

**Republic of Macedonia:
National Development Plan
2007 – 2009**

Skopje

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Chapter I:

Introduction

1.1. Why the NDP?

to strengthen consistency of structural and institutional with development oriented public investments; In the first 15 years of its independence, the Republic of Macedonia has made a significant progress towards becoming a politically and economically stable sovereign state. Integration of the country into the NATO and the EU, full implementation of the Ohrid Framework Agreement accompanied with decentralisation from central to local level, and coherent long-term development of the country that would include higher economic growth, job creation and poverty reduction are the key overarching goals which encompass all political elements of the country and enjoy the overwhelming support of the population.

Despite numerous shocks, such as the lost of the SFRY's market in early 1990s, economic sanctions against the FRY throughout most of that decade, the Kosovo refugee crisis in 1999, and the internal security crisis in 2001, the Republic of Macedonia has succeeded to maintain basic macro-economic stability. The economic policy mix chosen by the authorities in agreement with the multilateral financial institutions is based on a peg of the national currency to the euro accompanied by disciplined monetary and fiscal policy.

Until very recently, however, this stability in macro-economic policies was not accompanied by strong economic growth and job creation. The country is also characterised with persistently wide external imbalances which reflect both the significant import dependency and the relatively low export, the vulnerability of which is additionally increased due to the export's high concentration. Growth, employment and external sector weaknesses clearly indicate the need of complementing achievements in the macro-economic area with structural reforms aimed at improving the business climate and competitiveness. Intensification of these reforms will provide an environment where the country can reach its full growth potential and can raise the living standard of its population.

Ambitious structural reforms are also fully consistent with the country's efforts towards EU accession, and more specifically towards meeting the Copenhagen economic criteria. In order to meet these criteria, i.e., to establish itself as a functioning market economy that is able to withstand the competitive pressure of the EU common market, the country's production and exports will have to grow at high and sustainable levels. That, in turn, will require strengthened efforts to speed up transition, to improve the functioning of economic institutions, and to increase public investments in development oriented activities of the country.

to improve consistency of sectoral and topic-oriented programming documents in the area of public investments; Experiences show that in early years of the transition process – it is aimed primarily at macro-economic stabilization of the economy – economic programming is usually focused on macro-economic and fiscal programming of the country. The expertise required for this type of programming is typically provided by a rather small group of qualified economists from the core economic ministries and the central bank as well as from international institutions. As far as medium-term programming of investment requirements as well as of structural and institutional reforms is concerned, it has been typically done in these

countries on a fragmented basis only. Similarly as in most other transition economies, also in the Republic of Macedonia numerous sectoral or topic-oriented programming documents have been drafted over the recent years by national and international experts, and many of them have also been adopted by the authorities¹. Though these documents may well be of a good professional quality, if considered from a point of view of the sector or the topic concerned, they are often not fully integrated into the general development framework of the country that is of crucial importance for effective policy-making. More precisely, these documents are often not consistent with the country's institutional capacities and even more so with its public funding possibilities.

In order to integrate sectoral and topic-oriented programming documents there has been a growing need in the Republic of Macedonia for a consistent overall development strategy of the country. Several attempts have been made or are being made towards achieving this goal in the recent years. The first one of them was already in 1997 with the National Development Strategy of Macedonia prepared by the Macedonian Academy of Sciences and Arts. Later on, some other documents followed. The most comprehensive among them is the National Strategy for European Integration of the Republic of Macedonia from 2004. Though the document has a strong EU accession dimension, its chapter III provides a basic framework for the country's overall socio-economic development over the next medium-term period. More recently, a rather comprehensive program of economic reforms has been designed by the authorities within the framework of 3-year arrangements of the authorities with the two multilateral financial institutions, the IMF and the World Bank, in the second half of the 2005.

Last but not least, two other strategically important documents are at this moment under preparation of domestic and foreign experts. The first one, Blue Ribbon Report prepared under the auspices of the UNDP, was presented in ~~October~~ November 2006, while the other one, the Strategy for Sustainable Development of the Republic of Macedonia, should be completed by mid-2008.

to initiate programming of investments that is consistent with the EU multi-annual programming practice; Full integration into the EU is a strategic orientation of the Republic of Macedonia. In order to speed up this process the country should strengthen its overall process of transition. Experiences of the ten new members of the EU namely clearly confirm that the EU accession process is an extremely effective framework for accelerating the transition process of the candidate country and for making it resistant to competitive pressures of the EU market.

In December 2005, Republic of Macedonia obtained a status of a candidate country for accession to the EU. Along with the status, the country also received the second European Partnership modified and up-dated according to the findings of the Avis, presenting a list of short- and medium-term priorities for the country's preparations toward further integration in the EU.

There are two strategic documents that derive from the European Partnership (EP) and outline the government agenda in the process of EU integration. The first one is the Action Plan for

¹ For example, National Environmental Action Plan 1996, Health Strategy of R. Macedonia 2006-2015; Strategy on the Reform of the Judicial System 2004, or Spatial Plan of Macedonia 2004, National Development Strategy for Small and Medium Sized Enterprises 2006-2012

European Partnership which deals exclusively with the short-term priorities according to the five key recommendations from the EP and was recently adopted and presented to the international community. The second one is the National Programme for the Adoption of the Acquis (NPAA) which, de-facto, represents a comprehensive response of the Republic of Macedonia to the EP. The draft NPAA, adopted by the government in early 2006 and sent for comments to the Commission, represents a comprehensive overview of reforms and activities that will be carried out by the authorities in the next medium-term period. It basically outlines how the authorities envisage the Republic of Macedonia's approaching to the Copenhagen criteria. In addition to policy reforms to be designed and implemented in order to meet the political and economic criteria for accession to the EU, the document puts special attention to the administrative capacity and financial needs that are required to achieve these objectives.

to support preparation of programming documents required for the use of EU pre-accession funds; Similarly as in the case of other candidate countries before their accession to the EU, the Republic of Macedonia is entitled for the pre-accession assistance. According to the recently agreed multi-annual financial framework of the EU for the 2007 – 2013 period, the pre-accession aid will be channelled to the candidate countries through the so-called Instrument for Pre-accession Assistance (IPA). As an official candidate country, the Republic of Macedonia will be eligible for all five components of the IPA, namely for institution building, regional and cross-border cooperation, regional development, human resource development and rural development.

While programming for the first two IPA components, i.e., for institution building, including investment in EU compliance, and for regional cooperation, have been relatively well defined through the EP and the draft NPAA, there is for the time being no coherent strategy that would guide investment support of economic and social cohesion under the remaining three of the IPA components, i.e., for regional development, human resource development and rural development. Resources under these three IPA components are governed by the so-called programming principle. This means that a beneficiary country is requested to prepare a multi-annual program that will put the EU assistance into the general framework of the country's development and will ensure that both, the country and the EU development priorities and policies, are respected. In addition, minimum standards for implementation, management and financial control must be met in order to obtain financial support from the pre-accession funds.

In order to address this identified deficiency, the Republic of Macedonia has decided to prepare a National Development Plan (NDP) of the country for the three-year period 2007 – 2009. Together with the Multi-annual Indicative Planning Document (MIPD) and the Multi-annual Indicative Financial Framework (MIFF) both prepared by the Commission for the same 2007 – 2009 period, the NDP should be a backbone for drafting of the two types of the programming documents associated with regional development and human resource development components of the IPA². The first one, the Strategic Coherence Framework, should provide single a conceptual framework for the EU assistance provided under these two components and to prepare the country for using European Regional Development Fund, European Social Fund and Cohesion Fund. The second type of programming documents are so called Operational Programmes. These strategic planning documents are expected to outline "priority axis", i.e., global objectives to be achieved in a particular field, and "measures", i.e., means by which the "priority axis" are supposed to be implemented.

² For the rural development component of the IPA, a special programming document is expected to be prepared.

As stated by the Commission, preparation of the Strategic Coherence Framework and of Operational Programmes should be based on relevant development documents of a respective candidate country, including the National Development Plan, when available.

1.2. What is the role of the NDP within a family of national programming documents?

Successful implementation of a country's programming documents – either an overall development strategy or a sectoral/topic-oriented strategy – can be achieved only by applying an appropriate mix of instruments. The combination of the instruments applied varies within each of the areas of policy activities. While some of the instruments, like *institutional building* and *policy reforms*, are better suited to address effectively concerns in some areas (for example, efficiency of the state, fiscal reform, pension reform, etc.), other instruments, like *public investment*, can play a more important role in some other areas (for example, infrastructure development).

In contrast to overall or sectoral/topic-oriented strategies that are aimed at formulating the country's strategic objectives and at outlining policy activities that are required to achieve these objectives, the NDP should be considered as an investment “implementation” document focusing on the role of public investments that are needed to meet the stated objectives of the strategies. The NDP is therefore of crucial importance for medium-term planning of all development oriented investments of the country that are expected to be at least partially financed from public funding sources, domestic or foreign. Within this framework, it is of high importance for programming the EU financial assistance the Republic of Macedonia will be receiving from the IPA funds.

The NDP therefore does include all development/investment programs and projects to be implemented in the country as it does not take into account all those programs and projects that are financed entirely with funds from the private corporate sector as well as from the household sector. This means that some important segments of the overall investment activity in the country, including a large majority of private corporations' investments and investments in housing, are not covered by the NDP. In addition, the NDP does also not include all segments of public sector investments. It, for example, excludes those publicly (co)financed investments that do not qualify as development investments but are necessary for running a sovereign state, such as investments for the army, policy and internal security purposes.

1.3. What are the NDP's objectives and why it covers a 3-year period only?

Strategic objective of the NDP is to provide an overall framework for investments to be (co)financed from domestic and foreign public sources that will be consistent with overall development objectives of the Republic of Macedonia in the three-year period 2007 - 2009.

In more operational terms, the NDP has the following four objectives:

- To make a detailed assessment of the existing economic, social and environmental situation of the Republic of Macedonia from the point of view of its development gaps vis-a-vis the EU as well as from the point of view of the disparities among various geographical areas within the country;
- To formulate strategic and operational objectives of the NDP;

- To identify at the national level the key development/investment priorities that are needed for effective achievement of objectives stated above;
- To design a consistent matrix where development/investment priorities will be met with the country's financial capabilities. The matrix should be consistent with the country's macroeconomic and fiscal scenarios.

Like the EP and the NPAA, the NDP is designed as a living and evolving document. This means that the document will be updated from time to time so as to reflect developments and adjustments in the country's own development strategy, and in order to be consistent and compatible with the relevant planning and programming documents of the EU. Across the years, also the time horizon of the updated NDP will most probably be extended. There is no doubt that a NDP covering a five- or even seven-year period would be desirable. There have, however, been strong arguments in favour of drafting the first NDP of the Republic of Macedonia for the 3-year period only. First, administrative capacities within the country for drafting a medium-term programming document are rather limited. Experiences have shown that even 3-year period chosen for preparation of this NDP has sometimes been considered to be too long for financial programming. Through the "learning by doing" process carried out in the context of the 3-year NDP preparation the authorities have gathered valuable experiences and methodological skills that may be useful and necessary for programming exercise covering longer time horizon. Second, both documents of the Commission outlining the IPA multi-annual programming orientation, namely the MIPD and the MIFF, have a 3-year horizon. Third, in the context of the regional and human resource development components of the IPA, the Republic of Macedonia is requested to prepare two types of multi-annual programming documents, namely the Country Strategic Framework and Operational Programmes. In both of them, financial tables are expected to be provided for the same 3-year period as provided in the MIFF. Last but not least, first national programming documents of many new member states have been done for a 3-year period.

1.4. Structure of the document

In addition to this *Introduction*, the NDP consists of four chapters. The *second chapter* sets a stage for the whole document by presenting the current state of affairs in the Republic of Macedonia. The document first assesses the key factors currently contributing to economic, social and environmental disparities and development gaps both between the Republic of Macedonia and various sub-groups of the EU member states as well as among various geographical areas within the country. The chapter then continues with a SWOT analysis of the Republic of Macedonia providing a summarized view about the country's strengths, weaknesses, opportunities and treats.

Rather short *third chapter* outlines key objectives of the NDP, both strategic and operational ones, and continues with a brief presentation of the four national development/investment priorities that have been articulated for effective achievement of these objectives.

A far more detailed presentation and argumentation of each of the four national development/priorities of the NDP is the core of the *fourth chapter*. In the introductory part of this chapter, the development/investment priorities, they are all horizontal in their character, are discussed and analysed vertically, i.e., within the context of their relevance/importance for individual geographical areas of the Republic of Macedonia. Assessment of the development investment needs at the local level combined with an analysis of the existing situation of the

country at the national level, as presented in the Chapter 2, provides a strong case for determination of the four horizontal development/investment priorities. In the continuation of the chapter, each of the priorities is presented in methodologically same manner. The text starts with a brief presentation of specific concerns to be addressed with this particular development/investment priority, and continues with a formulation of objectives to be achieved by this priority, and by an explanation of its importance for reaching the strategic and operational objectives of the NDP. In the continuation, individual development/investment activity areas, each of them consists of various instruments, such as policy and institutional measures, technical assistance, investments, will be briefly outlined³. At the very end, public “investment needs” and envisaged sources of their financing, as specified by respective line ministries and by other relevant public institutions, are presented for each individual development/investment activity areas and for each year of the 2007 – 2009 period.

The *fifth chapter* of the NDP aims at matching development “investment needs” of the country to be (co)financed from public sources over the 2007 – 2009 period with the public “funds available” for these purposes. The starting point of this chapter is quantification of the NDP’s funding gap. This is the “funding gap” between the “investment needs” of potential public fund users, and the country’s public finances, of domestic and foreign origin, available for NDP investment purposes over the next three years. “Availability of funds” is based on the macro-economic, fiscal and public investment scenarios as outlined by the authorities. The text then continues with an identification and presentation of the criteria and benchmarks that have been applied in order to match the NDP’s investment needs with the funds available for these purposes. Based on these criteria and benchmarks the chapter ends with a proposed allocation of available funds among the four national development/investment priorities of the NDP and with the articulation of criteria to be applied to selection of individual projects/programs to supported with the NDP.

At the end of the text there are two annexes that summarize contribution from the 8 regions of the republic of Macedonia that have been prepared in the context of the NDP’s preparation.

1.5. Methodology of the work

Following the conclusion of the government of the Republic of Macedonia from May 2006, all activities associated with the preparation of the NDP have been carried as a combination of a “top down” and “bottom up” approaches. Partnership principle has therefore been applied in the process of the NDP preparation, especially by involving the local communities into the preparation of the document.

As far as the “top down” approach is concerned, the government has established two bodies. At the political level, the preparation of the document has been coordinated by the NDP Inter-ministerial Committee composed of high-ranking government officials at the ministerial level, of the governor of the Central Bank, of the director of the State Statistical Office, and the

³ Please be attentive on the distinction between (i) *a development/investment priority*, and (ii) *a development/investment activity area*. A *development/investment priority* talks above a broad area of intervention (corporate sector, infrastructure, human resources, agriculture), while a *development/investment activity area* is a specific set of interventions within a particular *development/investment priority*. Each *development/investment priority* consists of several interventions in *development/investment activity areas*.

director of Agency for Civil Servants. The NDP Committee has been chaired by the minister of finance. At an operational level, the responsibility for the NDP preparation has been entrusted to the NDP Secretariat. It has been composed of high-ranking civil servants and is chaired by a senior government official from of the Ministry of Finance.

UNDP has officially been asked by the government to support the preparation of the NDP. Its assistance has been provided through facilitation of the overall process, and communication stakeholders, especially at the local level. Further on, assistance of the UNDP has also been provided in the areas of technical expertise in identifying development/investment priorities, in collecting and systemizing large sets of data, mostly provided by the State Statistical Office, and in bringing to attention best practices in multi-annual investment programming from other countries. The NDP preparation process has also been substantially assisted by international and domestic experts.

Ministries and some other public sector institutions have been the main providers of inputs based on the “top down” approach.

On the one hand, the Ministry of Finance and the Secretariat for European Affairs have provided all the inputs that are necessary for determining the overall level of public funds available for development investment financing in the 2007 – 2009 period; the first one by outlining the three scenarios, macro-economic, fiscal and investment scenarios, as well as a public sector borrowing program for this period, and the second one by making an overall assessment of potential funds to be tapped by the Republic of Macedonia from bilateral donors.

On the other hand, all the line ministries and some other public sector institutions have been asked to provide inputs, including financial tables with development/investment needs, to be integrated into the document. In order to get the inputs from the line ministries in a form that would be as useful as possible for drafting of the document various methodological tools have been applied. They included specially designed standardised “Request for Contributions” with templates, workshops either with one ministry or with a group of ministries, and numerous bilateral meetings of the core drafting team members with the providers of the inputs.

As far as the “bottom up” approach is concerned, the key substantive contribution has been provided by the UNDP structure established at the local level throughout the whole territory of the Republic of Macedonia. Based on a “Request for Contributions from municipalities” specially designed for local communities, the UNDP has collected inputs from 71 local communities of the country. Based on information provided by local communities, the UNDP associates have prepared standardised reports for each of the eight statistical regions in the Republic of Macedonia. These reports include, first, the regional SWOT analysis, second, presentation of key development/investment priorities for the region, and third, identification of individual development investment projects and programs and their financial quantification. In Annexes 1 and 2, a summary of these reports is presented.

An assessment of the inputs received from the ministries as well as from regions has confirmed that they vary enormously both in terms of their comprehensiveness as well as the quality of data and analysis provided. This can be at least partly attributed to extremely short period time that was available for preparation of the NDP. Besides, the 3-month period between mid-May and end August has also coincided with the timing of regular parliamentary elections (in July) and with the top vacation period for the administration (August).

Chapter 2:

The current economic and social context: disparities and development gaps

2.1. Economic and social position of the country

2.1.1. General description of the country

Macedonia is a small country, with 25.713 sq. km. and a population of about 2 million. It is also a landlocked country, located in the midst of the Balkan Peninsula, bordering one EU member state in the South - Greece with a mainland border 246 km long, one EU [member state candidate country](#) in the East - Bulgaria with border 165 km long, Serbia (including Kosovo) in the North (232 km) and Albania in the west (151 km).

Macedonia has a diversified topography, with high hills and deep valleys attractively cut and surrounded by mountains, picturesque rivers, large and small natural lakes, spas and it is renowned with its rich biodiversity. The highest point is the top of the mountain Korab, with a height of 2.764 m. Macedonia has three large natural lakes, in the south of the country: Ohrid, Prespa and Dojran. Ohrid is the deepest lake in the Balkans (285m). The largest river Vardar traces the country roughly in the middle in a North-South direction. Macedonia's cultural sites and treasures have a distinct position in the world heritage.

