out in parallel with infrastructure planning in terms of the quality of the road network and irrigation network as part of an integrated approach to rural development.

Priority will be given to regions with developed and intensive agriculture where small and fragmented parcels significantly limit the further development of agriculture as a primary agricultural activity in rural areas, primarily on the basis of interest shown by the farmers. The process of land consolidation will be initiated by at least half of the land owners in the consolidated area or ex officio by the relevant ministry. The consolidation is implemented if at least 70% of owners of land parcels in the consolidation area agree to conduct the consolidation through distribution of agricultural land, or all owners in the case of consolidation with exchange. Consolidation process will be used to increase the area of land per farm by purchasing or allocation of state agricultural land available for rent.

To achieve better results, the active land consolidation policies in agriculture will be combined with appropriate adaptation to other policies which have an impact on preventing further

fragmentation or initiation and intensification of the consolidation process of the agricultural land such as “the mobility of the agricultural land market”.

Activities per year:

2017:

- Awareness raising on consolidation procedures and identification of new consolidation regions;
- Initiation of a process of capacity building of MAFWE and other stakeholders for successful implementation of land consolidation projects;
- Initiation of process of development of tools and procedures for implementation of consolidation projects;
- Establishment of Monitoring and Evaluation system.

2018:

- Capacity building of MAFWE and other stakeholders;
- Development of tools and procedures for implementation of consolidation projects;
- Implementation of three/four consolidation projects;
- Monitoring and Evaluation.

2019:

- Capacity building of MAFWE and other stakeholders;
- Implementation of three/four consolidation projects;
- Monitoring and Evaluation.

Budgetary impact:

Total costs amount to EUR 4 million (out of which EUR 1 million national funding).

Expected impact on competitiveness

Allowing farmers to acquire farms with fewer parcels that are larger and better shaped and to expand the size of their holdings enables them to become more competitive. Improving the agricultural property structure can facilitate the adoption of new agricultural technologies leading to a more prosperous and efficient agricultural sector. Benefits from land consolidation in EU countries include increases in gross income of farmers and reduction of working hours in the field.

In order to create considerable impact, roughly at least 30% of all agricultural land will be consolidated in the coming 30 years. This requires each year to ‘deliver’ about 3,000 hectares of land consolidation projects being finalized. Assuming a preparation / implementation time of three years, it means that in each year about 10,000 hectares will be under implementation.

Expected social outcomes

By renewal of rural communities, land consolidation can promote social stability. Results from various research and assessments of land consolidation projects show that many communities that have experienced land consolidation show increases in the number of new jobs created.

The project will be implemented in compliance with the VGGT-Voluntary guidelines of land tenure, a gender sensitive and social inclusive approach of interviewing and meetings in which all participants will be able to express their interests and will influence the project options.

Measure 10. Agricultural cooperatives

Short description of the measure

In accordance with the National Strategy for Agriculture and Rural Development 2014-2020, the project „Creation and support of agriculture cooperatives" is planned, which will improve the structure in the agriculture sector, improve the market position of the farmers, increase their negotiation power in relation to the wholesale buyers, as well as getting lower prices for the raw materials, machinery and investment assets. The project will extend the support for the association of the farmers in agriculture cooperatives, i.e. creating and functioning of the agriculture cooperatives, through the following measures and activities:

- Elimination of the legal and administrative barriers for the creation and the successful functioning of the agriculture cooperatives;
- Providing an advisory and financial support for the initiatives to create agriculture cooperatives, and their continuous monitoring in the initial period after their establishment to reaching optimal functionality;
- Establishment of a system for continuous training of managers who are going to manage the agriculture cooperatives, in terms of improving their marketing, organizational, communicative, and managing capabilities, and
- Organizing a national media campaign for promoting the economic partnership of the farmers.

The National Strategy for Agriculture and Rural Development also indicates certain sub-sectors such as production of poultry and dairy products, where support for formation of cooperatives was identified as an opportunity to revitalize the industry through grouping of small producers.

In the „Program for financial support of the rural development for 2016" a measure is planned for the „Economic association of agricultural holdings for joint agricultural activities", where funds are granted for support of investment for the following sub-measures:

- creation and functioning of agriculture cooperatives registered in the Registry for agriculture cooperatives at the Ministry;
- assistance for insurance premiums, not exceeding 70% of the costs for insuring of the agricultural cooperatives of small size, and 80% for agricultural cooperatives of large size, and
- investment for purchasing agricultural machinery in the amount of 90% of the total cost of the purchase.

In the Registry of agriculture cooperatives there are 35 registered agriculture cooperatives, of which 7 are cooperatives of a large size, and the other 28 are cooperatives of a small size, with a total capacity of 1,100 ha agriculture land, 260 bee families, 450 cattle, 200 goats and 250 sheep.

Activities per year

2017

- Encouraging the process of market-oriented association of farmers in agricultural cooperatives.
- Providing continued financial support for cooperatives (continuation of the implementation of the previous period).
- Support for investments in processing, finalization and marketing of agricultural products.

2018

- Providing continued financial support for cooperatives (continuation of the implementation of the previous period).
- Support for investments in processing, finalization and marketing of agricultural products.

2019

- Support for acquisition of Protected labels of quality of the agriculture and processed products.
- Providing continued financial support for cooperatives (continuation of the implementation of the previous period).

Budgetary impact

The total cost of the implementation is 5,550,000 EUR, 2017: 2,650,000 EUR, 2018: 2,200,000 EUR and 2019: 700,000 EUR.

- Encouraging the process of market-oriented association of farmers in agricultural cooperatives and Providing continued financial support for cooperatives (continuation of the implementation of the previous period): 850,000 euro in 2017, 700,000 euro in 2018, 700,000 euro in 2019.
- Support for investments in processing, finalization and marketing of agricultural products: 3,300,000 euro IPA support.
- Support for acquisition of Protected labels of quality of the agriculture and processed products: 150,000 euro from measures for support cooperatives in programs for financial support of agriculture and rural development.

Expected impact on competitiveness

Establishment of agricultural cooperatives is an opportunity for development of farms by promoting economic partnership in form of agriculture cooperatives, that through joint production, sale and marketing of their products, will strengthen their market role, increase competitiveness and efficiency, increase individual income of the farmer, and moreover will provide for qualitative production, assured sale and higher profits. As a result, the objective of horizontal integration of the entities involved in the sector of food production basically is oriented towards agricultural cooperatives as the most suitable way for improvement of supply chain of agricultural products.

Expected social impact

Development of agricultural cooperatives will additionally contribute to the community by increasing and retaining jobs in agriculture and processing industry, environmental protection, retaining life and culture in rural areas.

At this moment 36 persons are employed as managers of the existing cooperatives. It is expected that this number will be doubled with the employment of staff for machinery operation if we take into account new investments in modernisation of agriculture production. Also new cooperatives will emerge so the number of the employees will be even higher.

Potential risks

Limited capacity of cooperatives prevents modernization of production practices and transfer of new technologies into production.

4.3.3.2. Industry sector development

Macedonia's economy is reliant on a small number of industrial sectors and exports to a limited number of trading partners, so that adverse market conditions affecting one or more of these sectors or economic developments in these trading partners could have a material and unfavourable effect on the overall economic conditions in Macedonia. Although in recent years Macedonia has sought to diversify its economy, with sectors such as the automotive industry that is becoming increasingly important, Macedonian industry remains heavily reliant on the metals, mining and quarrying and textiles sectors. Even though these sectors are relatively diversified and consist of a range of producers, at the end of 2015, in total textiles and clothing accounted for 14.6%, mining and quarrying accounted for 11.6% and metals accounted for 5.5% of industrial production.

The UNIDO Competitive Industrial Performance Index (CIP)⁴⁵ is a good indicator of the capacity and potential of the industry. Industrial competitiveness is defined as the capacity of countries to increase their presence in international and domestic markets while developing industrial sectors and activities with higher value added and technological content. According to UNIDO, the Macedonian industry index accounted for 0.026 in 2013 (last available data). For illustration, Germany has the highest CIP index of 0.576.

⁴⁵ United Nations Industrial Development Organization, Industrial Development Report 2016

The problems that industry is facing with are dependence on imported raw materials and intermediate goods and materials from distant suppliers, low bargaining power with suppliers, major domestic exporters are mostly in traditional industries with price as primary driver of competitiveness, underdeveloped clusters, limited access to finance, underdeveloped management and marketing skills, etc.

An important structural problem is the lack of cooperation between scientific and educational institutions and industry, as well as mismatch between educational programs and labor market needs, resulting in a lack of adequately trained workforce.

In recent years, there has been a gradual change in the structure of industrial production as a result of opening new facilities that produce products with higher technological value, particularly in the TIDZs, which are targeted at attracting foreign investors and which have been established in order to support modern technologies. The TIDZs are free zones with regard to customs and tax laws, and provide fully developed infrastructure and connections to utilities.

There are currently four operating TIDZs in Macedonia, with several others in the planning stage. Foreign companies operating in the TIDZs include several companies in the automotive, electronics, machinery and equipment manufacturing sectors. These companies generally manufacture higher value-added goods for export. However, spillover into domestic economy is considered limited. To ensure broad-based benefits and sustainability of the FDI-led growth strategy, complementary reforms to remove impediments faced by the domestic private sector, such as constrained access to finance and unpredictability of business environment, are recommended.⁴⁶

4.3.3.3. Services sector development

The services sector of the Macedonian economy has the highest share in GDP with over 50%. The sector registered growth of 3.9% in 2015, whereas the highest contribution to the growth was recorded in the wholesale and retail trade with real growth rate of 7,3%. The services sector also employs the highest number of employees in the economy with a share of over 50% in 2015. The following areas are identified as key in the development of the services sector in the next years: 1) electronic commerce, 2) tourism and catering, and 3) creative industries.

Electronic commerce

The electronic commerce experiences an increasing trend in the last couple of years, although it is still underdeveloped compared to the EU member states. The main reasons for its development are: increased internet access, increased use of credit cards and regulatory simplicity and low transaction costs.

The Law on Electronic Commerce regulates information society services relating to electronic commerce, the responsibilities of providers of information society services, commercial communication and the rules relating to the conclusion of contracts in electronic form. The existing legislation does not contain specific requirements regulating the work of online traders and thereby it is not a problem for commencing activities in this sector. The only obligation is to prescribe and publish rules and policies pertaining to privacy, delivery and refund that guarantee consumers' security. The transaction costs are also insignificant, as the fees charged are around 3-5%, while the customs duty during the submission of the export declaration for this type of commerce has been abolished⁴⁷.

Nevertheless, it should be highlighted that there are limiting factors that prevent the further development of the electronic commerce, such as: 1) lack of awareness about the existence of online shops, 2) the risk of misusing consumers' personal data and 3) the need of expanding the existing legislation. The lack of awareness about the possibilities to execute online transactions and the risk personal data misuse directly affect the low demand for this type of commerce, as

⁴⁶IMF Article IV Report, November 2016

⁴⁷ Analysis of e-commerce in Macedonia, USAID, 2010 http://mioa.gov.mk/files/pdf/dokumenti/Analiza_e-trgovija_29.11.10.pdf

data for the first quarter of 2016 show that only 10.4% of the companies with more than 10 employees own a website for online shopping and booking. There is a need for raising public awareness about advantages of online shopping as modern and easy way of trading without risks of personal data misuse.

Tourism and catering

According to SSO data, the number of tourists rose by 26.0% in the period 2011-2015, primarily due to the increased number of foreign tourists by 48.3%. Growth of 10.1% was also recorded in the number of nights spent, mainly as a result of the increased number of nights spent of foreign tourists by 37.2%, whereas the number of nights spent of domestic tourists experienced decline. However, it is evident that this growth is higher during the summer months, implying to an accelerated development of the summer tourism. The total number of employees in the accommodation and catering facilities in the same period has increased by 14.3%, while the number of new jobs created in the sector was only 5.5% of the total number of jobs created in the economy.

Yet, it should be taken into account that the efforts made to boost development of tourism are mainly focused on the summer tourism, leaving the country with underexploited potential for developing other types of tourism, such like the winter, rural, wellness/spa and enotourism⁴⁸. The convenience of the geographical factors and cultural heritage create potential for attracting domestic and foreign tourists, but limiting factors are the underdeveloped infrastructure and the lack of accommodation and catering facilities. An important aspect for sustainable development of the tourism sector is the highly qualified young workforce, while currently the largest share of employees in the sector are persons without any graduate degree. Additionally, another limiting factor is the lack of long-term strategy for developing the tourism in the country.

Creative industries

Macedonian software industry showed favourable outcomes during 2011-2015, resulting in an increased number of companies, employees, turnover and exports. At the same time, around 95% of the revenue comes from the IT services (contractor model) extended on the foreign markets, which does not limit the potential of the domestic market. In addition, the supply side of the IT services in Macedonia does not consist of companies only, but of highly qualified free lancers with the required skills and competencies.

The most recent trends indicate to a willingness of the foreign companies to expand their capacities in Macedonia. This creates a highly favourable state for the highly qualified workforce, but on the other hand, the domestic companies face certain challenges in employing qualified staff. For that purpose, a number of measures have been recently implemented for stimulating enrollment of students at technical faculties which yielded good results.

The main challenges for sustainable development of the creative industries arises from the necessity of creating a quality supply of workforce that can respond to the requirements of foreign companies, therefore it is inevitable to carry on the implementation of the measures for incentivising the increase of the number of students at the technical faculties.

Measure 11: Increasing competitiveness in Tourism & Hospitality Sector

Short description of the measure

The measure is aimed at implementing activities for increasing the competitiveness of SMEs in the sector, which will contribute to increasing the incomes of men and women, especially the youth. It is important that the focus is placed on ensuring systemic changes in the sector which are sustained.

The measure is implemented within the Program for increasing market employability (first phase), supported by the Swiss Agency for Development and Cooperation. The program aims to

⁴⁸ National Strategy for tourism development, draft plan of Kohl & Partner

encourage change in this sector, using a market approach that includes effective platforms with stakeholders on the basis of guidelines for sustainable change. It will lead to the growth of enterprises in tourism and hospitality sector by expanding the existing market and access to new market opportunities.

Three tourism destinations Ohrid, Mavrovo and Krushevo will be assisted to exploit the full potential of their historical, natural and cultural heritage through the University of St. Gallen's methodology for collaborative destination management, improved service delivery and enriched touristic offer. This will attract more tourists, which in turn will lead to economic growth and employment.

- The National Agency for promotion and support of tourism and the Macedonian travel agencies will continue to promote and support the tourism sector in Macedonia through targeted promotion on international markets (road shows, fam trips, targeted fairs etc.), which should improve the competitiveness of the tourism sector on national level.

- Introduction of new and upgraded services such as rescue, insurance, parking etc. will add value to Krusevo's tourism offer and will be incorporated in the tourist offer, thus creating the basis for commercially sustainable business model and creating competitive advantage of Krusevo as paragliding destination.

- Consolidation and strengthening of the tour guide sector through interactive IT platform that will have wider impact on Macedonian tourism industry. Establishing global standards in the tour guide sector (digital registry of licensed tour guides, criteria of reviewing the licenses, rating system, online reviews, etc.) will indirectly help in development and access to new markets and will support the efforts of the country to reveal new destinations for active tourism.

Activities per year

2017:

- Improved access to international markets (Destination Ohrid scaled up to export),
- Improved destination management in order to access international markets for paragliding (Destination Krusevo),
- Improved tour guide services and visibility of tour guides to travel agencies.

2018 and 2019: Activities are defined annually

Budgetary impact

226,022 euro (annual budget for 2017). The measure is carried out with support from the Swiss Government.

Expected impact on competitiveness

The increased potential of the three tourist destinations for attracting more tourists through enhanced provision of services and enriched tourist offer will enable greater participation on the domestic and world markets leading to economic growth.

Expected social outcomes

New jobs will be created along the whole tourism value and supply chain and it is expected higher participation of young people and women. Around 600 guides and their set of skills and capabilities will be visible and accessible on the market of travel agencies.

Measure 12: Increasing competitiveness in Creative Industries Sector

Short description of the measure

Software and IT services and Product Design subsectors will be supported, so that software development and product design services by Macedonian companies enjoy large market penetration in the country and international markets as well.

The measure is implemented within the Program for increasing market employability (first phase), supported by the Swiss Agency for Development and Cooperation and includes the following activities:

- Implementation of design management (DM) function in three selected industries: Food processing, Light metal manufacturing and Furniture. In joint cooperation with processing associations (Macedonian Association of processors (MAP), Association of Light manufacturing (MAMEI) and House of 1000 Designers (HO1000D)) the process has started for engaging the designers in product development process based on the companies demand ending up with introduction of design management function as integral part of the product development process.
- New and upgraded service that will be offered by MASIT (Macedonian chamber of ICT industry) towards the member and non-member companies, following the newly developed business plan will be piloted. Seven companies were selected based on their commitment and readiness for 3 different markets (UK, Sweden and Israel). These companies will offer their products, based on performed in depth analysis and pre-match making with potential partners.
- Following the established collaboration and the joint workshop between the Faculties of mechanical engineering (FME) and Zurich University of the Arts (ZHdK), the Dean and the professors from FME expressed interest to include the design research methodology in their educational training subjects in order to increase the skills and qualification of the students starting from Year 1 of their studies.
- Supporting SMEs access to finance and more qualified staff in order to increase their competitiveness. An Employment Agency, specialised in IT sector only, will be also supported, which will lead the communication between companies, providers of informal training and unemployed young people, according to the industry needs.

Activities per year

2017:

- Access to market for designers,
- Increased export from IT Companies,
- Design with social impact,
- Support services for IT Companies.

2018 and 2019: Activities are defined annually

Budgetary impact

237,593 euro (annual budget for 2017). The measure is realised with support from the Swiss Government.

Expected impact on competitiveness

The manufacturing companies will increase the number of new products and services, increase their competitiveness on international markets and increase the volume of sale that will create new jobs for designers and other professionals. Macedonian IT industry will create competitive advantage in promoting its own developed products.

Expected social outcomes

- Increased presence of companies on international markets should lead to increased income of the companies and creation of additional jobs.
- The introduction of new research methodology subject will increase students' skills for proper practical research processes which they will follow when designing new products and will allow them to better understand the market demand and the needs of the end beneficiaries.
- HR Agencies, HUBs and accelerators that are already established or are in the process of establishing offer support services for youth for obtaining additional technical and team work skills. It is expected, aside from selected partners that are going to promote and test the collaboration models with big companies, other entities to replicate this model in order to increase their access to skilled employees.

4.3.4. BUSINESS ENVIRONMENT AND REDUCTION OF INFORMAL ECONOMY

General business environment

Improving the business environment and increasing the competitiveness of the economy are one of the main priorities of the economic policies of the Government of the Republic of Macedonia. Republic of Macedonia has significantly strengthened its business environment through a number of measures undertaken in recent years aimed at reducing the regulatory and administrative barriers, speeding up procedures and reducing costs. The main problems that the business sector faces are continuously identified in order to design measures to overcome them.

This progress has been confirmed in the latest report on doing business by the World Bank "Doing Business 2017" where Macedonia was ranked on the 10th place among 190 economies in the world. Macedonia ranks best in Starting a business where it is positioned at the 4th place in the world. Macedonia is ranked well at the indicators Paying Taxes (9th), Dealing with Construction Permits (11th), Protection of Minority Investors (13th) and Getting Credit (16th place among 190 countries). However, there are areas such as Registering property and Enforcing Contracts where further improvements can be made.

According to the Global Competitiveness Index 2016-2017 of the World Economic Forum, Macedonia is ranked on the 68th place among 138 countries, which is lower by 8 places compared to the previous year. Regarding the extent of development of the economy assessed by the report, Macedonia is in phase 2 Guided by efficiency, together with 30 other economies, including Albania, Bosnia and Herzegovina, Bulgaria, Montenegro, Romania and Serbia.

The report on Assessing the implementation of the European Act for Small Businesses (Small Business Act) states that despite being a landlocked economy, Macedonia is relatively competitive and dynamic compared to its regional competitors.

The private sector mainly consists of small and medium enterprises accounting for 99.8% of the total number of active enterprises. SMEs are the dominant type of enterprises. Because of their high share in the total number of enterprises they are important source of employment, investment and significant creators of GDP. The growing number of SMEs absorbs the majority of the workforce and contributes to reducing the unemployment. SMEs contribute with 76.6% of the total employment and 66.6% of the value added. For more dynamic development of SMEs, it is necessary to obtain more diversified access to financing, more comprehensive and better targeted support and higher quality services. However, the country lacks an up-to-date National Strategy for Development of SMEs. The previous strategy referred to the period 2002-2013 and included measures and activities to support the development of entrepreneurship and competitiveness of small enterprises.

OECD's publication Competitiveness in South East Europe: A Policy Outlook 2016 monitors the competitiveness according to 15 dimensions. Macedonia ranks very well among the region in several areas such as trade policy, digital society, innovation policy, investment policy etc. The need to further improve the business climate, attract investments and enhance the export potential are stated as important priorities in the coming period, which are essential to achieve sustainable growth led by the private sector and job creation.

According to the World Bank's indicator Rule of Law⁴⁹ which captures perceptions of the extent to which entities have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence, Macedonia has 50.48% for 2015 on a scale from 0 (lowest) to 100 (highest level). In the past period, Macedonia has noted a steady progress in this indicator, while decline was registered only in 2015.

⁴⁹ <http://info.worldbank.org/governance/wgi/index.aspx#reports>

One should have in mind that the continuous efforts to improve the business environment assume frequent amendments of legislation and regulations which may be a limitation/ risk for foreign investors, if they are not certain the country has predictable working environment.

Fiscal and para-fiscal burden

The total tax rate in Macedonia was 12.9%⁵⁰ in 2015 and it has been declining continuously over the years, which means the overall tax burden on companies is low. The average tax rate in the region of Eastern Europe and Central Asia is 35.2%, in the EU and EFTA 40.6%, while the world average is 40.8%. The time required for payment of taxes in Macedonia is 119 hours which is the shortest time for paying taxes among the countries of Central Asia and Eastern Europe, where the average time for paying taxes is 247 hours, while the world average is 261 hours. Payment of taxes is completely conducted via electronic system for paying taxes making the procedure greatly simplified and cheaper.

Small and large scale privatization

According to 2014 EBRD's transition indicators, in the area of large scale privatization Macedonia is scored 3.3 which means that more than 25% of large enterprise assets are in private ownership or in the process of being privatised. Regarding small-scale privatization, Macedonia is scored 4 which means complete privatisation of small companies. In terms of Governance and enterprise restructuring, the country scored 2.7 which means: significant and sustained actions to promote corporate governance effectively. In terms of price liberalization and trade and foreign exchange system, Macedonia fully meets the standards and performance typical for developed advanced industrial economies, while in terms of competition policy it is stated that the country has established appropriate legislation and institutions.

Enforcing Contracts

Regarding the Enforcing contracts indicator according to Doing Business Report 2017, Macedonia is ranked 36th out of 190 countries, which is lower by 10 places compared to last year. The duration of the court proceedings is 634 days and the cost is 28.8% (of claim). In Europe and Central Asia the average duration of court proceedings is 486 days, while expenses amount to 26.6% (of claim). The lower rank is due to the introduction of the mandatory obligation for the parties to try to resolve the dispute through mediation before filing a lawsuit to the court, which is expected to reduce the number of lawsuits filed to courts.

Corruption and informal economy

According to the Corruption Perception Index for 2015, Macedonia is ranked 66th out of 168 countries and has 42 index points which represents a 2 places decrease in the rank compared to 2014 (64th place). This report notes that although in some countries in Europe and Central Asia there are some improvements in fighting corruption, the general picture for the region is that the fight against corruption is stagnating. Governments are willing to adopt appropriate laws to deal with corruption, but their implementation remains an issue. In Hungary, Macedonia, Spain and Turkey some deterioration is registered in dealing with corruption, making the fight against corruption a major challenge in the region.

The informal employment rate is around 20% in 2015⁵¹ and is constantly decreasing since 2009. The gray economy in the country is causing losses of budget revenues due to non-payment of taxes and social security contributions to the state and increases the tax burden for entities that operate within the formal economy. In order to reduce informal employment and the informal economy in Macedonia annual action plans are implemented with activities aimed at strengthening inspections and preventive measures (education, legislative amendments etc.), and strengthening the cooperation between institutions on the labor market.

⁵⁰ World Bank Doing Buisness 2017 Report

⁵¹ <http://www.stat.gov.mk/Publikacii/2.4.16.02.pdf>

Access to Finance

According to an EIB analysis⁵², in general, credit is available but not always affordable. With almost 6,000 employees and 430 branches across the country, banks serve enterprises of any size. Interest rates have been decreasing, however, unsecured lending is rarely used. Moreover, funds are also available from other sources at preferential conditions (especially for start-ups), but the debt financing market is not yet developed. Over the years, increased competition has resulted in better terms and conditions for SME loans. Lenders cite a number of constraints that do not allow them to grow their SME portfolios faster. Lenders argue that SMEs bear a higher risk as their earning capacity is less certain. Risk assessment of SMEs is more difficult due to insufficient and often unreliable information and leads to the need for a different approach. Furthermore, smaller loan amounts translate into higher transaction costs. Most banks seem to have already dealt with all these obstacles. They normally have separate units and staff members to deal with large and SME clients, respectively, and some even distinguish further between micro-enterprises and SMEs.

From the banks' point of view, the most important limitation is the general scarcity of feasible business projects. Banks are not satisfied with the entrepreneurial skills and financial literacy of their potential SME clients. As a result, many loan applications get rejected. Financial support is necessary to facilitate SME development, but SME development is necessary to justify financial support. SMEs see the situation from a different perspective. SMEs complain about complex and cumbersome lending procedures and excessive documentation requirements. In addition, many of them cannot provide sufficient collateral and are not very well informed about the guarantee schemes that are available to them. SMEs also find it difficult to fully understand all the costs involved with a loan and that banks are not properly disclosing them. Most respondents, however, are of the opinion that access to finance is not the biggest constraint to SME growth in Macedonia.

According to the World Bank's Enterprise Surveys 2013⁵³ the value of the collateral needed to obtain a loan or credit was estimated at 275.5% of the total loan amount. The survey was conducted in the period November 2012 - May 2013, when business owners and top managers in 360 firms were interviewed. Out of them 246 were small (5-19 employees), 94 were medium (20-99 employees) and 20 were large companies (100+ employees). According to a more recent document⁵⁴ the collateral requirements is around 150% of the value of the loan. It should be noted that the amount of collateral depends on the bank's assessment of the financial condition of the client and the project's level of risk. The Competitiveness Strategy and Action Plan of the Republic of Macedonia 2016-2020 includes several measures to improve access to finance for companies and efforts will be made for their operationalization in the medium term⁵⁵.

E-services

Currently, there is no single central gateway for access to government e-services with higher level of sophistication, and the users of government e-services (citizens and businesses) are accessing the e-services in non-uniformed manner. The official public e-services portal www.uslugi.gov.mk is obsolete and provides only informational services. The identification and payment options are not consistent across the services, which creates confusion and discourages the usage of e-services. As recommended in the SIGMA 2015 Baseline Measurement Report, the Ministry of information society and administration should foster development of the official public service portal <http://uslugi.gov.mk/>. The portal should evolve from a static information site to a platform where users and the administration can interact on service delivery as well as on service transformation (e.g. by continuous testing of new feedback mechanisms).