Several significant transport routes connect Macedonia with Central and Eastern Europe and with South and South-East and beyond. The basic infrastructure of the country is relatively well established and it can be viewed as a good basis for further modernization. Half of the territory – 49 per cent – is agricultural land, while forests account for additional 37 per cent of the territory.

According to the last census of 2002, Macedonia has 2.022.547 inhabitants, with an average density of 78.5 residents per sq km, around 60 per cent of which live in urban areas. The capital of the country is Skopje, located in the northern part of the country. Other larger cities are Bitola, Kumanovo, Prilep, Tetovo. The city of Ohrid is the most prominent tourist place in the country, renowned for its natural and cultural uniqueness, for which it has been awarded a status of UNESCO city. The country is administratively divided into 84 municipalities and the city of Skopje, as a separate entity, composed of ten municipalities.

Being a small country Macedonia has a relatively open economy with foreign trade accounting for over 90 percent of GDP, thus it is vulnerable to external developments and has suffered their negative impact several times since the Country's independence. The country has now stabilized and is well advanced in its economic reform agenda process. Still, there are things to be done in the process of enabling and improving business environment in order to attract private investors and start creating more jobs through private sector led growth.

Macedonia's over-encompassing goal is to join the EU. It was the first country in the region to sign a Stabilization and Association Agreement (SAA) with the EU in April 2001, while in December 2005 the Presidency of the European Council awarded Macedonia a candidate EU member state status.

The estimated GDP per capita at purchasing power parity in Macedonia in 2005 was around EUR 6.000, which is only 26 per cent of the EU 25 average, slightly behind Romania, Turkey and Bulgaria.

2.1.2. Macro-economic developments

GDP growth and its structure

After the initial transition-induced recession which started in 1991, Macedonian economy started to grow again in 1996. However, between 1996 and 2003 the growth rate was rather poor, partly as a result of various external shocks. With an average annual rate of around 2 per cent the country's growth performance was below that one in a large majority of other transition economies. In 2004 and 2005, however, the growth has been accelerated to around 4 per cent /year as shown in Table 2.1.

Table 2.1.: Main Economic Indicators

	2000	2001	2002	2003	2004	2005*
GDP (USD million)	3,588.0	3,437.0	3,769.0	4,631.0	5,368.0	5,766.0
GDP (USD million) – PARE method	3,588.0	3,706.0	3,872.0	4,119.0	4,298.0	4,519.0
GDP per capita (in USD)**	1,380.0	1,321.9	1,449.6	1,781.2	2,064.6	2,163.5
GDP per capita (in EUR)***		1,887.0	1,981.0	2,025.0	2,128.0	2,277.0
GDP per capita (EUR at PPP)***	...	5,000.0	5,210.0	5,350.0	5,650.0	6,000.0
GDP per capita (USD at PPP)**		4,478.0	4,907.4	6,035.7	7,014.2	7,462.0
GDP per capita (USD) PARE method, 2000 as base year	1,771.0	1,821.0	1,917.0	2,032.0	2,114.0	2,219.0
GDP Growth Rate %	4.5	-4.5	0.9	2.8	4.1	3.8
Inflation (annual average; %)	5.8	5.5	1.8	1.2	-0.4	0.5
General Government budget (in % of GDP)***						
-Revenues		34.4	34.9	33.4	33.2	32.7
- Expenditures		40.8	40.0	34.5	33.2	32.5
- Deficit (-)/Surplus (+)		-6.3	-5.0	-1.1	0.0	0.2
Exports (USD million)	1,323.0	1,158.0	1,116.0	1,367.0	1,676.0	2,041.0
Imports (USD million)	2,094.0	1,694.0	1,995.0	2,306.0	2,932.0	3,228.0
Trade Balance (USD million)	-771.0	-536.0	-880.0	-939.0	-1,256.0	-1,187.0
Current Account (USD million)	-75.0	-235.0	-358.0	-152.0	-415.0	-81.0
Current Account (as % of GDP)	-2.1	-6.8	-9.5	-3.3	-7.7	-1.4
External Debt (as % of GDP)	39.9	41.0	43.1	44.9	44.6	40.1
FDI (USD million)	175.1	440.7	77.7	94.3	150.1	120.0
FDI per capita (USD)	87.6	220.4	38.9	47.2	75.1	60.0
FDI (as % of GDP)	4.9	12.8	2.1	2.0	2.8	2.1
Foreign currency reserves**** (in million USD)	699.5	755.6	725.3	903.4	975.3	1,324.7
Foreign currency reserves/average monthly import of goods f.o.b. and services, in months ****	3.7	4.7	4.0	4.3	3.6	4.4

* Preliminary data; ** Own calculations; *** WIIW Research Report; **** NBRM

Source: State Statistical Office, Ministry of Finance, NBRM

On the other hand, Macedonia permanently had stable macro-economic position, characterized by low inflation, stable exchange rate of the Denar, conservative fiscal policy of the authorities, growing international reserves which, accompanied with the recent intensified structural and institutional reforms, allowed Macedonia to enter into a period of a higher and sustainable economic growth.

Looking at the Macedonian GDP from the European perspective, the country belongs to a group of countries with lowest per capita GDP expressed in PPP terms. As Table 2.2. shows, it was in 2005 equivalent to only 26 per cent of the EU-25 average. At the same time, Macedonian per capita GDP is similar to the levels achieved in the neighbouring countries. It is very similar to that one Bosnia and Herzegovina, higher than in Albania and Montenegro, and little bit lower than that in Serbia.

Table 2.2.: Per capita GDP and GDP growth rates of selected transition economies

	EU 25 countries average=100	GDP per capita (EUR)			GDP per capita (EUR at PPP)			GDP Growth Rate		
	GDP p.c. at PPS in 2005 **	2003	2004	2005	2003	2004	2005	2003	2004	2005
Czech Republic	72.9	7933	8540	9773	14860	16000	17360	3.6	4.2	6.1
Hungary	60.8	7263	8031	8714	12890	13630	14260	3.4	5.2	4.1
Poland	49.8	5013	5327	6385	10210	11060	11690	3.8	5.3	3.4
Slovak Republic	55	5434	6287	7082	11290	12010	12910	4.2	5.4	6.1
Slovenia	79.8	12458	13105	13675	16510	17930	18720	2.7	4.2	3.9
Bulgaria	32.1	2258	2515	2771	6470	6920	7530	4.5	5.7	5.5
Romania	34.7	2420	2805	3665	6520	7290	8140	5.2	8.4	4.1
Croatia	48.8	5906	6397	6972	9980	10610	11450	5.3	3.8	4.3
Macedonia	25.7	2025	2128	2280	5350	5690	6000	2.8	4.1	3.8
Turkey	30.7	3028	3416	4040	5810	6520	7210	5.8	8.9	7.4
Albania		1669	1945	2140	4250	4640	4860	5.7	6.7	5.3
B&H		1642	1796	1961	5500	5780	5990	3	6	5.5
Montenegro		2311	2456	2600	5140	5460	5790	2.3	3.7	4.1
Serbia		2251	2419	2583	5170	5790	6300	2.4	9.3	6.3

* Preliminary data ** Source: Eurostat

Source: wiiw Research Report

The structure of economic activities in Macedonia changed substantially during the transition period. The share of industry dropped considerably, from around 45 per cent in the early 1990s to around 25 per cent in 2005. With around 60 per cent share, services are now dominant in the structure of the GDP, with major contributions coming from trade, transport, and telecommunications. Agriculture still accounts for 12 per cent of GDP.

In contrast to 2004, when industrial production had negative growth, in 2005 it was the major driving force behind intensifying economic activity. The projections for industrial growth in that year were at a level of 5 per cent while actual figure was much higher (7 per cent). Although most of the industrial activities were growing, still the highest growth rates were registered in the traditional export oriented branches: basic metals (with a growth rate of 33.4 per cent), construction materials industry (21.4 per cent), food industry, petrol industry, production of electronic machines, etc. Other sectors of the economy also demonstrated high growth in 2005. This was in particular the case with the trade (growth rate of 7.9 per cent), but also with the transport and communications (6.1 per cent), tourism (6.6 per cent) and

financial sector. The only industry showing negative growth in 2005 was construction, due to the delayed start of the construction of some large infrastructure projects.

On the expenditures side of the GDP, the 2005 growth was mainly pulled by the final consumption, which was dominated by the increased private consumption (increased wages, transfers and private loans) and had annual growth of 4 per cent, net exports which accounted for 2.8, while imports accounted for 1.5 percentage points in the overall GDP growth. The contribution of gross investments was negative by 0.3 percentage points.

Inflation

A very notable success of Macedonian economic policy soon after the transition started was the stabilization policy, which resulted in a substantial reduction in inflation in a relatively short period of time, and was successfully maintained at a stable and predictable single-digit level since. Inflation measured through the CPI (since 2000), averaged 2.3 per cent p.a. in the period 1996-2004. Monetary policy and its proper coordination with the fiscal policy and wage policy significantly contributed to reaching and maintaining price stability. The stable exchange rate of the Denar against the Deutsche Mark (and the Euro since 2002) was a positive consequence of the policy of macro-economic stability, and it has been permanently maintained at a stable level since 1994 (except for the correction of the foreign exchange rate of 16 per cent in 1997, as a result of the significant aggravation of the balance of payments).

Unemployment

One of the main weaknesses of the Macedonian economy is the continuously high level of unemployment. It is due to the relatively poor economic growth in the period until 2003 as a result of the inefficient privatisation process, the implemented macroeconomic policy mix (the de facto fixed foreign exchange policy combined with prudent monetary and fiscal policy), and other structural problems. The employment rate in Macedonia had a declining trend, from the start of transition process until 2004. The negative trend was stopped and reversed in 2005, when the number of employed was 4.4 per cent higher than a year before. In addition to the somewhat increased economic activity, the update of the database of the unemployed person, the fight of the labour inspectorate against unregistered employment and the new more flexible labour regulation were the main factors for the change. Around 57 per cent of the employees in 2004 are employed in the private sector, what is a 20 per cent increase in comparison to the year 1997.

In spite of these facts, the unemployment rate remains at an unacceptably high level. According to the Labour Force Survey conducted by the State Statistical Office, it was 37.3 per cent in 2005. Some of the structural patterns of the unemployed are the following (i) The gender structure of unemployed (59 per cent men vs. 41 per cent women) corresponds entirely with the gender structure of the active population (60 per cent men vs. 40 per cent women). (ii) 47 per cent of the unemployed were in the 25–49 age group, whereas the unemployment in the youngest group of less than 25 years was 20 per cent. (iii) The dominant education level in the unemployed group are persons who have completed secondary school and the ones who started but have not completed high school (58 per cent). This group is followed by groups of persons with primary education (21 per cent), with high education (14 per cent), and finally with no education (7 per cent). (iv) The duration of the unemployment status tends to be very

long - around 2/3 of the unemployed persons maintain the status of unemployment for more than 4 years.

The Government has continuously conducted several policies and programs to fight with this large problem. Yet, the results were missing until the last year. The recently adopted Law on Labour Relations is regarded as a very flexible law that is expected to encourage growth, investment, and a gradual shift in employment from the informal sector to the formal sector, with a concomitant strengthening of workers' rights. Further results in the strengthening the labour market flexibility are expected to come with the establishment of alternative dispute resolution mechanisms, and a renegotiation of collective agreements and other similar, especially active labour market measures. These could rebuild the skills of the unemployed, and screen out those who register as unemployed but work in the informal sector.

Foreign trade liberalization

The fact that Macedonia is a small country makes foreign trade relations a very important part of its development matrix. In this respect, EU integration is unanimously understood as an additional driving force to increase the capability of Macedonian economy for achieving economic development under competitive conditions in the Common European market.

From the very beginning of the transition, the Republic of Macedonia has consistently implemented a policy of external economic openness and liberalisation. Macedonia has signed 10 free trade agreements, of which 8 are bilateral (5 SEE Stability Pact states, Ukraine and Turkey), and 2 are multilateral (with the EFTA states and the SAA with the EU). Macedonia has signed a Memorandum of Understanding on Trade Liberalisation and Facilitation with other SEE states. In April 2003, the Republic of Macedonia became the 145th member of the World Trade Organisation (WTO), and in 2005 Macedonia became also a CEFTA member.

The liberalisation of the foreign trade regime of Macedonia was, to a great extent, implemented according to WTO principles even before Macedonia achieved the membership in this organisation. The process resulted in a continuous reduction in tariffs and the acceptance of a harmonized tariff system.

Signing of the SAA in 2001 represented a big step towards getting closer to the EU trade regime. Under the terms of the SAA, most Macedonian goods are already benefiting from access to the EU market, free of duties and quotas. In return, the Republic of Macedonia has already begun to remove its existing trade barriers on EU products, under a variable timetable of between five and ten years, for different groups of goods. With the most recent enlargement of the EU in 2004, the trade regime between Republic of Macedonia and the EU was adjusted through an Enlargement Protocol of the SAA.

In 2001 intensive activities were initiated to improve the efficiency of the customs system and all customs offices in the country were linked. The Laws on Standardisation, Metrology and Accreditation have been adopted, as well as the technical requirements for product compatibility and conformity assessment. Other activities are also in the process of being conducted for the adaptation of the national legislation: establishing compatible institutions to apply the New Approach directives and harmonised standards for free movement and safety

of industrial products; provision of information in the field of standards and technical regulations; electro-magnetic compatibility; general and technical safety, etc.

Public finances

Public finances of the Republic of Macedonia are consolidated in the general government budget of the country. In addition to the central government budget, it includes the core budget, budgets of self-financing activities, and also loans and donations to central budget users, and local communities' budgets, the consolidated general government budget incorporates also the budgets of four extra-budgetary funds, namely of the Pension and Disability Insurance Fund, the Health Insurance Fund, the Employment Agency, and the Regional and national Road Fund.

Republic of Macedonia is known as a country that runs very cautious fiscal policy with low levels of central budget and general government deficits. The country has gone through a significant fiscal consolidation over the past three years. The central budget deficit was reduced from 5.3 per cent of GDP in 2002 to only 0.1 per cent in 2004 and a small surplus of 0.3 per cent of GDP was achieved in 2005. With respect to the general government budget, the deficit of 5.6 per cent of GDP in 2002 was almost eliminated in the last two years. Implementation of a prudent fiscal policy created conditions for higher elasticity of the monetary policy what resulted in a decrease of the Central bank bills interest rate (as a referent interest rates of the economy) from 10 per cent at the beginning of the 2005 to around 5 per cent at the end-November 2006, as well as in the credit to private sector growth of around 25 per cent on annual level. These positive fiscal developments have contributed to positive review of the country by major credit rating agencies.

In 2003 the Government initiated a Strategy for the development of the government securities market. The strategy was a basis for a start of a continuous issue of government securities. In 2004 the Ministry of Finance started the first issue of 3-months' government bills and by the end of 2005 it has regularly issued 3, 6 and 12-months' government bills and 2 years' government bonds and it has also issued a 5 years' bond. In 2006 is, in addition to these, issued 3 years' government bonds. The interest rates of these securities have been determined freely on the market, based on the demand and supply and the interest rates have been constantly decreasing since.

Besides establishing the primary market of government securities, the Ministry of finance and the National Bank of the Republic of Macedonia supported the development of the secondary markets of government securities by setting-up an infrastructure for trading on the Over-the-Counter (OTC) markets. Namely, the National Bank of the Republic of Macedonia adopted rules for trading on the OTC markets and established a system for electronic interbank trading with short-term securities⁴ (Tenfore) as well as a system for settlement in real time. The new infrastructure enables market participants to conclude and settle transactions with low costs and in real time, creating an environment for better liquidity management. Also, the National bank of the Republic of Macedonia adopted General Repo Agreement as a legal framework for concluding repo transactions with government securities aiming to improve monetary operations and liquidity management of market participants, as well as to enhance the liquidity of government securities markets.

⁴ The system for electronic trading is in process of up-grading in order to enable trading with government bonds.

Current account position and its components

Although some improvements have been achieved in recent years, external imbalance continues to be another weak side of the Macedonia economy. The current account balance of Macedonia is in permanent deficit, averaging 5.5 per cent of GDP in the period 1993-2005. In the last year of this period, the deficit was much smaller than in previous years and amounted to only 1.4 per cent of GDP. A high increase of exports of 22 per cent was one of the components contributing to this positive development. The exports increased because of intensified industrial production led by growing external demand. The highest export growth rates were registered in the following branches: steel, mineral fuels, tobacco, and food and beverages. As far as imports is concerned, its growth rate was 10 per cent in 2005 due mainly to the increased costs of the energy; electricity and oil. They contributed 70 per cent to the country's import growth in that year.

The current account developments of the Republic of Macedonia are decisively influenced by its trade component. The country's trade balance has been in a continuous deficit throughout the whole transition period (except in 1992), reaching a level of over 50 per cent of the export value in some years. In the 2000 - 2005 period the trade deficit was on average equivalent to 20 per cent of GDP. As long as the export performance is concerned, its main feature is its high concentration (the Herfindal-Hirschman export index for 2005 is 0.251). Two product groups - iron and steel and textile - account for around 50 per cent of the total export. Besides, much of the export is import dependent, since it deals mainly with products, the production of which is adding value to semi-finished products and imported raw materials. On the import side, petrol and petrol derivatives accounted for 14.8 per cent of the total imports in 2005. It is expected that the increased import costs of petrol, and the increased import of electrical energy in 2006 will have contributed to an increased trade deficit in this and the following years.

It is worth noting that the EU member states are the dominant trading partner of Macedonia. In 2005, 53.1 per cent of the total exports went to the EU member states, with 45.5 per cent of total imports coming from this group of countries. Other developed OECD countries accounted for 9.2 per cent of exports and for 7.3 per cent of imports. For EFTA countries, the shares were 0.4 per cent on the export and 2 per cent on the import sides. Exports to East European states participated with 6.6 per cent in the total exports and 25.6 per cent in total imports 25.6 per cent. For the states of the former Yugoslavia the corresponding figures were 29 per cent for exports and 11.2 per cent for imports.

A very significant characteristic of Macedonian exports is that a considerable component of most export products is the cheap domestic labour and that the most important factor of the existing export competitiveness of the Macedonian economy lies with the relative low price level, rather than on other more distinctive competitiveness factors. This is why the strengthening of the competitiveness of Macedonian economy has been recognised as being a very important goal of the Government's economic policies.