⁵² Macedonia Assessment of financing needs of SMEs in the Western Balkans countries, European Investment Bank, August 2016

⁵³ <http://www.enterprisesurveys.org/data/exploreeconomies/2013/macedonia-fyr#finance>

⁵⁴ Competitiveness Strategy and Action Plan of the Republic of Macedonia 2016-2020, January 2016

⁵⁵ Within this area, the Strategy includes measures for: establishment of a national credit guarantee scheme, development of debt financing and new financial instruments, to improve the financial literacy of SMEs and others.

Measure 13: Development of National Portal for e-services

Short description of the measure

Creation of dynamic web portal for e-services (National Portal for e-services) as the single-point of contact with the state bodies on the "one-stop-shop" principle and using standardized user interfaces. The Portal will be available via the Internet on a different web oriented platforms. Portal's visual design, its user friendliness, easy navigation and usage of the W3CG standards are of great significance.

The purpose of the e-service portal is to increase the efficiency of the state institutions and to provide faster and simpler services, by creating single point of contact between the citizens and businesses (e-service users) and service providers and by implementing a solution that will perform electronic data exchange between institutions to accelerate the process of e-service delivery.

The e-services portal foundations lay in the adopted legal and established organizational and technical measures for implementing one-stop-shop system, thereby enabling secure electronic data exchange among state institutions in accordance with their competences.

Activities per year

2017: - Improvement of the Legal framework on electronic management.

- Draft revision and amending the Law on electronic management and its bylaws.
- Draft guidelines/ methodology/ legal act for e-services fees.
- Strengthening capacities for implementation of the improvements of the Law on electronic management and acts for e-services fees.

2018: - Implementation of E-services.

- Develop and provide fully functional National Portal for e-services.
- Increasing the number of electronic services available, and increasing overall level of sophistication of electronic administrative services in accordance to EU benchmarks.
- Increased usage of e-services by end-users.

Budgetary impact

The total cost for this measure is 518.980 EUR (300.462 in 2017 and 218.518 in 2018). It is a component of a larger service contract.

Expected impact on competitiveness

Decreasing the administrative burden for citizens and companies, increasing efficiency of the companies.

Expected social impact

Wide inclusion of all social groups, increased trust in the government, open areas for new businesses, satisfied users, faster and quality services, facilitated access to services for rural communities.

Measure 14: Adoption of a National Strategy for SMEs (2017-2022) with an Action plan (2018-2020)

Short description of the measure

The adoption of a National Strategy for SMEs (2017-2022) is foreseen for 2017, aimed at supporting the development of SMEs and entrepreneurship for the purpose of increasing the productivity and innovation of SMEs and enhance their competitiveness in national and international markets.

The objectives of the strategy are:

Competitive SMEs are drivers of inclusive economic growth and creation of productive and decent jobs.		
Even better business environment	Productive and competitive SME sector	Dynamic ecosystem of entrepreneurship and innovation
Improve policy-making and coordination Simplify the legal and regulatory environment Strengthening and institutionalizing of social dialogue Improving data on SMEs and monitoring and evaluation Establishing National Association of SMEs	Improve services for business development Improving access to finance Facilitate the internationalization Supporting the development of industrial sector	Expanding entrepreneurship education and training Improving science, technology and innovation in the development of SMEs Establishing science and technology parks and incubators for innovation

Activities per year:

2017: Second quarter - Adoption of the Strategy and Action Plan

Budgetary impact:

Preparation of the Strategy = EUR 38.300, funded by the International Labour Organisation.

Expected impact on competitiveness:

1. Competitive SMEs are drivers of inclusive economic growth and creation of productive and decent jobs.
2. SMEs operate in a favorable business environment where they encourage entrepreneurship, investment and productivity, in line with European norms and standards.
3. SMEs are highly productive and competitive participants in the European and other international markets.
4. The competitiveness of Macedonian economy is increasingly encouraged by the more entrepreneurial and innovative SME sector.

Expected social impact:

Strengthening consultation and mechanisms for conducting dialogue between the government and the private sector. Special attention will be given to the inclusion of business women in these mechanisms, as well as ensuring that the voice of micro-enterprises will be heard.

Potential risks:

Untimely adoption of the strategy.

4.3.5. RESEARCH AND INNOVATION

The private sector spending on R&D is very low, even within the high-tech and mid-tech sectors⁵⁶. According to the latest available data from SSO private R&D expenditure in Macedonia accounted for only 0.02% of GDP in 2010. Public R&D expenditures have slightly been increasing and accounted for 0.52% of GDP in 2015. Key obstacles to RDI are the high costs of innovation and the limited access to bank loans, risk capital and other funds, as well as the limited capacity of the companies to access funding available through international funds and financial institutions. SMEs' access to finance for activities related to research, development and innovations has been improved with the establishment and operation of the Fund for Innovations and Technology Development (FITD). However, with exception of the Fund's support instruments, other mechanisms and infrastructure for enhancement of RDI such as for example a technology transfer offices, business accelerators and incubators, venture capital, tax incentives, etc. are scarce. On the demand side, the inclusion of innovation in the public procurement is still in initial phase and there is no investment in innovation through pre-commercial procurement.

⁵⁶EBRD (2014), "Transition report 2014: Innovation in transition"

Consequently to the above, the country's RDI outputs are limited. The latest Innovation Union Scoreboard (IUS 2015), ranks the country as a "modest innovator", in comparison to other European countries, albeit relative country performance has been steadily improving from 35% in 2007 to 42% in 2014 with a growth performance (3.7%) well above the EU average. Such ranking mostly stems from the country's underperformance (below the EU average) in all indicators. However, relative strengths have been identified in non-R&D innovation expenditures and SMEs with product or process innovations.⁵⁷ The State Statistical Office data show that the number of innovative business entities in the period 2012–2014 was 1078. Out of the total number of innovative business entities, 37.1% have introduced product and process innovations, 35.8% have introduced organisational and marketing innovations, while 19.1% have introduced product, process, organisational and marketing innovations at the same time.⁵⁸

According to the "create or buy technology" analysis, the countries from SEE are mostly in the "buying technology" category (Bosnia and Herzegovina, Macedonia, Montenegro, and Serbia) or in the "low level of innovation" category (Albania). The export of high technology amounts to less than 4% of the total export in Albania, Bosnia and Herzegovina and Macedonia, 10% of the total export in Croatia, and 15.5% of the total export in the EU countries⁵⁹. However, 22% of the SEE companies are included in some type of innovations, which places Southeast Europe in front of the other regions in transition. In Macedonia 22.5% of the total export of services comes from activities which use higher degree of knowledge. However, the number of universities or other institutions for higher education which were partners in an active cooperation in the introduction of product and process innovations is significantly low (less than 30%)⁶⁰. The cooperation between the public sector, the research and development institutions/academic institutions and the industry is weak and usually insufficiently documented or promoted even where it exists.

The above presented information leads to conclusion that the limited investment in research, development and innovations in SMEs, as well as the weak cooperation between the private sector and the academic institutions are a serious obstacle to strengthening the innovation activities in micro and SMEs with the goal of increasing their competitiveness. In compliance to the diagnostics, activities are taken aiming to improve the innovation infrastructure which include piloting and implementation of the support instruments of the Fund for Innovations and Technology Development and establishing and operationalising the National Technology Transfer Office (NTTO).

The national strategic documents that co-ordinately target these challenges are: Strategy for innovations of the Republic of Macedonia 2012-2020, Strategy for competitiveness of the Republic of Macedonia 2016-2020 and Strategy for education 2016-2020 (to be adopted in 2017).

Measure 15: Improvement of the infrastructure and the access to funding for research, development and innovations

Short description of the measure

The indicators related to the innovation ecosystem in the Republic of Macedonia show a lack of financial investment, as well as weaknesses in the existing „hard" and „soft" infrastructure. The Fund for Innovations and Technology Development has improved the situation to some extent by implementation of two support instruments. The first instrument supports projects with clear commercial ambitions from "proof of concept" to "ready to market" phase. Through this instrument, the Fund provides funding up to 85% of the total project budget, up to a maximum of 30,000 euros. The second instrument supports projects with clear commercial purpose which are in the phase of a prototype (or appropriate stage depending on the type of innovative product,

⁵⁷ Innovation Union Scoreboard 2015, European Union, Belgium 2015

⁵⁸ State Statistical Office of the Republic of Macedonia, News Release No. 2.1.16.20, 01.06.2016

⁵⁹ Competitiveness in South East Europe A POLICY OUTLOOK, 2016

⁶⁰ Statistical Yearbook 2016, State Statistical Office

service, and process) until “ready to market” phase. Through this instrument, the Fund provides funding up to 70% of the total project budget, up to a maximum of 100,000 euros.

The above presented support instruments cover only some segments of the innovation cycle, while the innovation ecosystem should offer diverse and flexible support to all the phases of the innovation cycle (from idea to global market commercialization). In addition, the results and experience gained from the implementation of the two support instruments demonstrated low investment readiness in SMEs. In order to overcome these gaps, there is a need to expand the existing innovation infrastructure so as to increase access to finance to complement various phases of the innovation cycle and strengthen the investment readiness of the companies which in the long run would lead to a more effective utilization and more significant results. Therefore, in the forthcoming period, the Fund for Innovations and Technology Development plans on developing and piloting new support instruments such as:

I. Instrument for support - „Co-financed grants for technology extension"

This instrument will be intended for analysis of the needs and introduction of new, advanced technologies that would improve the performances of the Macedonian SMEs and would improve their competitiveness both on the domestic and the foreign markets. Advanced technologies would allow further introduction and strengthening of innovation activities of enterprises and would improve the potential of the private sector to absorb investment capital.

II. Instrument for support - „Co-financed grants for establishment, operation and investment in business-technological accelerators"

This instrument will be intended for the establishment and active operation of business-technological accelerators as subjects for giving infrastructural support to the innovative activity, from which is expected to be the key part in the national innovation system through providing resources (technical and financial) that lead to accelerated and sustainable growth and development of start-ups. This instrument is expected to offer additional sources of funding for innovation activity in start-ups, and also to significantly strengthen human capacity within the newly established enterprises and to contribute to increased readiness to attract investment and venture capital.

III. Introduction of new support instrument – „Technical assistance for support to the innovation activity"

This instrument will be intended for provision of consultancy services for support to the innovative activity (analysis of innovative potential, introduction and management of innovations, protection of intellectual property, preparation for attracting investments, development of innovative projects etc.) in the private sector at favourable terms.

Activities per year

2017: Improvement of the regulatory framework: adopting by-laws for introduction of the new support instruments

Piloting of the new support instruments: Co-financed grants for technology extension and Co-financed grants for establishing, operation and investment of business-technology accelerators

2018: Piloting of the new support instrument: Technical assistance for support to the innovation activity

2018-2019: Implementation of the new support instruments

Budgetary impact

Instrument No.	2017	2018	2019
I.	€125.000	€650.000	€575.000
II.	€83.333	€458.334	€500.000
III.	€100.000	€200.000	€200.000
Total	€218.333	€1.308.334	€1.275.000

The funds for the support instruments I and II have been provided by the loan agreement with the International Bank for Reconstruction and Development (World Bank), the operational budget of

the Fund and IPARD, the support instrument III shall be implemented under condition that aid is provided from other sources.

Expected impact on competitiveness

It is expected that the support instruments would increase the public and private investment in RDI (as % of GDP), increase the number of companies introducing innovation of product /process /service, strengthen the capacities of the SMEs and enhance the cooperation between the private sector and academia. It will contribute to the increase of quality of the supply of goods and services, as well as, to the increase of the domestic companies' capacities to meet the international standards for safety and quality, leading to greater competitiveness and international market participation.

Expected social impact

Investment in research, development and innovation increases the competitiveness of the domestic companies on the domestic and global market, which results in economic growth and increased job creation. Through the improvement of the economic performance, as well as through the increase in the quality of goods and services available on the market, the introduction of innovations also leads to a higher standard of living of the population.

Potential risks

The involvement of the relevant stakeholders and the further strengthening of the capacities of the Fund for Innovations and Technology Development are the key preconditions for successful implementation of this measure. Increase of investment readiness of SMEs in parallel to the increase of funding is crucial for the absorption of available funds. Insufficient complementarity of resources and mechanisms is a major risk for further implementation of the existing and the proposed support instruments.

Measure 16: Triple Helix Partnership

Short description of the measure

Triple Helix partnership as a potential for innovation and economic development in a knowledge based society lies in a more prominent role of universities, industry and government to generate new institutional and social formats for production, transfer and application of knowledge. Thus, Ministry of Education and Science has initiated establishment of the NTTO as a mechanism for linking and facilitating co-operation between academia, business and government. The preparatory activities for NTTO establishment are completed. The Founding Assembly meeting is postponed due to the need for amending the Law on innovation activity, to the end of providing a legal framework for NTTO, as well as including the Fund for Innovations and Technological Development as one of the founders of NTTO. The proposed amendments to the Law on innovation activity are submitted to all stakeholders and should be adopted by the Government of Macedonia. It's planned for NTTO to start functioning in the first half of 2017.

Based on the analysis of the potential, priorities, and strategies of the country, it is concluded that there are three main sectors that should be included in the technology transfer process:

- I. Agriculture,
- II. Information and communication technology –ICT,
- III. Renewable resources of energy (green energy)

Projects from several (5-10) „additional areas": chemical, pharmaceutical, metallurgical, mechanical, automotive industry, the creative industries and tourism will be supported by NTTO, if they are identified with sustainable results from research and development, experience in running applicative projects and commitment. Besides technology transfer, NTTO will offer a wider set of services, including research agreement management, encouragement for increased collaboration between universities and the industry, support to the universities and the industry for activities related to technologies and intellectual property. As a result of these services, NTTO should generate income, which will support its activities in the long run, given the fact that

technology transfer is not a profitable business, but a mechanism for developing the economy. NTTO will prepare a registry of experts from different industrial sectors in the country, as well as a registry for available laboratories and laboratory services acquired from the “Equipping laboratories for scientific research and applicative activities” project, to the end of increasing the availability to the final consumers. The following final consumers are identified: scientific and research institutions, public and private universities with a research potential, start-ups and spin-offs, SMEs, innovative companies and industries, foreign technology-oriented companies interested in a collaboration with local partners, existing and potential foreign investors, economic chambers, government institutions, nongovernmental organizations and foundations, cluster associations, research companies, consultancy companies and banks.

Activities per year

2017: Operationalization of the NTTO (staffing a team, equipping the NTTO, organizing trainings for the employees, establishing the processes and developing a strategy for industrial property protection, developing a marketing strategy, funding strategy, strategy for securing funding sources, and establishing a financial reporting and control system).

2018: Support to at least 5 pilot innovative projects in the first functioning year (2018), a double increase of the target in the second year and a continuous increase of the number of supported projects yearly from the third year onwards.

2019: Submitting at least 5 patent analyses and 2 patents in a period of 4 years.

Budgetary impact

Within the “Project for development of skills and support to innovations” (funded by a loan from World Bank), conducted within the Ministry of Education and Science, EUR 870,000 are planned for the provision of technical assistance and financial resources, as well as acquiring databases for purchasing a patent and researching the market to the end of facilitating the initial phase of the NTTO creation.

The funding of NTTO is planned to be conducted through the SKILS project until the middle of 2019, until when NTTO is expected to become the main partner in the technology transfer area.

Expected impact on competitiveness

This reform measure is expected to stimulate key elements of an innovation economy, i.e. entrepreneurship, commercially oriented research, university-industry partnership, and risk taking that can lead to improved exports of products and services.

Expected social outcomes

NTTO will also focus on the large companies and will encourage their cooperation with the universities, especially through the development and the implementation of practice needed for projects on master and doctoral studies, and specific educational programs. All involved stakeholders are expected to have benefits from the NTTO activities, because it should encourage the commercialization of technologies, and the absorption of knowledge on a national and global level. Enhancing innovation capacity and efforts to evolve toward a knowledge-based economy provide opportunities for more and higher value-added employment, and ultimately greater productivity and economic growth.

Potential risks

- Lack of inner technological capabilities – the import of technology does not mean a complete understanding and knowledge of the technology.
- High price of the technology – the high price in resources for integration of the existing well developed tool or methodology can occur as a result of the high operational and/or maintenance costs.
- Organizational resistance and communication barriers – the basic elements for a successful technology transfer are a secure source of useful information, commitment to information exchange, and flexible information transfer channels.

- Business risk – arises from the constant changes of the business context, and can be a costs risk, demand risk, exchange rate risk and interest risk.

4.3.6. EXTERNAL TRADE AND INVESTMENT FACILITATION

As a small, open economy Macedonia has to rely on exports and increased competitiveness to sustain long-term growth. Supported by an active strategy to promote foreign direct investment, Macedonia is gradually shifting to a more export led growth model. As a result, in recent years, the country has diversified its exports both in terms of products and destinations and increased the technological intensity of its export basket.

Technologically⁶¹, Macedonian goods exports are average and mainly consist of metals, chemical products, textiles and machinery. Macedonia therefore exports some higher-quality goods including machinery and vehicles as well as chemical products. Moreover, despite an increase in unit labour costs, Macedonia was able to expand its market share for goods exports into the European Union in recent years, suggesting, among other things, a higher quality of the range of goods available for export. The exchange rate is pegged to the euro, being the main currency in foreign trade.

The overall export performance of Macedonia's manufacturing sector is satisfactory compared with other Western Balkan countries. Germany is by far Macedonia's most important export market. Other important export markets include Bulgaria, Kosovo, Italy and Serbia. The transport industry plays an important role in Macedonia's tradable services sector, while the tourism industry is comparatively underdeveloped and currently attracts mainly regional guests. Though, overall, net services exports contribute to improving Macedonia's current account balance.

Having in mind that most domestic firms in Macedonia are small (fewer than 10 employees) they have great difficulty competing in export markets, because of their inefficiencies, and the high costs related to customs, logistics, and trade infrastructure. Small and medium Macedonian companies face challenges of integration into international markets due to lack of managerial, financial and technical capacity, which limits their competitiveness. While multinational firms have made an impact on employment and growth of new industries with better long-term prospects, their limited backward linkages to domestic companies prevent a broader impact on the economy. Macedonia will need to boost and upgrade its exports further in order to improve its competitiveness, by: investing in its infrastructure; promoting a stronger investment climate; facilitating business growth and trade linkages; and, supporting business sophistication, skills, and innovation. This will help the country to attract additional investments for sustained private sector-led growth.

In relation to trade agreements, in 2016 the Law on ratification of Protocol 4 towards the SAA between Macedonia and the European Community and its members was adopted and its implementation has started.

Till end of 2017, it is planned to finalize the process of harmonization of Protocols for rules of origin with Turkey and EFTA countries according to the Regional Convention on Pan-Euro Mediterranean Rules of Origin and to carry out the ratification process.

Within CEFTA, conclusion of the Supplementary Protocol 5 on trade facilitation (faster movement and clearance of goods, including those in transit) is planned till the of first half of 2017, while concluding of Protocol on trade in services is planned until the end of 2017. In parallel to negotiation on liberalization of services, in 2017 it is foreseen to negotiate and conclude an Agreement on mutual recognition of professional qualifications which will have direct impact on facilitation of trade and liberalization of services in order to reduce any existing limitation on the export of services in the region.

⁶¹ Improving Competitiveness in the Balkan Region – Opportunities and Limits, June 2016, The Vienna Institute for International Economic Studies

Considering that not all CEFTA countries are WTO members yet (Serbia, Kosovo and Bosnia and Herzegovina), and following the latest development in facilitation and liberalization of trade with goods and services, all CEFTA countries decided to conclude regional documents on trade facilitation and liberalization respecting the WTO provisions. Those documents will be annexed to the existing CEFTA Agreement. Its intention is to further eliminate possible trade barriers that exist in pre-arrival of goods and to provide higher liberalization on trade of services than what is agreed or still being negotiated within WTO.

Measure 17: Upgrading the customs clearance facilities of road border crossings Tabanovce (IPA 2012) and Kafasan (IPA 2013)

Short description of the measure

Due to spatial limitations and increased volume of traffic flow of loads of goods at road border crossing (BC) Tabanovce, the most frequent BC in the Republic of Macedonia, along the Pan-European Corridor X and BC Kafasan, the most frequent BC towards the Republic of Albania, along Pan-European Corridor VIII, the present condition for processing shipments of goods are limited. In order to expedite and facilitate trade upgrading of the existing facilities is needed.

Construction works at the border crossings will include expansion of the existing customs terminals and other facilities, as well as additional traffic lanes for the movement of cargo shipments at the BC Tabanovce.

Activities per year

In 2016 the preparatory activities for the implementation of the project to upgrade BC Tabanovce are finalized, the required documentation for construction is obtained and the contractor for construction works and supervision over the implementation is selected. Construction work has started in fourth quarter of 2016. A period of 12 months is projected for realization of the construction works. The preparation of documentation for provision of building permits and technical documentation for tender publication for upgrade of BC Kafasan is ongoing.

2017: In 2017 it is foreseen to complete the construction works at the BC Tabanovce, The Tendering procedure for the BCP Kafasan is planed until Q3 2017, while construction works will be carried out from Q4 2017.

2018: In 2018, until Q4 2018, it is planned to complete the upgrade, construction works and the upgraded facilities to be operational at the BCP Kafasan,

Budgetary impact

The project for upgrade of BC Tabanovce is financed from IPA (2012) and national co-financing. Allocated funds for the project are EUR 1.89 million out of which EUR 1.45 million are IPA funds (Component 1) and national co-financing amounts to EUR 0.44 million.

The project for upgrade of BC Kafasan is financed from IPA (2013) and national co-financing. Allocated funds for the project are EUR 1.48 million out of which EUR 1.14 million are IPA funds (Component 1) and national co-financing amounts to EUR 0.37 million.

Expected impact on competitiveness

It is expected that the number of passing vehicles using BC Tabanovce will increase: at entrance by 25%-30%; at exit by 34%-38% while the number of transit vehicles in both directions would be 30% of total passing cargo vehicles.

The projects will contribute to: expedite and facilitate exchange of goods through both border crossings; facilitate transport along Trans National Axes North- South (Corridor X) and East-West (Corridor VIII) linked to the Trans European Transport Networks after 2018, reduce bottlenecks and within other ongoing activities such as introduction of the Common transit system completed in 2015, for increased competitiveness.

Expected outcomes (benefits) from the implementation of the projects are: increased flow of shipments of goods, reduced time to complete border formalities, improved infrastructure for

application of modern inspection tools, thus expediting the exchange through border crossings, and facilitating transport along Pan-European Corridors X and VIII.

4.3.7. EDUCATION AND SKILLS

The access to education is improved, however there is still an insufficient link between the education system results and the private sector needs. The companies point to an insufficient quality and availability of skills despite the high unemployment.

The education system consists of pre-school, elementary (6-14 years of age), secondary (15-17/18 years of age) and high education. The pre-school education system faces significant challenges among which are the insufficient inclusion of children in the pre-school institutions, inconsistent implementation of the norms and standards in the pre-school institutions, incomplete standards for early learning and development, insufficient number of teachers etc.

The level of literacy in the country is high, it is 98.8% for males and 96.8% for females (SSO, 2015). The gross enrolment rate is 63%, and the net rate is 91%.

The vocational education does not attract a sufficient number of students and a contemporary system for post-secondary vocational education has not been established. There is a discrepancy between the supply of graduates from the VET system and the demand on the labour market; the system for introduction of new qualifications in VET is inflexible and inefficient, there are significant shortcomings in the knowledge of teachers about modern technologies related to the school subjects, and cooperation with the business sector for practical training of students and learning in a work environment is inefficient. The Centre for vocational education and training has limited capacities for realisation of activities and a low budget. According to the OECD Competitiveness in SEE Report, Macedonia has an index of 2,5 (the index range is from 1 to 5) for the cooperation between the Centre for vocational education and the business environment, which is higher than most countries in the SEE region (Serbia, Bosnia and Herzegovina, Kosovo, Montenegro). However, there is a lot of room for improvement of this cooperation.

The main obstacles in the high education are the insufficient quality of the high education along with the not fully functional accreditation and evaluation system of universities, and the non adjusted study programs to the labour market needs.

While access to education has improved, challenges remain in the provision of integrative “new economy” skills⁶², and in better linking the products of the education system to private sector needs. The secondary Vocational Education and Training and higher education systems emphasize traditional cognitive skills, and in the case of secondary VET, focus is on narrowly-defined occupational profiles with low vertical and horizontal flexibility. The findings of a survey conducted by World Bank in the project STEP for skills measurement, show that the demand is growing for “new economy” skills, such as capability for completing complex tasks, analytical and organizational capabilities etc., which cannot be automated. Also, the new jobs require a high use of different skills, and less elementary skills. These findings indicate that the education system has to change its role from teaching facts and theory to developing skills which can be applied to different workplaces. The development of the National Qualification Framework is significant for reducing the noncompliance between the supply and demand of workforce.

The main challenges for the informal education and adult education sector are the noncompliance between the demand and supply of adult education due to lack of information for the labour market needs, low awareness of the population and the companies, lack of a system for validation of the nonformal and informal learning, and lack of a comprehensive system for funding of adult education.

⁶² World Bank Country Partnership Strategy for the Republic of Macedonia 2015 – 2018

The indicator for participation in lifelong learning, which measures the number of persons aged 25-64 that acquired education and training, is only 2,6% in Macedonia (Eurostat), being far below the EU-28 average of 10.7%.

In the period 2007-2014 the share of early school leavers has significantly dropped. There is an improvement in the share of population aged 30-34 with completed high education, which has doubled in the last 7 years. In 2014, 25% of the population aged 30-34 in Macedonia had completed high education, which is still below the EU-28 average (38%).

The drafting of a comprehensive Strategy for education 2016-2020 for improving the conditions in education is in its final phase. The strategy will be based on the accomplishments already achieved in the education system and will aim to their further improvement, according to the established priorities. Key obstacles identified in the Strategy are:

- Insufficient data for analysis and forecasting of the labour market needs;
- Insufficient social dialog between the education and training and the labour market stakeholders;
- Lack of human resources with relevant skills;
- Insufficient capacities for a quality practical training at the workplace.

Measure 18: Further development of the qualification system

Short description of the measure

The further development and implementation of the qualification system will contribute to acceleration of the process of reforming the education and training systems and development and gaining qualifications according to the labour market needs. The measure aims at establishing a balance between the supply and demand for knowledge and skills and competences, enabling education for all and gaining qualifications through a formal and informal way to create competitive workforce, qualifications mobility and their recognition, increasing of the employment, especially for the youth and the vulnerable groups, and strengthening the social dialog.

The "Analysis of the assessment and survey of the labor market prepared for the process of reforming the curriculum for VET and Adult Education" shows that the largest number of new jobs in the period 2011-2014 were created in the sectors: Agriculture, Forestry and Fishing - Skilled agricultural workers (22,036), Manufacturing industry - Handlers and integrators of machines and plants (14,322), Transport and storage - Handlers and integrators of machines and plants (6,848), Wholesale and retail trade; repair of motor vehicles and motorcycles for workers in service industries - Workers in shops and market sales (6,830), Accommodation and food service activities - Workers in services, workers in shops and market sales (3,109) and Construction - Occupations in the non-industrial way of working in production (2,828).