In comparison to other transition countries, Macedonia has in most years of the 2000 – 2005 period over-performed the South-eastern European countries' average, and was more volatile than the all transition countries' average:

Table 2.3.: Current account position in transition economies (in % of GDP)

Country/ Group of countries	2000	2001	2002	2003	2004	2005
Macedonia	-1.9	-7.1	-9.5	-3.2	-7.8	-1.4
South-eastern Europe average*	-5.5	-7.3	-9.6	-8.8	-9.3	-9.3
All transition countries' average *	-3.1	-4.1	-4.4	-5	-5.5	-4.1

* Unweighted average for the region

Source: EBRD: Transition Report Update, May 2006; NBRM

Private transfers (remittances) have been constantly in surplus and they have been constantly financing the negative trade balance, covering in average 60 per cent of the trade balance deficit. In average, they have accounted for 11.4 per cent of GDP in 2001-2004, but in 2005 they increased to a level of 17.4 per cent of GDP. This growth was among the highest in the region. According to the IMF data, this level is higher than the level of countries which traditionally have high levels of private transfers (Serbia and Albania, around 14 per cent in 2005, Bosnia and Herzegovina, Bulgaria almost 10 per cent, Croatia 4 per cent)⁵. The increase in private transfers is explained by the increase in the foreign currency cash conversion, particularly the one exchanged in exchange offices.

Capital account and its components, including FDI

In line with the commitment accepted in the SAA, Macedonia started with the first phase of its capital account liberalization already at the end of 2002. In addition to FDI, short-term and long-term trade credit transactions, short-term and long-term financial transactions and non-residents' portfolio investments on the domestic capital markets were fully liberalised. This opened the possibility for a continuous inflow of foreign portfolio investments, especially from the last quarter of 2004. In 2005 they amounted to 49 million EUR what is equivalent to 1 per cent of GDP. Of this total, 44 per cent were investments in shares and 57 per cent investments in state bonds. At the end of 2005, the participation of foreign investors in the overall turnover of Macedonian Stock Exchange was as high as 32.6 per cent on the buy-side and 10 per cent on the sell-side. In order to protect the economy against short-term speculative capital flows this phase of the capital account liberalization was accompanied by introduction of specifically designed policy measures. In the next, i.e. second phase of the capital account liberalization, a liberalization of portfolio investments in both directions will be completed, together with the real estate transactions of residents abroad. The free opening of the residents' accounts in foreign banks is after the second phase of the SAA is completed.

Though portfolio investment is getting more important, FDIs are expected to be the main source of the current account deficit financing. An analysis of the FDI inflows into Macedonia over the last fifteen years confirms a rather weak performance of the country in this area (see Table 2.4). According to the State Statistical Office and the National Bank of the Republic of Macedonia, the cumulative value of FDI in the Republic of Macedonia starting from 1991 to the end of 2005 amounts to USD 1,3 billion, or to USD 660 per capita. In 2006, the FDI inflow figure was higher than in any of previous 4 years mainly as a result of a large scale privatization of the distribution electricity company. The company was sold to the foreign strategic investor and the FDI generated through this privatization amounted to 225 million EUR.

⁵ IMF Country Report No. 06/188, May 2006.

Table 2.4.: Foreign direct investment in Macedonia (in million USD; in % of GDP)

Year	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 (I-VII)
Volume	30.7	128	32.8	179	445	81.0	97.5	163	112	319
Share in GDP	0.8	3.6	0.9	4.5	11.9	2.2	2.1	3.1	1.8	

Source : NBRM

As shown in Table 2.5., Macedonia is lagging behind other countries in South-East and Central Europe as an FDI destination.

Table 2.5.: Foreign direct investment in transition countries

Country/Group of countries	Cumulative FDI inflows 1989-2003 (in USD million)	Cumulative FDI inflows per capita 1989-2003 (in USD)	FDI inflows per capita (USD)		FDI inflows (in % of GDP)	
			2002	2003	2002	2003
Macedonia	1,002	501	38	47	2.0	3.0
South-eastern Europe	31,276	664 ⁶	72	141	3.3	4.7
All transition countries	220,626	928	157	103	5.0	4.3

Source: EBRD: Transition Report 2004

The inflow of FDIs into the Republic of Macedonia has been generated primarily through the privatisation process with “Greenfield” investments still being more exception than a rule. In terms of the origin of investors, Hungary figures as the most prominent investor country. Other major investments originate from Greece, Austria, Cyprus, Switzerland, Great Britain, Slovenia, the Netherlands and Germany. Most of the investments were made in services, telecommunications, electric energy, banking and insurance, foods and beverages production, metals industry, oil refinery.

The balance of payment projections of the FDIs forecast that FDIs as percentage of GDP should slowly increase in the forthcoming years reaching 4 per cent figure in 2009. Yet, privatisation-led FDI can no longer be expected to play a dominant role in attracting FDIs, even though sales of some large utilities are still in the pipeline. They include ELEM, energy generating company, Macedonian Railways, Macedonian Post Office, and probably some public institutions in the social sector, for example, in the healthcare sector.

Hence, in order to improve the overall business and investment environment in the country, and more specifically, to make the country more attractive FDI destination, to overcome the

⁶ The improved FDI performance in 2005 and especially in 2006, with the privatization of FDI, increases Macedonian cumulative per capita FDI inflow figure to around USD 800, which will probably be a better than South-Eastern European average according to this performance criterion.

natural low attractiveness of the Macedonian small market and to reduce the perception of the country as a destination risky for investment, Macedonian authorities have designed and put into operation a wide set of politic measures. For instance, a one-stop-shop for the companies' registration is operational as of January 1 2006. This specific measure is just one among many structural and institutional reforms that are aimed at attracting more FDIs in the coming years. The country plans to have a more structured investment promotion activity and the EU candidacy status is a good pillar to assist in these efforts.

In August 2003 the Government of the Republic of Macedonia prepared a Programme for the Promotion of Investments in the Republic of Macedonia, whereby, in accordance with basic international principles for good business environment, the national priorities have been elaborated. In the process of creating transparent legislation and a stable investment environment, the Government of the Republic of Macedonia, in cooperation with the appropriate body of the World Bank (FIAS), has prepared an extensive analysis of the administrative barriers faced by investors. The analysis confirmed the already known position of foreign investors, that for them, the elimination of administrative barriers is much more important than extensive fiscal and other financial incentives. For that purpose, a Steering Committee has been established, in order to help eliminate the barriers to investment, through the implementation of the FIAS recommendations, which have been incorporated in an action plan that represents a programme for reform of the economic business environment, identifying the responsible bodies and timeframe for its implementation.

The promotional activities of the Republic of Macedonia for attracting foreign direct investments are still not sufficiently systematic, synchronized and efficient. After many years' preparations an Agency for promotion of investments MakInvest started working in January 2005. This institution needs to have a much stronger financial enhancement and programs for its capacity building are also projected. A new Programs for investment promotion will be prepared on permanent basis.

With the objective to support FDI inflows, the Republic of Macedonia has also signed Agreements on the Mutual Protection and Promotion of Foreign Investment with a number of countries, including most SEE and EU countries, as well as Agreements for the Avoidance of Double Taxation. FDIs in Macedonia enjoy "national treatment". The tax burden in Macedonia is favourable, with Corporate Flat Income Tax at 10 per cent, Personal Flat Income Tax at 10⁷ per cent, total Social Contributions at around 32 per cent of salaries, and VAT rates at 18 per cent and 5 per cent. There are also a number of investment and tax incentives for FDI and for investment no matter its origin.

External debt and access to international financial markets

Macedonian economy has maintained a relatively low level of debt, with the external debt averaging 40 per cent of GDP and this is the level expected in the following years. The World Bank, i.e., IBRD and IDA, are the largest creditors. The external debt of the private sector is increasing in line with the liberalization of the credit transactions and in 2005 it amounted to 22.1 per cent of the total long-term external debt. The banks' loans from abroad, amount to 24.5 per cent of the total private sector debt.

⁷ Starting 2008, but during 2007, Profit Tax and Personal Income Tax are 12 per cent

In December 2005 the first Eurobond was issued. The bond was worth 150 million EUR, with 10-year maturity and with a 4.625 per cent yield in December 2005. In comparison with comparable 10-years' bonds, Macedonia achieved relatively good interest rate. The demand for the bond amounted to 593 million EUR, quadrupling the amount offered. The rating of the bond was BB+ by Fitch and Standard and Poor's. The proceeds of the bond were used for repayment of the 221 million USD debt to the London Club of creditors due in January 2006. Public debt of the Republic of Macedonia amounted to 41.9 per cent of GDP at the end of 2005.

Foreign exchange reserves

The gross foreign exchange reserves have been constantly increasing, and by the end of 2005 they amounted to 1.123 billion EUR, or 4 average months' of the following year imports and at the end of 2006 they reached amount of 1.416.7 billion EUR, or 4.6 average months' of the following imports for 2007. In August 2005 Republic of Macedonia concluded a Stand By arrangement with the IMF, and the first tranche of EUR 12 million was withdrawn. According to the IMF arrangement the Central bank will provide for an average coverage of more than four months' imports of goods and services of the following year and this level should be maintained in the next three years. This notable increase in reserves has allowed the NBRM to cut interest rates significantly, from 10 percent in November 2005 to around 5.5 per cent by end-January 2007.

Investment climate reform

The investment climate will be supported by radical tax and customs system reform:

- introduction of a flat rate tax with a single tax rate for income tax and profit tax in two stages. Deadlines: January 2007 to 12%, January 2008 to 10%;
- zero tax rate for reinvested profit;
- elimination of politically motivated inspections by the State revenue office;
- unconditional fight against tax evasion;
- harmonization of the bases for payment of the income tax and social contributions. Deadline: 31.12.2007;
- organizational changes and complete computerization of the Public revenue office database. Deadline: 31.12.2006;
- full introduction of fiscal cash registers in legal entities throughout the country. Deadline: 30.06.2007;
- introduction of a much simpler tax payment system for small companies and micro companies with low income and profit. Deadline: 31.03.2007;
- a return of VAT in a maximum of 30 days. Deadline: 01.01.2007;
- customs revenue will be increased through rigorous, but simplified scanning with modern and sophisticated equipment and professional customs office management.

Furthermore, following reforms will be implemented in order to improve the business environment:

- expedient, three-day company registration procedure with minimum number of administrative procedures;
- reduced corruption and bureaucracy;

- a more efficient and competitive financial system;
- simple and transparent tax system;
- functional real estate registry that regulates real estate, etc.

2.1.3. Determinants of economic growth and international competitiveness

Maintenance of the macroeconomic stability is a necessary but not a sufficient condition for achieving accelerated and sustainable economic growth. If the country wants to safeguard past gains in macroeconomic stabilization and at the same time increase economic growth and employment, and reduce the external imbalance as its main economic objectives, it will have to intensify structural and institutional reforms. Although progress has been achieved in many segments of these reforms and are reflected in improved indicators, Macedonian growth and structural changes lack dynamism and energy. This is especially the case when compared with some other, more fit-to-growth economies among the transition countries.

Table 2.6.: Transition indicators for the Republic of Macedonia and some other transition economies⁸

Country	Private sector share of GDP mid-2004 (EBRD estimate in %)	Enterprises			Markets and trade			Financial institutions		Infrastructure reform
		Large-scale privatisation	Small-scale privatisation	Governance & enterprise restructuring	Price liberalisation	Trade & foreign exchange system	Competition policy	Banking reform & interest rate liberalisation	Securities market & non-bank financial	
Macedonia	65 ↑	3+ ↑	4	2+	4	4+	2	3-	2 ↑	2
Albania	75	2+	4	2	4+	4+	2 ↑	3- ↑	2-	2
BiH	50	2+	3	2	4	4-	1	3- ↑	2-	2+
Bulgaria	75	4 ↑	4-	3-	4+	4+	2+	4- ↑	2+	3 ↑
Croatia	60	3+	4+	3 ↑	4	4+	2+	4 ↑	3-	3 ↑
Serbia	50	2+	3+ ↑	2	4	3+	1	2+	2	2
Slovenia	65	3	4	3	4	4+	3-	3+	3-	3
Romania	70 ↑	4- ↑	4-	2	4+	4+	2+	3 ↑	2	3+ ↑

Source: EBRD Transition Report 2004

With a strategic orientation of relying on exports as the principal driver of sustainable economic growth, improvement of the country's international competitiveness is becoming an issue of crucial importance. Experience shows that the insufficient external competitiveness of Macedonian goods and services is to a large extent caused by unfavourable export structure leading to absence of an appropriate supply response. Consequently, the need to enhance the competitiveness of Macedonian economy has again brought to attention that medium-term agenda of policy measures should be focused on strengthening and intensification of the structural reforms, among which the labour market reform, judiciary reform, improvement of the institutional capacity, i.e. improvement of the public sector management and efficiency, and further development of the financial sector. These reforms should lead to improvement of the business climate and to result in attracting of foreign direct investments

A good assessment of the of the existing competitiveness capabilities of the Republic of Macedonia is the first National Competitiveness Report prepared by the National

⁸ The measurement scale for each individual indicator ranges from 1 to 4+, with 1 representing little or no change from the beginning of the transition process and 4+ representing a standard that is in place in a mature market economy.

Entrepreneurship and Competitiveness Council of Macedonia and published in December 2005. The report also provides a list of priorities and key recommendations for upgrading the competitiveness of Macedonian economy. Among the key recommendations addressed by this Report are the following: (i) to intensify the structural reforms in the country, together with intensification of the transfer of responsibilities from national to local economic levels; (ii) to support (through upgrading the institutional infrastructure) the development of innovations, of technology transfer and of “knowledge-based companies”; (iii) to prepare technology development policy of Macedonia; (iv) to reform the education system towards creating work-force which will meet the needs of businesses, and to integrate the education with the needs of businesses; (v) to implement fully the European System of Transfer of Credits in the universities in Macedonia and to create a system of life-long learning and vocational training of employees, (vi) to stimulate further inflow of FDIs, (vii) to stimulate the entry of foreign large banks on the market, and so on. The implementation of those and other recommendations will create the background for a medium-term upgrading of the competitiveness of Macedonian economy having in mind the realization of country’s comparative advantages.

The intention of this sub-chapter is two-fold: First, to analyse the situation, problems in particular, of the major determinants of the Macedonian competitiveness. It includes the competitiveness of the corporate sector as well as competitiveness of the environment in which this sector operates. Financial sector, judiciary and overall business environment, labour market and human resources, economic infrastructure is of particular importance in this context. And second, to analyse strengths, weaknesses, opportunities and threats of Macedonia's development potential and (iii) finally, to set the target development scenario for the 2001-2006 period. These are the basis for setting the NDP's objectives in Chapter 3.

Enterprise sector competitiveness

It is well known and confirmed in numerous international comparative studies/surveys that the overall international competitive position of Macedonia is rather unfavourable. In one of the most recent international competitiveness rankings, the 2005 Growth Competitiveness Index, the Republic of Macedonia was ranked at 85th position among 117 countries. It is not only that all Central European countries are ranked much higher than Macedonia, but also that many countries of the South-East European region perform better in this respect. In fact, only two countries of the region are ranked lower, Bosnia and Herzegovina (95) and Albania (100).

Table 2.7 presents some basic competitiveness indicators of the Macedonian economy in the 2000 – 2005 period. From this Table the following determinants of the country’s international competitiveness position can be observed: (i) investment in machinery and equipment is correlated with the increase of the industrial production with one year lag (investment in previous year leads to increased industrial production, except in 2000/2001 due to the crisis), (ii) labour costs are also positively correlated with the increase of industrial production (in years of decreasing labour costs per unit of industrial production, industrial production increases), and the same is true for productivity, (iii) domestic prices of industrial products are not systematically correlated to increase of industrial production, and (iv) world prices of most important Macedonian export products (which were increasing in the period observed) are strongly positively correlated to increase of industrial production and to rise of exports. All these observations point to the same conclusion - that international competitiveness of the Macedonian industrial production and exports is highly price (or cost) sensitive.

Table 2.7.: International competitiveness indicators of the Macedonian Economy**Some Competitiveness Indicators of Macedonian Economy**

	2000	2001	2002	2003	2004	2005
(% change to previous year):						
Industrial production	3,5	-3,1	-0,8	6,6	-2,1	7,0
Investment in machinery and equipment	20,8	-16,9	16,4	-7,7	4,9	4,9
Productivity	6,0	0,5	3,0	13,1	3,9	2,5
Labor costs per unit of production	-4,7	-0,7	0,2	-10,3	0,7	-0,5
Real labour expenses per unit of production	-12,5	-2,7	1,1	-10,1	-0,4	-4,4
Nominal net wages	5,5	3,6	6,9	4,8	4,0	4,5
Real net wages	-0,3	-1,9	5,0	3,6	4,4	2,0
Domestic prices of industrial products	8,9	2,0	-0,9	-0,3	0,9	3,2
World prices of most important export products (in USD)						
* Nickel	8.638	5.945	6.772	9.629	13.823	14.744
* Copper	1.813	1.578	1.559	1.779	2.866	3.679
* Lead	45	48	45	62	89	98
* Zinc	113	89	78	83	105	138
* Cold-rolled steel sheets	387	299	328	445	607	733
* Hot-rolled steel sheets	296	217	249	320	603	633
* Lamb meat	262	291	330	388	481	443
Exports (in mill USD)	1.321	1.153	1.112	1.359	1.674	2.041

Source: Bulletin of the Ministry of Finance, Jan./Feb. 2006

Some other more detailed analyses⁹ of the Macedonian manufacturing exports add some more light on its competitiveness position. These analyses suggest that the competitiveness problem reflects a specialization pattern. In the period 1995 to 2004, Macedonian export share increased in sectors whose share in total world manufacturing exports have declined; in branches such as textiles, clothing, iron and steel. Since these branches are losing share in the world manufacturing trade, Macedonia's share in the total world exports has fallen as well. Low FDI levels compared to the rest of the region may also be a reason of this pattern of focusing on non-dynamic sectors.

With different dynamics, Macedonia has been pursuing enterprise sector reforms aimed at strengthening its competitiveness position throughout the transition period. Similarly as in other transition economies, the corner stone of the reforms have been privatisation, sometimes including restructuring of state-owned firms, and promotion of SMEs.

Privatisation, including restructuring; Privatisation of the Macedonian economy has been carried out for a period of a decade and a half, completing the ownership restructuring in more than 95 per cent of Macedonian socially-owned enterprises. By the end of 2005, the privatisation process was completed in almost 1,700 enterprises (out of the total portfolio of the former Privatisation Agency of approximately 1,750 enterprises). At the beginning of the privatisation process the priority of the Government was to sell enterprises as they were, without their special prior restructuring. As the process was developing and as it was becoming obvious that some enterprises would not be able to get sold without certain pre-

⁹ IMF Country Report No. 06/188, May 2006

preparation, the Government's focus was turning more to restructuring of industries and even specific enterprises. There were several restructuring programmes in place, the first one having started in 1995 and encompassing 25 large loss making enterprises and the finalizing steps of the last programme are being currently implemented. The Privatisation Agency has completed its mission and it had been liquidated in 2005. Its remaining assets, liabilities, staff and activities have been transferred to several ministries and other government institutions.

Privatisation of the agricultural sector contained a large element of pre-privatisation restructuring, by virtue of the preparation of large agro-industrial combines to be sold separately along different product lines. In addition, 15 per cent of the land belonging to the large agricultural companies was offered for sale to the private farmers, with the objective to stimulate the land market in the country.

Financial sector has also been subject to special privatisation programme, and some of the banks went through a massive rehabilitation process. The Government already started tendering the remaining shares in the commercial banks, with the exception of Postal bank and the Macedonian Bank for Development Promotion.

In addition to the privatisation of the socially owned enterprises and banks, several public utilities, or social sector institutions have also been subject to privatization. The privatisation of public utilities was initiated by the sale of Macedonian Telecommunications – upon its being spun off from the larger state owned Macedonian Posts and Telecoms. Of the remaining shares amounting to 47 per cent of the company's equity still owned by the state, around 10 per cent were sold in the first half of 2006, while the remaining are going to be sold after liberalization of telecommunication market. The new Law on Electronic Communications, adopted in 2005, will enable easier entry of new operators and service providers through simpler administrative procedure. Further on, in March 2006, a part of the vertically integrated Electricity Power Company was sold to EVN - Austria. The intention of the Government is to consider the sale of part or all of the generating capacity in 2007, following a more detailed study on the regulatory implications of the privatisation of the hydroelectric capacity. Last but not least, some privatization activities are envisaged also in the railways sector, more precisely, within the context of the Macedonia Railways restructuring program. Under this program, the company's operations are being divided into two separate entities: one entity for transportation and the other for providing the necessary infrastructure. The intention is to privatize the transportation part in the course of 2007, while the infrastructure would remain being owned by the state.

International financial institutions are providing support in the privatisation of utilities. EBRD is a participant in the pre-privatisation process by providing funds and monitoring of all decisions connected with the privatisation, and the World Bank provides an assessment of the regulatory implications. Again, in parallel with the privatisation of the electricity sector, a process of market regulation and a gradual liberalisation has been pursued. A major step in this process was the adoption and utilisation of a new methodology for price setting of electricity by the Regulatory Commission for Energy, as a fully independent body for carrying out this function.

Privatisation has also started in the social sector of the economy and in public administration. A portion of non-core activities in health, education and administration has been carved out from the state entities and they have been subcontracted to private sector entities. The Government has also embarked upon a program of granting concessions for the use of some

large infrastructure assets, one of them being the state owned airports, and the procedure for preparation for requesting investors who would be interested to operate them on a concession basis has been already initiated.

Promotion of SMEs; The Importance of the SME development in Macedonian economy has been highly recognized as a means for nurturing the not so well developed entrepreneurial spirit, but even more for developing the voice and constituency for the needed change and reforms in the economic arena. In addition to this, well established measures and policies for development of SMEs, in combination with measures and policies for competitiveness promotion, are regarded as one of the best vehicles for the integration of the informal sector into the formal economy.

In parallel with the privatization, de novo firms started to enter the market early after transition started, thus forming the major body of the today's SME community. The Government of the Republic of Macedonia has always incorporated the support to the SMEs in its major development policy documents. In July 2002 the Government adopted a National Strategy for SME development – a strategy paper referring to a period of ten years. To the end of realizing the objectives within the strategy and the European Charter for Small Enterprises, in January 2003, the Government adopted Program of measures and activities for supporting the entrepreneurship and creation of competitive small and medium-size businesses. This Program covers a period of 4 years. In this respect, the main objective of the Programme of measures and activities for entrepreneurship promotion is to increase efficiency and international competitiveness of SMEs, by the creation of an economic structure compatible with the structure of European countries. The Programme is focused on four basic areas: (1) building institutional infrastructure for the promotion of entrepreneurship and competitiveness; (2) establishment of a favourable economic environment in accordance with the current development stage of the economy of Macedonia; (3) entrepreneurship promotion through non-financial forms for the support of entrepreneurship; and (4) financial reforms for the support of entrepreneurship.

Financial sector transformation

The transition to market economy in the Republic of Macedonia, similar to other countries in transition, required a drastically changed role for the financial sector, and the main challenge in this area was to develop an efficient system of financial markets and institutions. While financial sector has undergone significant restructuring over the recent years, it is still far from being internationally competitive in terms of product variety, soundness and costs, and the sector also remains small in both absolute and relative figures. The key general objective in this area therefore is to increase international competitiveness of the financial sector to the level that will allow its successful financial integration into the global market for financial services. A well functioning financial system will increase the level of national savings; it will reduce costs of capital for the enterprise sector and will improve the range and quality of financial services open to both savers and investors. Policy measures required to achieve the stated objectives in the financial sector are generally of four groups, namely competition, restructuring, supervision and straight legal approximation to EU legislation, although the relative importance of each group of measures varies among financial sub-sectors.

While the main priority in the banking area is capacity strengthening of the banking supervision and transition to more risk based supervision that is oriented towards the risks, the

activities in the insurance area will be more directed toward further legal approximation with the EU directives (with a special emphasis on strict licensing requirements and risk management rules) and enhancement of the supervision through establishment of an adequate and independent supervisory authority with legal power and tools for conducting timely and effective supervision over the insurance industry. Further broadening of the financial sector will be provided with different policy measures that will enable development of innovative financial instruments and non banking financial institutions such as, lending companies, agricultural support lenders, other small and micro lenders, investment funds etc.

Taking into account that banks dominate the financial sector in the Republic of Macedonia and are the major source of credit the economy, banking sector restructuring has been in the forefront of financial reforms. The sector has undergone profound changes in recent years in order to adjust itself to the competitive market conditions. Unlike many of the countries in transition, which in the second half of the 1990s faced banking crises, the Republic of Macedonia managed to avoid them. Crises were avoided also in the more recent past when the country suffered strong non-economic shocks, namely the Kosovo crisis in 1999 and the crises caused by the internal conflict in 2001.

At the end of 2005 the banking sector in the Republic of Macedonia comprised 19 private banks of universal type, 1 state-owned bank with specific functions due to which it is not a competition to the commercial banks and 15 savings houses. From the ownership structure point of view, the share of state-owned banks is below 5 per cent of the total banking system's capital while foreign capital participates in 16 banks. In 8 of these banks foreign owners are majority shareholders. These banks participate with 52.5 per cent in the total banking sector capital and with 51.8 per cent in the total volume of assets of the sector. Out of these 8 banks, 4 are subsidiaries of foreign banks. In the course of 2005, an increased interest of some important international banks to establish their subsidiaries in the Republic of Macedonia was registered and in 2006 one of the largest banks announced its decision to attract a large foreign bank as major shareholder.

As of December 31 2005, total assets of the banks in the Republic of Macedonia amounted to EUR 2.283 billion, while the own funds of the banks amounted to EUR 362 billion. There is a notable increase over the recent year. Thus, as of December 31 2004 the degree of financial intermediation calculated as a ratio of total assets, gross loans extended to clients and total deposits to the GDP of the Republic of Macedonia equalled 44.6 per cent, 21.7 per cent and 31.1 per cent respectively. For comparison, on December 31 2003 these indicators equalled 41.4 per cent, 17.8 per cent and 27.7 per cent, respectively. In spite of this increase the level of bank intermediation in the country is still rather low if compared with that of the Central European countries that have recently joined the EU. The financial intermediation, calculated as a ratio of the total assets to the GDP, as of December 31, 2004 were 99.8 per cent in the Czech Republic, 91.4 per cent in Slovenia, and 60.9 per cent in Poland. However, the level of financial intermediation is within the levels in the countries that will soon become member states of the EU (e.g. Bulgaria 38.3 per cent).

The performance of the banking sector in the Republic of Macedonia is rather good. This can be confirmed by the growing confidence of the population reflected in a strongly positive savings trend. At the end of 2004, the deposit base in the banks reached an amount of EUR 1,342 billion and had increased by 17.2 per cent compared to December 31 2003. The volume of deposits continues to increase also in 2005, and as of December 31 2005 they reached the highest level since the monetary independence of the Republic of Macedonia in

amount of EUR 1.575 million. Positive performance of the Macedonian banking sector is being reflected also in its financial performance figures. In 2005, the sector realised positive financial result in the total amount of EUR, 27.7 million, with the rate of return on assets (ROA) of 1.3 per cent and the rate of return on equity (ROE) of 8.1 per cent.

The National Bank of the Republic of Macedonia, as the banking sector supervisor, performs this role on the basis of the provisions stipulated in the Banking Law. Although the Law is harmonised with the *Acquis Communautaire* in terms of all important elements some further adjustments will be needed in the forthcoming period and are a part of the 3-year agreements with the IMF and the World Bank. These adjustments will have to address the issues of savings houses, further legal approximation of the national legislation in the field of credit institution, and strengthening of the prudent standards on their operations and strengthening banking supervision.

Although asset quality and financial performance of Macedonian banks has improved significantly over the recent years, the country's banking sector is nevertheless faced with a number of actual and potential challenges. Their common denominator is the lack of restructuring activities of banks which is needed for their effective adjustment to the challenges of the EU accession and, in more general terms, to the challenges of global financial services liberalisation. In addition to inadequate competitiveness, another area where further improvements are needed concerns the depth and sophistication of the banking system. Despite the progress over the recent years, the system is still shallow in comparison to CEE that recently joined the EU. At December 31 2004, the share of the monetary aggregates M1 (narrow definition) and M2 (broad definition for money) in GDP equalled 10.4 per cent and 30.8 per cent, respectively. For comparison, the average share of money supply M1 and M2 of GDP for the 10 new EU member-states at the end of 2004 equalled 30.6 per cent and 64.2 per cent, respectively. For five South-eastern countries, this share is lower but still higher than in the Macedonian economy, equalling 20.7 per cent and 51.8 per cent, respectively for M1 and M2 (only for Croatia M4). These data suggest that there is room for providing additional financial services to the enterprise sector.

During the last decade, the securities market has established itself as an important financial institution complementary to the banking sector. In spite of dynamic development of the securities market over the recent years, this segment of the Macedonian financial sector continues to be underdeveloped by western standards in terms of its depth. This can be confirmed by indicators typically used for summarising the role of securities in financial intermediation. The total market capitalisation at the end of 2005 is EUR 1.216 billion, which is 27.04 per cent of the expected GDP in 2005.

Issuance and trading with securities in the Republic of Macedonia is performed through the Macedonian Stock Exchange, established in 1995. The total volume of transactions (classical trading) in 2005 amounted EUR 109.5 million and represents increasing of the trade for 143.52 per cent in relation to 2004. The reasons for the market boom in 2005 mainly have resulted from an increased transparency, disclosure and availability of financial information, increased diversity of securities offered, increased interest of foreign investors, starting up of the two new pension funds as of January 1st 2006, sale of the shares under their book value (under-valued securities) and potential takeovers. Securities and Exchange Commission regulates and controls the participants on the market in terms of their operations with long-term securities on the territory of the Republic of Macedonia and within its legal competencies and authorisations; it is responsible for legal and efficient functioning of the

long-term securities market and for protection of the investors' rights. In order to further improve the legal environment for securities issuance and trading, and with the objective of further approximation to the EU legislation, a new Law on Securities has been adopted by the Parliament on November 7, 2005.

Important developments are currently underway also in other capital markets segments and they are all expected to have a positive influence on broadening and deepening of this segment of the financial system. In the second half of 2005, for example, two pension funds management companies commenced their operations and they have started collecting and operating the funds as of January 1, 2006. New developments are expected also in the investment funds area. For the time being, there are no funds of this kind in the country. From adjustment of the legislation in this area is expected not only to improve the legal framework for this segment of the financial industry but will fully harmonise the Macedonian legislation in this area with that one of the EU.

The volume of the gross premiums calculated in 2005, according to the financial reports of the insurance companies amounted to 5.105 million Denars what is equivalent to only 1.96 per cent of GDP. Also the structure of products offered is rather underdeveloped. The compulsory motor third party liability with 44.96 per cent share in the total written premiums still accounts the largest proportion of premiums collected, followed by property insurance with 25,86 per cent in the total premiums. Out of the total gross premiums collected in 2005, only 2.15 per cent referred to the group of life insurance. These figures clearly indicate that the insurance sector in the Republic of Macedonia is rather underdeveloped by the EU standards in terms of both, the volume of premiums and their structure.

Currently, there are 11 insurance companies registered in the Republic of Macedonia accompanied by 5 insurance brokerage houses that operate on the market as intermediaries between the insurance companies and their clients. Out of the 11 insurance companies, one has a license to operate non-life and re-insurance activities, another two to perform life insurance only, while the remaining eight companies are registered exclusively for non-life insurance activities. The share of the foreign capital in the insurance business was 67 per cent at the end of 2006. Five insurance companies are entirely foreign owned, while three are in dominant foreign ownership.

Basic legal framework that regulates incorporation, operations, and supervision of insurance companies and insurance brokerage houses in the Republic of Macedonia is the Law on Insurance Supervision. The Law has been harmonized with the EU insurance legislation in several respects, though further transposition will be needed in some areas, especially in the area of insurance supervision. Amendments of the Law to be prepared in line with the IAIS standards are expected to stipulate a legal framework for establishment of an independent supervisory body for the insurance sector. The Law and the related regulation should be adopted in the course of 2006 and 2007. They will more precisely regulate certain issues related to the operations of the insurance companies, such as the manner of setting technical reserves aside, investing funds that cover the technical reserves, the manner of determining the capital and the necessary level of solvency margin, calculating the liquidity ratio, detailed contents of the annual report to the insurance companies, detailed contents of the audit report, etc.

Business environment conducive to higher economic growth and competitiveness

Despite the numerous privatisation and restructuring activities and despite the fact that the economy is predominantly privately owned and that markets are largely liberalized, the economy is still facing numerous challenges that derive from the region's political instability as well as from country level deficiencies. These include a weak judicial sector, a failure to attract strategic investors for privatisation of state-owned enterprises, and a failure of owners and managers of newly privatised firms to restructure or introduce innovations. Table 2.8. provides a condensed assessment of the business environment in Macedonia in comparison with some other countries in the region as presented in the World Bank and IFC publication *Doing Business in 2006*¹⁰, Macedonia ranks 81 out of the 155 countries. The Table presents some indicators of easiness of doing business in the region.

Reforms aimed at improving business environment carried out in Macedonia in recent years did bring some positive results. As shown in the Table, there are only few of the observed countries in the region that have now a better rating of easiness of doing business than Macedonia. While Bulgaria rank (62) and Slovenia (63) much higher of the ranking scale, the country is almost at par with Romania (78) and even with Greece (80), its southern EU member neighbour. This further on implies that a natural competitiveness drawback of Macedonia, being a small market in a turbulent region, accompanied by several external shocks over the past years has required strong commitment on the side of the policy makers to improve the business climate in the country. In other words, the structural and institutional reforms this kind of counties need to be more profound and better designed and implemented than in economies having more "natural" allure.

In the continuation of the text, major recent reforms aimed at improving the business environment in the Republic of Macedonia presented in some detail.

In the FIAS 2003 Administrative Barriers Review and Administrative and Regulatory Cost Survey, most respondents considered the lack of clarity in the existing regulations, instability of laws and regulations, and corruption in the public sector as the major obstacles impacting the development of a business friendly environment. The generally deficient regulations relating to business start-up and operations translated into high compliance costs for businesses, generating strong incentives to remain in the grey economy. It also negatively affected Macedonia's attractiveness to investors. Being aware of the importance of fixing these deficiencies, the government has taken the necessary actions in the field of eliminating barriers to entry, i.e. easing the start-up of new companies but also streamlining the exit from the market and company bankruptcy and liquidation procedures.

In relation to the improvement of the quality of regulations covering business activities and building an institutional capacity and regulations significant for market entry and their proper functioning and monitoring, progress was achieved with the adoption of the new Company Law, the regulation for the trade registry becoming part of the central information base of the Central Registry. The one-stop-shop registration system, which is consistent with EU requirements, became operational as of January 4 2006. This made the start-up process simpler, quicker and cheaper. Now the process or companies registration has been decreased to maximum 5 days, down from the 48 average days prior to the establishment of this register. The number of licenses needed will be limited and the procedures for their issuing will be streamlined.

¹⁰ World Bank and IFC: *Doing Business in 2006. Creating jobs, 2006*

Table 2.8.: Ease of doing business in several Southeast European countries

	Macedonia	Albania	B & H	Bulgaria	Croatia	Greece	Serbia	Slovenia	Turkey	Romania
Ease of doing business (Rank)	81	117	87	62	116	80	92	63	93	78
Starting a business										
Procedures (number)	13	11	12	11	12	15	10	9	8	5
Time (days)	48	41	54	32	49	38	15	60	9	11
Cost (% of income p.c.)	11,3	31,1	40,9	9,6	13,4	24,6	6	10,1	27,7	5,3
Minimum capital (% of income p.c.)	145,2	39,9	57,4	104,2	22,7	121,4	9,5	17	20,9	0
Licences										
Procedures (number)	18	22	17	24	28	17	21	14	32	15
Time (days)	214	344	476	212	278	176	212	207	232	291
Cost (% of income p.c.)	67,5	227,4	8735,4	325,1	1236,7	71,9	2195	128,7	368,7	187,7
Hiring and firing workers										
Difficulty of hiring index (0-100)	61	44	56	61	61	78	44	61	44	67
Rigidity of hours index (0-100)	60	80	40	60	60	80	0	80	80	60
Difficulty of firing index (0-100)	40	20	30	10	50	40	40	50	40	50
Rigidity of employment index (0-100)	54	48	42	44	57	66	28	64	55	59
Hiring cost (% of salary)	33	31	42	32	17	30	25	17	22	34
Firing cost (weeks of salary)	41	64	33	30	38	69	21	43	112	98
Registering property										
Procedures (number)	6	7	7	9	5	12	6	6	8	8
Time (days)	74	47	331	19	956	23	111	391	9	170
Cost (% of property value)	3,6	3,6	6	2,3	5	13,7	5,3	2	3,2	2
Getting credit										
Strength of legal rights index (0-10)	6	9	8	6	4	3	5	6	1	4
Depth of credit information index (0-6)	3	0	5	3	0	4	1	3	5	4
Public registry coverage (% of adults)	1,9	0	0	13,6	0	0	0,1	2,7	4,9	1,4
Private bureau coverage (% of adults)	0	0	19,3	0	0	17,7	0	0	27,6	1
Protecting investors										
Extent of disclosure index (0-10)	5	0	3	8	2	1	7	3	8	8
Extent of director liability index (0-10)	7	6	6	1	5	4	6	8	3	5
Ease of shareholder suits index (0-10)	6	2	5	7	2	5	4	6	4	4
Strength of investor protection index (0-10)	6	2,7	4,7	5,3	3	3,3	5,7	5,7	5	5,7
Paying taxes										
Payments (number)	54	53	73	27	39	32	41	29	18	62
Time (hours per year)	96	240	100	616	232	204	168	272	254	188
Total tax payable (% of cross profit)	40,1	71,6	19,7	38,6	47,1	47,9	46,3	47,3	51,1	51,1
Trading across borders										
Documents for export (number)	10	6	9	7	9	7	9	9	9	7
Signatures for export (number)	8	13	15	5	10	6	15	7	10	6
Time for export (days)	32	37	32	26	35	29	32	20	20	27
Document for imports (number)	10	12	15	10	15	11	15	11	13	15
Signatures for import (number)	11	17	18	4	10	9	17	9	20	10
Time for import (days)	35	38	43	24	37	34	44	24	25	28
Enforcing contracts										
Procedures (number)	27	39	36	34	22	14	33	25	22	43
Time (days)	509	390	330	440	415	151	635	913	330	335
Cost (% of debt)	32,8	28,6	19,6	14	10	12,7	18,1	15,2	12,5	12,4
Closing a business										
Time (years)	4	4	3	3	3	2	3	4	5	5
Cost (% of estate)	28	38	9	9	15	9	23	15	7	9
Recovery rate (cents on the dollar)	15,4	26,9	32	33,5	28,4	45,9	20,3	27,9	7,2	17,5

Source: World Bank, IFC: Doing Business in 2006. Job Creation, 2006

The problems of property rights registration have been widely recognised as grave and seriously impeding the business environment, because of which, significant efforts have been made to recover and improve the matter. By 2009, a new reliable cadastre is to be set up.