The largest number of vacancies in secondary vocational education is noted at the following occupations: Workers in service activities, occupations for non-industrial way of working in manufacturing and handlers and integrators of machines and plants, while the index of vacancies (generally small at national level) is higher at the sectors Accommodation and restaurants, Construction, Administrative and support services, Transportation and storage, Manufacturing, Mining, Trade and repair of motor vehicles, etc. Sectors such as Construction, Manufacturing, Trade, ICT, Accommodation and food service activities had the greatest demand for new workers during the analyzed period 2012-2015.

Based on these findings, the next steps in process of reforming the curriculum for VET and Adult Education are undertaken. The target groups are persons aged between 15 - 65 (students in high schools, especially vocational schools, students in higher education institutions and participants in the lifelong learning process).

Activities per year

2017:

1. Development of qualifications for two priority sectors
 2. Development of the Skills observatory - developing a web portal which will display data available to the public
- Signing an Agreement with the Pension and Disability Insurance Fund and the Public Revenue Office for obtaining data on the status of students after their completion and average monthly income, according to teaching / study program, school/college
 - Obtaining data from the State University of Tetovo and South East Europe University through alternative module for data exchange
 - Connecting the information systems of private higher education institutions and obtaining data
3. Development of new occupational standards - 60 standards according to the analysis of the labor market needs
 4. Development of special programs for adult education and redesigning old ones.

2018:

1. Development of qualifications according to the requirements of employers
2. Development of the Skills Observatory - piloting and system upgrade (if required)
3. Development of special programs for adult education and training for easier mobility and employability
4. Validation of non-formal education to acquire specific qualifications (establishment of a system for validation and preparation procedures for validation)
5. Strengthening of cooperation between higher education institutions and the private sector, and vocational schools and the private sector to provide quality practical work for students in companies. The practical work allows application of knowledge and developing skills directly in the workplace in companies and ability to recognize quality labor force by the company where practical work takes place.

2019:

1. Development of qualifications required by employers and flexible access for their acquisition
2. Development of special programs for adult education and training for easier mobility and employability
3. Validation of non-formal education to acquire specific qualifications
4. Strengthening cooperation between higher education institutions and the private sector, and vocational schools and the private sector to provide quality practical work for students in companies through development of career centers.

Budgetary impact (until 2020)

Total costs for the measure is 10.300.000 EUR.

- Further improvement of the System for development and implementation of the National Qualification Framework, Budget: EU Funds EUR 2.300.000 + EUR 200.000 (85% EU + 15% national contribution)
- Strengthening of the lifelong learning process through Modernization of the systems for vocational education and training and Adult education, Budget: EU Funds EUR 2.300.000 (85% EU + 15% national contribution)
- Support to the development of skills and innovations, Budget: World Bank EUR 4.200.000
- ECVET Budget: European Commission – DG for Education and Culture and EUR 23.445 10% national contribution
- Support to the Modernization of the post-high school education system, Budget: EU Funds EUR 1.000.000 + EUR 200.000 (85% EU + 15% national contribution).

Expected impact on competitiveness

Cooperation between formal, non - formal / informal education and training and the business sector towards the labor market needs and reducing the inadequacy between education and the labor market and career development which will facilitate acquisition of skills and competencies that will contribute to competitiveness of enterprises, increasing recognition of qualifications acquired in our country by foreign investors and recognition of qualifications acquired abroad by our foreign employers.

Expected social outcomes

- Increase in employment, especially youth employment,
- Increased transparency,
- Inclusion of the vulnerable groups,
- Increased recognition of qualifications and
- Decrease of incompatibility between the education and labour market.

Potential risks

- Insufficient human and financial resources for the implementation of activities,
- Inefficient guidance of the reform process,
- Insufficient interest of the relevant stakeholders for participation.

4.3.8. EMPLOYMENT AND LABOUR MARKETS

Despite the progress achieved in the labour market, the country still faces high unemployment and low employment and activity rates. The overall employment rate is low due to low employment of women and youth.

Only 17.6% of the young people are employed, which is 2.5 times lower than the country's average. Young people face a difficult transition from education to the labor market: 40% of them find a job in 1 to 3 years after completion of the education, and the average time of transition from education to work for young people is 6 years (71.6 months)⁶³. Low-quality employment is also a concern, with large shares of young people earning below-average wages, working long hours, trapped in informal or irregular employment, or in positions for which they are overqualified⁶⁴. Youth unemployment remains predominantly a long-term phenomenon. Youth unemployment declines at higher educational attainment levels, with youth with no or little education facing higher unemployment rates than secondary and tertiary education graduates.

Persons with a minimal education are the most likely to be unemployed. Although the employment rate for those with higher education is significantly lower than the average, nonetheless at least 1 in 5 of all graduates is unemployed⁶⁵. This represents an inefficient use of human resources and hints at a mismatch between the education/training provided and the skills required in the labour market.

Inactivity of the women is unequally spread among young women, women in rural areas and unqualified women, whereby one of the most important reasons of the inactivity of the women is the household responsibilities. Activity rates increase with higher educational level.

The low job creation rate and the static labour market result in high long-term unemployment. In 2015, 81.6% of the unemployed persons sought work for more than 1 year, and over 69% for more than 2 years. This category is composed of discouraged workers, inactive persons or persons employed in the informal economy, whose knowledge and skills diminish, their productivity decreases, and thus their chances of finding a job. In this context, the objective of the employment policy is to provide unemployed people with the skills and qualifications they need in order to succeed on the labour market.

⁶³ National Employment Strategy of the Republic of Macedonia 2016-2020

⁶⁴ Partnership for Sustainable Development United Nations Strategy for 2016-2020

⁶⁵ SECTOR PLANNING DOCUMENT, REPUBLIC OF MACEDONIA, EDUCATION, EMPLOYMENT AND SOCIAL POLICY 2017-2020

The official employment data may overstate the levels of unemployment and inactivity. There is an informal employment of 20% in the total employment⁶⁶, which has been continuously declining since 2009. The challenge for the government, however, is how to translate informal jobs into sustainable employment.

The structure of employment and free (vacant) positions are dominated by medium-level occupations, requiring workers with secondary (vocational) education. The largest growth rates in the number of employees (jobs created) can be observed in highly educated people and people with secondary education. In the third quarter of 2016 there were 6,200 job vacancies which is around 1.3% of the existing number of jobs in the economy⁶⁷. Job vacancies were created in the processing industry, construction, transport and warehousing, trade and administrative and supporting activities. About 53% of the new jobs are related to vocational education and 34% to lower levels of education. The structure of employment is dominated by elementary occupations that are low wage and low-productive and do not exploit human potential. One fifth of the Macedonian workers are working at the level of elementary occupations⁶⁸.

The operation and services of the ESA have been significantly modernized in the past period, yet a small part of employers use the services of the Agency for job placement. Because of limited resources (material and human), and bearing in mind the need to confront the high registered unemployment, ESA is increasingly focused on supporting the population groups that face the most difficulties to be employed, and through the electronic system provides information about all other labour market participants. The burden on employees in the ESA is high, the ratio between staff of the Agency and active job seekers is 1: 230 (or 1: 378 when only those employees in the agency who offer services to customers are considered), which is significantly higher than the internationally accepted ratio of 1: 100.

Measure 19: Profiling of unemployed persons and designing Individual Employment Plan 2

Short measure description

This measure is linked to the sixth policy guidance from the Joint Conclusions of the Economic and Financial Dialogue from May 2016 "Strengthen the provision of activation measures especially for vulnerable youth, women and long-term unemployed and further improve the capacity of the Employment Service Agency for profiling and personalised counseling of job seekers."

The new tool in the working process of ESARM is targeted for persons in a disadvantageous position on the labour market in the context of ensuring the most adequate combination of services and programs for employment, which are available with the Annual Operational Plans for Employment Services and Active Labour Market Measures. With this approach, the confidence and cooperation between the unemployed person and ESARM as a service for the citizens will be strengthened, because all the activities will be adapted to the real needs of the unemployed person for his/her employment. On the other hand, the financial means which are spent for implementation of the services, programs and measures for employment will be mainly directed towards this category of unemployed persons who need assistance the most during the employment process.

Individual Employment Plan is designed for each person who is registered in ESARM as an unemployed person – Active Job-Seeker, within 30 days. It is valid for a period of 6 months, whereby, if the unemployed person does not find a job within this period, the Individual Employment Plan is reviewed and modified. An Employability checklist is also included for all job-seekers as a tool for improvement of the design of the Individual Employment Plan.

According to the answers from the employability check list, the unemployed people are divided in three categories: easily employable, with certain difficulties in employment and those who are difficult to employ. The first two categories, are directed for preparation of standard format of

⁶⁶<http://www.stat.gov.mk/Publikacii/2.4.16.02.pdf>

⁶⁷<http://www.stat.gov.mk/pdf/2016/2.1.16.33.pdf>

⁶⁸ National Employment Strategy of the Republic of Macedonia 2016-2020

Individual employment plan, whereas the third category are scheduled for preparation of the more detailed Individual employment plan 2.

Activities per year

2017: 7,500 unemployed people to be covered

2018: 7,500 unemployed covered and directly included into employment programs and measures

2019: 7,500 unemployed covered and directly included into employment programs and measures

Budgetary impact

The cost for implementation of this measure is 336 denars per unemployed person. It is funded by ESA's annual budget. For 2017, 2018 and 2019 the annual budget is estimated at 40,976 EUR.

Expected impact on competitiveness

This approach will strengthen the trust and cooperation between the unemployed people and ESA, because all the activities will be adjusted to the real needs of the unemployed. The active employment programs and measures will be addressed to the unemployed people who are most suitable for. It will also keep the unemployed activated and motivated in the process of job searching.

Expected social outcomes

This measure is to target the unemployed people who are in an unfavorable situation on the labour market and provides the most suitable combination of services and employment programs, available through the annual operational plans. The target will be the most vulnerable unemployed people, with special focus on young people up to the age of 29 and unemployed people who weren't employed in the previous 2 years.

4.3.9. SOCIAL INCLUSION, POVERTY REDUCTION AND EQUAL OPPORTUNITIES

The poverty rate is decreasing and reached 21.5%⁶⁹ in 2015, compared to 27% in 2010. However, it rises to 40.5% when social exclusion is factored in. The two indicators for inequality of income distribution, the Gini coefficient and the indicator S80/S20 (which shows the relation between the highest 20% and the lowest 20% of equivalent income of the people in the households), are both decreasing compared to 2010. In 2015, the Gini coefficient was 33.7% being slightly higher than EU 28 average (31% in 2015) while the S80/S20 indicator was 6.6% and is slightly higher than EU 28 average (5.2%). Unemployed face the highest poverty rate of 39.7%, as well as households of two adults with three or more dependent children (52.2%).

The gender differences at the labour market⁷⁰ are reflected in the much lower activity of women and lower rate of employment. They are mainly related to the still traditional role of the women in the households. For example, the main reason for the inactivity of women is the care of the family, children and the elders. This vulnerability on the labour market is even more pronounced with the women with lower education levels, the women in the rural areas, and the women from certain ethnicities. The measures for decreasing these gender differences are in the domain of the education policy (increasing access to education and decreasing education costs), active measures for employment, etc.

The gender differences exist in the employment sectors for and occupations. There is still a dominant viewpoint and stereotypes for "male" and "female" professions. There are differences in the wages too. The wage gap between men and women (assuming they have the same level of education, the same working experience, work in the same sector, occupation etc.) is 17.5%⁷¹. The gap is the largest in the industry and the traditional services.

⁶⁹ <http://www.stat.gov.mk/pdf/2016/4.1.16.101.pdf>

⁷⁰ National Employment Strategy of the Republic of Macedonia 2016-2020

⁷¹ National Employment Strategy of the Republic of Macedonia 2016-2020

A number of social groups are particularly vulnerable⁷². The Roma community (counted at 2.7% of the population in the 2002 census) experiences multiple deprivations, in income, health, education, employment and living conditions. Roma unemployment in 2011 was 53% against 27% for the non-Roma population, and income poverty was 41% against 14% for nonRoma. Participation in early childhood education, though expanding rapidly, remains low, at 39.5% in 2015, and attendance for both Roma and ethnic Albanians remains under 4%. Overall 84% of children attend secondary school, whereas the proportion for Roma is under 42%. Early marriage remains a concern: 22% of Roma girls aged 15-19 are married, against the national average of 4%.

Persons with disabilities are a second marginalized group⁷³. Only a fraction of children with disabilities receive any kind of formal education. Early detection and intervention services are limited in scope and coverage, particularly in rural areas, and widespread stigma even among parents continues to stand in the way of genuine inclusion of persons of all ages.

5. BUDGETARY IMPLICATIONS OF STRUCTURAL REFORMS

Projected expenditures in the Budget of the Republic of Macedonia include funds for key structural reforms in the coming period. Budget expenditures are the largest in the area Energy, transport and telecoms market, due to the infrastructure projects in transport and energy, being implemented to improve the country's competitiveness. Significant funds are earmarked for encouraging technology absorption and innovation, as an extremely important factor for achieving high rates of economic growth. Also, to promote agricultural production, significant resources are allocated for improvement of irrigation systems, consolidation and defragmentation of agricultural land and support of agricultural cooperatives. The effect on budget revenues is calculated at Measure 15: Improvement of the infrastructure and the access to funding for research, development, and innovations.

More details on the budgetary implications of the structural reforms are presented in Table 10 of Annex 1.

6. INSTITUTIONAL ISSUES AND STAKEHOLDER INVOLVEMENT

Economic Reform Programme 2017 represents a joint result of the collaboration of many institutions, while the overall preparation is coordinated by the Ministry of Finance. The preparation of this programme as a coherent strategic document is confirmation of the capacity of the administration in terms of coordination and efficiency. The programme was prepared by the Ministry of Finance, coordinated by the Minister of Finance, together with the following institutions:

- Cabinet of the Deputy Prime Minister in charge of economic affairs;
- Secretariat for European Affairs of the Republic of Macedonia;
- National Bank of the Republic of Macedonia;
- Ministry of Economy;
- Ministry of Labour and Social Policy;
- Ministry of Education and Science;
- Ministry of Transport and Communication;
- Ministry of Agriculture, Forestry and Water Economy;
- Ministry of Information Society and Administration;
- Ministry of Justice;
- Directorate for Technological Industrial Development Zones;
- Employment Service Agency of the Republic of Macedonia;
- Agency for Foreign Investment and Export Promotion;
- Ministry of Finance - Customs Administration;
- Fund for Innovation and Technical Development;

⁷² Partnership for Sustainable Development United Nations Strategy for 2016-2020

⁷³ Partnership for Sustainable Development United Nations Strategy for 2016-2020

- MEPSO (Electricity Transmission System Operator of Macedonia).

The program was submitted to the Government of the Republic of Macedonia on January 23, 2017.

Considering the fact that the Programme should be submitted to the European Commission no later than January 31st 2017, upon proposal of the Ministry of Finance, all participants in process adopted a timetable for implementation of activities for the preparation of this document:

- July 8, 2016 - initial meeting for the Programme of the Republic of Macedonia was held, after which a final work plan was sent to the EC and OECD;
- June 9 to July 22, 2016 the ministries and other institutions performed diagnostics of their own sector, using the tools provided by the OECD;
- July 14, 2016 the first OECD workshop was held and the draft tools for preparation of the document were presented;
- June 16, 2016 to July 25, 2016, the ministries and other institutions formulated proposals for sectoral reform measures and submitted them to the Ministry of Finance together with the diagnostics;
- Until August 19, 2016, the proposals were tested with the OECD's prioritisation tool;
- August 25, 2016 to September 9, 2016, the ERP Secretariat held 9 meetings with the relevant institutions where improvement of the proposals in the relevant field were discussed;
- September 23, 2016 the first draft of the structural reform measures part was finalised and submitted to the OECD;
- October 19, 2016, technical meeting with the national working group and the OECD was held for preparation of the Programme and improvement of the first draft;
- November 07 to 11, 2016, TAIEX expert mission was held to assess the budgetary impact of structural reforms, the expected impact on competitiveness and social impact;
- After the expert mission until November 15, 2016 the second draft of the structural reform measures part was finalised and submitted to the EC and OECD;
- November 23 and 24, 2016, the EC and OECD held technical meetings with the ERP Secretariat and the national working group so as to improve the second draft;
- December 24, 2016, the first version of the other parts of the Economic reform programme were finalised (macroeconomic and fiscal framework);
- December 27, 2016, the third draft of the structural reform measures part was finalised according to the EC and the OECD recommendations after the mission, and was published on the website of the Ministry of Finance;
- January 4, 2017 - consultative meeting with stakeholders was held;
- January 10, 2017, all interested parties could submit comments to the Programme;
- Submission of ERP to the Government – January 23, 2017;
- Submission of ERP to the European Commission no later than January 31 2017.

Having in mind that regarding last year's programme, the European Commission acknowledged the efforts that the Government is making in implementing reforms to improve competitiveness, the Ministry of Finance made a special effort to maintain, but also to improve the quality of this year's document in accordance with the recommendations made by the Commission.

During the preparation, consultation process with stakeholders was conducted: the business community, universities, ZELS, local authorities, social partners, civil society and other stakeholders.

In this regard, from December 27, 2016 to January 10, 2017, the draft ERP 2017 was published on the website of the Ministry of Finance and at the same time invitations were sent to interested parties for their active contribution to the process of preparation of the document by giving

opinions on the content of the document and suggestions for its improvement. The opinions and proposals received were reviewed by the institutions participating in the preparation of ERP 2017. Additionally, on January 4, 2017, a public debate was held in the premises of the Ministry of Finance between the institutions participating in the preparation of the document, representatives of the European Delegation in Skopje and the stakeholders.

More detailed information on contributions submitted by the stakeholders is presented in Annex 4 of the document.

Annex 1: Summary data

Table 1a. Macroeconomic prospects

	ESA Code	2015	2015	2016	2017	2018	2019
		Level (bn EUR)	Rate of change				
1. Real GDP at market prices	B1*g	8.44	3.8	2.3	3.0	3.5	4.0
2. GDP at market prices	B1*g	8.56	5.8	3.8	5.3	5.8	6.5
Components of real GDP							
3. Private consumption expenditure	P3	5.97	3.7	1.4	2.1	2.6	2.7
4. Government consumption expenditure	P3	1.47	2.1	1.0	1.3	1.3	1.4
5. Gross fixed capital formation ⁷⁴	P51	2.60	3.6	2.2	4.5	6.0	6.8
6. Changes in inventories and net acquisition of valuables (% of GDP)	P52+P53	:	:	:	:	:	:
7. Exports of goods and services	P6	4.12	6.7	5.8	6.0	6.7	7.3
8. Imports of goods and services	P7	5.71	5.2	3.6	4.7	5.8	6.1
Contribution to real GDP growth							
9. Final domestic demand		10.04	4.0	1.8	3.1	3.9	4.3
10. Change in inventories and net acquisition of valuables	P52+P53	:	:	:	:	:	:
11. External balance of goods/services	B11	-1.60	-0.2	0.5	-0.1	-0.4	-0.3

Source: SSO and calculations of the Ministry of finance

Table 1b. Price developments

		2015	2016	2017	2018	2019
1. GDP deflator	%, yoy	1.9	1.5	2.2	2.2	2.4
2. Private consumption deflator	%, yoy	0.0	0.1	1.4	1.7	2.0
3. HICP	%, yoy	:	:	:	:	:
4. National CPI	%, yoy	-0.3	0.0	1.3	2.0	:
5. Public consumption deflator	%, yoy	1.1	0.8	1.2	1.2	1.2
6. Investment deflator	%, yoy	4.8	4.0	4.2	3.3	3.2
7. Export price deflator (goods & services)	%, yoy	1.5	-0.3	1.7	1.5	1.5
8. Import price deflator (goods & services)	%, yoy	0.8	-0.3	1.7	1.5	1.5

Source: SSO and calculations of the Ministry of Finance

Table 1c. Labour market developments⁷⁵

	ESA code	2015	2015	2016	2017	2018	2019
		Level	Rate of change				
1. Population (thousands)			2,070.2	2,072.9	2,075.6	2,078.3	2,081.0
2. Population (growth rate in %)			0.13	0.13	0.13	0.13	0.13
3. Working-age population (persons, thousands)			1,676.7	1,680.7	1,682.4	1,686.6	1,693.8
4. Participation rate			57.0	56.5	56.8	57.1	57.6
5. Employment, persons			706.0	722.2	735.4	750.9	769.1
6. Employment, hours worked			:	:	:	:	:
7. Employment (growth rate in %)			2.3	2.3	1.8	2.1	2.4
8. Public sector employment (persons)			:	:	:	:	:
9. Public sector employment (growth in %)			:	:	:	:	:
10. Unemployment rate			26.1	23.9	23.0	22.1	21.1
11. Labour productivity, persons		776.1	1.5	0.0	1.1	1.4	1.6
12. Labour productivity, hours worked			:	:	:	:	:
13. Compensation of employees	D1	:	:	:	:	:	:

Source: SSO and calculations of the Ministry of Finance

⁷⁴ Data refers to gross capital formation.

⁷⁵ ILO definition (15+) is used for the labour market indicators.

Table 1d. Sectoral balance

% of GDP	ESA	2015	2016	2017	2018	2019
1. Net lending/borrowing vis-à-vis the rest of the world	B9	-2.0	1.6	-1.0	0.7	2.3
of which:						
- Balance of goods and services		-16.3	-15.3	-15.3	-15.1	-14.5
- Balance of primary incomes and transfers		14.3	13.1	12.9	12.5	11.9
- Capital account		0.0	3.8	1.4	3.3	4.9
2. Net lending/borrowing of the private sector	B9/EDP B9	1.4	5.6	2.0	3.3	4.5
3. Net lending/borrowing of general government		-3.4	-4.0	-3.0	-2.6	-2.2
4. Statistical discrepancy		0.0	0.0	0.0	0.0	0.0

Source: National Bank of the Republic of Macedonia

Table 1e. GDP, investment and gross value added

	ESA	2015	2016	2017	2018	2019
GDP and investment						
GDP level at current market prices (in bn Denars)	B1g	558.2	579.6	610.2	645.4	687.3
Investment ratio (% of GDP)		31.1	31.8	32.9	34.1	35.3
Growth of Gross Value Added, percentage changes at constant prices						
1. Agriculture		2.3	2.0	2.3	2.3	2.5
2. Industry (excluding construction)		6.9	-0.8	2.1	3.4	4.0
3. Construction		11.0	4.1	5.2	5.8	6.0
4. Services		5.0	2.4	2.8	3.1	3.6

Source: SSO and calculations of the Ministry of Finance

Table 1f. External sector developments

Euro billion	2015	2016	2017	2018	2019
1. Current account balance (% of GDP)	-2.1	-2.1	-2.3	-2.6	-2.5
2. Export of goods	3.04	3.34	3.48	3.73	4.06
3. Import of goods	4.87	5.23	5.49	5.85	6.29
4. Trade balance	-1.83	-1.90	-2.01	-2.12	-2.23
5. Export of services	1.37	:	:	:	:
6. Import of services	1.03	:	:	:	:
7. Service balance	0.34	0.43	0.49	0.52	0.58
8. Net interest payments from abroad	:	:	:	:	:
9. Other net factor income from abroad	-0.29	-0.30	-0.38	-0.42	-0.46
10. Current transfers	1.58	1.57	1.67	1.74	1.82
11. Of which from EU	:	:	:	:	:
12. Current account balance	-0.19	-0.20	-0.23	-0.27	-0.29
13. Foreign direct investment	0.20	0.25	0.28	0.32	0.36
14. Foreign reserves*	2.26	2.70	:	:	:
15. Foreign debt*	6.29	7.15	:	:	:
16. Of which: public*	2.93	3.54	:	:	:
17. O/w: foreign currency denominated	:	:	:	:	:
18. O/w: repayments due	:	:	:	:	:
19. Exchange rate vis-à-vis EUR (end-year)	61.6	61.6	61.6	61.6	61.6
20. Exchange rate vis-à-vis EUR (annual average)	0.0	0.0	0.0	0.0	0.0
21. Net foreign saving (lines 21-25: percentages of GDP)	61.6	61.5	:	:	:
22. Domestic private saving	0.2	-0.2	:	:	:
23. Domestic private investment	:	:	:	:	:
24. Domestic public saving	:	:	:	:	:
25. Domestic public investment	:	:	:	:	:

Source: National Bank of the Republic of Macedonia

* Data for 2016 are as of September 2016

Table 1g. Sustainability indicators

	Dimension	2012	2013	2014	2015	2016
1. Current Account Balance*	% of GDP	-3.2	-1.6	-0.5	-2.1	-2.1
2. Net International Investment Position**	% of GDP	-55.1	-55.9	-53.3	-56.1	-57.1
3. Export market shares*	% growth	-10.4	4.8	13.7	1.7	10.0
4. Real Effective Exchange Rate (CPI based, 2006=100)**	% growth	0.1	1.6	1.0	-0.2	1.4
5. Nominal Unit Labour Costs**	% growth	3.0	1.0	-1.1	-0.7	1.7
6. Private sector credit flow	% of GDP	2.4	2.8	4.4	4.3	:
7. Private sector debt	% of GDP	86.4	83.7	85.4	87.6	:
8. General Government Debt	% of GDP	33.7	34.0	38.0	38.1	41.3

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

*Forecast for 2016

** Data for 2016 are as of September 2016

Table 2a. General government budgetary prospects

	ESA	2015 Level (bn denars)	2015	2016	2017	2018	2019
% of GDP							
Net lending (B9) by sub-sectors							
1. General government	S13	-19.2	-3.4	-4.0	-3.0	-2.6	-2.2
2. Central government	S1311	-20.4	-3.7	-4.0	-3.0	-2.6	-2.2
3. State government	S1312	:	:	:	:	:	:
4. Local government	S1313	0.2	0.0	0.0	0.0	0.0	0.0
5. Social security funds	S1314	1.0	0.2	0.0	0.0	0.0	0.0
General government (S13)							
6. Total revenue	TR	173.0	31.0	32.1	32.7	32.4	31.6
7. Total expenditure	TE	192.3	34.4	36.1	35.7	35.1	33.8
8. Net borrowing/lending	EDP,B9	-19.2	-3.4	-4.0	-3.0	-2.6	-2.2
9. Interest expenditure	EDP,D41	6.5	1.2	1.2	1.4	1.5	1.6
10. Primary balance		-12.7	-2.3	-2.8	-1.7	-1.2	-0.7
11. One-off and other temporary measures		:	:	:	:	:	:
Components of revenues							
12. Total taxes (11 = 11a+11b+11c)		100.1	17.9	18.5	19.1	18.9	18.6
12a. Taxes on production and imports	D2	72.4	13.0	13.8	14.2	14.1	13.8
12b. Current taxes on income and wealth	D5	25.1	4.5	4.2	4.4	4.4	4.4
12c. Capital taxes	D91	2.7	0.5	0.5	0.5	0.4	0.4
13. Social contributions	D61	47.9	8.6	8.6	8.5	8.4	8.3
14. Property income	D4	5.1	0.9	0.9	0.9	0.8	0.7
15. Other (15 = 16-(12+13+14))		19.9	3.6	4.0	4.2	4.3	3.9
16 = 6. Total revenue	TR	173.0	31.0	32.1	32.7	32.4	31.6
p.m.: Tax burden (D2+D5+D61+D91-D995)		148.0	26.5	27.1	27.6	27.4	26.9
Selected components of expenditures							
17. Collective consumption	P32	64.6	11.6	12.0	11.2	10.7	10.1
18. Total social transfers	D62 + D63	82.9	14.9	15.4	15.2	15.0	14.5
18a. Social transfers in kind	P31 = D63	:	:	:	:	:	:
18b. Social transfers other than in kind	D62	82.9	14.9	15.4	15.2	15.0	14.5
19 = 9. Interest expenditure (incl. FISIM)	EDP,D41	6.5	1.2	1.2	1.4	1.5	1.6
20. Subsidies	D3	14.8	2.6	2.6	2.6	2.4	2.3
21. Gross fixed capital formation	P51	23.5	4.2	4.8	5.4	5.5	5.4
22. Other (22 = 23-(17+18+19+20+21))		0.0	:	0.0	:	:	:
23.=7. Total expenditures	TE	192.3	34.4	36.1	35.7	35.1	33.8
p.m. compensation of public sector employees	D1	39.1	7.0	6.9	6.8	6.4	6.1