On the other hand – the exit is mainly regulated by the bankruptcy regulation. Although the existing Law has been more or less positively evaluated by international experts, it has raised certain issues that needed to be specifically addressed. In addition to this, new EU Directives were adopted, and the preparation and adoption of a new bankruptcy law that would be harmonised with the already adopted EU Directives and the other upgraded relevant laws in the Republic of Macedonia became a notable priority. Streamlining the bankruptcy proceeding, making it faster, more efficient, less costly and fairer to the creditors and other stakeholders, but also insisting on building of the professional and ethical capacity of the bankruptcy proceeding bodies were among the main objectives of the new regulation. The new bankruptcy law was enacted by Parliament.

The new labour legislation, in addition to the improvements in the areas of easier entry and exit of firms on and from the market are considered to add much in the improving of the business environment. New projects are under way to liberalize the telecommunications sector and to abolish unnecessary licensing requirements.

In order to improve the corporate governance, the new Law on Audit, defining the conditions for the audit of entities performing activities in Macedonia and being in compliance with the Eighth Directive 84/253/EEC and the new Audit Directive, has been adopted. The International Audit Standards are binding and they have been published in Macedonian. The public institution building process will be completed by the establishment of a self-governing institute for the qualification and certification of auditors, which was set-up in the first May 2006. The Government also intends to use the findings of the June 2005 Report on Observance of Standards and Codes (ROSC) as a basis for developing and implementing further measures to improve the business environment. One part of the notes from ROSC report are already incorporated in the amendments to the Law on Securities that have been adopted at the end of 2005.

Largely on the basis of the FIAS study, and also as a result of additional research, the Government prepared a Programme for Promotion of Investments in the Republic of Macedonia and an Action Plan as its constituent part. The Programme provides the framework guiding the line ministries to propose measures for realisation of the reforms by specific performers and following a specific dynamics. Areas of priority where reforms are focused and which were identified in the Programme and the Action Plan are the following: reform of the market of immovable property – land, construction permits - approvals, court administration and judiciary system, customs, tax administration and labour legislation.

A very important project focused on the reform in the business environment and strengthening of institutions is the BERIS project (Business Environment Reform and Institutional Strengthening), which is supported with a loan by the World Bank, with an envisaged four-year implementation within the period 2006 – 2009. The Project has three-fold goals: (1) to secure more efficient and transparent registration of business entities, simplification of the procedure for issuing licences for the business entities and inspections, better access of the domestic and foreign entities to information necessary for starting and carrying out business activities in the Republic of Macedonia; (2) strengthening the capacity of the Government of the Republic of Macedonia in the process of continuing the business

environment reform agenda, through applying an appropriate analysis of the quality and the impact of the present and future regulations that shall be adopted concerning the business community, regulatory impact and the principles for good management; and (3) strengthened structure for promotion of the quality of Macedonian products and services on domestic and foreign markets, as well as better access of the Macedonian products on domestic and foreign markets.

Several analyses, surveys and studies have pointed the judiciary as an important segment that needs serious reforms, and once reformed it can play a key role in facilitating investment and accelerating growth led by private sector. By the end of 2004 the Government adopted a comprehensive Strategy on the Reform of the Judicial Sector with an Action Plan for its implementation. The goal of this Strategy is to establish an efficient judiciary system, based on European standards that would support a market economy. Judicial reform is a lengthy process, needing several years, but the process has been set in such a way to start with a number of key measures during the first year.

The first phase of this reform comprises the already adopted constitutional amendments as a basis for the new more business friendly, independent and professional legal system. The system of election, nomination and promotion of judges and prosecutors was amended to incorporate a competence based career development system. The second phase of the judiciary reforms is more aimed at improvement of the court administration and its efficiency. To the end of completing the overall process, the Law on Enforcement and the Law on Civil Procedure were adopted, as adjunct and very crucial regulation.

A very critical issue in the operation of Macedonian courts are the delays and the low ability to enforce the court decisions. Due to this two new laws have been adopted: Law on Civil Procedure, which is designed to accelerate the resolution of cases by imposing stricter deadlines and Law on Enforcement, the major innovation of which is that it moves the enforcement from the courts to specialized agents. As of May 2006 the new enforcement system became operational. The Law on Courts and the Law on Judicial Council were adopted in 2006, by which the new system of judicial appointments, founded on merit-based career development of judges and prosecutors and having the objective of strengthening the independence and professionalism of the judiciary become operational. A special training institution for judges and prosecutors (Judges and Public Prosecutors Academy) was established, incorporating training on business economics and commercial law, and it will become operational from September 2006. The Law on Judges and Public Prosecutors Academy was adopted in January 2006. Also, in terms of enhancing the court efficiency a new Law on Misdemeanors was adopted, that will allow public institutions and regulators, such as National Bank of the Republic of Macedonia, Public Revenue Office, Customs Administration and others to impose sanctions for certain types of misdemeanors without prior court approval.

The independence of the judiciary was substantially ensured by the passing of the Law on Court Budgets, which provided for a separate court budget and a Court Budget Council to administer the budgetary process. The independence of the Court Budget will be further enhanced by the amendments of the Law on Court Budget. The independence will be additionally enhanced by implementing the results of the human resource needs assessment for the court administration and police for the 2006 budget and by the improved incentive system which is scheduled to be gradually implemented by 2007. In terms of enhancing the

court efficiency, as well as in accordance to the provisions provided for in the new Law on the Courts, adopted in the first half of 2006, the process of courts reorganisation will start.

Human resource development

Human resource development is a very broad concept that encompasses very different segments of public life in a country. In the context of this document, the human resource development is composed of the following six segments: (i) education, (ii) R&D; (iii) employment/unemployment, employability of work force and labour market issues, (iv) social security; (v) public health; and (vi) human resources in the public administration in Macedonia. In the continuation of the text, the current status of the Republic of Macedonia in all these human resource development components is presented

Education; The average number of completed years of schooling in Macedonia is smaller than in EU countries, but the education background of younger generations increased in the last decade. During the 1990s the number of university students in Macedonia has also increased, which is followed by a larger share of university graduates. It is expected that this trends will continue in future, since vast number of citizens now (in contrast to previously) consider education as an investment in the future of young generations. The high share of secondary and post-secondary school students already has, and in the forthcoming years will continue to result in an increased number of educated and skilled job seekers on the labour market.

On the other hand, although certain reforms have been performed, the reforming of education and training institutions in Macedonia was rather slow. The result of this are the still prevailing old fashioned (obsolete) courses curricula at all education levels (primary, secondary, tertiary and post-graduate). At the levels of primary and secondary education completely modernised courses are still at an experimental stage in certain education centers, while the reforms at university level (the introduction of the Bologna Declaration Principles) have commenced only few years ago. Students in post-secondary education face low mobility between traditional educational programmes and between different levels. The effects are that the existing education in Macedonia is not conducive to nourishing entrepreneurship skills or skills required on the labour market and does not prepare the young for self-employment. The upgrading of the existing as well as the creation of an extensive network of modern education and training institutions is a precondition for securing the creation of a knowledge-based society in near future.

The education structure of the elder Macedonian population is less favourable compared to the average EU member states, both in terms of number of years of formal education and in terms of the quality of education and average skills. Hence, a relatively huge proportion of employees which have lost their jobs due to privatization and restructuring of companies was not able to secure new jobs via self-employment or finding new jobs. Yet, in embracing the concept of life-long learning Macedonia is at the very beginning, as is with the concept of corporate investment in education of employees. The range of educational programmes does not follow fast enough the new demand for modern methods of training and re-training of active labour force and certification of vocational and professional qualification. Educational programmes remain approved at national level, unconnected, closed and content instead of goal and problem-oriented, insufficiently answering the needs of the economic, social and

personal development (also from the point of view of culture, creativity environment and health protection). There is a lot to be done in this respect too.

Research and development; Institutional structure for R&D development consists of the Macedonian Academy of Sciences and arts organized in 5 departments and 5 research centers, three universities, Skopje, Bitola and Tetovo, and several research units with industry. The number of researchers per million inhabitants was 1,519 in 2002 what is well below the comparable figures not only for the EU member states but also for some countries in the region. Weak R&D potential is further confirmed with the volume of financial resources available for this purpose. The country spends only around 0.2 per cent of its GDP for R&D activities, and this amount declined substantially since 1997 when this share was almost twice higher (0.4 per cent of GDP). Low level of R&D financing is accompanied by very unfavourable structure of the funding sources, as almost all the funds are provided by the public sector. Privately funded R&D activity is limited to a handful of larger industrial companies.

The R&D sector in the country is obviously faced with numerous problems. The most pressing among them seem to be the following: (i) unsatisfactory level of funds for R&D activities, and within this low total volume, the share of private funds is very low, (ii) inadequate R&D infrastructure, equipment and materials, (iii) insufficient institutional infrastructure, (iv) complete lack of transfer of knowledge and research results into the business sector, (v) unfavourable structure of researchers (high share researchers in social sciences vis-a-vis those one in natural sciences; low share of researchers in the industry R&D units, (vi) research activity is not focused on applied research and innovation, and (viii) the brain drain problem.

Employment, unemployment and labour market; The labour market in Macedonia is faced with specificities. The employment rate was decreasing all until the end of 2004, since when the trend has reversed, though moderately. The main reasons for this are: the correction of the data-base of unemployed (deleting the persons registered as unemployed only to acquire social benefits); increased activities of the labour inspection; and the introduction of new more flexible employment modes (with the new Law on Labour Relations). Around 57 per cent of employed are in the private sector, but it has been estimated that the “de novo” private sector has not secured a proportional part in the employment, hence it is the privatized sector that still absorbs greater part of the work force. Part of the reasons for this is the fact that a great part of self-employed persons work in the informal (“grey economy”) sector, one of the important reasons for which is the highly restricted approach to social (health) insurance. Another important indicator for the labour market in Macedonia is the share of young unemployed. The share of unemployed in the age group between 15 and 24 is almost 23 per cent of the total number of unemployed, while the share of the age group above 50 years is less than 10 per cent. Around 7 per cent of unemployed youth have no education at all, 36 per cent have only primary education, 54 per cent have secondary education, and around 2 per cent have higher education. Apart from other things, this data are a proof that higher education “secures” higher employability and employment. But long-term unemployment among youth is also typical – 70 per cent of them have been unemployed for over a year. Long-term unemployment is typical for the entire unemployed population as well: around 64 per cent have been unemployed for over four years, while the share of long-term unemployed in the total work force is around 35 per cent (for the female the share is even higher).

Social security; Republic of Macedonia has a social security system comprised of two parts: (i) social protection, which is intended for alleviation of poverty through financial aid to socially vulnerable groups; and (ii) social security, which is mainly based on the principles of insurance. The system of social protection specifies several types of financial assistance, but it is important that intensive reform activities in this area have begun, primarily through the introduction of pluralism in the social protection (applying various models of partnerships between the public and the private sectors and the public and the non-governmental sectors). In addition, the reforms were focused on: de-institutionalisation (expanding the existing types of care centres for socially excluded people, homeless, victims of family violence, alcohol and narcotics users etc.), and decentralization (transferring the founding rights of care centres to the local level, as well as creating conditions for each of the local communities to be able to develop those forms of institutional or non-institutional protection which would best match the needs and priorities of its citizens). The reforms have two-fold objective: improvement of service delivery, and improvement of the quality of services.

Social insurance tackles the problem of unemployment by an unemployment benefit scheme, administered through the employment offices. According to this scheme, only unemployed persons who have been employed before and for whom the contributions to the Employment Fund have been paid by their employer are eligible to receive unemployment benefits. The unemployment benefit also covers health care insurance and disability and old age pension. Another part of the social insurance is the pension system, which used to be a mandatory universal pay-as-you-go (PAYG) regime, administered by the State Pension Fund. In 2000 a new pension system was established, which complements the PAYG scheme by the introduction of two new pillars – the compulsory capital financed pension insurance (the second pillar) and the voluntary capital financed pension insurance (the third pillar). This reform was implemented relatively successfully until now, especially the introduction of the second pension insurance pillar, but there are still important issues to be resolved.

Health; The health care sector was developed rather intensively over the past years. The network of healthcare institutions (and their units which provide primary, specialist and consultation healthcare, pharmaceutical and hospital care), covers all areas of the Republic of Macedonia, and enables wide accessibility to health protection which meets most of the basic healthcare needs of the population. However, one of the most serious problems of the health care system in the Republic of Macedonia is the lack of finances (i.e. its expensiveness). As result, the medical equipment is badly maintained and obsolete, its depreciation being over 80 per cent, hence regular operation is interrupted by frequent maintenance. The supply of new equipment is provided mostly through donations and humanitarian aid. Although activities have been undertaken to downsize the network of healthcare organizations and to decrease expenditures in the health sector, expected outcomes had limited effect. International cooperation is also established in the healthcare area.

Human resources in public administration; An analysis on the implementation of the public administration reform has shown that, although certain improvement has been achieved in the implementation of reforms in all of the relevant areas of the broader public administration (civil servants plus employees in healthcare, education and science, social issues and culture), the status and responsibilities of the employees is not appropriately legally regulated. The existing Law on Labour Relations is primarily compatible to the conditions in the private sector and does not correspond to the situation in the public sector. The aim of achieving the standards for a competent public administration can be reached with an extension of the basic principles of professionalism, efficiency, political neutrality and service oriented civil service,

presently stipulated with the Law on Civil Servants, to target the employees in the other segments of the public sector, as well. On the other hand, the decentralisation process which commenced in 2004 allows for the transfer of numerous competences to the local administration. Thus, besides at national level, a responsible and competent public administration at local level is a crucial precondition for successful implementation of the decentralisation process and for ensuring high quality of public services for the citizens. This derives the need for incorporating a thorough and systematic capacity building at all levels of the public administration. With regard to the development of IT in the operation of the public administration in Macedonia, significant progress has been achieved in the preceding period. An e-government project was designed, which is more than just an application of the new ICT-technologies, because it is designed as a kind of fundamental transformation of the functioning of the Government, as well as the way of thinking and performing of the public administration, with the goal of creating high quality services for the citizens, businesses and the public administration. However, the implementation of this project is at its very start, and the following period will be crucial for its full implementation.

Economic infrastructure

As discussed within the framework of this document, economic infrastructure consists of four large segments: (i) transport infrastructure, (ii) energy infrastructure, (iii) environmental infrastructure, (iv) telecommunications and information society.

Road transport; Road transportation infrastructure of the Republic of Macedonia is characterised by relatively high density, exceptions being the highways. The country's basic road network is composed of over 13278 km of roads, including 209 km of motorways, 906 km of national roads (548 km are "E" designated roads), 8566 km of local roads and 3806 km regional roads.

Insufficient level of the road infrastructure quality contrasts sharply with the high relative importance of this mode of transportation in the Republic of Macedonia. Road transportation namely accounts for by far the largest share of total transportation of goods and passengers in the country. Within the structure of all goods transported on the roads, internal transport participates with a dominant share while the rest is being distributed between international transport and transit. As far as passenger transportation is concerned, road transportation is even more dominant, as only a negligible per cent of all passenger travels in the country is done by railways.

The backbone of the country's road network are the two pan European corridors. Of the 172 km long pan-European corridor X passing the country in the North – South direction 70.1 per cent has been already constructed at modern highway standards with the remaining sections accounting 29.9 per cent of the total being ready for construction. Construction of the pan-European corridor VIII, with the total length of 304 km and passing the country from East to West, is less advanced. Only 27.6 per cent of the total is already built at modern highway standards with another 8.7 per cent being currently under construction.

The construction of both corridors is of equal importance for development of the core transport network in the country. Taking into consider the smaller percentage of remaining parts for completion of corridor X the Government of Republic of Macedonia has determined completion of the corridor X as a priority.

The Ministry of Transport and Communications is a state body, responsible for creating and implementing the transport policy in the area of road, rail and air transport. According to the legislation, provision of resources for construction and maintenance of the road infrastructure in Republic of Macedonia is a responsibility of the Fund for National and Regional Roads. This extra-budgetary fund is being financed primarily by transfers from the central budget, they include resources coming from loans and grants, with the rest coming from other sources, such as car registration duties, excises on gasoline, and tolls charged on certain highways sections. Investment to be funded by the Fund for National and Regional Roads, this means investments for new projects and for maintenance of the existing road network, are determined on the basis of PIP's annual updates. While construction for new investments is being tendered out, maintenance of the road network is being done by a PE Makedonijapat that de-facto has a monopoly in this area.

Railways; There is 925 km of railway infrastructure in the Republic of Macedonia and the sector is managed by the PE Macedonian Railways, a public company established by the state and which is also at present its sole shareholder. At present, the company is also the sole provider of railway services in the country

Similarly as major road links, it follows the pan-European corridors VIII and X. The basic infrastructure of the North – South corridor X, its total length in the Republic of Macedonia is 215km, is being in place and is fully operational. In contrast, only 50 per cent of the East – West corridor VIII, its total length is 309 km, has been constructed so far. At the moment, the country does not have railway links with the two neighbouring countries Republic of Albania and Republic of Bulgaria. The Eastern part of the corridor VIII towards Republic of Bulgaria requires another 89 km to be built (29 per cent of the total) while in its Western section towards Republic of Albania another 66 km is needed (21 per cent of the total).

In addition to incomplete basic infrastructure network, there are several factors behind the relatively small share of the railways in the total land and freight transportation in the country. Among others, they include reasons related to geographical specifics of the country (short distances among major destination in the country) and to railway's technical and technological characteristics (poor accessibility of the infrastructure).

Air transport; The air traffic in the Republic of Macedonia is carried out at two airports, Skopje and Ohrid, of which only the first one is of significant international importance. The airport facilities are at rather poor conditions due to delayed investment over the recent years, and also equipment, especially the air control system needs further upgrading.

Though the line ministry has the overall responsibility for the sector, the Civil Aviation Administration is the key professional body performing a wide range of professional activities. The most important among them include: (i) design of air transport policy, (ii) preparation, application and monitoring of regulations in the area of civil aviation, and (iii) regulation of airports, regulation and provision of full Air Navigation Services. The Civil Aviation Administration has annual operating costs of about 12 million EUR, of which about 10 million are funded by route charges and most of the remainder by airport charges.

The new Aviation Act adopted in February 2006 divides the overall responsibilities for the aviation sector between the Ministry of Transport and Communications and a new

independent state body, namely Civil Aviation Agency (yet to be established). The Ministry of Transport and Communications is assigned the following major competencies: i) the creation of a national aviation development strategy, ii) implementation of the national aviation policy, iii) drafting laws, and drafting and enactment of bylaws in the field of aviation, and iv) monitoring the operation of the Civil Aviation Agency. The Civil Aviation Agency is to take over all the regulatory functions of the former Civil Aviation Administration, most important of which are: i) duties based on the national aviation development strategy and the international agreements in the field of aviation ratified by the Republic of Macedonia, ii) drafting laws and enactment of bylaws in the field of aviation, iii) issuance, renewal, modification, suspension and revocation of licenses, ratings, certificates, approvals and other documents specified under the Aviation Act, iv) registration of aircraft, aerodromes, airfields and bookkeeping of landing strips, and v) aircraft search and rescue organization and coordination.

Energy infrastructure; Total consumption of energy in the Republic of Macedonia is around 120,000 TJ annually. In primary energy consumption oil accounts for 30 per cent, coal for about 52 per cent, natural gas 2-3 per cent, and the remaining around 15 per cent are hydro energy, wood and geothermal energy. Domestic energy production covers about 60 per cent of demand and 40 per cent are provided from imports.

The basic energy infrastructure in Macedonia includes the following: electricity power system, coal mines, gas pipeline system, an oil refinery, an oil pipeline, thermal and geothermal systems. The total installed capacity for electricity production is 1,524 MW, of which 1,010 MW are at thermal power plants, of which Bitola plant is by far the largest, and 514 MW are at hydro power plants. The transmission system of the country is connected with the systems of Greece and Serbia but not with the systems of the other two neighbouring states. Macedonia has no oil or gas reserves. All crude oil and gas are imported. Via an oil pipeline, oil is transported from Thessaloniki (Greece) to the refinery close to Skopje while gas comes into the country via 98 km long gas pipeline, stretching from the border of Bulgaria to Skopje. The pipeline capacity has not been fully used, as only a few pipeline branches to cities with a total length of 26 km have been build so far. In addition to hydro power potential, indigenous resources of energy are by and large limited to solid fuel mainly in the lignite form. The largest mines are part of thermal electricity plants and the coal from these mines is used for electricity production (around 7 million tonnes per year), while around 200,000 tonnes per year of lignite from other smaller mines are used by industrial consumers and households. Currently, five district heating systems are operational with a total capacity of 600 MW, powered by heavy oil, natural gas and lignite. Around 50.000 households are connected to these heating systems.

Until 2005 the electricity system was fully vertically integrated. The state owned power utility ESM was responsible for the entire generation, transmission, and distribution of the electricity, for its imports and transit, and also for maintaining the stability of the system. As result of the pricing policy, of poor payment discipline and managerial inadequacies, ESM was in permanent financial problems. In 2003, for example, the company had arrears of approximately \$200 million, of which more than 78 per cent overdue payments of industrial consumers. To tackle the institutional problems in the electricity sector, the authorities in 2004 adopted an ambitious privatization and restructuring plan. A year later ESM was initially split into a transmission company (MEPSO) and generation and distribution company (ESM), and then in separate companies for generation and distribution. At the moment, there are four separate companies emerging from ESM: (i) AD ESM as the distribution company

which also owns 11 mini- and small hydro power plants, (ii) ELEM as the largest generation company, (iii) TEC (TPP) Negotino as a one-plant generation company; and (iv) MEPSO as the electricity transmission system operator. In December 2005, a tender for the sale of 90 пер цент of the capital share of AD ESM was issued while privatization of the ELEM has been postponed for after the parliamentary elections in autumn 2006. The unbundling of the firm into separate generation, distribution, and transition companies, followed by the privatization of the integrated monopoly, is considered to be a key to liberalizing the sector and solving the local energy problems.

The only oil refinery in the country, which mostly produces petroleum products consumed domestically including the bulk of the gasoline and diesel, was privatized in 1999 by the Greek firm Hellenic Petroleum. The refinery has simple hydro skimming configuration and a low rate of utilization, which results in a competitive disadvantage to imports from complex modern refineries in the region. By far the largest oil products and gas distributor in the country is Makpetrol, a private joint-stock company which owns 114 petrol stations and 12 depots for oil products. Makpetrol has a strong role also in the natural gas sector. At the moment, the public enterprise JP GA-MA was transferred into joint stock company for transportation of natural gas and managing of the natural gas system. The present situation in the joint stock company is 50 пер цент of the shares belong to the Government of the Republic of Macedonia and 50 пер цент of the shares are governed by AD Makpetrol-Skopje.

The main domestic energy potential of the Republic of Macedonia lies in hydropower resources, mainly on rivers Vardar, Crn Drim and Strumica, and in low grade lignite. According to a Master Plan prepared as long ago as 1976 and other studies made later, “the technically usable” hydropower potential of the rives in the country are about 5.5 GWh. In 2003, output of hydro power plants was 1.5 GWh, somewhat below the maximum production achieved earlier (1.8 GWh). As far as lignite is concerned, the total known reserves are about 940 million tons, of which about 280 million tons are proven reserves. Possible resources are an additional ~1,000 million tons. Another potential source of energy on which the country is rather rich are geothermal sources. The largest geothermal occurrences in Macedonia are related to the Vardar tectonic unit. About 15 geothermal projects have been developed during the 70s and 80s. Four of them, the Kocani geothermal project, the Smokvica and Istibanja agricultural geothermal projects, and the integrated project in Bansko, are still very important while many others have been either abandoned or operate below design capacities.

A new Law on Energy was adopted by the National Assembly in May 2006. The reasons for proposing the Law include: (i) the need to regulate the entire energy sector in one consistent law, and (ii) the need for approximation and harmonization of the legislation of the Republic of Macedonia to that one of the EU legislation.

The energy sector of the Republic of Macedonia is faced with many problems. The most important among them seem to be the following: First, high dependency on imports of energy sources, particularly oil and gas. Second, insufficient connection with the energy sources in the neighbouring countries. The electro system is connected only with the neighbours on the north and south while the gas system has a connection with the eastern neighbour only. Third, inadequate use of the existing gas pipeline, only 15 per cent of its capacity is currently being used, due to the non-existence of the distribution system at the local and municipal levels. Fourth, renewable sources of energy have a rather limited role in the energy sector. And fifth,

high energy intensity of the country caused several factors including low energy prices in the past, obsolete and inefficient technologies as well as the practice of evaluating industrial performance in terms of quantitative physical output without regard on quality, resulted in high energy consumption and an over-emphasis on the supply side of energy activities.

Environmental infrastructure; This segment of economic infrastructure sometimes called communal infrastructure includes the following two segments: (i) communal water economy which includes water supply, and waste water collection and treatment¹¹, and (ii) solid waste management, including rehabilitation of industrial hot spots.

In the period of the 1980s and 1990s, the Republic of Macedonia has made some important advancement in the environmental protection. The most significant achievements include, first, improvement and enlargement of water supply systems in urban areas, connection of rural settlements to regional water supply systems and construction of local water supply systems; second, construction and extension of waste water collection systems in urban areas and construction of sewerage networks in rural areas, third, construction of waste water collection and treatment facilities in the areas of three protected natural lakes, Ohrid, Prespa and Dojran, and fourth, establishment of an organized municipal waste collection in most urban areas.

These positive developments with respect to the provision of environmental services have been a result of a high priority the authorities have been assigning to this subject. Since its independence the country has adopted numerous strategic documents addressing the environmental issues. Unfortunately, the competences for the development of the sector are still shared among several ministries what from time to time creates problems in designing and implementing policies as well as in programming investments.

In the municipal areas, the water connection rate in the Republic of Macedonia range from 82 to 100 per cent. In total, 1,2 million inhabitants in these areas are connected to a public water supply system. In rural areas, however, connection rates exhibit a spread between only 10 and up to 100 per cent. The available data indicate average connection rates of about 70 per cent. As far as waste water collection and treatment is concerned, the situation is more problematic. The total length of the sewage collection network in Macedonia is 1,239.1 km. In average, 60 per cent of dwellings are connected to a public sewage system, whereas 21 per cent of the dwellings have septic tanks, and another 12 per cent only have a system of uncontrolled waste water discharge. No monitoring of the waste water being discharged by municipal sewage systems exists, except for those equipped by WWTPs in operation (in Ohrid, Prespa, Dojran, Makedonski Brod etc.). There are several existing WWTPs which are out of operation (e.g. Sveti Nikole), due to high operating costs and inappropriate maintenance. Two new WWTPs are in the final phase of implementation (Kumanovo and Krivogastani), and the construction of WWTP in Gevgelija will start in near future. A large part of the surface water pollution in the country can be attributed to the discharge of untreated municipal wastewater into rivers.

Water supply and waste water services in the Republic of Macedonia are by and large provided by public enterprises established by local authorities. For the time being, there has been no involvement of the private sector in the provision of water and wastewater services as well as in the construction of infrastructure in these areas. A general pattern of these enterprises is that the quality of services is inadequate while the infrastructure is old and

¹¹ In this document irrigation is not considered a part of the environmental/communal infrastructure and is therefore dealt with within the agriculture and rural development priority of the NDP.

poorly maintained. Water losses in some municipalities are high and overpass 50 per cent. Another set of problems faced by the municipal enterprises in this segment of the economy are financial problems. In most enterprises even the full cost of operation and maintenance can not be covered from the income coming from tariffs. For investment, companies rely almost entirely on state budget. Explanation for poor financial performance of municipal utilities includes low tariffs and inadequate tariff system, inadequate collection rates and cross-subsidisation among various activities performed by the utilities.

Regular waste collection services are mainly limited to urban areas, providing up to 90 per cent coverage in cities and outskirts. In total around 70 per cent of the total population in Macedonia receives regular waste collection services, while the remaining part, residing in rural settlements distant from the main collection areas, manage wastes on their own. Regular separate collection of municipal waste on a large scale does not exist, except for some separate bulky waste collection in Skopje. Some recycling activities are undertaken by the informal sector for recyclables as metals, paper, plastics, car batteries and accumulators, waste oils. The recovery of the various types of potentially recyclable materials is considered not financially viable under prevailing conditions. Scrap metals represent the biggest part of the collected recyclables, and are being processed by the steel factory “Makstil” in Skopje. There is a well-established network of collectors and/or brokers, as well as a strong and stable market for recovered scrap metals. It can be concluded that scrap metals represent almost 80 per cent of the collected commodities.

Waste collection services are primarily performed by the public utilities providing also water supply and waste water collection services, and very often also other communal services, such as street cleaning, public parks and gardens, and cemetery maintenance. Only a small proportion of waste collectors are private companies, typically those dealing with waste in rural areas. In 2004, there were 54 municipal dumps used by communal enterprises and thousands of illegal dumpsites created by population not receiving waste collection service. Waste disposal practices do not comply with any technical and/or environmental standards. Most of existing municipal dumpsites are to be closed since the site conditions do not allow their upgrading to EU conform landfills under reasonable costs.

Similarly as practically all other countries in transition also the Republic of Macedonia is faced with the environmental liabilities from the past. Within the process of privatisation, old environmental burdens left behind by state-controlled industry have typically not been addressed appropriately. In most cases clear specification of environmental liability has not been elaborated in the privatization contracts with the new owners. Therefore, old environmentally contaminated industrial sites remained to represent a serious risk for humans who live in or near the contaminated areas, because of either their direct negative impact on the human health or, indirectly, through pollutants in the food chain production. The following three industrial hotspots are subject to former, ongoing or planned investigation and/or remediation: (i) Bucim copper mine (ongoing EU remediation programme), (ii) former Lojane chromium, arsenic, and antimony mine (planned UNDP remediation investigation), and (iii) Silmak ferro-silicium plant (EAR funded restructuring plan).

Since 2002 Republic of Macedonia started the process of harmonization of the environmental legislation with the EU and new laws on Environment, Nature, Air Quality and Waste Management passed the Parliament. Draft Law on Waters has been prepared during this process, but its adoption was delayed due to the joint responsibilities with other ministries and the need to define closer specific competences. Further regulation, regarding drafting of secondary legislation in the environmental sector as a whole is an on-going process, guided and supervised by the EU technical assistance. The approximation of the environmental

legislation is an important step towards implementation of projects which put in place EU requirements in the fields of waste water collection and treatment, as well as solid waste management.

Meeting the environmental objectives of the country's overall development and complying to the EU environmental acquis is associated with high investments into the environmental infrastructure. The best available figures for the volume of investment required for the Republic of Macedonia to comply with the EU environmental directives are the following: (i) Urban Waste Water Treatment Directive – 230 million EUR, of which nearly 100 per cent is to be provided from public sector funds, (ii) Municipal Solid Waste – 130 million EUR, of which again nearly 100 per cent is to be provided by public sector funds, and (iii) Large Combustion Plant Directive – 274 million EUR, of which rough 25 is to be provided by the public sector funds¹². These figures indicate that investment needs are largely concentrated in three areas; waste water collection and treatment area, solid, especially municipal waste management; and remediation of historical pollution.

Telecommunications; Recognising the importance of telecommunications for overall economic and social transformation of the country, the Republic of Macedonia has put a lot of attention to its development. Over the recent years, a telecommunication network with modern digital technology has been introduced. Ongoing activities for the system's further modernisation are underway with the objection to create necessary conditions for the future conversion of telecommunications, information technology and radio broadcasting.

The basic telecommunication infrastructure for fixed telephone services in the Republic of Macedonia was built by using SDX technology and 99 per cent digitalisation of the transmission and communication network has been achieved. The country is an active participant in the Trans-Balkan Telecommunication Line constructed as a part of the pan European corridor 8 linking Turkey, Bulgaria, Macedonia, Albania and Italy. Through this telecommunication line, a good connection between the Middle East and The Western European countries has been established via countries of the Western Balkan.

For the time being, Makedonski Telekomunikacii is a single operator for the fixed telephony. From December 2000, it is in 61 per cent foreign ownership, and until December 2004, the company had an exclusive right to provide fixed telephone services, telegraph services, telephone services through public booth as well as to build, own, and the fixed telecommunication network. There are 525,000 fixed telephone users in the country. As far as mobile telephony is concerned, there are two operators in the country with a total of approximately 776,000 subscribers. Since October 1997 the provision of Internet services in the Republic of Macedonia has been liberalised through awarding concessions for data transmission, so that today five major internet service providers are offering Internet services. There are a total of 126,000 Internet users in the Republic of Macedonia

The process of liberalisation and introduction of competition in the telecommunication markets is relatively well advanced in the Republic of Macedonia. According to the country's legislation which is by and large adjusted with the EU Acquis in this area, competition is now formally possible in all segments of the market although small market size is an obstacle by itself.

¹² From the EU-funded study "Economic, Financial and Administrative Requisites of Approximation to the European Union" (GOPA-Consultants) from early 2004.

As far as investments into telecommunications are concerned, they were strongly concentrated on the fixed telecommunications throughout the 1990s. The main focus of these investments was establishment of a modern network based on a digital technology. In the last few years, however, investments into mobile and internet networks have increased significantly. Investments into all three telecommunications segments were by and large financed by the service providers themselves (from their own resources and loans), and not from the country's budget.

Information society; Development of an appropriate telecommunication infrastructure represents a precondition for the development of the Macedonia information society. Fair competition in the telecommunication area is bringing down the prices of internet connections as well as those of the telephone networks opens the way for a continuous growth of their users in practically all segments from the society, from the administration over the business community to the population at large.

Based on a platform of an easy access to information and taking into account human capital development and building of a society based on knowledge as strategic orientations of the country's development, the government decided to prepare Strategy for Information Society Development. The document adopted by the Parliament in 2005 has an overall objective is to enable efficient implementation and use of ICT by all entities in the Republic of Macedonia. This broad objective is expected to be achieved through the completion of numerous policies and measures in six priority development areas: (i) adoption of the Law on Information Society, (ii) setting up an institutional framework composed of the agency for information society, inter-ministerial council and the national council for information society, (iii) raising of the public awareness in relation to the needs for and advantages of the information society advancements, (iv) enabling access to internet for all citizens, (v) defining mechanisms that provide resources for funding the process of information society building and development; and (vi) establishment of continuous monitoring and evaluation.

This mix of policies will be implemented and services will be provided primarily via e-business, e-government, e-education, e-health, and e-citizen. The government has a crucial role in supporting the information society development process. Its role is not only creating favourable legal environment for effective use of information-communication technologies but also to lead the way towards computerisation of the whole public administration. The process of e-Government introduction should be integrated within the process of the overall public administration reform and should be coordinated with the introduction of information society types of operation in all other segments of public life, especially in education and health sector. As far as introduction of e-business is concerned, it depends primarily on the interest of the business community in Macedonia to use this way of enterprise operations through active utilization of information-communication technologies and digitalization of business processes. How fast the enterprises will react to changes in technology, partnership relations and relations with customers will have a crucial impact on their own success in the contemporary business conditions. Attracting foreign direct investments and the export increase impose, more than ever, the Macedonian enterprises to change the way of operation, increase the ICT application and actively participate in the implementation of e-business in their operation. Last but probably most important is the potential of e-services for the population at large. To avoid the regional and social discrepancies from deepening and to fulfil one of the most important aims of eEurope – information society for all – major efforts

should be made to create necessary preconditions for bringing all citizens online and provide them e-services that are of practical significance for them.