Source: Ministry of Finance

Table 2b. General government budgetary prospects

	ESA	2015	2016	2017	2018	2019
Level (bn denars)						
Net lending (B9) by sub-sectors						
1. General government	S13	-19.2	-23.1	-18.6	-17.0	-15.4
2. Central government	S1311	-20.4	-23.1	-18.6	-16.8	-15.1
3. State government	S1312	:	:	:	:	:
4. Local government	S1313	0.2	0.0	0.0	0.0	0.0
5. Social security funds	S1314	1.0	0.0	0.0	0.0	0.0
General government (S13)						
6. Total revenue	TR	173.0	185.9	199.3	209.4	217.0
7. Total expenditure	TE	192.3	209.0	217.9	226.4	232.4
8. Net borrowing/lending	EDP,B9	-19.2	-23.1	-18.6	-17.0	-15.4
9. Interest expenditure	EDP,D41	6.5	6.9	8.3	9.5	10.7
10. Primary balance		-12.7	-16.2	-10.3	-7.5	-4.7
11. One-off and other temporary measures		:	:	:	:	:
Components of revenues						
12. Total taxes (11 = 11a+11b+11c)		100.1	107.1	116.5	122.1	128.0
12a. Taxes on production and imports	D2	72.4	80.0	86.5	90.7	95.0
12b. Current taxes on income and wealth	D5	25.1	24.2	27.1	28.5	30.1
12c. Capital taxes	D91	2.7	2.9	2.9	2.9	2.9
13. Social contributions	D61	47.9	50.1	51.9	54.5	57.2
14. Property income	D4	5.1	5.4	5.3	5.0	5.0
15. Other (15 = 16-(12+13+14))		19.9	23.3	25.6	27.8	26.8
16 = 6. Total revenue	TR	173.0	185.9	199.3	209.4	217.0
p.m.: Tax burden (D2+D5+D61+D91-D995)		148.0	157.2	168.4	176.6	185.2
Selected components of expenditures						
17. Collective consumption	P32	64.6	69.4	68.1	69.0	69.2
18. Total social transfers	D62 + D63	82.9	89.5	92.7	96.6	99.6
18a. Social transfers in kind	P31 = D63	:	:	:	:	:
18b. Social transfers other than in kind	D62	82.9	89.5	92.7	96.6	99.6
19 = 9. Interest expenditure (incl. FISIM)	EDP,D41	6.5	6.9	8.3	9.5	10.7
20. Subsidies	D3	14.8	15.0	15.9	15.8	16.0
21. Gross fixed capital formation	P51	23.5	28.1	32.8	35.5	36.9
22. Other (22 = 23-(17+18+19+20+21))		0.0	0.1	0.1	:	:
23.=7. Total expenditures	TE	192.3	209.0	217.9	226.4	232.4
p.m. compensation of public sector employees	D1	39.1	40.1	41.5	41.6	41.6

Source: Ministry of Finance

Table 3. General government expenditure by function

Percentage of GDP	COFOG	2015	2016	2017	2018	2019
1. General public services	1	4.3	4.5	4.6	:	:
2. Defence	2	1.0	1.0	1.0	:	:
3. Public order and safety	3	2.4	2.7	2.4	:	:
4. Economic affairs	4	3.5	3.8	3.7	:	:
5. Environmental protection	5	0.2	0.2	0.2	:	:
6. Housing and community amenities	6	2.0	2.2	2.3	:	:
7. Health	7	5.0	5.1	5.0	:	:
8. Recreation, culture and religion	8	0.8	0.8	0.8	:	:
9. Education	9	3.9	4.0	4.2	:	:
10. Social protection	10	11.3	11.7	11.5	:	:
11. Total expenditure (item 7 = 23 in Table 2)	TE	34.4	36.1	35.7	35.1	33.8

Source: Ministry of Finance

Table 4. General government debt developments

Percentage of GDP	ESA	2015	2016	2017	2018	2019
1. Gross debt ⁷⁶		38.1	41.3	42.7	43.0	43.9
2. Change in gross debt ratio		0.1	3.2	1.3	0.3	0.9
Contributions to change in gross debt						
3. Primary balance ⁷⁷		2,3	2,8	1,7	1,2	0,7
4. Interest expenditure (incl. FISIM) ⁷⁸		1,2	1,2	1,4	1,5	1,6
5. Stock-flow adjustment		-3,4	-0,7	-1,7	-2,3	-1,4
of which:						
- Differences between cash and accruals		:	:	:	:	:
- Net accumulation of financial assets		:	:	:	:	:
of which:						
- Privatisation proceeds		:	:	:	:	:
- Valuation effects and other		:	:	:	:	:
p.m. implicit interest rate on debt		3,2	3,2	3,5	3,6	3,9
Other relevant variables						
6. Liquid financial assets		:	:	:	:	:
7. Net financial debt (7 = 1 - 6)		:	:	:	:	:

Source: Ministry of Finance

Table 5. Cyclical developments

Percentage of GDP	ESA	2015	2016	2017	2018	2019
1. Real GDP growth (%)	B1g	3.8	2.3	3.0	3.5	4.0
2. Net lending of general government	EDP.B.9	-3.4	-4.0	-3.0	-2.6	-2.2
3. Interest expenditure	EDP.D.41	1.2	1.2	1.4	1.5	1.6
4. One-off and other temporary measure		:	:	:	:	:
5. Potential GDP growth (%)		2.6	2.7	2.4	2.2	2.0
Contributions (percentage points):						
- labour		1.4	1.5	1.1	0.9	0.8
- capital		1.7	1.6	1.6	1.5	1.5
- total factor productivity		-0.4	-0.3	-0.3	-0.3	-0.2
6. Output gap		-0.1	-0.5	0.1	1.4	3.3
7. Cyclical budgetary component		0.0	-0.2	0.0	0.5	1.1
8. Cyclically-adjusted balance (2-7)		-3.4	-3.8	-3.1	-3.1	-3.3
9. Cyclically-adjusted primary balance (8-3)		-2.2	-2.6	-1.7	-1.6	-1.8
10. Structural balance (8-4)		:	:	:	:	:

Source: Ministry of Finance

Table 6. Divergence from previous programme

	2015	2016	2017	2018	2019
1. GDP growth (% points)					
Previous programme	3.5	4.0	4.3	4.5	:
Latest programme	3.8	2.3	3.0	3.5	4.0
Difference	0.3	-1.7	-1.3	-1.0	:
2. General government net lending (% of GDP)					
Previous programme	-3.6	-3.2	-2.9	-2.6	:
Latest programme	-3.4	-4.0	-3.0	-2.6	-2.2
Difference	0.2	-0.8	-0.1	0.0	:
3. General government gross debt (% of GDP)					
Previous programme	38.6	39.4	40.7	41.5	:
Latest programme	38.1	41.3	42.7	43.0	43.9
Difference	-0.5	1.9	2.0	1.5	:

Source: Calculations of the Ministry of Finance

⁷⁶ As defined in Regulation 3605/93 (not an ESA concept).

⁷⁷ Cf. item 10 in Table 2.

⁷⁸ Cf. item 9 in Table 2.

Table 7. Long-term sustainability of public finances

Percentage of GDP	2007	2010	2020	2030	2040	2050	2060
Total expenditure	32.8	35.9	32.8	31.7	30.8	30.2	29.7
of which:	:	:	:	:	:	:	:
- Age-related expenditures	:	:	:	:	:	:	:
- Pension expenditure	7.7	8.9	9.5	9.7	9.3	9.0	8.8
- Social security pension	:	:	:	:	:	:	:
- Old-age and early pensions	:	:	:	:	:	:	:
- Other pensions (disability, survivors)	:	:	:	:	:	:	:
- Occupational pensions (if in general government)	:	:	:	:	:	:	:
- Health care	4.4	4.5	5.0	5.0	5.2	5.4	5.5
- Long-term care (this was earlier included in the health care)	:	:	:	:	:	:	:
Education expenditure	:	4.6	5.2	5.2	5.4	5.4	5.5
Other age-related expenditures	:	:	:	:	:	:	:
Interest expenditure	0.8	0.7	1.6	1.9	1.6	1.5	1.2
Total revenues	32.2	33.4	30.8	30.3	29.8	29.6	29.5
of which: property income	:	:	:	:	:	:	:
of which: from pensions contributions (or social contributions, if appropriate)	6.0	6.2	6.0	6.3	6.0	5.8	5.7
Pension reserve fund assets	:	:	:	:	:	:	:
of which: consolidated public pension fund assets (assets other than government liabilities)	:	:	:	:	:	:	:
Assumptions							
Labour productivity growth	2.9	2.2	2.0	1.8	1.9	2.0	1.8
Real GDP growth	6.5	3.4	4.2	4.0	3.5	3.3	3.1
Participation rate males (aged 20-64) ⁷⁹	74.8	76.3	77.7	81.4	84.6	86.9	88.7
Participation rates females (aged 20-64)	50.4	51.8	52.9	58.5	63.8	69.1	74.0
Total participation rates (20-64)	62.8	64.2	65.3	70.0	74.2	78.0	81.4
Unemployment rate	35.2	32.2	20.4	12.4	8.2	6.2	4.8
Population aged 65+ over total population	9.6	9.7	10.1	10.4	10.9	11.4	12.0

Source: Calculations of the Ministry of Finance

Table 7a. Potential liabilities

% of GDP	2016	2017
Public guarantees	10.5	:
Of which: related to the financial sector	2.3	:

Source: Ministry of Finance

Table 8. Basic assumptions on the external economic environment underlying the programme framework

	Dimension	2015	2016	2017	2018	2019
Short-term interest rate	Annual average	0,0	-0,3	-0,3	-0,2	0,0
Long-term interest rate	Annual average	1,2	0,8	1,2	1,5	1,7
USD/EUR exchange	Annual average	1,1095	1,1133	1,1039	1,1039	1,1039
Nominal effective exchange rate	Annual average	:	:	:	:	:
Exchange rate vis-à-vis the EUR	Annual average	61,6	61,6	61,6	61,6	61,6
Global GDP growth, excluding EU	Annual average	3,3	3,2	3,7	3,8	4,0
EU GDP growth	Annual average	2,2	1,8	1,6	1,8	1,8
Growth of relevant foreign markets	Annual average	:	:	:	:	:
World import volumes, excluding EU (y-o-y)	Annual average	0,8	1,0	3,0	3,3	3,5
Oil prices (Brent, USD/barrel)	Annual average	53,4	45,2	54,7	56,8	58,0

Source: European Commission, Economic Forecast Autumn 2016

⁷⁹ Labour market calculation refer to the 15-64 age group

Table 9. Selected employment and social indicators

	Data source	2013	2014	2015	2016	2017
1. Labour market participation rate (%) total (aged 15+)	SSO	57.2	57.3	57.0	56.5	56.8
- male	SSO	68.5	69.3	68.9	:	:
- female	SSO	45.8	45.3	44.9	:	:
2. Employment rate (%) total (aged 15+)	SSO	40.6	41.2	42.1	43.0	43.7
- male	SSO	48.7	50.1	50.5	:	:
- female	SSO	32.5	32.4	33.7	:	:
3. Unemployment rate (%) total (aged 15+)	e	29.0	28.0	26.1	23.9	23.0
- male	e	29.0	27.6	26.7	:	:
- female	e	29.0	28.6	25.1	:	:
4. Long-term unemployment rate (%) of total unemployment ⁸⁰	SSO	23.9	23.4	21.3	:	:
- male	SSO	24.0	23.1	22.1	:	:
- female	SSO	23.8	23.8	20.1	:	:
5. Youth unemployment (15-24 yrs) rate (%)	e	51.9	53.1	47.3	:	:
- male	e	52.5	52.0	49.7	:	:
- female	e	51.0	55.0	43.3	:	:
6. Young people (aged 15-24) not in employment, education or training (NEET), in %	e	24.2	25.2	24.7	:	:
7. Early school leavers ⁸¹ , in % (aged 18-24)	e	11.4	12.5	11.4	:	:
8. Participation rate in early childhood education and care**	e	:	:	:	:	:
9. GINI coefficient	e	37.0	35.2	33.7	:	:
10. Inequality of income distribution S80/S20, %	e	8.4	7.2	6.6	:	:
11. Social protection expenditure in % of GDP	MoF	11.2	11.3	11.3	11.7	11.5
12. Health expenditure in % of GDP	MoF	5.1	4.9	5.0	5.1	5.0
13. At-risk-of-poverty before social transfers and pensions, % of the population	e	41.0	41.7	40.5	:	:
14. Poverty rate ⁸²	e	24.2	22.1	21.5	:	:
15. Poverty gap ⁸³	e	40.9	37.0	:	:	:

*The data for 2016 and 2017 is forecast

** Last available data is as of 2012

Table 10. Matrix of policy commitments

Description of policy	2016	2017	2018	2019
Measure 1: Public Finance Management Reform Programme				
A. Duration of the reform*		X		
B. Net direct budgetary impact (if any) (in €)	0	0		
B.1 Direct impact on budgetary revenue (in €)	0	0		
B.2 Direct impact on budgetary expenditure (in €)	0	0		
B.3 Possible non-budgetary financing (in €)	0	0		
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	0	0		
Measure 2: System (IT platform) for co-ordination, management, monitoring and evaluation of funds on regional and local level (SiReRa)				
A. Duration of the reform*	X			
B. Net direct budgetary impact (if any) (in €)	- 200.000	- 100.000	- 100.000	- 100.000
B.1 Direct impact on budgetary revenue (in €)	0	0	0	0
B.2 Direct impact on budgetary expenditure (in €)	200.000	100.000	100.000	100.000
B.3 Possible non-budgetary financing (in €)	350.000	400.000	650.000	1.600.000
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	0	0	0	1.600.000
Measure 3: Joint border railway station Macedonia - Serbia				

⁸⁰ Long-term unemployment rate (%) – share of people unemployed for more than 1 year in the total workforce

⁸¹ The indicator for early school leavers is defined as the share of people aged 18-24 who have no education or have only elementary education in relation to the total population of the same age group

⁸² The at-risk-of-poverty rate is the share of people with an equivalised disposable income (after social transfer) below the at-risk-of-poverty threshold, which is set at 60 % of the national median equivalised disposable income after social transfers.

⁸³ The relative median at-risk-of-poverty gap is calculated as the difference between the median equivalised total net income of persons below the at-risk-of-poverty threshold and the at-risk-of-poverty threshold, expressed as a percentage of the at-risk-of-poverty threshold (cut-off point: 60% of median equivalised income).

A. Duration of the reform*		X		
B. Net direct budgetary impact (if any) (in €)		0	0	0
B.1 Direct impact on budgetary revenue (in €)		0	0	0
B.2 Direct impact on budgetary expenditure (in €)		0	0	0
B.3 Possible non-budgetary financing (in €)		380.000	1.500.000	1.500.000
- B.3.1 Of which committed IPA funding including WBIF funding (in €)		380.000	1.500.000	1.500.000
Measure 4: Upgrading and rehabilitation of Corridor X				
A. Duration of the reform*				
B. Net direct budgetary impact (if any) (in €)	-108.335.000	-57.844.243	-5.151.475	-12.065.759
B.1 Direct impact on budgetary revenue (in €)	0	0	0	0
B.2 Direct impact on budgetary expenditure (in €)	108.335.000	57.844.243	5.151.475	12.065.759
B.3 Possible non-budgetary financing (in €)	22.860.500	30.537.135	17.365.738	0
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	22.860.500	30.537.135	17.365.738	0
Measure 5: Upgrading and rehabilitation of Corridor VIII				
A. Duration of the reform*				
B. Net direct budgetary impact (if any) (in €)	-25.000.000	-770.257	0	0
B.1 Direct impact on budgetary revenue (in €)	0	0	0	0
B.2 Direct impact on budgetary expenditure (in €)	25.000.000	770.257	0	0
B.3 Possible non-budgetary financing (in €)	69.493.644	99.419.942	100.041.260	50.001.500
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	450.000	5.419.942	41.260	1.500
Measure 6: Construction of 400kV Overhead Transmission Line SS Bitola 2 to Macedonia-Albania border and SS 400/110 kV Ohrid				
A. Duration of the reform*				
B. Net direct budgetary impact (if any) (in €)	0	0	0	0
B.1 Direct impact on budgetary revenue (in €)	0	0	0	0
B.2 Direct impact on budgetary expenditure (in €)	0	0	0	0
B.3 Possible non-budgetary financing (in €)	180.000	6.365.000	14.230.000	16.020.000
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	180.000	2.670.000	3.630.000	3.400.000
Measure 7: Modernization of the transmission network and power system management				
A. Duration of the reform*				
B. Net direct budgetary impact (if any) (in €)	0	0	0	0
B.1 Direct impact on budgetary revenue (in €)	0	0	0	0
B.2 Direct impact on budgetary expenditure (in €)	0	0	0	0
B.3 Possible non-budgetary financing (in €)	500.000	9.944.973	12.080.000	11.940.000
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	0	0	0	0
Measure 8: Improvement of Irrigation Systems				
A. Duration of the reform*				
B. Net direct budgetary impact (if any) (in €)	-2,174,706	-29,567,752	-34,638,963	-31,810,392
B.1 Direct impact on budgetary revenue (in €)	0	0	0	0
B.2 Direct impact on budgetary expenditure (in €)	2,174,706	29,567,752	34,638,963	31,810,392
B.3 Possible non-budgetary financing (in €)	1,150,000	925,000	925,000	3,000,000
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	1,150,000	925,000	925,000	3,000,000
Measure 9: Consolidation and defragmentation of agricultural land				
A. Duration of the reform*	X			X
B. Net direct budgetary impact (if any) (in €)	0	-330.000	-330.000	-340.000
B.1 Direct impact on budgetary revenue (in €)	0	0	0	0
B.2 Direct impact on budgetary expenditure (in €)	0	-330.000	-330.000	-340.000
B.3 Possible non-budgetary financing (in €)	197.000	1.094.000	1.000.000	1.000.000
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	0	1.000.000	1.000.000	1.000.000
Measure 10: Agricultural cooperatives				

A. Duration of the reform*	X			
B. Net direct budgetary impact (if any) (in €)	-330.000	-850.000	-700.000	-700.000
B.1 Direct impact on budgetary revenue (in €)	0	0	0	0
B.2 Direct impact on budgetary expenditure (in €)	-330.000	-850.000	-700.000	-700.000
B.3 Possible non-budgetary financing (in €)	100.000	1.800.000	1.500.000	0
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	100.000	1.800.000	1.500.000	0
Measure 11: Increasing market employability in Tourism & Hospitality Sector				
A. Duration of the reform*				X
B. Net direct budgetary impact (if any) (in €)	0	0	0	0
B.1 Direct impact on budgetary revenue (in €)	0	0	0	0
B.2 Direct impact on budgetary expenditure (in €)	0	0	0	0
B.3 Possible non-budgetary financing (in €)	230.030	226.022	152.461	40.155
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	0	0	0	0
Measure 12: Increasing market employability in Creative Industries Sector				
A. Duration of the reform*				X
B. Net direct budgetary impact (if any) (in €)	0	0	0	0
B.1 Direct impact on budgetary revenue (in €)	0	0	0	0
B.2 Direct impact on budgetary expenditure (in €)	0	0	0	0
B.3 Possible non-budgetary financing (in €)	230.619	237.593	162.574	37.646
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	0	0	0	0
Measure 13: Development of National Portal for e-services				
A. Duration of the reform*		X	X	
B. Net direct budgetary impact (if any) (in €)		-30.046	-21.851	
B.1 Direct impact on budgetary revenue (in €)		0	0	
B.2 Direct impact on budgetary expenditure (in €)		30.046	21.851	
B.3 Possible non-budgetary financing (in €)		270.416	196.667	
- B.3.1 Of which committed IPA funding including WBIF funding (in €)		270.416	196.667	
Measure 14: Adoption of a National Strategy for SMEs (2017-2022) with an Action plan (2018-2020)				
A. Duration of the reform*	X	X		
B. Net direct budgetary impact (if any) (in €)	0	0		
B.1 Direct impact on budgetary revenue (in €)	0	0		
B.2 Direct impact on budgetary expenditure (in €)	0	0		
B.3 Possible non-budgetary financing (in €)	19.150	19.150		
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	0	0		
Measure 15: Improvement of the infrastructure and the access to funding for research, development, and innovations				
A. Duration of the reform*				
B. Net direct budgetary impact (if any) (in €)	0	-208.333	-1.108.334	-1.046.250
B.1 Direct impact on budgetary revenue (in €)	0	0	0	28.750
B.2 Direct impact on budgetary expenditure (in €)	0	208.333	1.108.334	1.075.000
B.3 Possible non-budgetary financing (in €)	0	100.000	200.000	200.000
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	0	100.000	200.000	200.000
Measure 16: Triple Helix Partnership				
A. Duration of the reform*				
B. Net direct budgetary impact (if any) (in €)	0	-255.000	-355.000	-162.000
B.1 Direct impact on budgetary revenue (in €)	0	0	0	0
B.2 Direct impact on budgetary expenditure (in €)	0	-255.000	-355.000	-162.000
B.3 Possible non-budgetary financing (in €)	0	0	0	0
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	0	0	0	0
Measure 17: Upgrading the customs clearance facilities of road border crossings Tabanovce (IPA 2012) and Kafasan (IPA 2013)				

A. Duration of the reform*	X			X
B. Net direct budgetary impact (if any) (in €)	0	- 83.430	- 610.471	-86.099
B.1 Direct impact on budgetary revenue (in €)	0	0	0	0
B.2 Direct impact on budgetary expenditure (in €)	0	- 83.430	- 610.471	- 86.099
B.3 Possible non-budgetary financing (in €)	0	274.398	2.111.183	404.419
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	0	274.398	2.111.183	404.419
Measure 18: Further development of the qualification system				
A. Duration of the reform*				
B. Net direct budgetary impact (if any) (in €)	-2.002.635	-1.822.635	-1.462.635	-62.635
B.1 Direct impact on budgetary revenue (in €)	0	0	0	0
B.2 Direct impact on budgetary expenditure (in €)	2.002.635	1.822.635	1.462.635	62.635
B.3 Possible non-budgetary financing (in €)	3.063.000	2.043.000	3.000	3.000
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	3.063.000	2.043.000	3.000	3.000
Measure 19. Profiling of unemployed persons and designing an Individual Employment Plan 2				
A. Duration of the reform*	X			
B. Net direct budgetary impact (if any) (in €)	-37.317	-40.976	-40.976	-40.976
B.1 Direct impact on budgetary revenue (in €)	0	0	0	0
B.2 Direct impact on budgetary expenditure (in €)	37.317	40.976	40.976	40.976
B.3 Possible non-budgetary financing (in €)	0	0	0	0
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	0	0	0	0
Total net budgetary impact				
Total impact on budgetary revenues	0	0	0	28.750
Total impact on budgetary expenditures	138.079.658	91.902.672	44.519.705	46.442.861

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

Table 11: Summary of structural reform measures

	Measure 1: Public Finance Management Reform Programme
Short description	Adoption of the Public Finance Management Reform Programme which envisages improvement in several segments within public finance area such as: strengthening and implementation of medium term budget framework including budget planning, introducing integrated information system for PFM, improving compliance, efficiency and effectiveness of public procurement system, modernizing tax system and improving revenue collection, increasing quality of customs procedures and services, further improvement of public internal financial control and external audit efficiency.
Timetable by year	2017: Adoption of Public Finance Management Reform Programme 2017-2020
	2018: /
	2019: /
Cost of implementation and impact on the annual budget	/
Expected impact on competitiveness	The Programme will be a base for implementation of measures which will contribute to strengthening institutional capacities for preparation and execution of mutual coordinated economic policies that should tackle key structural challenges for increasing economic growth and job creation.
Expected social outcomes including on employment and on social groups in particular on gender	/
	Measure 2: System (IT platform) for co-ordination, management, monitoring and evaluation of funds on regional and local level (SiReRa)
Short description	A System (IT Platform) with several components (HR, programmes, projects, funds) which will provide information and assist the process of coordination in the planning and implementing activities on regional and local level, aimed at improving the socio- economic condition and quality of life. The System will also monitor the implementation and allocation of budget and donor funds and will provide data for future strategic decision making.
Timetable by year	2017: Establishing legal, organizational and technical environment for functioning of the system
	2018: Functional electronic system on national level (phase I)
	2019: Functional electronic system on local (municipal) level (phase II)
Cost of implementation and impact on the annual budget	According to the Feasibility study the establishment of fully functional and operational system is estimated around EUR 3.5 millions Impact on annual budget: 2017 – EUR 100,000, 2018 – EUR 100,000 and 2019 – EUR 100,000.
Expected impact on competitiveness	The establishment of the system will contribute to continuous monitoring of the level of development of the regions, for timely and effective adjustment of programs and measures for balanced regional development that will increase the economic potential of regions.
Expected social outcomes including on employment and on social groups in particular on gender	Increasing the economic potential of the regions is closely linked to creating new jobs and better living standards of the population.
	Measure 3: Joint border railway station Macedonia - Serbia
Short description	Construction of a joint railway border station Tabanovce between Macedonia and Serbia that will provide for efficient and fast passage of passenger and freight traffic at border crossings by reducing the control procedures performed by officials of the two countries.
Timetable by year	2017: Preparation of feasibility studies, main design and tender documentation and submission of application to WBIF for investment grant
	2018: Selection of a construction company, concluding the contract and commencement with construction works
	2019: Construction works