Agriculture and rural development

The agriculture has traditionally been one of the most significant industries of Macedonian economy. Unlike some of the transitional economies, in which the agriculture suffered loss of its importance in certain periods, Macedonian agriculture has constantly maintained its position in the economy during the overall transition. As an example, in the period 1998-2004, it grew by a 4.6 per cent average annual growth rate. Still the production tends to be rather volatile and dependent on the weather conditions. This is more the case with the farming production, whereas the livestock production is more stable. Numbers of livestock are decreasing, but the milk production has almost doubled between 1994 and 2000. Macedonia's climate is characterized by uneven rainfall, dry summers with water deficiencies in most of the country, and occasional droughts.

The agricultural goods output, excluding agricultural services output, in 2004 amounted to approximately EUR 970 million at current prices. Its main component was the production of crops, accounting for 79 per cent followed by the livestock production for 21 per cent. The production of grapes participates for 5 per cent in the total crop production.. The agriculture accounts for around 11 per cent of Macedonian GDP and with the food processing industry, this contribution increases to around 14 per cent of GDP.

Agriculture is an important contributor to the foreign trade. In 2004, the export of agricultural products accounted for 15,9 per cent of Macedonian exports and 14,4 per cent of imports. Main agricultural products exported are wine and mineral water, vegetables and lamb. These products accounted for one third of agricultural exports in 2004. On the other hand, main agricultural imports are meat and meat products, sugar, cereals, oils and fats, coffee, tea, cocoa and spices. The trade pattern is similar to other products' export pattern: exporting labour-intensive products. On the import side, the pattern is such that land intensive cultures are being imported, which is in line with the size of Macedonia not having much land.

Macedonia has some comparative advantages in agriculture, which comprise in fertile soils, a range of favourable micro-climate features, natural upland pastures convenient for production of some crops, horticultural produce and lamb. About 49 percent of the total area, or 1.27 million ha, is agricultural land, including about 700,000 ha of pastures. A further 37 percent of the country (950,000 ha) are forests. Most of the cultivable land (82 per cent or 461,000 ha) is used for production of cereal and other crops and vegetable gardens, 26,000 ha (5 per cent of the cultivable land) are vineyards, 15,000 ha (or 3 per cent) are orchards and the remaining 58,000 ha (10 per cent) are meadows. Around 1 per cent of the total agricultural land are swamps and fish ponds.

More than 80 per cent of the cultivated land (approximately 463,000 ha) is owned or leased by private family farms, some 180,000 of them. The remaining land is operated by 136 agricultural privatized companies. Most of the pastures are owned by the state and are operated by the public companies.

Table 2.9.: Main agricultural indicators in year 2004

	Agricultural GDP as % of GDP	Agricultural employment	Ratio of agricultural employment to agricultural GDP
	1	2	3 = (2 : 1)
Czech Republic	2.7	3.7	1.4
Estonia	4.5	5.7	1.3
Hungary	3.3*	5.3	1.6
Latvia	4.3	12.5	2.9
Lithuania	5.7	15.8	2.8
Poland	2.9	19.3	6.7
Slovakia	3.9	3.9	1.0
Slovenia	2.6*	10.4	4.0
Macedonia (2005)	12	19.5	1.6
Average**	3.0	9.6	3.2

* Data for 2003; ** The average excludes Macedonia.

Source: Eurostat

In average, the yields of Macedonian agricultural products are not very high, but in some crops they rank rather high (grapes, peaches, tomatoes, plums). The technology production systems are not very modernized, the use of fertilizers, certified seeds and improved varieties is also relatively low and the insufficient access to irrigation are the factors reducing yields and discouraging production of high-value crops. Macedonia's irrigation schemes have been in decline in the transition period and by 2004 the total area under irrigation constituted only 18 percent of the once-irrigated area. As a general rule, private farms have higher productivity and yield levels than larger agricultural enterprises, however a big impediment to further increases in the productivity of small farms is fragmentation of private farms and poorly-functioning land and leasing markets. Land policy is one of the priorities of the agricultural policy of Macedonia, the first step of which will be to provide a reliable analysis of land ownership.

There has been no agricultural census since 1969 and the need to complete an agricultural census is among the priorities in the agriculture sector. This is largely needed for enhancing planning for EU accession. In the absence of a census, much of the data in the agriculture have been derived by estimation. Such census is expected to be conducted by the end of June 2007.

Forty five percent of Macedonian population is rural population and it has higher poverty levels than in urban areas, although there has been some convergence in recent years. Agriculture is a significant employer: it employs around 20 percent of the economically active population. Based on the Labour Survey in 2004, there are almost 88,000 employed in the agriculture, or 16.8 per cent of all employees in that year. There are additional estimates that some 20,000 persons are engaged on part-time basis and there are significant number of seasonal workers, on whom there are no data whatsoever. The comparison of agriculture's contribution to GDP and agricultural employment in Macedonia with the average for new EU member states is presented in the table above. The ratio of average employment in agriculture in relation to agriculture's contribution to GDP compares favourably with other new member states.

There is a serious problem of fragmentation of agricultural land in Macedonia. According to the census of the population in 1994, the 178,000 agricultural households were cultivating, in average 2.5 to 2.8 ha of land, which was in most cases fragmented in smaller 0.3-0.5 parcels of land. In most cases, these holdings were diversified and further fragmented in order to amortise the market fluctuations of specific crops. The estimates are that the fragmentation continued to happen and that today's average size of the land holding per individual farming household is around 1.7-2.0 ha.

It should be noted that the agricultural production was performed with bad practices (long-lasting tradition of mono-cultural production, lots of non-forested areas and inappropriate intensification of the agriculture) that have to a certain extent polluted the soil, the waters, the air, the biodiversity. Some evidence of this damaging processes exist in the drying of the soil, pollution of lakes, and loss of local crop sorts. Another aspect of loss of cultivable land comes from its use for other, non-agricultural purposes. Some 18.6 per cent have been lost because of this reason since the 1960s, which also had its negative impact on the environment. This situation positions the integration of the agriculture with the environment protection and incorporation of the ecological component in the creation of the agricultural policy as one of the crucial goals of the agricultural development in the future.

A short description of different agricultural products is presented below.

Cereals are the most frequent crops on the cultivable land. In 2004 there were around 190,000 ha under cereals, (wheat, barley, corn, rye and rice), which is 14 per cent less than in 2003. Because of the steeply declining trend of the state support for cereals production, especially in wheat, the areas under cereals have been continuously decreasing in the last several years. The WTO agreement imposes serious obligations to the Republic of Macedonia in terms of limiting the Bureau of Reserves' quantities to the level of emergency reserves only and granting import licenses according to the first-come-first-served principle. The average yield on all cereal crops are below the main world cereal suppliers, but they are in line with regional averages. There is practically no difference in yield in cereals between the individual farmers and agricultural companies' production.

There were 27,000 ha under industrial crops in 2004, which is much lower than in the past. In 1999 only, these crops were cultivated on 42,000 ha. The most important industrial crops are: tobacco (accounting for more than two thirds of the industrial crops' land), sun-flower, sugar beet, poppy and the industrial pepper. The tobacco has traditionally been a very important agricultural product in the Republic of Macedonia. It is a labour intensive crop, engaging thus a significant number of rural population and it is a single most important agricultural product in Macedonian export (23 per cent of the total export of the agricultural products in 2004, or 26,8 per cent together with tobacco processed products). Still, the areas under tobacco are constantly decreasing.

The production of vegetables, especially the early vegetables is one of the most significant potential of the Macedonian agriculture. The production of vegetables is located in the northern and southern part of Macedonia, on approximately 53,000 ha in 2004, or 6% more than in 2003, plus additional 10,500 ha as an interim crop. Around 300 ha are in green houses equipped with heating system. Dominant crops are the following: tomato, peppers, cucumber, cabbage, potato, onion, melons and water melons. They have traditionally been produced in this area, together with the crops that are produced in lower quantities: beans, garlic, leak, green salad, aubergine, carrot, cauliflower, and since recently other, not so traditional crops

started to be produced: broccoli, Brussels sprout, asparagus, Chinese cabbage etc. The vegetables have a very noticeable seasonal price pattern, being the highest in the period January-April and the lowest in July-September. Macedonia is a net exporter of vegetables and it has excess production of 60 per cent of the production. Five main products dominate the exports: tomato, peppers, cabbage, melons and water melons, cucumbers and the destination markets are the EU markets (Czech Republic, Slovakia, Poland, Greece, Germany, Slovenia), but also the neighbouring (mainly former Yugoslav) markets. The early vegetables come a month earlier in Macedonia than in these neighbouring countries. The distribution system is not very well organized and an improvement in this area may significantly stimulate the production,

Production of fruits is concentrated in areas higher of 300-800m. altitude in the western and south-western part of Macedonia. There were 15,000 ha under fruit trees in 2004, half of which were under apple trees. Other fruit trees cultivated are cherries, sour cherries, peaches, apricots, plums, walnuts and almonds. Orchards' land has also decreased significantly: there were 24,000 ha in 1985. The problem of low organization of distribution is present in the fruit production as well. There is also a visible process of obsolescence of the fruit trees and not enough interest for their replacement, because of the high costs and long duration until economical return occurs.

The livestock production is mainly conducted in the hilly areas along the western, northern and eastern part of the country. The livestock production is produced by many small agricultural households, mainly for their own production; a few commercially oriented family firms, the number of which is growing; and several large livestock companies, the number of which is declining. Historical trends are such that the livestock production was a dominant activity in the private agricultural households, with the exception of pig production, which was mainly organised by the large state-owned farms. The herd in the agro-combinats is decreasing while increasing in the private farms, especially such being the case with cows and pigs. The sheep has decreased dramatically: by 25 per cent for only seven year. The major problem were the deceases in the period 1996-1998, which caused a serious problem in exports of lamb. Lamb and cheese are considered to be some of the most recognised Macedonian agricultural products and they have been subject to several support projects, including clustering. A National Programme for Livestock Production in the period 2000-2009 has been prepared. The breeding programme envisages systematic activities in the reproduction of animals, based on research. The aims of the livestock production are the following: (i) production of livestock products (meat, milk, eggs, wool, leather, and processed products thereof), (ii) improving the value chain in the livestock production in all its phases, and (iii) organization of the livestock infrastructure; there are 27 slaughtering houses, out of which eight have a license for export.

Macedonia is net importer of beef, pork and chicken meat and net exported of lamb. The export of lamb accounted for 90 per cent of all livestock produce exports. EU markets are the main destination for this Macedonian product.

The annual production of milk in Macedonia in 2004 was estimated to be 260,000 tons, 197,500 of which was a cow milk and the remaining was sheep milk and a small amount of goat milk. The average yield is around 2,100 liters per cow and this has been stable in the last several years.

There are around 50 dairy production plants in Macedonia, which are relatively small. Only one of them is registered for export in EU. Pasteurised milk, yoghurt, cream, cheese and butter are being produced in most of them. As mentioned lamb and cheese were part of the cluster support programs, which includes policy analysis and lobbying, assistance to farmers, access to good quality laboratory and equipment, quality assurance system, marketing assistance etc.

2.2. Regional aspects of development

2.2.1. Regional disparities

The nomenclature of statistical territorial units (NUTS) in Macedonia was adopted in 2001. According to this nomenclature, the whole territory of Macedonia is a single unit at NUTS levels 1 and 2, while on the NUTS 3 level there are eight statistical territorial units: Pelagonia region, Vardar region, North-east region, South-west region, Skopje region, South-east region, Polog region and East region. The basic data for each region is presented in Table 2.10.

Observed by formal and legal terms, the regional development policy in Macedonia is not yet articulated within a single comprehensive law, but certain aspects are enclosed in the Law on Stimulation of the Development of Less Developed Areas. The provisions of this Law pertain to 64 per cent of the country's territory, 22 per cent of the total population and 68 per cent of the settlements.

Table 2.10.: Basic data on NUTS 3 regions in Macedonia

Territorial units	Population (2002 census)		Density (per km ²)	Area (in km ²)		Settlements	
	Number	%		Number	%	Number	%
R. Macedonia	2,022,547	100.0	78.6	25, 713	100.0	1,767	100
Pelagonia region	238,136	11.8	50.5	4,719	18.3	343	19.4
Vardar region	133,180	6.6	39.8	3,346	13.0	171	9.7
North-east region	172,787	8.5	74.9	2,306	8.9	192	10.8
South-west region	221,546	10.9	67.0	3,280	12.7	286	16.2
Skopje region	578,144	28.6	318.0	1,818	7.0	142	8.0
South-east region	171,416	8.5	62.5	2,741	10.6	188	10.6
Polog region	304,125	15.0	123.4	2,479	9.6	184	10.4
East region	203,213	10.0	48.5	4,188	16.3	261	14.8

In 2004, the Government adopted an Information on the legal and institutional framework for balanced regional development, together with an action plan of activities which should be undertaken in future: Among other, they include: (i) preparation of a strategy and a law on regional development, (ii) establishment of institutions for implementation of the regional (at NUTS 3 level) development policy, (iii) definition of criteria for measuring the development levels, (iv) creation of statistical data at the NUTS 3 level, (v) preparation of national and regional development plans, (v) provision of funds for implementation of the regional development policy, (vi) development of policy instruments and human resources, (vii)

transformation of the Bureau for less-developed regions, (ix) establishment of financial control in the implementation of the regional development policy, etc. However, until now very limited part of these activities has actually been implemented. This means that for the time being, the balanced regional development policy focuses strongly on securing financial transfers from the central budget (in the form of grants for economic and social infrastructure, preparation of feasibility studies and professional training) to less developed local communities and “specific” local communities (those which are at the national border, mountainous local communities etc.). The amount of funds transferred through the Bureau for less-developed regions is presented in Table 2.11. As shown in this Table, the role the Bureau as a provider of funds has been drastically reduced during the last few years. On the other hand, overall transfers to the regions have drastically increased as a part of the fiscal decentralization process in the country stipulated in the 2004 Law on financing of local self-government. The amount of funds that are being channelled to local communities on this basis increased from 1 to 7 per cent of total public expenditures.

Table 2.11.: Funds transferred to less developed regions

Year	Number of projects	Economic infrastructure (000 denars)	Number of projects	Social infrastructure (000 denars)	Total (000 denars)	% of GDP
2000	204	702,638	37	52,295	754,932	0.30
2001	163	469,451	42	80,549	550,000	0.20
2002	179	600,370	39	125,130	725,500	0.40
2003	126	217,223	7	5,80	223,203	0.1
2004	74	175,768	9	17,850	193,618	0.08
2005	76	174,040	--	2,000	176,040	0.06

Source: Bureau for less developed regions, Skopje, 2006

The economic and social conditions of the country presented in the previous part of this chapter have huge impact upon the regional aspect of the economic development in Macedonia. The general economic and social conditions, coupled with the lack of comprehensive balanced regional development policy throughout the entire transition period, are at the core of the existing economic structures and social conditions at regional (local) level. In other words, there are considerable regional disparities within the country. According to an Analysis prepared by the Ministry of Local Self-government, the existing economic structures and social conditions at regional level, stated in summarized manner, point to the following:

- *there is hypertrophy of the center-periphery problem in Macedonia;* A monocentric regional structure has been created with emphasized dominance of the capital. The city of Skopje absorbs almost 29 per cent of the total and 40 per cent of the urban population, enormous amount of the financial resources, investment (including FDI), apart from the really huge concentration of knowledge, science, cultural and other types of the social capital;
- *an economic and social degradation of middle-sized-cities is evident;* Due to the lack of coordinated policy, the market-driven structural adjustment during the transition resulted in a damaged “rank-size-rule”; second-rank cities are not even nearly

economically attractive enough to compete with the capital, which means loss of one of the most important levers of the polycentric economic development model;

- *the differences between urban and rural centres are widening*; Manifestations of deprivation of rural settlements are obvious, as is social and technical degradation, the reasons of which can, to a great extent, be traced to the lack of support of the basic rural economic activities (agriculture).

Table 2.12. presents some basic demographic indicators about the regions in Macedonia while more comprehensive economic and social indicators are not available at all or at least not for the more recent period.

Table 2.12.: Selected demographic indicators for NUTS 3 regions in Macedonia

	Population on 31.12.2005	Population growth 2005	Natural increase 2005	Net migrations 2005	% of population aged 65 and over	% of population below 15
R. Macedonia	2,038,514	5,970	4,076	1,894	11.0	19.2
Pelagonia r.	236,316	-840	-557	-283	15.2	16.6
Vardar r.	133,214	-83	-12	-71	11.9	17.5
North-east r.	173,890	438	410	28	10.5	21.1
South-west r.	222,623	209	309	-100	10.3	20.8
Skopje r.	588,930	5,039	2,576	2,463	10.6	18.5
South-east r.	171,880	-99	221	-320	11.3	18.3
Polog r.	309,507	2,257	1,366	891	8.2	23.3
East r.	202,154	-951	-237	-714	11.9	16.7

1. Difference between born and deceased; 2. Changes of place of residence within Macedonia; 3. Migrations of Macedonian citizens from Macedonia abroad, and migrations of foreigners;

2.2.2. Rural-urban disparities

Due to several specific reasons, Macedonia historically has had relatively high proportion of urban population compared to the level of its economic development. According to the Law on Territorial Organisation, there are 1,767 populated settlements in Macedonia, of which 29 are urban, which encompass 60 per cent of the population. The cities are relatively well scattered within the territory, with an average density of 886 sq. km per settlement. The position according to the road network is also favourable, since the cities are mainly located along the main traffic routes. The road network allows decent interconnection of cities, while the network of main transport corridors provides connection with other countries. Advantages of the beneficial configuration utilize 25 urban settlements located on plain terrains, while 4 cities are located on mountainous terrains.

As to the rural settlements, beneficial position have 38 per cent of them located on plain terrains and additional 40 per cent located on low hills, while 22 per cent of the rural settlements are located on mountainous terrains. Almost 90 per cent of rural settlements have compact structure, while the remaining settlements, of which over 90 per cent are mountainous villages, have non-compact structure. Favourable position in terms of close proximity to road connections enjoy 11 per cent of the rural settlements, while around 20 per cent have very unfavourable position in those terms.