Cost of implementation and impact on the annual budget	Project preparation: 380.000 EUR, WBIF Construction: around 3.5 MEUR WBIF Investment grant
Expected impact on competitiveness	The objective of the Project is to improve the international rail transport between the railway networks of the two neighbouring countries, and to establish and implement the legal and institutional framework for a gradual market opening of the rail transport in South East Europe, based on gradual achievement. The measure will contribute to reducing delays at borders by streamlining and shortening of the border-crossing procedures via Single window method of providing services and to increase competitiveness of the rail sector compared to other transport sectors.
Expected social outcomes including on employment and on social groups in particular on gender	The measure will contribute for facilitating transport of passengers at this border crossing.
Measure 4. Upgrading and rehabilitation of Corridor X	
Short description	Upgrading and rehabilitation of Corridor X which will provide for the entire road Corridor X to be completed at a highway level and together with the rehabilitation of sections along Corridor X the capacity and overall efficiency of the E-75 North - South road will improve. Upgrading and modernization of railway Corridor X is also envisaged.
Timetable by year	2017: - Construction of the road section Demir Kapija-Smokvica- length of 28.3 km. - Rehabilitation and upgrading of the section Smokvica-Gevgelija - total length of 10.15 km. - Rehabilitation and upgrading of the left section of Kumanovo-Miladinovci highway- length app. 22.5 km - Renewal of railway section Negotino-Nogaevci- length of 30 km. - Modernization of 10 railway stations along Corridor X.
	2018: - Rehabilitation and upgrading of the right section of the Kumanovo-Miladinovci highway- length app. 22.5 km - Procurement and installation of equipment for automatic regulation of the speed of trains (ETCS) and the radio stations controller (GSMR) along Corridor X Tabanovce – Gevgelija.
	2019: - Construction of road A1 and Pan-European Corridor Xd Gradsko – Prilep - first section - length of 10.2 km, second section - length of about 15 km.
Cost of implementation and impact on the annual budget	Section Demir Kapija – Smokvica = 210 MEUR (IPA, EBRD, EIB and Budget of RM) Section Smokvica-Gevgelija = 4.153 MEUR construction + 0.518 Contract for supervision (85% IPA, 15% budget support) Section Gradsko – Prilep = 31.8 MEUR (EBRD) and 41 MEUR (IPA 2) (assumed value) Kumanovo - Miladinovce = 5.1 MEUR construction + 0.60 MEUR Contract for supervision. (85% IPA, 15% budget support) Negotino - Nogaevci = 10 MEUR - loan from the European Bank for Reconstruction and Development (EBRD) Railway stations = 2.4 MEUR (85% IPA, 15% budget support) Procurement and installation of equipment for automatic regulation of the speed of trains = 0.5 MEUR, radio stations controller = 0.3 MEUR (WBIF)
Expected impact on competitiveness	With the construction and rehabilitation of these sections, the entire Corridor X will be built at a highway level. This will significantly improve the competitiveness of the country in terms of increasing traffic, increase traffic safety and reduce travel time. The effect will be to improve the transport of goods for domestic and transit carriers as well as reduce travel time. It will also provide a stronger integration with the markets of the region and connecting with the common EU market. Restoring of sections of the railway line will allow increase of the speed limit to 120 km/h, which will reduce the time and cost of travel and will improve the competitiveness of passenger and freight rail versus road transport on Corridor X. It will also reduce the time and cost of moving goods

	and passengers around train stations by setting up separate entrances for passengers and cargo. The improved control of movement of trains will enable the safe and secure use of rail transport, both for transporting passengers and freight traffic.
Expected social outcomes including on employment and on social groups in particular on gender	<p>In the short term there will be significant improvement in the employment of local population in the regions associated with the construction and rehabilitation of the sections. The employment effects of the project Demir Kapija -Smokvica is presented as number of jobs is the following: Number of jobs directly created during implementation phase is 4.165 persons with average duration of these jobs of 48 months. During operational phase 87 persons will be employed with average duration of these jobs of 276 months.⁸⁴</p> <p>In the long term this project will affect a better geographical connection, it will accelerate the transport of passengers and goods in this section both for domestic and for transit carriers. The project will contribute to improving the safety and security of passengers.</p> <p>The renewal of the sections will significantly improve passenger safety in passenger rail transport. Railway stations will be modernized according to EU best practices in order to meet the demands and needs of passengers including passengers with special needs. The improved control of movement of trains will increase safety of railway transport for passengers.</p>
Measure 5. Upgrading and rehabilitation of Corridor VIII	
Short description	Upgrading and rehabilitation of road and railway Corridor VIII.
Timetable by year	<p>2017:</p> <ul style="list-style-type: none"> - Construction of highway A2 section Kicevo – Ohrid (57 km) - Reconstruction of the railway section from Kumanovo to Beljakovce (30.8 km) - Construction of new and reconstruction of the existing railway section from Beljakovce to Kriva Palanka (34 km). - Preparation of main design with tender documentation for construction of new railway section from Kriva Palanka to Deve Bair, border with Bulgaria - Preparation of the main design for construction of new section from Kicevo to Lin, border with Albania length of 62.6 km
	<p>2018:</p> <ul style="list-style-type: none"> - Construction of highway A2 section Kicevo – Ohrid - Reconstruction of the railway section from Kumanovo to Beljakovce - Construction of new and reconstruction of the existing railway section from Beljakovce to Kriva Palanka
	<p>2019:</p> <ul style="list-style-type: none"> - Construction of highway A2, section Trebenishte – Struga (8.5 km) - Construction of expressway A2, section Rankovci – Kriva Palanka (23 km) - Reconstruction of the railway section from Kumanovo to Beljakovce. - Construction of new and reconstruction of the existing railway section from Beljakovce to Kriva Palanka.
Cost of implementation and impact on the annual budget	<p>Kumanovo- Beljakovce: loan from EBRD for construction works: EUR 46.4 million, supervision of the construction: EUR 2.5 million WBIF grant, preparation of main documentation EUR 1.5 million WBIF grant.</p> <p>Beljakovce Kriva Palanka: construction works-loan from EBRD EUR 145 million, supervision of the construction: EUR 3.0 million WBIF grant and EUR 4 million from the loan, preparation of main documentation EUR 2.7 million WBIF grant.</p> <p>Kriva Palanka-Deve Bair border with Bulgaria, preparation of main design with tender documentation EUR 3.0 million IPA grant.</p> <p>Kicevo-Lin, border with Albania, for preparation of the main design with tender documentation EUR 8.0 million IPA grant.</p> <p>Construction of highway A2, section Kicevo - Ohrid: EUR 374 million (90% EXIM Bank and 10% Public Enterprise for State Roads)</p> <p>Construction of highway A2, section Trebenishte - Struga: EUR 45 million EBRD loan.</p>

⁸⁴ Source the CBA of the Project for Construction of the section Demir Kapija - Smokvica

	Construction of expressway A2, section Rankovci - Kriva Palanka: EUR 78 million World Bank loan. - Construction of the expressway A2 section Kriva Palanka - border with Bulgaria: EUR 30 million EBRD loan.
Expected impact on competitiveness	By the construction and completion of the railway Corridor VIII travel time between Skopje and Sofia by rail will be reduced for about 1 hour in relation to the current travel time compared to road traffic. The time of regional travel between Kumanovo and Kriva Palanka by rail will be reduced for approximately 35 minutes from the current travel time of approximately 50 minutes by road. The rail link between Macedonia and the Black Sea will be shortened for approximately 200 km, while the one between Macedonia and Istanbul for approximately 150 km. The capacity for transporting cargo will be increased by obtaining capacity for crossing of 10 freight trains in each direction, which is equivalent to 400 road trucks. The measure will provide direct rail route between Macedonia and Bulgaria, avoiding the need to pass through Serbia, as well as facilitation of trade with Bulgaria. The construction of the road sections along Corridor VIII will significantly improve the competitiveness of the country in terms of improved connectivity of this region of Macedonia and integration of this region with the entire trans-European network. It will provide efficient access to ports in Bulgaria and Albania, as well as access to potential markets in the East and connection of the TRACECA Corridor ⁸⁵ . Trade exchange between Bulgaria, Macedonia and Albania will be facilitated and better connections with the regional district of inclusion of Corridor VIII to the main southern Italian ports and this area will be provided.
Expected social outcomes including on employment and on social groups in particular on gender	In the short term, new jobs will be created during the phase of construction of the road and railway sections along the entire road Corridor VIII. In the long term it will provide better geographical connectivity, thus accelerating the transport of passengers and goods for both domestic and transit carriers. The measure will contribute to improving the safety and security of passengers.
Measure 6: Construction of 400kV Overhead Transmission Line SS Bitola 2 to Macedonia-Albania border and SS 400/110 kV Ohrid	
Short description	This project is a part of an initiative to establish a major East - West electricity transmission corridor between Bulgaria, Macedonia, Albania and potentially Italy (via a planned submarine cable). This section (Bitola to Macedonia - Albanian border, with substation at Ohrid) is part of the Macedonia / Albania section of that corridor. The overall objective of the project is the construction of a high voltage 400 kV electricity transmission line between Sub Station Bitola 2 and Macedonia - Albanian border, with the construction of a new 400/110 kV substation near Ohrid. This project, which has been identified as a priority for the creation of the regional electricity market in South East Europe, and will contribute to the stability and security of the electricity system of the Balkans, not only for the two countries directly concerned, but also for the electricity systems of the region by closing a 400 kV ring between Albania, Greece and Macedonia.
Timetable by year	2017: starting tendering process for Overhead Transmission Line Bitola 2 SS to Ohrid SS, Ohrid SS, Extension of Bitola 2 SS and Smart Grid Improvement
	2018: starting construction works for Overhead Transmission Line Bitola 2 SS to Ohrid SS, Ohrid SS, Extension of Bitola 2 SS and Smart Grid Improvement
	2019: proceed with construction works for Overhead Transmission Line Bitola 2 SS to Ohrid SS, Ohrid SS, Extension of Bitola 2 SS and Smart Grid Improvement
Cost of implementation and impact on the annual budget	The total cost of the implementation is 49 MEUR. The project is financed by MEPSO and does not impact the annual budget of Macedonia.
Expected impact on competitiveness	The implementation of the project will result in: reduction of technical losses; reduction of unsupplied electricity; increased generation in both interconnected systems; increased transfer capacity and ability to participate in cross-border electricity exchanges. From the perspective of the Macedonian economy the project is economically justified throughout a wide range of variations of the value of electricity

⁸⁵ TRACECA is an abbreviation of Transport Corridor Europe-Caucasus-Asia

	and value of imported electricity, mainly owed to the forecasted benefit from increased generation. In the feasibility study ⁸⁶ the impact for Macedonian economy is estimated at 37,8 MEUR on a 15 year perspective.
Expected social outcomes including on employment and on social groups in particular on gender	The Project will engage local companies for the preparatory and construction works. Also the outcome of this Project is to improve the electricity supply quality and this will create better environment for doing business and increase employment.
	Measure 7: Revitalisation and modernisation of the transmission network and power system management
Short description	The investment for revitalization and modernization of the transmission network and management of the power system consists of four components: <ul style="list-style-type: none"> - Revitalization of six 110 kV transmission lines (SS Bitola 1 - TS Prilep 1 SS Oslomej - Kicevo TS, TS Skopje 1 – TS, - Miladinovci, SS Veles - SS Ovce Pole SS Skopje 4 - SS Veles, Stip TS - TS Ovce Pole, SS Stip - Probistip TS) - New equipment for substations, - Complete closing of the optical ring of transmission network and - Installation of the supervisory and management substations.
Timetable by year	2017: Equipment for SS's: Rehabilitation of Substations, High Voltage Equipment and Relay Protection - Optical loop: Supply and Installation of Optical Ground Wire and Equipment and Construction of Underground Installation for Optical Connection
	2018: The activities will be determined next year
	2019: The activities will be determined next year
Cost of implementation and impact on the annual budget	The total cost of the implementation is 40.5 MEUR. The project is financed by MEPSO and does not impact the annual budget of Macedonia.
Expected impact on competitiveness	The revitalization and modernization of the transmission network will contribute to accurate and reliable operation of the network, will facilitate the exchange of data between the National Dispatch Center and the power facilities, transmission of data in the area of business and financial operations, data transmission for remote regulation and video surveillance of all objects connected to the transmission network, connection with the neighboring telecommunications networks for data transmission in Serbia, Bulgaria, Greece and Albania through existing and new interconnection lines, fulfilling the requirements, meeting the requirements of the European Network of Transmission System Operators ENTSO-E to provide digital electronic connection with at least two neighbouring transmission system operators for data exchange, being of vital importance for the system management and supply stability in the region.
Expected social outcomes including on employment and on social groups in particular on gender	The Project will engage local companies for the preparatory and construction works. Also the outcome of this Project is to improve the electricity supply quality and this will create better environment for doing business and increase employment.
	Measure 8: Improvement of Irrigation Systems
Short description	In order to ensure continuous and long-term investments in infrastructure for irrigation and drainage, a ten-year planning document "Investment Plan for the Water Management Master Infrastructure for the period 2015-2025" is prepared. This plan includes: Rehabilitation and reconstruction of installed infrastructure for irrigation and drainage in order to achieve their sustainability and water conservation; Upgrading and expansion of the existing hydro-system in order to increase the irrigated area in the country; and Construction of new major facilities in the Macedonian hydro-system.
Timetable by year	2017: Starting with construction of Orizarska dam.

⁸⁶ Feasibility Study and ESIA for Elbasan (AL) - Bitola (MK) 400 kV Transmission Line – Europe Aid/128073/C/SER/MULTI WB4bis-REG-ENE-01: 2013

	<p>Starting construction works on Konsko dam and irrigation system Raven - Rechica</p> <p>Construction activities for building an access road to the Rechani dam</p> <p>Prepare technical documentation for the dam on the Slupchanska River</p> <p>Develop infrastructure project, detailed design and elaborate on the environmental impact for HS "Lisiche"</p> <p>Implementation of the Second phase of the "Irrigation Program Southern Vardar Valley"</p> <p>Implementation of the Second phase of construction of the HS "Lisiche"</p>
	2018: Continuing construction works according to signed agreement
	2019: Continuing construction works according to signed agreement
Cost of implementation and impact on the annual budget	Cost for the complete implementation of the measure for the period 2017-2019 is EUR 96.000.000. The annual budget for 2017 under the programme for rural development is EUR 4.560.261.
Expected impact on competitiveness	<p>The implementation of the measure will increase the proportion of irrigated agricultural land from the current 4% to approximately 6% (from 20,575 to 20,575+11,700) and will also improve the existing irrigation systems. With implementation of these capital investment projects, farmers in those regions will have available irrigation water for irrigation of agricultural land and possibilities for increasing of agricultural crops yields. The measure will enable production of electricity through construction of hydropower plants, as well as provision of additional quantities of water for the hydro system "Rescue of Dojran Lake".</p> <p>Access to farmers to regular irrigation is expected to increase competitiveness by adoption of new varieties, diversification to higher value crops and higher yields.</p> <p>Sustainable management of irrigation and drainage systems, through investments in irrigation and drainage infrastructure.</p>
Expected social outcomes including on employment and on social groups in particular on gender	<p>Building of dams will provide access to drinking water of people in those areas, flooding control downstream and industrial developments of the region through increased production of electricity leading to creation of new jobs. Improved farming will result in increased agricultural irrigation. Facilitating community small scale irrigation systems shall promote sustainability of rural livelihoods.</p>
	Measure 9: Consolidation and defragmentation of agricultural land
Short description	According to the National Strategy for Agriculture and Rural Development 2014-2020: "Re-parcelisation projects and consolidation of land will be carried out in parallel with infrastructure planning in terms of the quality of the road network and irrigation network as part of an integrated approach to rural development. Priority will be given to regions with developed and intensive agriculture where small and fragmented parcels significantly limit the further development of agriculture as a primary agricultural activity in rural areas, primarily on the basis of interest shown by the farmers.
Timetable by year	<p>2017: Awareness raising on consolidation procedures and identification of new consolidation regions;</p> <p>Initiation of a process of capacity building of MAFWE and other stakeholders for successful implementation of land consolidation projects;</p> <p>Initiation of process of development of tools and procedures for implementation of consolidation projects; establishment of Monitoring and Evaluation system.</p>
	<p>2018: Capacity building of MAFWE and other stakeholders;</p> <p>Development of tools and procedures for implementation of consolidation projects;</p> <p>Implementation of three/four consolidation projects;</p> <p>Monitoring and Evaluation.</p>
	<p>2019: Capacity building of MAFWE and other stakeholders;</p> <p>Implementation of three/four consolidation projects;</p> <p>Monitoring and Evaluation.</p>
Cost of implementation and	Cost of implementation is 4.000.000 euro and impact on the annual budget is 1.000.000 euro

impact on the annual budget	
Expected impact on competitiveness	<p>Allowing farmers to acquire farms with fewer parcels that are larger and better shaped and to expand the size of their holdings enables them to become more competitive. Improving the agricultural property structure can facilitate the adoption of new agricultural technologies leading to a more prosperous and efficient agricultural sector. Benefits from land consolidation include increases in gross income of farmers and reduction of working hours in the field.</p> <p>In order to create considerable impact, roughly at least 30% of all agricultural land will be consolidated in the coming 30 years. This requires each year to 'deliver' about 3000 ha of land consolidation projects being finalized. Assuming a preparation / implementation time of three years, it means that in each year about 10.000 hectares will be under implementation.</p>
Expected social outcomes including on employment and on social groups in particular on gender	<p>By renewal of rural communities, land consolidation can promote social stability. Results from various research and assessments of land consolidation projects show that many communities that have experienced land consolidation show increases in the number of new jobs created.</p> <p>The project will be implemented in compliance with the VGGT-Voluntary guidelines of land tenure, a gender sensitive and social inclusive approach of interviewing and meetings in which all participants will be able to express their interests and will influence the project options.</p>
	Measure 10: Agricultural cooperatives
Short description	Strengthening the establishment of agricultural cooperatives is the most effective approach to improve the situation of farmers on the market. Consequently, the horizontal integration of the entities involved in the sector of food production is basically oriented towards agricultural cooperatives as the most appropriate way to improve the structure for supply of agricultural products.
Timetable by year	<p>2017: - Encouraging the process of market-oriented association of farmers in agricultural cooperatives.</p> <p>- Providing continued financial support for cooperatives (continuation of the implementation of the previous period).</p> <p>- Support for investments in processing, finalization and marketing of agricultural products.</p>
	<p>2018: - Providing continued financial support for cooperatives (continuation of the implementation of the previous period).</p> <p>- Support for investments in processing, finalization and marketing of agricultural products.</p>
	<p>2019: - Support for acquisition of quality protection labels of the agriculture and processed products</p> <p>- Providing continued financial support for cooperatives (continuation of the implementation of the previous period).</p>
Cost of implementation and impact on the annual budget	<p>The total cost of the implementation is 5.550.000 and 2.650.000 in 2017.</p> <p>The impact on the state budget is 420.000 in total and 140.000 in 2017.</p>
Expected impact on competitiveness	Fostering the establishment of agricultural cooperatives is an opportunity for the development of farms by promoting economic association in the agriculture cooperatives, by common performance in the production, sale and marketing of their products to strengthen their market role, increased competitiveness and efficiency, increased individual income of the farmer, qualitative production, assured sale, higher support from the state and greater profits. As a result, the objective of horizontal integration of the entities involved in the sector of food production basically is oriented towards agricultural cooperatives as the most suitable way for improvement of supply chain of agricultural products.
Expected social outcomes including on employment and on social groups in particular on gender	<p>Development of agricultural cooperatives will additionally contribute to the community by increasing and retaining jobs in agriculture and processing industry, environmental protection, retaining citizens in rural areas.</p> <p>At this moment 36 persons are employed as managers of the existing cooperatives. It is expected that this number will be doubled with the employment of staff for machinery operation if we take into account new investments in modernisation of agriculture production. Also new cooperatives will emerge so the number of the employees will be even higher.</p>
	Measure 11: Increasing competitiveness in Tourism & Hospitality Sector
Short description	The measure is aimed at implementing activities for increasing the competitiveness of small businesses in the sector, which will contribute to increase of the income of men and women, especially youth. What is important is that the focus is placed on ensuring sustained systemic changes.
Timetable by year	<p>2017: - Improved access to international markets (Destination Ohrid scaled up to export)</p> <p>- Improved destination management in order to access international markets for paragliding (Destination Krusevo)</p>

	- Improved tour guide services and visibility of tour guides to travel agencies
	2018: Activities are defined annually
	2019: Activities are defined annually
Cost of implementation and impact on the annual budget	226,022 euro (annual budget for 2017). The measure is realised with support from the Swiss Government.
Expected impact on competitiveness	The increased potential of the three tourist destinations for attracting more tourists through enhanced provision of services and enriched tourist offer will enable greater participation on the domestic and world markets leading to economic growth.
Expected social outcomes including on employment and on social groups in particular on gender	New jobs will be created along the whole tourism value and supply chain and it is expected higher participation of young people and women. Around 600 guides and their set of skills and capabilities will be visible and accessible on the market of travel agencies.
Measure 12: Increasing competitiveness in Creative Industries Sector	
Short description	Software and IT services and Product Design subsectors will be supported, so that software development and product design services by Macedonian companies enjoy large market penetration in the country and international markets as well.
Timetable by year	2017: -Access to market for designers - Increased export from IT Companies - Design with social impact - Support services for IT Companies
	2018: Activities are defined annually
	2019: Activities are defined annually
Cost of implementation and impact on the annual budget	237,593 euro (annual budget for 2017). The measure is realised with support from the Swiss Government.
Expected impact on competitiveness	The manufacturing companies will increase the number of new products and services and increase their competitiveness on international markets, increase the volume of sale that will create new jobs for designers and other professionals. Macedonian IT industry will create competitive advantage by promoting its own developed products.
Expected social outcomes including on employment and on social groups in particular on gender	- Increased presence of companies on international markets should lead to increased income of the companies and creation of additional jobs. - The introduction of new research methodology subject will increase students' skills in proper practical research processes which they will follow when designing new products and will allow them to better understand the market demand and the needs of the end beneficiaries. - HR Agencies, HUBs and accelerators that are already established or are in the process of establishing offer support services for youth for obtaining additional technical and team work skills. It is expected, aside from selected partners that are going to promote and test the collaboration models with big companies, other entities to replicate this model in order to increase their access to skilled employees.
Measure 13: Development of National Portal for e-services	
Short description	Creation of dynamic web portal for e-services (National Portal for e-services) as the single-point of contact with the state bodies on the "one-stop-shop" principle and using standardized user interfaces. The Portal will be available via the Internet on a different web oriented platforms.
Timetable by year	2017: Improvement of the Legal framework on electronic management; - Draft revision and amending the law of electronic management and its bylaws; - Draft guidelines/ methodology/ legal act for e-services fees; - Strengthening capacities for implementation of the improvements of the Law on electronic management and acts for e-services fees.
	2018: Implementation of E-services

	<ul style="list-style-type: none"> - Develop and provide fully functional National Portal for e-services; - Increased number of electronic services available, and increasing overall level of sophistication of electronic administrative services in accordance to EU benchmarks - Increased use of e-services by end-users.
	2019: /
Cost of implementation and impact on the annual budget	The total cost for this measure is 518,980 EUR (300,462 in 2017 and 218,518 in 2018). It is a component of a larger service contract.
Expected impact on competitiveness	Decreasing the administrative burden for citizens and companies, increasing efficiency of the companies.
Expected social outcomes including on employment and on social groups in particular on gender	Wide inclusion of all social groups, increased trust in the government, open areas for new businesses, satisfied users, faster and quality services, facilitated access to services for rural communities.
	Measure 14: Adoption of a National Strategy for SMEs (2017-2022) with an action plan (2018-2020)
Short description	Adoption of a National Strategy for SMEs (2017-2022) aimed at supporting the development of SMEs and entrepreneurship for the purpose of increasing the productivity and innovation of SMEs and enhance their competitiveness in national and international markets.
Timetable by year	2017: Second quarter - Adoption of the Strategy and Action Plan
	2018: /
	2019: /
Cost of implementation and impact on the annual budget	Preparation of the Strategy is funded by the International Labour Organisation in the amount of EUR 38,300.
Expected impact on competitiveness	<ul style="list-style-type: none"> - Competitive SMEs are drivers of inclusive economic growth and creation of productive and decent jobs. - SMEs operate in a favorable business environment where they encourage entrepreneurship, investment and productivity, in line with European norms and standards. - SMEs are highly productive and competitive participants in the European and other international markets. - <u>The competitiveness of Macedonian economy is increasingly encouraged by the more entrepreneurial and innovative SME sector.</u>
Expected social outcomes including on employment and on social groups in particular on gender	Strengthening consultation and mechanisms for conducting dialogue between the government and the private sector. Special attention will be given to the inclusion of business women in these mechanisms, as well as insuring that the voice of micro-enterprises will be heard.
	Measure 15: Improvement of the infrastructure and the access to funding for research, development, and innovations
Short description	<p>Measures include development and piloting of new instruments:</p> <ul style="list-style-type: none"> - Co-financed Grants for Technology Extension - Co-financed Grants for Establishing, Operations and Investing of Business-technology Accelerators - Technical Assistance to Support Innovative Activity <p>These support instruments will not only increase the access to finance for innovation activities, but will also strengthen investment readiness of Macedonian companies, which in the long run would lead to more effective utilization and significant results from investments made in research, development and innovation.</p>

Timetable by year	2017: Improvement of the regulatory framework - adopting by-laws for introduction of the new support instruments - Piloting of the new support instruments - Co-financed grants for technology extension and Co-financed grants for establishing, operation and investing of business-technology accelerators 2018: Piloting of the new support instrument - Technical assistance for support to the innovation activity 2018-2019: Implementation of the new support instruments																							
Cost of implementation and impact on the annual budget	Total cost of the measure is EUR 2,801,667, according to the following dynamic: <table><tr><th>Instrument no.</th><th>2017</th><th>2018</th><th>2019</th></tr><tr><td>I.</td><td>€125.000</td><td>€650.000</td><td>€575.000</td></tr><tr><td>II.</td><td>€83.333</td><td>€458.334</td><td>€500.000</td></tr><tr><td>III.</td><td>€100.000</td><td>€200.000</td><td>€200.000</td></tr><tr><td>Total:</td><td>€218.333</td><td>€1.308.334</td><td>€1.275.000</td></tr></table>				Instrument no.	2017	2018	2019	I.	€125.000	€650.000	€575.000	II.	€83.333	€458.334	€500.000	III.	€100.000	€200.000	€200.000	Total:	€218.333	€1.308.334	€1.275.000
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Expected impact on competitiveness	The increased investment in research, development and innovations, which is the primary objective of the abovementioned components, leads to the introduction of innovative products/services/processes which contribute to the increase of the quality of the supply of goods and services, as well as, to the increase of the domestic companies' capacities to meet the international standards for safety and quality. It is expected that the support instruments would increase the public and private investment in RDI (as % of GDP), increase the number of companies introducing innovation of product/process/service, strengthen the capacities of the SMEs and enhance the cooperation among the private sector and academia.																							
Expected social outcomes including on employment and on social groups in particular on gender	Investment in innovation increases the competitiveness of the domestic companies on the domestic and global market, which results in economic growth and job creation. Through the improvement of the economic performance, as well as through the increase in the quality of goods and services available on the market, the introduction of innovations also leads to a higher standard of living of the population.																							
	Measure 16: Triple Helix Partnership																							
Short description	The National Technology Transfer Office is going to be established as a part of the Strategy for Innovation 2012-2020, and will be organized as institutional Triple Helix Partnership. The three main areas of work within the process of technology transfer, based on the analysis of the country potential, priorities and strategies would be: Agriculture, Information and Communication Technology and Reusable Energy Sources. NTTO's main aim is to establish a link of cooperation between the industry, especially the large companies and the universities for different activities related to the technology and intellectual property. Furthermore, the aim is to stimulate the key elements of the innovation economy - entrepreneurship, commercially oriented researches, the partnerships between the industry and universities which will contribute to the improvement of exports of products and services.																							
Timetable by year	2017: Operationalisation of the NTTO (staffing a team, equipping the NTTO, trainings for the employees, marketing and developing a strategy, funding strategy, strategy for securing funding sources, and establishing a financial reporting and control system).																							
	2018: Support of at least 5 innovative pilot projects.																							
	2019: To submit at least 5 patent analysis and 2 patents within a period of 4 years.																							
Cost of implementation and impact on the annual budget	The total budget for the NTTO is 870.000 euro. The impact on the annual budget per year is as following: 2017 – 255,000 euro 2018 – 355,000 euro 2019 – 162,000 euro																							
Expected impact on competitiveness	The expected impact on competitiveness is in regard of stimulating key elements of an innovation economy – entrepreneurship, university-industry partnership and risk taking that can lead to improved exports of products and services.																							

	In addition to its main focus on SMEs and their cooperation with universities, NTTO will offer services to public authorities in the area of development of national strategies and legislation, as well as development of programmes required for their implementation. Furthermore, NTTO will also target big companies and fosters their cooperation with universities especially through development and implementation of practice oriented master and PhD projects, and specific educational programmes.
Expected social outcomes including on employment and on social groups in particular on gender	The measure has more impact on youth, especially students as they will have a chance to obtain active engagements in technology transfer process, and it should open new dimensions in research fields since they will adapt the subject areas and details according to the needs of the industry. Students will also benefit from development and implementation of practice oriented master and PhD projects, and specific educational programmes.
	Measure 17: Upgrading the customs clearance facilities of road border crossings Tabanovce (IPA 2012) and Kafasan (IPA 2013)
Short description	Upgrading the customs clearance facilities of road border crossings Tabanovce and Kafasan due to the limited space and the increased volume of freight traffic at the border crossing Tabanovce - the most frequent border crossing points (BC) in the country, along the Pan-European Corridor X, and the most frequent border crossing with Albania, BC Kafasan along the Pan - European Corridor VIII, the conditions of processing shipments are limited. In order to expedite and facilitate trade requires upgrading of existing facilities.
Timetable by year	2017: Construction of BC Tabanovce will continue. Planned period for works is 12 months and at the end of 2017 is envisaged completion of construction works of the BC Tabanovce. BC Kafasan – the tender procedure will start in the first quarter of 2017. The beginning of the implementation of the project is planned for the fourth quarter of 2017.
	2018: Construction works will continue. During the fourth quarter is planned to complete the upgrade, construction work and the upgraded facilities of BC Kafasan to be functional.
	2019: /
Cost of implementation and impact on the annual budget	The project for upgrade of BC Tabanovce is financed from IPA (2012) and national co-financing and amounts to EUR 1.89 million out of which EUR 1.45 million are IPA funds (Component 1) and national co-financing amounts to EUR 0.44 million. The project for upgrade of BC Kafasan is financed from IPA (2013) and national co-financing and amounts to EUR 1.48 million out of which EUR 1.14 million are IPA funds (Component 1) and national co-financing amounts to EUR 0.37 million.
Expected impact on competitiveness	It is expected that the number of passing vehicles using BC Tabanovce will increase: at entrance by 25%-30%; at exit by 34%-38% while the number of transit vehicles in both directions would be 30% of total passing cargo vehicles. The projects will contribute to: expedite and facilitate exchange of goods through both border crossings; facilitate transport along Trans National Axes North- South (Corridor X) and East-West (Corridor VIII) linked to the Trans European Transport Networks after 2018, reduce bottlenecks and within other ongoing activities such as introduction of the Common transit system completed in 2015, to greater competitiveness. Expected outcomes (benefits) from the implementation of the projects are: increased flow of shipments of goods, reduced time to complete border formalities, improved infrastructure for application of modern inspection tools, thus expediting the exchange through border crossings, and facilitating transport along Pan-European Corridors X and VIII.
Expected social outcomes including on employment and on social groups in particular on gender	/
	Measure 18: Further development of the qualification system
Short description	Balancing between supply and demand of knowledge, skills and competencies, providing education for all and acquiring qualifications in formal and informal way to allow competitive workforce, mobility qualifications, their recognition, increase employment, particularly among the young and vulnerable groups and strengthening social dialogue.

Timetable by year	2017: 1. Development of qualifications for two priority sectors 2. Development of the Skills observatory - developing public web portal which will display data available to the public - Signing an Agreement for obtaining data with the Pension and Disability Insurance Fund and the Public Revenue Office for data on the status of students after their completion and average monthly income according to study program, school / college. - Obtaining data from the State University of Tetovo and South East Europe University through alternative module for data exchange - Connecting the information systems of private higher education institutions and obtaining data 3. Development of new occupational standards - 60 standards according to the analysis of the labor market needs 4. Development of special programs for adult education and redesigning old ones
	2018: 1. Development of qualifications according to the requirements of employers 2. Development of the Skills Observatory - piloting and system upgrade (if required); 3. Development of special programs for adult education for training and retraining for easier mobility and employability 4. Validation of non-formal education to acquire specific qualifications (establishment of a system for validation and preparation procedures for the validation) 5. Strengthening of cooperation between higher education institutions and the private sector, and vocational schools and the private sector to provide quality practical work of students and students in companies. The practical work allows application of knowledge and developing skills directly in the workplace in companies and ability to recognize labor force by the company where practical work takes place.
	2019: 1. Development of qualifications required by employers and flexible access for their acquisition 2. Development of special programs for adult education for training and retraining for easier mobility and employability 3. Validation of non-formal education to acquire specific qualifications 4. Strengthening cooperation between higher education institutions and the private sector, and vocational schools and the private sector to provide quality practical work of students and students in companies through the development of career centers.
Cost of implementation and impact on the annual budget	10.300.000 EUR
Expected impact on competitiveness	Cooperation between formal, non - formal / informal education and training and the business sector towards the labor market needs and reducing the inadequacy between education and the labor market and career development which will facilitate the acquisition of skills and competencies that will contribute to competitiveness of enterprises, increasing recognition of qualifications acquired in our country by foreign investors and recognition of qualifications acquired abroad by our foreign employers.
Expected social outcomes including on employment and on social groups in particular on gender	<ul style="list-style-type: none"> • increasing employment • increasing youth employment • inclusion of vulnerable groups
Measure 19. Profiling of unemployed persons and designing an Individual Employment Plan 2	
Short description	First time registered unemployed people are covered within this measure. According to the answers from the employability check list, the unemployed people are divided in three categories: easy employable, with certain difficulties in employment and those who are difficult to employee. The first two categories, are directed for preparation of standard format of Individual employment plan, whereas the third category are scheduled for preparation of the more detailed Individual employment plan 2.
Timetable by year	2017: 7500 unemployed people covered
	2018: 7500 unemployed people covered and directly included into the employment programs and measures
	2019: 7500 unemployed people covered and directly included into the employment programs and measures
Cost of implementation and	The cost for implementation of this measure is 336 denars per unemployed person. It is funded by ESA's annual budget.

impact on the annual budget	For 2017, 2018 and 2019 the annual budget is estimated at 40.976 EUR.
Expected impact on competitiveness	This new approach will strengthen the trust and cooperation between the unemployed people and ESA, because all the activities will be adjusted to the real needs of the unemployed. The active employment programs and measured will be addressed to the unemployed people who are most suitable for. It will also keep the unemployed activated and motivated in the process of job searching.
Expected social outcomes including on employment and on social groups in particular on gender	This measure is to target the unemployed people who are in unfavorable situation on the labour market and provides the most suitable combination of services and employment programs, available through the annual operational plans. The target will be most vulnerable unemployed people, with special focus on young people up to the age of 29 and unemployed people who weren't employed in the previous 2 years.

Table 12: Reporting on the implementation of the structural reform measures of the ERP 2016-2018

	Measure 1. Upgrading and rehabilitation of Corridor X
Short description of actions planned for 2016	<ol style="list-style-type: none"> 1. Renewal of the railway Corridor X 2. Construction of the section Demir Kapija – Smokvica 3. Rehabilitation and upgrade of the highway section Smokvica-Gevgelija, 4. Rehabilitation of bridges with a grant from NATO (road Corridor X)
Were the actions planned for 2016 implemented?	<ol style="list-style-type: none"> 1. Partially 2. Partially 3. Partially 4. Yes
If yes/partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	<ol style="list-style-type: none"> 1. In the past year the rehabilitation and upgrading of the railway station in Skopje and 9 other major stations has been completed. Also, in the past period, the sections Tabanovce – Kumanovo (L = 12 km) and Miravci - Smokvica (L = 12 km) were renewed. Regarding the section Nogaevci – Negotino, the contract with the contractor is extended to 31.12.2017. 2. 87% of the construction works are carried out and the section is expected to be fully completed by mid-2017. 3. Progress of the construction works is 75% as of October 2016 inclusive. 4. The third phase of the project Reconstruction of bridges with a grant from NATO, that envisaged 13 bridge structures to be reinforced along the section Veles - Katlanovo, was fully completed at the end of June 2016.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	The total cost for implementation of this measure was 131,195,500 euro in 2016, of which 108,335,000 euro funding from the state budget and loans, and 22,860,500 euro IPA funds.
	Measure 2: Upgrading and rehabilitation of Corridor VIII
Short description of actions planned for 2016	<ol style="list-style-type: none"> 1. Railway infrastructure <ul style="list-style-type: none"> - Reconstruction of part of the railway line from Kumanovo to Beljakovce - Construction of new and reconstruction of existing railway section from Beljakovce to Kriva Palanka - Preparation of the main design for construction of new section from Kichevo to Lin, border with Albania 2. Road Infrastructure <ul style="list-style-type: none"> - Construction of motorway A2 section Kicevo - Ohrid

Were the actions planned for 2016 implemented?	1. Partially 2. Partially
If yes/partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	Reconstruction of the railway section from Kumanovo to Beljakovce is underway. For construction of new and reconstruction of existing railway section from Beljakovce to Kriva Palanka, loan in the amount of 145 million euros was awarded from EBRD in December 2014, intended for the construction works. With this contract the selected construction company will perform the reconstruction of the existing bridges, tunnels, alignment and build new ones in a period of 48 months. An EUR 2.7 million WBIF grant was used for preparation of project documentation. The prequalification process started on 23.05.2016. The evaluation of the 15 applications is underway. Preparation of the main design for construction of new section from Kichevo to Lin, border with Albania. This project is ongoing. The construction of motorway A2, section Kicevo - Ohrid is implemented in line with the envisaged dynamics and 35% have been completed so far. The time frame for completion of the investment is February 2018.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	The total cost for implementation of this measure was 25.45 million euros in 2016, of which 25 million euros funding from the state budget and loans, and 450,000 IPA funds.
Measure 3: Upgrading and rehabilitation of the local and regional road infrastructure	
Short description of actions planned for 2016	1. Construction of A4 highway, section Miladinovci - Sveti Nikole – Stip
Were the actions planned for 2016 implemented?	1. Partially
If yes/partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	Construction of A4 highway, section Miladinovci - Sveti Nikole – Stip is ongoing. The overall progress of construction works is 56%. The timeframe for completion of this investment is May 2017.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	The contract value is 206 million euros. This project is funded 90% by the EXIM Bank and 10% by the Public Enterprise for State Roads budget. So far, 96.65 million euros have been paid.
Measure 4: Construction of 400 kV Interconnection overhead line SS Bitola 2- Macedonian/Albanian border and 400/110 kV Ohrid	
Short description of actions planned for 2016	<ol style="list-style-type: none"> 1. Land acquisition 2. Preparation of Main Design and Tender Documents <p>The main objectives of the assignment shall be preparation of:</p> <ul style="list-style-type: none"> • Main design of the 400kV OHTL SS 400/110 kV Bitola 2 – MK/AL border and 400/110kV substation at Ohrid • detailed technical specification • other documents required for the preparation of Tender Dossier.
Were the actions planned for 2016	1. Partially

implemented?	2. Partially
If yes/partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	<ol style="list-style-type: none"> 1. The land acquisition is connected with the design of the OHTL and SS Ohrid. When the route of the OHTL and position of the SS is selected and approved than the tower spots and the land under the SS Ohrid will be under acquisition process. This reform will continue in next 2017. 2. The consultant/designer started working on site preparing the Main design for the OHTL and SS in Ohrid. The Mobilization report was submitted by the consultant/designer to AD MEPSO. AD MEPSO accepted this Mobilization report. This task will continue and is expected to be finished in Q3 2017.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	180.000 EUR Grant from WBIF and EBRD.
Measure 5. Rehabilitation and modernization of the transmission network and power system management	
Short description of actions planned for 2016	<ol style="list-style-type: none"> 1. Preparation of technical documentation, preparation of tender documentation and tendering and contracting with the best bidders <p>Equipment for SS's</p> <ul style="list-style-type: none"> - Rehabilitation of Substations - High Voltage Equipment - Relay Protection <p>Optical loop</p> <ul style="list-style-type: none"> - Supply and Installation Optical Ground Wire - Equipment and Construction of Underground Installation for Optical Connection <p>Signing contracts and beginning with the implementation</p>
Were the actions planned for 2016 implemented?	1. Partially
If yes/partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	Technical documentation was prepared and tenders was published. One contract is signed, two contracts are in the procedure of signing. Two tenders are published and are still open for calls. The implementation of those Contracts will continue in 2017.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	Actual cost in 2016 was 500,000 euros, the total estimated cost for the project in 2016 was 8,000,000. The project is financed by MEPSO and does not impact the annual budget of Macedonia.
Measure 6: Improvement of Irrigation Systems	
Short description of actions planned for 2016	<ol style="list-style-type: none"> 1. Finishing construction of road to location where Orizarska dam will be constructed. 2. Obtaining construction license for building of dam Konsko

	3. Obtaining construction license for building of irrigation system Raven Rechica
Were the actions planned for 2016 implemented?	1. Yes. 2. Partially. 3. Partially.
If yes/partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	1. Road to location where Orizarska dam will be constructed, will be finished until end of 2016. 2. Construction Agreement for Konsko dam was signed in 2015, but since construction license is still not delivered, contractor has not yet started with construction. 3. During 2016 tendering for construction of Raven – Rechica will be finished and Contract signed. Activities will continue in 2017 in accordance with the signed contracts with contractors.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	Actual budget cost for these projects in 2016 was EUR 2.174.706 budget funds and 1.150.000 IPA funds.
Measure 7: Consolidation and defragmentation of agricultural land	
Short description of actions planned for 2016	1. Continuation with project activities (2 pilot land consolidation projects) with in FAO project “Support to the implementation of a national land consolidation program”. 2. Signing of the Project “Mainstreaming of the National Land Consolidation Programme” (MAINLAND). Implementation of at least two pilot projects for consolidation with FAO support and identification of possible large-scale consolidation projects that would cover larger consolidation area.
Were the actions planned for 2016 implemented?	1. Yes 2. Yes
If yes/partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	1.1 Detailed assessment of interest and needs for consolidation in tow pilot regions Konce and Egri – (Jan/May 2016) 1.2 Establishment of assembly and other consolidation bodies for the comprehensive consolidation pilot region Egri (June/July 2016) 1.3 Land valuation in both consolidation regions Konce and Egri (July/September 2016) 1.4 Development of re-allotment plans for Konce and Egri (October/December 2016) 2. Signing of the Project “Mainstreaming of the National Land Consolidation Programme” (MAINLAND) (November/December 2016)
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	Actual cost in 2016 was 300,000 which is equal to the estimated cost of 300,000 in 2016. The project did not impact on the annual budget as it was finance from FAO donation. Note: 394,000 euro are from FAO donation for 2 consolidation projects, that are underway and will end in March 2017, - 300,000 euro will be spend until 2016 -in 2017 94,000 euro will be spend
Measure 8. Programme for increasing market employability (I phase)	
Short description of actions planned for 2016	1. Tourism & Hospitality: • Commencement of activities for Destination management in order to improve and diversify tourism products / services in Krusevo,

	<ul style="list-style-type: none"> Continuation of the activities for Destination management in order to improve and diversify tourism products / services in Ohrid and Mavrovo, Building capacities of students at the Faculty of Tourism in Ohrid through the Young Talents Programme of the World Tourism Forum (Lucerne). <p>2. Creative Industries:</p> <ul style="list-style-type: none"> Improved access to international markets for Macedonian IT companies, Services to support designers, with easier market approach Presentation of policies and practices for gender-sensitive human resources management in Creative Industries, Facilitating access to services and best practices for IT companies through establishment of an accelerator within the Faculty of Engineering and Information Technology in Bitola. <ul style="list-style-type: none"> Access to services that support development of female entrepreneurship and businesses owned by women in the five sub-sectors (organic agriculture, sustainable building, tourism, product design and software & IT services)
Were the actions planned for 2016 implemented?	<p>1. Yes</p> <p>2. Yes</p>
<p>If yes/partially, include:</p> <p>-Description of steps taken</p> <p>-Timeline of implemented actions</p> <p>-Difficulties and delays in implementation</p> <p>-Whether the reform will continue in 2017</p> <p>If no, explain why not</p>	<p>Tourism & Hospitality:</p> <ul style="list-style-type: none"> Supported the organization of the Adventure NEXT Conference in Ohrid with 42 international tour operators. Upscale of the intervention in 2017 with new marketing and sales tools (organization of road shows, fam trips and participation at international fairs). Establishing of the DM Working group and prioritization of Strategic Victors Flows. Upscale of the intervention in 2017 focusing on paragliding offer. Promotion of Mavrovo as tourist destination on regional markets (Kosovo and Albania). Building capacities of students at the Faculty of Tourism in Ohrid through the Young Talents Programme of the World Tourism Forum (Lucerne). <p>Creative Industries:</p> <ul style="list-style-type: none"> Match making and establishing collaboration models between designers and companies from light manufacturing, food processing and furniture in order to improve their access to new market, increase their sales and potentially cut costs in production and transport. Associations/proxy company's services portfolio towards the IT industry will be promoted as well as the success stories from pilot intervention (covering all members of the ECO System) in order to increase the collaboration and increased export promotion. Faculty of Mechanical Engineering will introduce new subject for research methodology and will continue to collaborate with professors from Zurich University of the Arts (ZHdK) to develop the methodology Building capacities of the HUBS, accelerators and incubators in order to support the SME and startups. Increased presence on the IT labor maker for HR agencies as mediators between the companies and the non-formal training providers
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	<p>Tourism & Hospitality: 230.033 euro (annual budget for 2016). No deviation.</p> <p>Creative Industries: 230.619 euro (annual budget for 2016). No deviation.</p>
	Measure 9: Financing companies through business angels
Short description of actions planned for 2016	<p>1: Adoption of the Law on business angels</p> <p>2: Promotion of the concept for business angels and education of the public</p> <p>Establishing a scheme for accreditation of qualified business angels.</p>

	3: Establishing a reliable investment system (web platform) where angel investors and entrepreneurs can meet and negotiate
Were the actions planned for 2016 implemented?	<ol style="list-style-type: none"> 1. Partially 2. No 3. No
If yes/partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	<ol style="list-style-type: none"> 1. Working group composed of representatives of relevant institutions, reviewed the experiences of the region in terms of the functioning of the networks of business angels, the tax benefits that individual countries are predicted to encourage business angels and experiences concerning the their accreditation. Based on available information, draft Law on business angels will be prepared which will define the conditions and criteria for licensing and evaluation of business angels, tax breaks for investments, protection of investments etc. 2. The preparation of the Law on business angels continues and adoption is planned for 2017. 3. Delays in the implementation of the measure (activities 2 and 3) were due to unsecured funding. 4. The reform is under preparation and is not included in ERP 2017-2019.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	There was no actual cost in 2016. The planned budget for 2016 was 2.000.000 EUR.
Measure 10: Support to competitiveness of the enterprise sector	
Short description of actions planned for 2016	<ol style="list-style-type: none"> 1. Announcing public call 2. Implementation of the Program for competitiveness, innovation and entrepreneurship by the Ministry of Economy and the Program for support of entrepreneurship, competitiveness and innovation in SME's by the Agency for entrepreneurship support.
Were the actions planned for 2016 implemented?	<ol style="list-style-type: none"> 1. Yes 2. Yes
If yes/partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	<p>All measures were successfully implemented. Public calls for each measure were announced, and all applications were processed by specially defined commissions. The companies that have approved applications received the co-financing.</p> <p>In general nearly 150 companies received some kind of support through these programs, as follows:</p> <ul style="list-style-type: none"> -woman entrepreneurship 23 companies -ISO, HACCP, HALAL standards..... 15 companies -craftsmen..... 12 craftsmen -business centers 11 centers - craft chambers..... 4 chambers -clusters..... 10 clusters -specialized trainings..... 60 participants -patents..... / -vouchers..... 30 companies - clients..... 5 clients <p>These programs with similar measures will continue to be implemented in 2017 with same budget that was approved. New programs were announced in the Official Gazette of the RM No.192 from 2016, and will start with their implementation by announcing public calls in the beginning of 2017.</p>
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	In total, the amount of both programs is 258.400 EUR that are financed by the Budget and actual cost (support) is: SME 144.000 euro + IP 25.000 euro + Clusters 26.000 euro + APPRM 63.400 euro = Total 231.400 euro

deviation from estimated costs if any)	
	Measure 11: Establishment of One Stop Shop System for business licenses and permits
Short description of actions planned for 2016	For 2016 Legal, organizational and technical framework (analysis, studies and technical documentation) were planned. 1. Review of the current databases of licences and permits, procedures, business processes, organisational structure and technical ICT infrastructure 2. Software solution for electronic issuing of business licenses and permits 3. Support activities for fully functioning One stop shop system
Were the actions planned for 2016 implemented?	1. No 2. No 3. No
If yes/partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	The project has not started due to delays in tendering procedures and lowering the programmed financial allocation. The project is under preparation and is not included in ERP 2017-2019 measures.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	There was no actual cost in 2016. In 2016 the total indicative budget was EUR 694.400 (from which National Budget EUR 69.400, IPA EUR 625.000)
	Measure 12: Triple Helix Partnership
Short description of actions planned for 2016	1. Election of director and employees in NTTO. Preparation of technical specifications for procurement of Office supplies. Concluding lease agreement for NTTO. 2. Employing director and other employees. Purchase office furniture and supplies. Preparation of a detailed business plan 2016 and Operational Plan 2016- 2019. Study visit to Austrian TTO. 3. Defining the NTTOMIS system. Preparation of documents for operational functioning of NTTO. Acquisition of Patent Base Implementation of planned activities Under the Operational Programme. 4. Implementation of planned activities under the Operational Programme
Were the actions planned for 2016 implemented?	1. No 2. No 3. No 4. No
If yes/partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation	The establishment of NTTO was prolonged due to the need of compliance with the national Law on Innovation Activities, in order to set up a legal frame for and also include the Fund of Innovations and Technology Development as one of the founders of the office. The proposed amendments for the Law of Innovation Activities are submitted for an opinion and should be adopted by the Government of Republic of Macedonia and afterwards the Parliament of the Republic of Macedonia. The measure will continue in 2017.

-Whether the reform will continue in 2017 If no, explain why not	
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	There was no actual cost. The planned budget was 130,000 euros.
	Measure 13: Extending access to finance for innovation and technological absorption
Short description of actions planned for 2016	1. Expanding of existing grant schemes 2. Establishment of Fund for Equity and Mezzanine Investments and Co-investing scheme
Were the actions planned for 2016 implemented?	1. No 2. No
If yes/partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	It was planned that these measures would be implemented with the financial assistance granted under IPA2. The envisaged measures were not approved for funding under this instrument and therefore their implementation hasn't started.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	There was no actual cost.
	Measure 14: Establishing free trade area within CEFTA
Short description of actions planned for 2016	1. Negotiations on financial and transport services liberalization 2. Signing Protocol on Trade in Services 3. Signing Regional Additional Protocol on Trade Facilitation
Were the actions planned for 2016 implemented?	1. Yes 2. Partially 3. Partially
If yes/partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	Negotiations are underway to conclude a regional Protocol on Trade in Services by the end of 2016, where CEFTA countries should provide higher liberalization in services, business and professional services, tourism services, environmental services, communication services, construction services, distribution, educational and health services, financial services and transportation needs of the region. The procedure of ratification of the protocol will follow in 2017 and effective application will be in 2018.
Actual cost of implementation and	There was no actual cost in 2016.

impact on the annual budget (indicate deviation from estimated costs if any)	
	Measure 15: Application of the Regional Convention on Pan-Euro Mediterranean rules of origin
Short description of actions planned for 2016	1. Harmonization of protocols on rules of origin with EU, Turkey and the EFTA countries and the ratification of protocols on rules of origin
Were the actions planned for 2016 implemented?	1. Partially
If yes/partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	In order to better integrate in the global economy, Republic of Macedonia began the process of harmonization of Protocols for rules of origin for application of diagonal cumulation according to the free trade Agreements that Republic of Macedonia has signed with EU, European Free Trade Association States, CEFTA Parties and the Republic of Turkey, in line with the rules of the Regional Convention. The goal is to apply unified rules of origin. Republic of Macedonia adopted the Law on Ratification of Protocol 4 towards the Stabilisation and Association Agreement between Macedonia and the European Community and its members ("Official Gazette" no. 71 of April 11, 2016). Republic of Macedonia continues to harmonize protocols on rules of origin with the EFTA countries and Turkey, which is planned to be completed by the end of 2017.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	There was no actual cost in 2016.
	Measure 16: Upgrading the customs clearance facilities of road border crossings Tabanovce (IPA 2012) and Kafasan (IPA 2013)
Short description of actions planned for 2016	1. Preparatory activities for the implementation of the project to upgrade BC Tabanovce to be completed, required documentation for construction to be provided and a contractor for works and supervision of works to be selected. 2. Preparatory activities for the implementation of the project to upgrade of BC Kafasan.
Were the actions planned for 2016 implemented?	1. Yes 2. Partially
If yes/partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	1. Contracts published in May 2016 and contract signed in September 2016. Project implementation commenced in fourth quarter (October) of 2016. 2. Preparatory activities for the implementation of the project to upgrade BCP Kafasan under progress. Documentation for construction in final stage. Reform will continue in 2017
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	In 2016 there were no actual costs.
	Measure 17: Profiling of unemployed persons and designing an Individual Employment Plan 2 (IEP 2)
Short description of actions planned	Preparation of Individual employment plan and formulating individual employment strategy (IEP version 2) for unemployed people facing

for 2016	significant obstacles to employment. 1. Profiling of the first time registered unemployed people 2. Preparation of the Individual employment plan 2
Were the actions planned for 2016 implemented?	1. Yes 2. Yes
If yes/partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	As of 31.10.2016, the profiling of employability is done for 4.869 active job seekers, of which 1.893 are classified as unemployed with significant difficulties in hiring. Out of these, an IPV 2 is prepared for 1.635 persons. In 2016 this measure is implemented as pilot-measure, but it will continue as one of the ESA's regular activities. There was a process of full reconstruction of 12 employment service centers, which caused a short delay in the implementation of this measure in those centers. Also, ESA's staff was internally redeployed with more focus on the active employment services and measures.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	Actual costs in 2016 (up to October) were 26,600 EUR, while the estimated budget for 2016 is 37,317 EUR. The measure is financed from the annual budget.
Measure 18: Education and Qualifications for All	
Short description of actions planned for 2016	<ol style="list-style-type: none"> 1. Analysis and redefinition of existing qualifications and develop new qualifications based on the labour market needs 2. Establishment of Sectoral Commissions for qualifications 3. Harmonization of labor market with technical vocational education by developing curricula based on occupational standards and promote school - industry cooperation through grants to schools. 4. Establishing Skills Observatory 5. Reforming curricula, practical work, the cooperation of students and teachers at the 2- and 3-year vocational education and training, develop new occupational standards and qualifications standards. 6. Strengthening of cooperation between higher education institutions and the private sector, and vocational schools and the private sector to provide quality practical work of students and students in companies.
Were the actions planned for 2016 implemented?	<ol style="list-style-type: none"> 1. Yes 2. Partially 3. Partially 4. Partially 5. Partially 6. Partially
If yes/partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017	<ol style="list-style-type: none"> 1. Analysis and redefinition of existing qualifications and developing new qualifications based on the needs of the labor market (mid-June 2016) <ul style="list-style-type: none"> - Analysis of the survey and assessment of the labor market prepared for the process of reforming the curriculum for VET and Adult Education 2. Establishing Sectoral Commissions for Qualifications (continues in 2017) <ul style="list-style-type: none"> - Developing criteria for selecting the members of sectoral qualifications; - Election of members 3. Harmonisation of the labor market and the technical vocational education by developing curricula based on occupational standards and

If no, explain why not	<p>promote school - industry cooperation through grants to schools. (continues in 2017).</p> <ul style="list-style-type: none"> - An analysis is prepared - Occupational standards are prepared - A model for technical vocational education is being prepared - Selection of 10 pilot schools and companies that will cooperate - Cooperation has started <p>4. Establish Skills observatory (continues in 2017).</p> <ul style="list-style-type: none"> - Establishment of a system architecture of the Skills observatory. - Developed Web services - An updated alternative module for data exchange for institutions - The development of statistical reports available to the public is completed. - Private web portal is developed that consists of three modules: Administrator module, statistics module and alternative module for data exchange. - Data on completed high-school students are downloaded and a connection is made with the information systems of the following higher education institutions: University "Ss. Cyril and Methodius "- Skopje, University "Goce Delchev "- Stip University of Information Science and Technology" St. Apostle Paul "- Ohrid and the University" Ss. Kliment Ohridski "- Bitola. <p>5. Reforming curricula, practical work, cooperation of students and teachers at the 2- and 3-year vocational education and training, develop new occupational standards and qualifications standards (continues in 2107)</p> <ul style="list-style-type: none"> - Field analysis of required skills and qualifications is completed "Analysis of assessment and survey of the labor market prepared for the process of reform of the curriculum for VET and Adult Education" - Prepared documents (Methodology to ensure permanent harmonization and alignment of vocational education and training with the labor market, methodology for developing special programs for adults based on the needs of the labor market and guide the development and writing of learning results and their assessment) - Developed 60 standards for vocations - Starting the development of standards of qualifications <p>6. Strengthening cooperation between higher education institutions and the private sector, and vocational schools and the private sector to provide quality practical work of students and pupils in companies (continues in 2017)</p>
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	For the implementation of this measure a total of 5,065,635 euros were allocated in 2016, of which 2,002,635 euros from the state budget and 3.063 million euros from other sources (grants, donations, etc.).
Measure 19: Equal Education Opportunities	
Short description of actions planned for 2016	<ol style="list-style-type: none"> 1. Providing textbooks, free transport and scholarships to students <p>Students from rural areas and vulnerable groups of students, talented students or athletic students will be motivated to achieve better results.</p> <ol style="list-style-type: none"> 2. Equal and inclusive quality early learning and education 3. Creating new comprehensive educational strategy for the period 2016-2020
Were the actions planned for 2016 implemented?	<ol style="list-style-type: none"> 1. Yes 2. Yes 3. Partially
If yes/partially, include:	1. In 2016 following public calls were conducted to provide better education for all in the school year 2016/2017:

<ul style="list-style-type: none"> -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not 	<ul style="list-style-type: none"> - Awarding scholarships to students in the Sports Academy, - Awarding 150 scholarships for talented student-athletes from public and private schools, - Awarding 50 scholarships for students with special needs in public and private secondary schools, - Awarding 15 scholarships to students from secondary schools in the catering and tourism field, - Awarding 400 scholarships for social support of students from public and private schools, - Awarding 50 scholarships for talented students from public and private schools (45 scholarships for talented students from public high schools and 5 scholarships for students from private schools). <p>2. Public call was announced for awarding funds to organize activities in primary and secondary schools contributing to the development and promotion of multiculturalism, integration and inter-ethnic tolerance.</p> <p>3. A comprehensive education strategy 2017-2020 is in its final phase and its adoption is planned in 2017.</p> <p>The measure will continue in 2017 as a regular activity of the Ministry of Education and Science.</p>
<p>Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)</p>	<p>For the implementation of the measure in 2016, 32,637,000 euros were allocated, of which 30,777,000 euros from the state budget and 1,860,000 euros from other sources (grants, donations, etc.).</p>

Annex 2: Indicators for the Macedonian Economy in 2015 according to the Macroeconomic Imbalances Procedure of the European Commission

Monitoring economy using scoreboard indicators with indicative thresholds, under the EC Macroeconomic Imbalances Procedures⁸⁷ implemented in the EU member states may also be useful for monitoring the main areas of vulnerability of the candidate countries, and for understanding their extent of convergence towards the EU. The main indicators of this approach for the Macedonian economy in 2015, according to the given thresholds, are given below.

The Macedonian current account deficit, as a three-year moving average, in the period 2011-2015, is held below the minimum vulnerability threshold (-4% of GDP), i.e. ranges within the limits. The net international investment position of the country in the last five years is above the allowed threshold, which despite the moderate narrowing in 2014, again expanded in 2015 to -56.1% of GDP. However, it should be borne in mind that the net international position on the liabilities side also includes foreign direct investments, which make up nearly half of the increase in total external liabilities in the period under observation. In this light, when analyzing converging countries, because of the effect of foreign direct investment, under the EC's approach, additional indicators should also be considered, such as net external debt that covers only net debt instruments. At the end of 2015, the net external debt of the Republic of Macedonia was 24.8% of GDP (21.6% of GDP in 2014).

Indicators	Indicative thresholds		2011	2012	2013	2014	2015
	upper	lower					
External imbalances and competitiveness							
Current account balance (% of GDP, 3-year moving average)	-4	6	-3,8	-2,6	-2,4	-1,9	-1,3
International Investment position, net (end-year, % of GDP)	-35		-52,6	-55,1	-55,9	-53,3	-56,1
Real effective exchange rate (CPI-based, 3-year percent change)	-11	11	-1,4	-2,5	2,1	2,7	2,3
Share in the world export (at current prices, 5-year percent change)	-6		9,5	-13,6	2,9	8,4	19,9
Nominal unit labour costs (3-year percent change)		12	12,3	-1,0	4,1	3,3	4,6
Internal imbalances							
Real estate prices (annual change in %, deflated)		6	-10,3	-1,1	-6,1	-0,5	0,1
Credit flows to the private sector (% of GDP)		14	3,5	2,4	2,8	4,4	4,3
Private sector debt (% of GDP)		133	81,5	86,4	83,7	85,4	87,6
Public debt (% of GDP)		60	32,0	38,3	40,3	45,8	46,7
Liabilities of the financial sector (annual percent change)		16,5	9,6	9,9	4,9	7,9	8,4
Unemployment rate (3-year moving average)		10	31,9	31,5	30,4	29,3	27,7
Activity rate (3-year change in percentage points)	-0,2		0,5	-0,2	0,3	1,0	0,8
Long term unemployment rate (3-year change in percentage points)		0,5	-2,8	-0,8	-2,8	-2,5	-4,2
Youth unemployment (3-year change in percentage points)		2	-1,2	-1,1	-1,7	-2,1	-6,6

Source: National institutions, IMF, Eurostat; NBRM calculations using available data. However, some indicators do not correspond fully with the requirements under this approach. Shaded fields point to noncompliance with the threshold.

In the period 2013-2015, the three-year change in real effective exchange rate (REER) indicates moderate appreciation of about 2% (determined mainly by the NEER), which is within the allowable range. Export market share of the economy in the world exports, as a five-year change, after the fall in 2012 as a consequence of the crisis, registered an accelerated annual growth in the period 2013-2015. These developments reflect the improved export performance, considering structural changes in the economy in recent years. Nominal unit labor costs, as a three-year change, have been in the safe zone since 2011, and relatively stable in the last three years, registering modest annual changes. *In general, taking into account the arguments in the area of external liabilities, the analysis indicates solid trends in the external sector.*

Analyzing internal imbalances, the annual changes in banks' loans to the private sector are constantly below the threshold, despite the acceleration in the last two years (4.3% of GDP in

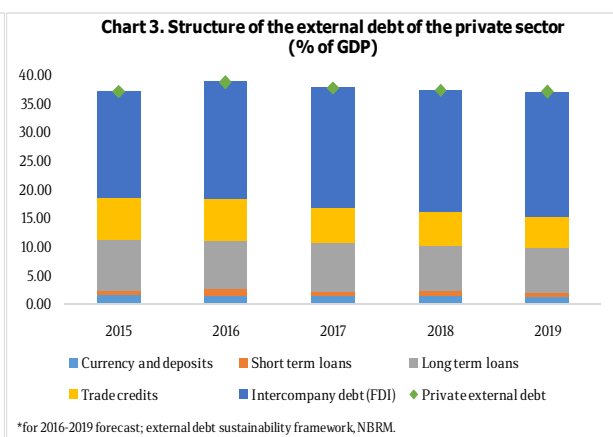
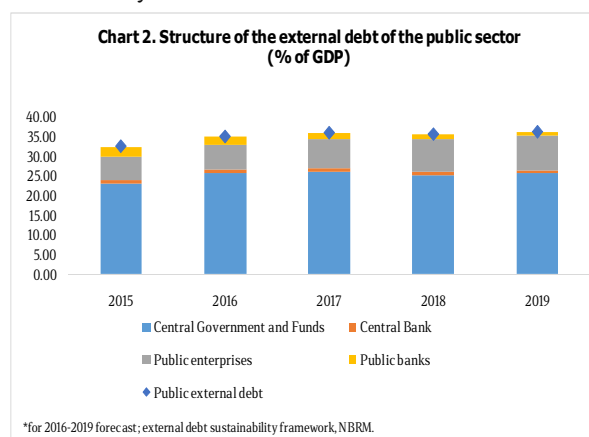
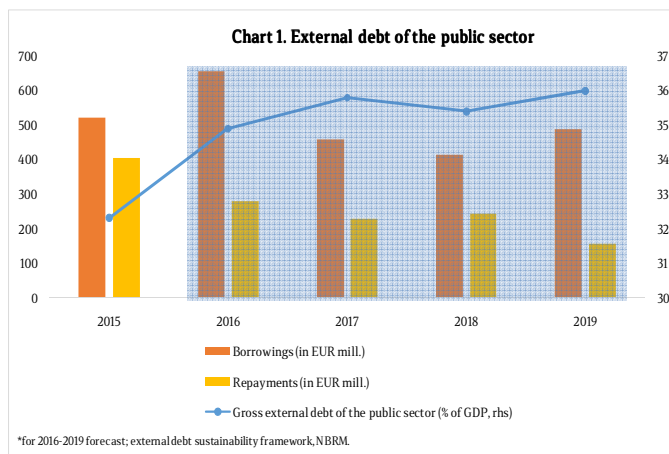
⁸⁷ Alert Mechanism Report, European Commission, February 2012.

2015). In 2015, financial sector liabilities accelerated and recorded an annual growth of about 8%, which is below the threshold (16.5%). In the period 2010-2014, real estate prices registered a negative annual growth, while in 2015, they remained almost unchanged. The total domestic and foreign debt of the private sector (loans from domestic banks and abroad) was also constantly below the threshold of vulnerability. In 2015, it composed 87.6% of GDP, which is significantly below the threshold of 133% of GDP, but it should be noted that in recent years, it has been increasing. Public debt is also below the threshold (46.7% in 2015, while the threshold is 60% of GDP), but constantly increasing. The unemployment rate, as a three-year moving average, although abating in recent years, has constantly been well above the threshold of 10%. Within the labor market, the indicators of activity, youth unemployment (aged 15 to 24) and long-term unemployment (unemployed for more than one year) have been monitored since 2015. These indicators of the Macedonian economy have seen positive changes in recent years (increased activity rate and reduced youth unemployment and long-term unemployment). *Hence, within the internal imbalances, the Macedonian economy shows vulnerability to the overall unemployment rate, albeit with favorable developments both in this indicator and in the additional indicators of this segment.*

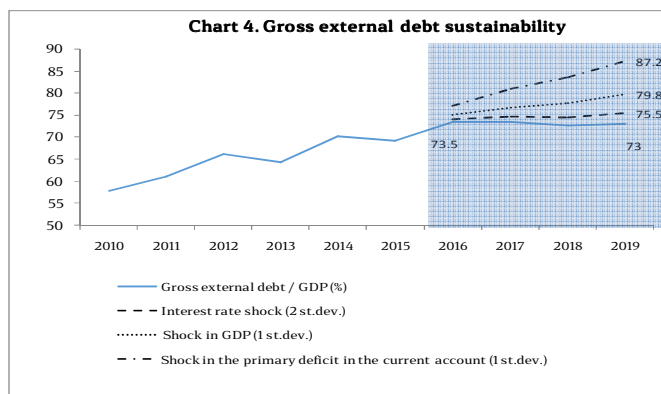
Annex 3: External debt sustainability analysis

The basic scenario of the analysis of the sustainability of the external debt⁸⁸, after the increase in the gross external debt in 2016 (estimated at 73.5% of GDP), indicates that in 2017 it would remain stable, while in the next period it will notice a slight decline (73% of GDP in 2019). The primary current account deficit (excluding interest payments) is the basic flow that creates debt. On the other hand, the automatic debt dynamics (which includes the effects of the real GDP growth and the changes in the prices and nominal effective interest rate) and non-debt capital flows act towards its reduction. The currency structure of the total external debt is relatively stable, with 80% of the debt denominated in Euros. The maturity structure is also stable, with long term debt composing close to 80% of the total external debt throughout forecasting horizon.

The expected decline of the external debt on a medium run by 2019, will come out from the reduction of the private sector debt (by 1.6 p.p. relative to 2016), while the external debt of the public sector would increase (by 1.1 p.p. of GDP relative to 2016). In the period 2017-19, relatively stable amounts of new withdrawals by the public sector are expected, while debt repayments will be higher in the period 2017-18 and lower in 2019. Within the external public debt, only the share of the public enterprises' debt to GDP is expected to increase, considering the expected borrowings for infrastructure projects, while within the private sector external debt only the intercompany debt relative to GDP is expected to increase by 2019.



⁸⁸Source: Calculations and analysis of NBRM, based on the IMF approach. The basic scenario assumes average GDP growth in the period 2017-2019 of 4% and it is based on the Fiscal strategy of the Republic of Macedonia and the presented balance of payments forecast, thus it is worth to point out that balance of payments statistic does not fully correspond to the external debt statistic.



The stress tests indicate that the expected debt dynamics on a medium run, is however, especially sensitive to shocks with the primary current account and the economic growth. However, the structure of the external debt is in favor of lower vulnerability, considering relatively high share of close to 40% in the overall forecasting horizon of trade credits and intercompany debt, as more flexible types of debt.

Annex 4: Contribution from consultations with stakeholders ERP 2017-2019

The Economic reform program 2017 represents a joint result from the collaboration among several institutions, and the overall preparation is coordinated by the Ministry of Finance.

Content of the Economic Reform Programme	Institution	Person in charge
1. Overall Policy Framework and Objectives	Ministry of finance	Andrija Aleksoski Vesna Cvetanova Bojana Ilievska
1.1. Measures taken to implement the targeted policy guidelines adopted at the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey in May 2016	All institutions in charge	
2. Macroeconomic framework		
2.1. Recent economic developments	Ministry of finance National Bank of the Republic of Macedonia	Nedzati Kurtishi Bojana Ilievska Lenche Tagasovska Violeta S. Petreska Aneta Krstevska
2.2. Medium-term macroeconomic scenario	Ministry of finance National Bank of the Republic of Macedonia	Nedzati Kurtishi Aneta Krstevska
2.3. Alternative scenario and risks	Ministry of finance National Bank of the Republic of Macedonia	Nedzati Kurtishi Aneta Krstevska
3. Fiscal framework		
3.1. Policy strategy and medium-term objectives	Ministry of finance	Maja Argirovska Verica Prokovikj Elena Trpkovska
3.2. Budget implementation in 2016	Ministry of finance	Branko Dimchevski Mara Srezovska Liljana Gjurovska
3.3. Medium-term budgetary outlook	Ministry of finance	Maja Argirovska Verica Prokovikj Elena Trpkovska Vukica Saveska Suzana Peneva Kristina Pavlovska Andrija Aleksoski
3.4. Structural balance	Ministry of finance	Nedzati Kurtishi
3.5. Debt levels and developments, analysis of below-the-line operations and stock-flow adjustments	Ministry of finance	Sanja M. Mancheva Dejan Nikolovski
3.6. Sensitivity analysis	Ministry of finance	Nedzati Kurtishi Dejan Nikolovski Sanja M. Mancheva
3.7. Fiscal governance and budgetary frameworks	Ministry of finance	Maja Argirovska Verica Prokovikj Elena Trpkovska
3.8. Sustainability of public finances	Ministry of finance	Nedzati Kurtishi
4. Structural reform priorities in 2017-2019		
4.1. Identification of key obstacles to growth and competitiveness	Ministry of finance	Andrija Aleksoski Vesna Cvetanova Bojana Ilievska
4.2. Summary of reform priorities	Ministry of finance	Andrija Aleksoski Vesna Cvetanova Bojana Ilievska

4.3. Structural reform priorities by area		
4.3.1. Public Finance Management (PFM)	Ministry of finance	Andrija Aleksoski Vesna Cvetanova Bojana Ilievska
4.3.2. Energy, transport and telecoms markets	Ministry of Transport and Communication Ministry of Economy MEPSO (Electricity Transmission System Operator of Macedonia)	Goran Temovski Biljana Zdraveva Jasminka Kirkova Ljupka Siljanovska Milica Karafiloska Andonov Jordan Angelovski
4.3.3. Sectoral development		
4.3.3.1. Agricultural sector development	Ministry of Agriculture, Forestry and Water Economy	Maja Lazareska Aleksandar Georgievski Aleksandar Mitrevski Lile Simonovska
4.3.3.2. Industry sector development	Ministry of finance	Bojana Ilievska
4.3.3.3. Services sector development	Ministry of finance Cabinet of the Deputy Prime Minister in charge of economic affairs	Bojana Ilievska Vesna Cvetanova Marija Pantikj Dane Josifovski
4.3.4. Business environment and reduction of the informal economy	Ministry of finance Ministry of Economy Ministry for information society and administration	Bojana Ilievska Desanka Zdravkovska Jasmina Majstoroska Suzana Kostadinovska Solza Kovachevska
4.3.5. Research and innovation	Ministry of Education and Science Fund for Innovation and Technical Development	Jasminka Janakieva Katarina Krecheva
4.3.6. External trade and investment facilitation	Ministry of finance Ministry of Economy Customs Administration	Vesna Cvetanova Bojana Ilievska Biljana D. Stojanovska Ilija Janoski
4.3.7. Education and skills	Ministry of Education and Science	Natasha Janevska
4.3.8. Employment and labour markets	Ministry of labour and social policy Employment Service Agency Ministry of Finance	Goran Veleski Biljana Zhivkovska Bojana Ilievska
4.3.9. Social inclusion, poverty reduction and equal opportunities	Ministry of finance	Bojana Ilievska
5. Budgetary implications of structural reforms	All institutions in charge	
6. Institutional issues and stakeholder involvement	Ministry of finance	Andrija Aleksoski Vesna Cvetanova Bojana Ilievska
7. Annexes	All institutions in charge	

Having in mind that for the last year's programme the European Commission acknowledged the efforts the Government is making in implementing reforms to improve competitiveness, the Ministry of Finance made additional effort to maintain and improve the quality of this year's document in accordance with the recommendations made by the Commission.

During the preparation of this program a consultation process with stakeholders was conducted at national level: the business community, the universities, ZELS, local authorities, social partners, civil society and other stakeholders. The consultation process was conducted in accordance with the ERP 2017 Guidelines.

An initial meeting with stakeholders was held on July 8th, 2016 with the following agenda:



Kick-off Meeting of the Economic Reform Programme 8 July 2016 AGENDA

VENUE:

Ministry of Finance
Dame Gruev br. 12
1000 Skopje, Republic of Macedonia

11:45 – 12 :00 Registration

12:00 – 12:30 Welcome and Opening Remarks

Mr. Kiril Minoski, Minister of Finance
Mr. Stefano Dotto, DG NEAR, European Commission
Mr. Jaromir Levicek, Delegation of EU in Republic of Macedonia

moderator **Mr. Andrija Aleksoski**, National ERP Coordinator

12:30 – 13:00 Lessons learned from the 2016 ERP Process followed by a roundtable discussion

Ms Vesna Cvetanova, Assistant Head of Macroeconomic Department, Ministry of Finance

Presentation of the Commission Assessment of ERP 2016 and Joint Conclusions of the Economic and Financial Dialogue followed by a roundtable discussion

13:00 – 13:30 The 2017 ERP guidance note followed by a roundtable discussion

Ms Bojana Ilievska, Head of Unit, Macroeconomic Department, Ministry of Finance

Presentation of the new version of the ERP Guidance note supporting the ERP 2017-2019 preparation process followed by a roundtable discussion

13:30-14:00 2017 ERP preparation process and support followed by a roundtable discussion

Mr Andrija Aleksoski, National ERP Coordinator, Ministry of Finance

Main milestones and key dates with a focus on the government internal coordination process, the consultation of stakeholders and options for additional technical support. Presentation of the individualised work plan and the support available from the OECD to help prepare the ERP 2017-2019 followed by a roundtable discussion.

In the period from December 27, 2016 to January 10, 2017, the draft ERP 2017 was published on the Ministry of Finance's website and at the same time, a public announcement and invitation were posted for the stakeholders to actively contribute to the process of the document preparation by

providing opinions on the document content and proposals for its improvement
<http://www.finance.gov.mk/en/node/6198>

On January 4th, 2017 a public debate among the institutions participating in the preparation of the document, representatives of the European Delegation in Skopje and the stakeholders was held in the Ministry of Finance.

The screenshot shows a web browser window displaying the public consultation page for the draft Economic Reform Program 2017. The page has a red header with navigation links: HOME, MINISTRY, PUBLIC FINANCE, MACROECONOMICS, TAXES & CUSTOMS, FINANCIAL SYSTEM, PFC, PUBLIC PROCUREMENT, LAWS AND REGULATIONS. The main content area is titled "Public consultation for draft Economic Reform Program 2017" and includes an invitation for public consultation. It mentions that the Government of the Republic of Macedonia would submit the draft ERP 2017 Reform Priorities to the European Commission at 31 Jan. 2017. The page also features a sidebar with a "MINISTER" section showing a portrait of Kiril Minoski, MA, Minister of Finance, and a "LINKS" section with various links including "КУПИ КУКА КУПИ СТАН", "Invest MACEDONIA", "GRANT FUNDS FOR RURAL INFRASTRUCTURE IPA", "Е-АУКЦИИ", "Е-ТРГОВИЈА", and "Mof Auctions".

During the consultations with stakeholders, the following opinions and suggestions were received:

Acad. Taki Fiti

PROMOTING THE RESEARCH AND INNOVATIVE ACTIVITY IN THE REPUBLIC OF MACEDONIA

In modern conditions, **research and development (R & D) and innovation** have a special importance to the economic dynamism and economic progress of the countries. Hence, improving the research and innovation performances of the Macedonian society is the highest priority for the future development.

Today, the Republic of Macedonia, according to the key indicators of the quality of the research and innovation process, drastically falls behind, not only in the highly industrialized countries, but also in terms of the EU average – 28. For many years the indicator for scientific and research intensity (the share of allocation for R & D in the country's GDP) manifests tendency of constant decrease and today it is just 0.22% of the GDP. According to this indicator, the World Economic Forum, among 132 countries ranked Macedonia in 111th place. The structure of allocations for R & D by sectors (business - sector, Government, higher education and non-profit sector) is extremely poor, with marginal participation of the business sector of only 0.04% and is atypical in regard to the situation in the developed countries. The research community of the Republic of Macedonia consists of around 2,400 scientific personnel (with a tendency of reducing this number) of which only 80 work in companies. The number of full-time researchers (Full-time equivalents), however, shows even a faster pace of reduction and today it has been reduced to 1.6 researchers per 1,000 inhabitants, which is 2 times less than Bulgaria, almost 2.5 times less than Croatia and 4 times less than the EU average – 28. According to the number of innovative companies, Macedonia falls behind 10 to 15 index points behind the EU average – 28. It conditions a low share in the exports of products with high technological content in the total industrial exports – only 3.1%, which is almost six times less than the European average. The number of employees in the service sectors based on knowledge (knowledge - intensive) in the total employment in Macedonia is 19% versus 33% in the EU. And according to other relevant indicators (registration and use of licenses and patents, number of scientific publications in renowned international journals, participation of the venture capital in the GDP etc.), Macedonia drastically falls behind the developed countries and the European average. Hence, it is understandable why the composite innovation of Macedonia is only 0.238 versus 0.544 of the EU.

Improving the situation in this crucial area to the overall development of the country, first, assumes drafting a complex and well-designed strategy for scientific and technological development of the Republic of Macedonia, accompanied by specific policies and measures for its implementation. It is a fact that in this sphere there isn't a lack of researches, analyses and proposal strategies (by domestic and international relevant research institutions) that diagnose the situation, weaknesses and challenges and that suggest policies and measures to overcome them. However, it is also a fact that there still isn't a consistent strategy for the future scientific and technological development of the country which, based on the existing research, will clearly define the priorities, policies, measures and carriers of activities in this domain. That strategy should be drawn from the domestic scientific potential, with the participation of representatives from the economy and government experts from the relevant departments and institutions.

Meanwhile, in the short and medium term, measures and policies are necessary that will mark and initiate a turnaround that must be made on this issue.

First, it is necessary the scientific institutions (academy, universities, research institutes and other scientific and research institutions, including the

scientific and research units in the enterprise sector) in dialogue with politics, to establish a clear dynamics for increasing the allocations for R & D in the GDP of the country. In a country with a level of development as Macedonia, the government and the higher education in the future will have a leading role in alimending the resources for R & D. Public assistance in the area of R & D is significant, because it directly contributes to strengthening the research capacity of the national research institutions, to encourage and facilitate their cooperation with the business sector and to intensifying their international cooperation. Macedonia, like many other countries, is faced with significant budget constraints and lack of resources. Nevertheless, in Macedonia there is room for serious cuts in the non-rational government spending (hypertrophied public administration, large unproductive costs for government buildings, furniture, monuments etc., large subsidies for non-productive economic sectors, etc.) and for the reallocation of these resources in the support to the research and development. For achieving this goal, we suggest: **a)** the dynamics of growth of allocations for R & D to be done before the dynamics of growth of the country GDP (that is the case in many countries in the world); **b)** the allocations of the budgetary funds for R & D to be treated as non-discretionary government “cost” – as, for example, the obligation for regular servicing (payment) of the public debt of the country. In this situation the government will have to meet the stated requirement for allocations of the budgetary funds for R & D that would ensure achievement of the planned objective (target), even in the medium term.

Second, in a situation of recession, governments apply expansionary fiscal policy (increase of government spending, lower tax rates or combination of both measures) in order to cope with the effects of the recession and to revive the economic activity. Experience confirms that during the Great Recession of 2007 - 2009, and the European debt crisis, half of the EU Member States have used the increase in the investment for R & D as a fiscal stimulus to the economy. This practice should also be applied by the Government of the Republic of Macedonia, because the allocations for R & D is an investment in the future and it is always a better solution than the governmental (unproductive) consumption.

Third, it is necessary MASA and the other scientific institutions, more than it was the case so far, through regional cooperation to appear as leaders or partners in the application of joint scientific projects financed by the European Structural Funds. It can make a significant contribution to the increase of the investments for R & D. The experiences of Slovenia, Estonia, the Czech Republic, Croatia and Malta, for example, confirm that these countries, more recently, have managed to substantially increase the investment in R & D thanks to the greater use of the European Structural Funds and the funds of the FP7 Program.

Fourth, the migration of young scientists of the country is a serious problem with devastating long-term negative consequences, because it comes down to losing the most creative part of the human capital. Here, we especially emphasize that there is an essential difference between the process of mobility of scientists within the international cooperation in the area of R & D, which is basically positive, especially if it is accompanied by a return of the personnel in the country (who have acquired new knowledge and have established communication with the colleagues from foreign universities) and the migration process followed with the “brain drain”. In order to prevent the loss of human capital, it is necessary in the country, within the dialogue

science - politics - economy, to establish a clear dynamics of employment of young high education personnel in all scientific institutions and the business sector. The best graduates, and holders of masters and PhD degrees should be provided an easy access to employment, to prevent the leaving of the country – especially the permanent leaving of the country.

Fifth, increase of the innovative activity of the business sector (enterprise sector) is of crucial importance to improve the research and especially the innovative performance of the Macedonian economy. In developed European countries, the business sector accounts for 60% to 65% in the allocations for R & D, versus 15% to 20% in our country. In the Republic of Macedonia, in recent years, the official statistics has seen some progress in the innovation activities of the Macedonian business entities. Namely, in the period 2010 - 2012, the 42.8% of Macedonian enterprises (small, medium and large – micro enterprises are not included in this analysis) apply some kind of innovation – technological (innovation of product or process), organizational and marketing. If trade sector and construction are separated from the surveyed companies, the number of innovative companies in the Macedonian economy is even lower and falls behind the European average by 10 to 15 points. For illustration, we will say that if Macedonian companies for research and development on average annually allocate between 4 to 6 million euros, that amount in the case of the companies in Slovenia, annually, is higher than 500 million euros. The increase of the incentives for the Macedonian companies for innovation requires to take a number of measures by the business itself, but also by the central government and local authorities. Among them, in particular, we will mention the following:

A) The strategies for research and innovative activities to improve the situation in the sector of enterprises often suggest to work on raising the awareness of managers and entrepreneurs for the benefit of innovation in business - innovations improve the quality of products and services, they reduce the production costs, they increase labor productivity, they improve the competitive advantage of companies and enable them to achieve economic, i.e. above-average profits. The campaigns of the government and its departments and agencies to promote the entrepreneurship, creativity and innovation, and beyond, the development of the entrepreneurial culture are useful for achieving this goal. These promotions, among others, need to focus on raising and improving the treatment and status of successful entrepreneurs, managers and innovators in society. In addition, scientific debates, round tables, conferences, etc. dealing with this issue, with the presence of businessmen, politicians and other stakeholders responsible for the situation in this sphere can significantly contribute to encouraging the companies to undertake innovative activities.

B) Numerous studies confirm that the intensification of the competitive pressure in the economy could play a key role in encouraging companies to innovate. This assumes a continued commitment to work on improving the investment climate in the country – construction of infrastructure, easier access of companies to commercial properties, preventing monopolistic behavior and misuse of the monopolistic positions of individual companies, transparency and fairness in the area of public procurements, elimination of corruption, abandoning the practice of involvement of politics in business, just and fair regulation of business and etc. Although Macedonia, in certain segments of the business climate achieved good results (introduced single-window system for companies registration, through the “regulatory guillotine” project numerous administrative and bureaucratic barriers associated with the entry of new firms in the sectors have been abolished, in the procedures on bankruptcy of

companies, etc., the procedures for issuing construction permits have been facilitated, the cadastral records of immovable property have been improved, etc.), new breakthroughs are required especially in dealing with corruption and in eliminating the involvement of politics (political parties) in the business. Involvement of politics in business has numerous modalities – division of companies by the ruling parties in “ours” and “theirs”, privileges of “our” companies in the operation (easy and regular access to the public procurements, exempting the companies of the control by the inspection bodies – tax, labor, health and similar privileges in court cases and protection of property rights, etc.), as opposed to the strict approach, discrimination and sometimes even a real “torture” of “their” companies. Such practice is detrimental to the business climate and the incentives for the companies to invest productively, to innovate, to expand businesses and to create new jobs. Therefore, this practice must stop because it undermines the foundations of the functioning market economy.

C) Improving the access of business to assets for financing their development is also exceptionally important for boosting the innovation activity of the companies. In this context, we emphasize that: the Macedonian Bank for Development Promotion (MBDP) as the only bank in full state ownership, from 1998 to date has played an extremely important role in the financing of businesses, especially in lending to SMEs and in support to the export of the enterprises. It has also contributed and further contributes to the increasing of the supply of the loan capital in the country and in reducing the interest rates on the capital market. Therefore, we suggest to perform an additional capitalization of the MBDP. The money from the budget that would be allocated for this purpose would be a good, productive government investment, because the operationalization of loans is mainly left to the commercial banks, which the resources to end users place under strict banking criteria. It is necessary within the MBDP to form a special fund for venture capital (as in the case of other state development banks in the world – such is the case with the German banking group KfW) whose main goal and task would be to support the highly innovative Macedonian companies in the start-up phase, but also in the higher stages of development. This would be a contribution of the Government towards the promotion of financing businesses through an official venture capital and beyond, through informal venture capital (business angels) who operate under the same principles as the official risk funds. We think that the establishment of the Fund for Innovations and Technological Development is a significant step forward, not only to facilitate the access to funds for the growth of highly innovative start-up businesses, but also to the promotion of new approaches in supporting the innovative activities of the Macedonian enterprises. It is recommended its capacity to be increased with governmental (budget) allocations of assets in future. Companies, however, have to be more agile and more committed on improving their own business plans and on developing a profitable and promising investment programs as an important condition for improving the access to funding from commercial banks.

D) Having in mind the significance of innovation in raising the performance of the operations of the companies it is important to design and conceptualize special tax breaks (as it is done many countries in the world) to encourage the innovative activity in the country. As a positive and instructive example in this area, of which Macedonia can learn, we indicate that of the Netherlands.

E) Strengthening of the ties and cooperation between the industry and science is crucial for raising the innovation activity in the business sector of our country. The starting point for intensifying the relations science - industry is the preparation of the scientific institutions (public and private) and of the consulting

companies in the country to offer new and applicable knowledge for the enterprise sector. In this context it is particularly important:

- Strengthening and enhancement of the institutional infrastructure, significant for the innovation activity – institutes, scientific and research centers, centers of excellence, business incubators and technology parks, clusters, centers for technology transfer, higher education institutions etc. There is no doubt that the public support to these institutions is very important – this was confirmed by international experience and, again, those are public investments with high long-term viability.

- The capacity of action of the scientific institutions, primarily is determined by the quality of the personnel that works in these institutions. More significant budget allocations for new employment of researchers in public institutions, and incentives for private research institutions which employ such personnel should become an integral part of the policies for support of R & D and the innovation activities in the country. Moreover, as mentioned, it is necessary to extremely facilitate hiring the best graduates, MDs, PhDs, etc., from different professions, to prevent the depreciation of human capital, to prevent the brain drain of these personnel abroad, and thus to prevent the great losses of the Macedonian society, because education of these personnel is associated with high social costs.

- More significant government support to research institutions is essential for strengthening their ties and cooperation with foreign scientific institutions (exchange of personnel, study visits and specializations at foreign institutions, knowledge transfer, etc.).

- Networking of scientific institutions is especially important because it allows the exchange and diffusion of information and knowledge

- Chambers of commerce can play a special role in the field of animation and fostering and encouraging businesses to greater cooperation with science, aimed at raising the quality of the innovation activity.



January 10, 2017

Dear Mr. Aleksoski,

Please find the attached AmCham Macedonia response to the draft 2017 National Economic Reform Program released for public comment on 29.12.2015. Please note that we have included both a Macedonian and English version to be used, as required.

I'd like to thank the Ministry of Finance for including the American Chamber of Commerce in Macedonia in the process of reviewing and commenting on the 2017 National Economic Reform Program. I'd also like to mention that to have greater inclusion of all relevant stakeholders toward creating a quality program that will address the current situation, it would be advisable to publish draft Programs on the National Electronic Register of Regulations (ENER), allowing them to be reviewed and commented on for at least 15 working days.

Given the limited time we had to comment on the Program, we have limited our feedback to just 3 subsections of the document (4.3.1 Public Finance Management; 4.3.4: Business Environment; and 4.3.7 Education and Skills). For the same reason, we look forward to continued dialogue with respect to the Program's implementation details.

Our general impression is that the measures included in the draft fail to address important challenges and therefore are unlikely to help the country meet its reform and growth goals. Specifically, we believe that the Program should include measures in the following reform areas:

- Ensuring all budget users increase the transparency and timeliness of payments owed the private sector;
- Fostering real, open and systemic dialogue with company representatives;
- Reducing the grey economy;
- Reducing regulatory confusion;
- Increasing the predictability, consistency and fairness of inspections;
- Increasing transparency and oversight of company appeal and complaint mechanisms;
- Ensuring para-fiscal charges, taxation and penalty policies are rational and fair;

- Making strategic investments in educational quality; and
- Encouraging internships in companies.

We hope you will receive these comments as constructive criticism aimed at producing a higher quality reform program. Please feel free to contact me directly, if you have any questions or concerns.

Sincerely,



Michelle Osmanli
Executive Director

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**American Chamber of Commerce in Macedonia response to
the draft 2017 National Economic Reform Program
released for public comment on 29.12.2016**

**Comments on Subsection 4.3.1.
Public Finance Management**

Though not explicitly stated as a desired goal of neither proposed reform Measure 1 nor 2, we would welcome any and all reforms aimed at increasing the transparency of the payment practices of budget users toward its private sector contractors, as well as their timeliness. Late payment by budget users toward companies here contributes significantly to liquidity problems in the country. Starting this year, the Law on Financial Discipline applies fully to all budget users, however there is no evidence that institutional payment practices have improved. Given the State's obligation to monitor itself in this process (up to and including fines issued to the Minister of Finance his/herself), transparency of public payment practices is a key missing element that needs to be addressed.

Another important reform along this line would be to define a standardize methodology in the Enforcement Law by which municipalities' reserved "operational funds" are to be calculated in enforcement proceedings and introduce other measures that prevent blatant and long-term abuse of private contractors who have delivered public works in good faith. The current Enforcement Law lacks a methodology by which judges determine the minimum level of "operational funds" necessary for municipalities to continue normal operations (Article 218). In practice, this means that private contractors who have delivered public works and proven their right in court to be compensated for their work, sometimes cannot realize this right. In essence, this exception allows municipalities to operate above the law, avoid settling past debts and continue normal operations, including issuing new tenders.

**Comments on Subsection 4.3.4:
Business Environment**

We agree that Government efforts to reform various aspects of Macedonia's business environment in line with assessments for the *Doing Business* Report and, to a lesser degree, the *Global Competitiveness Report* have raised the country's visibility as an FDI destination in the region. This is proven by an increase in Brownfield and Greenfield foreign direct investment and increased employment in such newly established operations. A limited number of bureaucratic processes have been tangibly improved, which has helped the businesses that utilize them.

Unfortunately, the measures included in the draft 2017 Program are limited to very small investment in a long talked-about e-government services portal (0.5 million EUR) and development of a national strategy related to SMEs (Measures 13-14). While we would echo the need for continued investment in e-government systems and adoption of a strategy to support SMEs, these measures cannot be considered fundamental reforms.

Instead, concrete and tangible reform is needed in a number of fundamental areas that would create positive change in the business environment overall. These reforms should include measures to:

- Foster real, open and systemic dialogue with industry via proper use of the National Electronic Register of Regulations (ENER), placing a moratorium on the use of the “short procedure” in Parliament and extending the standard public comment period.
- Reduce the grey economy by ensure enforcement institutions’ responsibilities are properly set, do not generally overlap with one another and that they are properly trained, equipped and motivated to tackle this problem systematically, throughout the territory of the entire country.
- Reduce regulatory confusion by ensuring official, consolidated legal texts are published more regularly, reducing conflicts between new laws and existing legislation, and requiring enforcement institutions to publish official, legally-binding guidance on the application of laws in concrete cases;
- General alignment of the tax (Corporate Income Tax and Value Added Tax) legislation with the requirements of the global digital transformation and alignment with the global taxation. This would contribute to the ease of providing electronic services and doing e-commerce in Macedonia, as well as to the overall transparency and revenue collection
- Increase the predictability, consistency, fairness of inspections by increasing the scope of the Inspections Council’s work, increasing the transparency of all State institutions that carry out inspections; increasing the transparency of fine issuance as well as instructional material to help companies increase their compliance, and eliminating incentives for inspectors to increase collections;
- Increase transparency and oversight of company appeal mechanisms; and
- Ensure Para-fiscal Charges, Taxation and Penalty Policies are Rational and Fair

Fostering Real, Open and Systemic Dialogue with Company Representatives

We applaud the inclusion of the following goals as part of the Measure 13: Adoption of a National Strategy for SMEs (2017-2022) with an action plan (2018-2020): “Improve policy-making and coordination”; “Simplify the legal and regulatory environment”; and “Strengthening and institutionalizing of social dialogue”. Real, open and systemic dialogue with company representatives must be a cornerstone of future Government efforts to improve the business environment.

The Government’s introduction of ENER was a commendable move toward increasing public comment on proposed legislation that has been recognized by many. Unfortunately, over time, the platform is rarely used by ministries to notify citizens of planned legislative changes, let alone as a tool to encourage open, 2-way communication. In the first half of 2016, 91% of all laws passed by Parliament were passed without any supporting materials being published in advance on ENER.

While selected companies and business associations are occasionally invited to action-oriented meetings with the highest government officials, the vast majority of companies operating in the country are systematically excluded from legislative and regulatory dialogue. This is because too many laws are being passed without any public comment period whatsoever. According to the Government’s work plan, the so-called “short procedure” is meant to be used only when proposed changes are not “complex and large”. Given the vagueness of this definition, this procedure is being used for all kinds of changes, reducing the effectiveness of parallel efforts that government bodies make to conduct dialogue with select representatives of the business community. In the first half of 2016, the short procedure was used for 80% of all laws and amendments adopted in Parliament. Meaningful public-private dialogue reform should begin with a moratorium on the use of the “short procedure” by Parliament.

Finally, even when it is respected, the minimum period of 10 calendar days for public comment confirmed by the government is simply too short to allow for thoughtful and constructive responses from company

American Chamber of Commerce in Macedonia response to the draft 2017 National Economic Reform Program released for public comment on 29.12.2016

representatives. Thus, an impactful reform would be to set a minimum *15 working day* public comment period for all proposed legislation and a 20 working day public comment period minimum for public comment on legislation proposed the summer and year-end periods.

Reducing the Grey Economy

We recognize significant government efforts since 2012 to decrease the operations of unregistered companies and particularly to punish those that fail to handle cash transactions and pay taxes in accordance with the law. However, we were surprised to see that the draft 2017 Program did not include any reforms necessary to further reduce the grey/informal economy. We believe that reform is needed to ensure enforcement institutions' responsibilities are properly set, do not generally overlap with one another and that they are properly trained, equipped and motivated to tackle this problem systematically, throughout the territory of the entire country.

The State Market Inspectorate (SMI) should be one of the country's most important enforcement institutions when it comes to tackling the grey economy. However, SMI has virtually no budgetary resources for computers, software, vehicles, storage of seized items or other fundamental tools that would enable it to properly carry out its mission. Also, the law requires an in-person response to every citizen complaint, regardless of the issue in question or transaction size. Further, due to a Government order, an average of 70% of inspections SMI carries out are to enforce non-smoking legislation and closing times. All of these factors severely limit the SMI's ability to tackle the grey economy.

Similarly, while proposed Program measures outline Government programs to support private sector innovation, research and development and similar, the current State Office of Industrial Property struggles to perform even it's most basic function of processing patent and trademark applications. In their 2015 annual report, SOIP reports receiving 5,357 applications for recognition and protection of trademarks in Macedonia, but issuing a total of just 614 decisions to recognize their rights (11%). In fact, this ratio has averaged about 20% in the 2003-2014 period. This means that a backlog of thousands of existing trademarks (many of them globally-recognized) have yet to receive basic recognition of their rights in Macedonia. We believe Government efforts to encourage innovation among local companies must begin by efficiently recognizing and protecting those that are already here.

Reducing Regulatory Confusion

In addition to a rapidly changing legislative and regulatory environment where companies are rarely involved in the policy-making process, companies working in Macedonia face a great degree of regulatory confusion caused by:

- The lack of Regulatory Impact Assessments (RIA) that consider impacts on the private sector as well as sufficient time for companies to adjust to new legislation;
- The lack of official, consolidated texts of all laws in force;
- Passage of laws that conflict with measures in existing legislation; and
- The lack of official information published by enforcement institutions on how laws are to be applied in specific cases.

Thus, we believe that reform targeting the reduction of regulatory confusion should include measures to address each of these issues.

It is common practice in Macedonia for Parliament to adopt laws that enter immediately into force upon being published in the Official Gazette. This means companies have virtually no time to adjust their systems, deliver

training to their employees or take other measures to comply with the law before it officially enters into force. We believe this is at least partly due to the fact that government RIAs do not take impact on the private sector into account (only State budget impact). The “grey zone” regularly created by this practice is further compounded by implementing legislation that is delayed by several months (such as is the case with the new Enforcement Law set to come into force on 1.1.2017). Thus, reform targeting the reduction of regulatory confusion should include measures that ensure companies are not held liable for complying with a new Law until its sub-laws have been duly published and a reasonable amount of time has passed, allowing companies to take measures to comply with those sub-laws.

Too often, companies are forced to work from unofficial versions of laws that are manually pieced together with amendments either by private service providers or company employees. This practice exposes companies to unnecessary legal risk and favors large organizations that have the resources to manage this difficult process. For example, the Law on VAT was not officially consolidated between the years 1999-2013, despite many amendments to it during that time. Similarly, a consolidated version of the Company Law has not been published since 2004. Thus, reform aimed at reducing regulatory confusion in Macedonia’s business environment should include the creation of a process that ensures that the responsible Parliamentary Commission publishes official, consolidated legal texts for general public use within 1 month of any and all amendments.

While the Secretariat of Legislation is tasked with ensuring new laws do not conflict with existing measures, this is happening on a regular basis. Reform is necessary to ensure the Secretariat has the appropriate resources, authority and influence needed to reduce the confusion created when laws conflict with one another.

Finally, companies are often in need of reliable official guidance on the application of laws to their concrete situation. Today, institutions with the authority to decide how a given regulation applies to a concrete company situation do not publish these opinions in that official capacity. This encourages uneven application and means that companies are not aware how the law is applied to similar cases, except in rare cases when companies seek an “authentic interpretation” from Parliament. Given the slowness of response and privacy concerns, this measure is rarely used. Companies are also discouraged from going this route by Parliament’s practice of rejecting such requests on the basis that the adopted laws are clear. Thus, reform should be made to require enforcement institutions to publish official, legally-binding guidance on the application of laws in concrete cases (excepting private entity data). This is particularly critical when companies have been punished for interpreting the application of the Law differently than enforcement institutions.

Increasing the Predictability, Consistency, Fairness of Inspections

Reforms targeting greater predictability, consistency and fairness of inspections would have a great impact on the local business environment. Such reforms would reduce unnecessary compliance risk for companies and increase their rate of proactive compliance. Specifically, reform is needed to:

- Increasing the scope of the recently-formed Inspections Council to all government entities that carry out inspections;
- Requiring State institutions that carry out inspections to publish materials online relevant for companies to understand their role and how to contact them with questions;
- Increase the transparency of fine issuance as well as instructional material for companies to increase their proactive compliance; and
- Eliminating all incentives for inspectors to increase collections from companies.

The creation of an Inspections Council with the goal of standardizing the work of all inspectorates was an important step in the right direction. However, the Council should include all State institutions that carry out

inspections (e.g., Public Revenue Office, Customs Administration). Also, it is critical that the Council work to identify and reduce overlap in the responsibilities of State institutions that carry out inspections.

Toward increasing general awareness of the number, type and responsibilities of the country's 28 State institutions that carry out inspections, each one must have a functional web site, where they will publish a relevant laws, sub-laws and internal procedures that are necessary for companies to understand their work and to be able to contact them with open questions. For example, today, the State Inspectorate for Agriculture doesn't have a single piece of information available online.

Another important reform would be toward increasing the transparency of the issuance of fines. If fines are to serve an instructive role to other companies, more data must be made available publically on which types of entities are being fined (e.g., size, sector, region) and for which types of offenses. Ideally, inspectorates would regularly publish case studies and other instructional materials on issues for which companies are commonly being fined, to help increase compliance.

Finally, inspectors must not be incentivized in any way to increase collections from companies. For example, UJP annual reports from at least 2007 mention "25% of revenues from discovered and paid taxes and interest" as a source of financing of the institution itself. We believe this constitutes a formal incentive for inspectors to find ways to increase collections, rather than simply ensuring the law is consistently applied as it was intended.

Increase Transparency and Oversight of Company Appeal and Complaint Mechanisms

To avoid creating a business environment where companies are considered guilty before being proven innocent, complaint and appeal mechanisms must be consistent, transparent and efficient. Thus, reform is needed to prevent abuse of companies by individual inspectors by increasing the transparency of institutional handling of company complaints and ensuring best practices are being applied. Such measures would provide internal and independent oversight of appeal mechanisms and publishing of detailed data on complaints received from companies. Important questions to be answered include:

- What portion of appeals to institutional decisions are fully or partially accepted or rejected?
- How often does the Administrative Court overturn a decision by a State institution?
- What steps are taken to ensure decisions of the Administrative Court are respected? and
- Are the disciplinary actions taken for abuse of public positions consistent?

As part of this reform, it's critical to increase the transparency of the work of the Administrative Inspectorate. In the absence of concrete information about the workings of this institution, companies doubt that it is carrying out its intended function.

Ensure Para-fiscal Charges, Taxation and Penalty Policies are Rational and Fair

A pillar of Macedonia's strategy to attract FDI has included maintaining comparatively low tax rates and a simple taxation system. However, no measures have been taken to prevent a corresponding rise in the myriad para-fiscal charges companies must pay. At least anecdotally, they seem to be on the rise. Thus, an important reform would involve first assessing then rationalizing para-fiscal charges levied at the national and municipal level. We believe this reform would allow companies to make much more accurate investment and operational cost estimations and enable policy makers to view future cost increases in an holistic context.

Currently, a tiny portion of the business community bears an extremely high portion of the tax burden. The economy's tax burden should be shared across all sectors in a more even fashion, to prevent reducing the

competitiveness of certain sectors. Thus, AmCham recommends that the country's tax structure be reviewed and reformed with the aim of spreading the country's tax burden as evenly as possible.

The recent amendment to Misdemeanor Law that reduced fines across a great number of laws was a step in the right direction, since fines had been consistently raised over the past several years without regard to their impact on companies of all sizes. However, penalty policies must be reformed more fundamentally with the goal of ensuring they serve the function of encouraging compliance. Specifically, the severity of misdemeanor fines must correspond to the severity of the offense, human/machine error must not be punished; companies that voluntarily identify and correct errors should not be punished; and enforcement officials must offer warnings and education to companies and allow time for corrective action before punishment is levied.

Comments on Subsection 4.3.7. Education and skills

We applaud this year's Program focus on educational qualifications as well as targeted assistance to the unemployed. Effective reforms in this area will focus on quality, not quantity and substance over form.

Namely, public investments in education have largely been limited to improvements in physical infrastructure and opening new schools and universities. While this is a very necessary activity in a country with aging public education infrastructure, public investment is equally needed in teacher training and the introduction of modern teaching texts and other learning materials. This is particularly necessary in technical and vocational education institutions, which are meant to produce tangible skills that are meant to align with the local labor market. While the very high graduation rate from the country's higher educational institutions is often cited as proof that the country's labor force is highly qualified, businesses working here generally agree that the skills gap is widening.

Further, we do not believe current Government reforms consider the importance of increasing the number and quality of company-based internship programs. The current regulatory approach to such programs is overly rigid; encourages superficial internships and forgeries; and unnecessarily depresses the number of quality internships offered in the country. Reforming the current legal framework to allow employers to create programs that are beneficial to both companies and interns would encourage a practice that imparts critical employability skills on workers and helps companies find the most qualified people for the job. Specifically,

- Companies should be allowed to engage non-students as interns without regard to their age or educational status (i.e., those formally excluded from internship programs include non-students who are not registered with the Employment Services Agency as well as anyone older than 27).
- Companies need a clear legal framework to guide their engagement of interns. Such a framework should include details such as the form of contract, maximum duration, remuneration, insurance, etc. Macedonia's current Labor Law is out of sync with its Law on Higher Education on the subject of internships. While Article 99 of the Law on Higher Education requires every university student in the country to complete at least 30 days of "practical work" per year during their studies, there is no recognition of this practice in the current Labor Law.
- Detailed official guidance is lacking on internship terms and conditions, resulting in inconsistent treatment of interns in the country (e.g., as volunteers, part-time employees).
- Companies should not be required to go through intermediary institutions (e.g., temporary employment agencies, the Employment Services Agency, individual faculties) to engage interns.

To address each of the above challenges, the Ministry of Education & Science and the Ministry of Labor & Social Policy should propose specific legal guidance that will encourage the practice of internships in the country.