Considering demographic and socio-economic development, under the direct influence of the de-agrarisation and de-ruralisation processes, the number and the size of the rural settlements are exposed to constant changes. The development of rural settlements and regions in Macedonia has been carried out in terms of dominant influence of the urban centres, especially the big cities. By the same token, the changes which occurred since the 1980s' reflect an increase of the number of settlements above 2,000 and of those below 100 inhabitants, while the number of settlements with inhabitants between 100 and 2,000 has decreased. In most cases these changes actually reflect a polarization of the rural population, and they stand as typical under the influence of the socio-economic changes (industrialization and urbanization) which have occurred – flourishing villages (those near bigger cities) grow in demographic, infrastructural and economic terms, while poor ones depopulate and deprive; rural population (in general) decreases, as does the size of agricultural land. In future additional significant demographic and socio-economic changes of the rural settlements can be expected.

Table 2.13.: Rural settlements and population by size categories 1981-1994

Settlements size groups	Number of settlements		Index 1981=100	Number of inhabitants		Index 1981=100
	1981	1994		1981	1994	
Up to 99	379	576	151.1	17,549	23,121	131.7
100-499	703	568	81.2	177,177	142,797	80.6
500-999	312	233	74.6	220,421	170,480	77.1
1,000-1,999	165	137	83.1	227,945	192,955	84.6
2,000-4,999	74	80	108.1	221,631	236,717	106.8
Above 5,000	3	10	333.3	15,214	17,239	346.1
Total	1,636	1,604	98.1	879,937	782,877	88.9

As with the regional aspect, the rural development policy in Macedonia is also not yet articulated within a single comprehensive law, but certain aspects are enclosed in the Law on Stimulation of the Development of Less Developed Areas, in the Law on Self-government and the Law on Spatial and Urban Planning. The Law on Stimulation of the Development of Less Developed Areas regulates the development issues of those areas which, under the criteria set by the Law, have a status of less developed, which are mostly rural centers, mountainous areas and areas close to borders. In order to close the development gap and secure their balanced and sustainable economic growth a special system has been designed. By the measures of this policy the development is supported through support and building of technical and non-business infrastructure, support to agriculture (especially sheep-breeding), and also support to industrial SMEs and some services. The measures are implemented through the Bureau for less developed areas, while the eligible areas are set by a Government decision. In this respect, the Decision of eligibility for the 2004 - 2007 period encompasses a total number of 1,092 settlements, out of which 500 in mountainous areas, 319 in mostly deprived areas and 116 settlements established as rural centers. The total area of the less-regions covers 64 per cent of the total area of the country, and is living place for 21 per cent of the total population. The Law stipulates that the funds for development support of less developed areas are generated from the central budget, in the amount of 1 per cent of the GDP p.a. Eligible areas of development support include: (i) support to development industrial, agricultural and tourist projects; (ii) subsidies for new employment in small industrial capacities and development of human resources in them; (iii) building of water supply systems; (iv) electrification of rural settlements; (v) building of road network; (vi) support to SMEs; technical support to energy projects; (vii) employment of disabled people; (viii) support to increase employment (through subsidising employment contributions); (ix) re-

qualification and training of unemployed; etc. Besides these funds, other ministries (for Agriculture, Economy, Transport), within the scope of their activities, also undertake measures for development support to rural areas.

2.3. SWOT analysis

Most important strengths of the Republic of Macedonia are the stable macro-economic framework, a consensus of the population about the EU integration process, and a geographical position at the cross roads of the two pan European corridors. The main weaknesses are related to insufficient long-term international competitiveness of the corporate sector associated with a large share of ill-prepared and non-flexible labour that fails to meet labour market requirements. The most important opportunities for the Republic Macedonia are associated with the strengthening of the overall international competitiveness of the country, while the main threat lies in the continued potential for political instability in the country as well as

Strengths, weaknesses, opportunities and threats of the Republic of Macedonia are summarized in Table 2. 13.

Table 2.14.: SWOT analysis of the Republic of Macedonia

Strengths	Weaknesses
<ul style="list-style-type: none"> • Consensus in the country about the EU integration • EU Stabilisation and Association agreement signed and ratified • EU candidate country status obtained • Bilateral and regional trade agreements • Geographical proximity to the major EU markets • Crossroad of the European corridors 8 and 10 • Proximity to Adriatic and Mediterranean seas • Favorable climate conditions, especially for agriculture and tourism • Attractive natural environment, cultural and tourist attractions • Stable macro-economic environment and banking sector • Operational road, airport and telecommunication infrastructure • Relatively low-cost educated labour • High share of young people involved in education • Basic ICT infrastructure available • Relatively extended energy network • Recognised agricultural products, although not branded • Sound basis for a prospective rural development 	<ul style="list-style-type: none"> • Perception of instability of the country and of the region • Small domestic market with low per capita income • High unemployment • Low competitiveness of enterprises (low content of value added, problem of quality standards) • Inadequate entrepreneurial culture • Poorly organised agricultural sector production and marketing chain • Limited access to foreign markets and strong concentration of export products in few industries • Lack of export, trade and investment promotion • Poor railway infrastructure and operation • Insufficient environmental infrastructure • Poor awareness regarding efficient use of energy and exploitation of renewable energy • Skill mismatches, including lack of specialization, shortages in vocational education, and retraining system • Old-fashioned, unreformed educational system • Low level of R&D spending and insufficient take up of science-based studies • IT penetration rate below the peer EU states • Lack of pipeline of projects, especially in the knowledge based areas • Low cost efficiency of the health-care and social security system • Low level of administrative capacity to effectively design and implement policies • Insufficiently integrated systems of data collection and management of registers, insufficient analysis capacities to support creation and implementation of policies • Not completely resolved status of the land

	<ul style="list-style-type: none"> • Weak economic development in rural areas and big disparities between the capital city and the rest of the country • High level of poverty and social exclusion • Inadequately developed non-banking financial sector • Relatively high corruption perception index and low drive of state institutions • Judicial bottlenecks
Opportunities	Threats
<ul style="list-style-type: none"> • Geographical location favorable for transit of goods, services, and energy resources within the regional framework • Growing cooperation within the region • Large diaspora and remittances • Potential for valorization of cultural heritage and natural environment resources • Further improving the business environment in line with EU standards • Design and implement a business friendly land policy • SME development, cluster formation, technology and innovation development, network of business information centres and incubators • Creation of environment conducive to creativity, new ideas, contest and competition • Embark more decisively on public private partnerships • Potential for diversification in main economic sectors • Better branding for main economic sectors (tourism, agriculture) • Potential for increasing efficiency and value added in agriculture production and marketing • More creative and effective export and investment promotion • Potential for cost-effective increase of the labour force quality • Potential for increase of R&D international cooperation and cooperation between academia and businesses • Life-long learning • More transparent public administration – e-government • Increasing openness of the economy, encouraging strategic alliances and internationalization of companies • Expansion of ICT services • Potential for increasing social inclusion and integration of different levels of society through ICT • Capitalising on untapped financial services potential • Potential to increase domestic and commercial energy efficiency 	<ul style="list-style-type: none"> • EU enlargement fatigue • Continued potential for ethnic tension • Vulnerability due to small size of the economy, low per capita income, and low international competitiveness (potential of marginalisation) • Costs and challenges of meeting the EU requirements, being in relative terms more complex due to the small size of the country • Low absorption capacity of EU funds • Widening welfare gap between urban and rural as well as between geographical areas of the country • Low dynamics of the reforms in education – widening educational gap • Further marginalization of R&D in Macedonia • Further drain of highly educated people • Potential rerouting of the European corridor No. 8 • Not enough participation and activism to improve business environment by the government authorities and judiciary, because of fear of loss of position and power – if they do not feel ownership in the process – they may block the process • Over-utilisation of finite energy resources and overdependence from a single energy source

Detailed SWOT analyses for each of the 8 regions within the Republic in Macedonia are enclosed as Annex 1 of the document.

Chapter 3:

Objectives and development/investment priorities of the NDP

Based on the detailed assessment of the current economic, social and environmental situation in the Republic of Macedonia, including the SWOT analysis, the strategic objective of the NDP is to increase international competitiveness of the country that is required for a sustained economic growth and higher employment.

At a more operational level, the NDP's key objectives are the following:

- To strengthen economic competitiveness of the corporate sector through intensification of broad range structural reforms, including improvements of the business environment and investment climate, conducive to economic growth and job creation.
- To develop new and improve existing physical infrastructure, particularly those related to transport, energy, ICT, environment and irrigation, in order to support economic growth and improve the overall competitiveness of the country.
- To improve quality of education and training so that it will respond effectively to the requirements of the labour market, including the requirements of the knowledge based economy.
- To create preconditions for better use of agricultural potential of the country through better land management and institutional capacity building of the sector, through strengthened rural development, and through establishing conditions for safe food production and trade.
- To create preconditions required for effective design and implementation of the balanced regional development policy within the country.

The implementation of the objectives outlined above request flexible set of policy measures and investment interventions that will take due account to rapidly changing economic and social environment. More specifically, the NDP's objectives are aimed to be achieved through the following four development/investment priorities:

- Corporate sector competitiveness
- Human resource development
- Economic infrastructure
- Agriculture and rural development

These four development/investment priorities, they are outlined in detail in the chapter 4 of the NDP, reflect well the development/investment priorities of the 8 regions of the Republic of Macedonia. They are presented in Annex 2 of this document.

Chapter 4:

Detailed presentation of development/investment priorities of the NDP

4.1. Corporate sector competitiveness

4.1.1. Summary of the current situation and the SWOT analysis

Macedonian enterprise sector, operating in a relatively open economy environment, is open to the competition in the global market milieu and this has especially been visible once the Republic of Macedonia joined WTO. There is strong evidence that domestic enterprises have had a poorer performance on domestic and international market and that exports have not been sufficient to spur a more flourishing development. A common denominator of the weaknesses of the Macedonia's corporate sector could be summarized as a lack of its international competitiveness.

It is a fact that different external shocks to which the Republic of Macedonia was exposed over the 15 years has contributed significantly to unfavorable international competitiveness of the Macedonian corporate sector today. The external shock which has hit the companies the most was the sudden loss of traditional markets on the territory of the former SFR Yugoslavia. The experiences show that Macedonian companies have not been able to recover from this shock and to penetrate other markets. In many respects they still are behind the race.

Another set of reasons for rather slow dynamics of the Macedonian corporate sector and consequently for its poor international competitiveness is associated with weaknesses in the country's overall economic and business environment that has not been conducive to private investment including FDIs. Their low level has deprived the Macedonian economy from the FDI driven technology transfer, technological modernisation and R&D. Consequently, technological development, innovativeness and development activities of companies are lagging far behind.

Economic policy of the Republic of Macedonia has in the past been strongly concentrated on achieving macroeconomic stabilisation. It is still believed that good achievements in this area should not be jeopardized and that this was an appropriate policy to follow, which can be observed by the improved current account balance, and the stabilization of higher growth rate for the last two years in a row. Still structural reforms, aimed at increasing growth and employment and reducing external imbalances, while securing the past gains of macroeconomic stabilisation should be extended. Hence activities aimed at improving international competitiveness of the corporate sector should be tackled as a matter of the highest priority.

To improve international competitiveness position of its corporate sector, the country will have to strongly support the key factors of competitive advantages of companies in the global competition, such as technology and innovativeness, flexibility, entrepreneurship and organisation, enabling the maximum innovativeness, entrepreneurial spirit flourishing, and strategy of constant changes in all business aspects. On the other hand, all potential weaknesses and threats that may endanger the way toward an improved international competitiveness of the corporate sector, including those ones in the areas of finance, education and training, should be mitigated to the largest extent possible. The following

SWOT analysis provides a summarized assessment of the international competitiveness position of the Macedonian corporate sector.

Table 4.1.: SWOT for the corporate sector competitiveness priority of the NDP

Strengths	Weaknesses
<ul style="list-style-type: none"> • Stable macroeconomic environment, balanced public finances, • A relatively well developed tax system and favourable corporate tax rates; • Stabilization of the growth rate in the last two years; • Relatively cheap and qualified labour, equipped with the main skills, ready for further and more specialised education and training. • Favourable qualification structure of population, high share of young people involved in education. • Proximity to the EU markets; • Favourable geographic position - cross road on the Balkans • Good communicational linkages • Ability to provide tailor made and smaller size services as opposed to the huge, mass serial production in the newly industrialized countries • Some strengths for certain businesses, especially tourism: natural beauties (lakes, mountains, thermal springs, national parks, biodiversity, natural uniqueness), rich cultural and historical heritage, clean environment, • Basic infrastructure in almost all areas is established. 	<ul style="list-style-type: none"> • Too high a share of traditional industries (textiles, clothing, steel industry); • Small share of SMEs with new technologies; • Relatively low efficiency of production factors and exploitation of capacities, which reflects in lower productivity; • Low export competitiveness of industry, reflected in exports of products with low value added; • Low share of foreign direct investments as a consequence of non-stimulative environment in Macedonia; • High social security contributions from personal income; • Low level of technological innovations and organisational know-how in companies, poor cooperation between companies as well as between the economic, education and research spheres; • Import dependent production, based on the import of raw materials and other inputs; • Low level of restructuring of the privatized companies; • Obsolete and internationally not recognized system of Metrology, standardisation, testing and quality; • Low rate of new companies' formation, due to some market limitations, lack of entrepreneurial skills, lack of cheap and easily available finance; • High costs of doing business and high inducement to remain in the grey economy; • Corruption and low drive of some state institutions; • Non-effective public administration; • No credit information for the businesses' • Non-efficient judiciary and long duration of court processes • Not enough protection of the creditors; • Low share of employees with higher level of education in manufacturing, low inflow of employees who are highly qualified in technical sciences and lack of managerial staff and experts with special skills; • Lack of (cheap) locations for new companies and for developing the existing companies, lack of large developed industrial districts; • In industries with high value added small enterprises are growing slowly; • SMEs are not particularly keen on co-operating and integrating, strong individualism; • Technologically rather obsolete equipment; • Lack of high quality management with a professional management education; • Lack of marketing skills, • Lack of export and investment promotion;

	<ul style="list-style-type: none"> • Little government investment in applicative and fundamental research as well as in the modernisation of research infrastructure; • Not enough private investment in research and development, lagging in technological development, innovativeness and company-financed R&D. The consequence is that products with higher value added are introduced too slow' • Not recognized brands in many industries; • No direct air connection with many countries and destinations; • Not sufficient airport infrastructure; • Problems with the visa regime; • Low level of communal services quality.
Opportunities	Threats
<ul style="list-style-type: none"> • Continue with structural reforms, including the ones for easing the companies' exit from the market - streamline bankruptcy and liquidation processes; • Introduction of a flat and reduced personal income tax (12% in 2007 and 10% from 2008); • Reduction of the profit tax rate from 15% to 12% in 2007 and 10% from 2008; • Introduction of a zero tax on reinvested profits; • Increasing the volume of domestic and foreign investment; • Making the most of Macedonia's geographical position and some its natural beauties and cultural heritage for tourist purposes; • Stimulate developing Macedonian brands in different business, enterprise, product and service areas; • Developing special tourist programs: caves, spas, hunting, eco-tourism, religious and cultural, wine, sports and adventures (paragliding, kayaking, mountain biking, alpinism, climbing, water sports - yachting, diving - skiing, cross-country, hiking) herbal tourism etc. • Development of healthy food production, crafts. • Developing the financial market enabling investment in new industries with high value added; • Increasing investment in development, education and training of companies' personnel, acquiring new organisational and technological skills; • Increasing investment in applicative research and innovations, higher concentration of investment in priority research and development; • Improving co-operation and transfer of knowledge and qualified staff between the corporate sector, education system and science by providing a more simulative environment 	<ul style="list-style-type: none"> • Structural and institutional reforms are carried out too slowly; • Not enough participation and activism to improve the business environment by the government authorities and by the judiciary, because of fear of loss of position and power - if they do not feel ownership, they may block the processes; • The education system is too slow to adapt to changes brought about by globalisation; • SMEs do not invest enough funds and human resources in R&D and innovations; • The initial entrepreneurial potential has been exhausted and the process of establishing new companies has slowed down; • Piling up administrative barriers hindering the establishment of the companies; • Lack of capital needed for quick implementation of large-scale projects; a lot of entrepreneurial opportunities are missed; • Co-operation between the academic sector and SMEs is poor; • Continuing decrease in government investment in research and development in real terms; • If a simulative environment for research and development is not created in due time, the possibility of stronger "brain drain" might increase;

<p>for research and technological development;</p> <ul style="list-style-type: none"> • Removing administrative barriers and creating an environment which stimulates entrepreneurship and FDI; • Increasing the institutional capacity for implementation of the existing regulation and making amendments towards it even more business friendly; • Increasing the transparency and responsibility of the Government institutions in the business environment creation and implementation process and increasing the dialogue in the regulatory reform process. Making the e-government completely work; • Better use of company development instruments (incubators, technology parks, risk capital); • Increasing the capacity for implementation of competition policies; • Programme for clustering of large companies and SMEs; • Stimulating groups which are less active as entrepreneurs (women, young people, farmers); • Increasing openness of the economy, encouraging strategic alliances and internationalisation of companies; • Strengthening international cooperation in research and development, with particular emphasis on integration of SMEs in the EU framework programmes, increasing the mobility of researchers (in both directions) and activating scientific and research potential of the Macedonians living abroad; • Creation of credit bureaus; • Creation of environment conducive to creativity, new ideas, contest and competition; • Design and implement a business friendly land policy; • Embark more bravely to public private partnerships; • More creative and offensive export, trade, investment promotion. 	
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4.1.2. Objectives

The strategic objective for the corporate sector development in the Republic of Macedonia for the period 2007-2009 is to strengthen its international competitiveness through intensification of broad range of reforms and policy measures conducive to economic growth and job creation. Through these reforms the following key competitiveness issues of the Macedonian corporate sector should be addressed: Technology and innovativeness, flexibility, thrive for competitiveness, entrepreneurship, proper education and skills development, increased investment in new technologies, in education, qualifications, skills, qualifications exchange, inspiring innovations, corporate strategies innovations and market orientation.

In more operational terms, objectives under this development/investment priority are the following:

- To improve business environment for both existing and new companies, and within this context especially of SMEs and start ups, by supporting the development of business infrastructure
- To support directly the enterprise sector development by measures aimed at strengthening R&D and innovation capacity of the businesses
- To stimulate an inflow of FDIs
- To diversify and improve the quality of the tourism sector

Policy measures and investment required to meet the stated objectives of this NDP's development/investment priority will have to be closely coordinated with the corresponding activities in at least another two priorities, namely in the human resource development priority and in the economic infrastructure priority. For example, entrepreneurs applying for start-up support have much stronger possibilities for success if they have gone through appropriately designed and implemented educational programs. Or, a strong factor inhibiting the performance and expansion of SMEs has often been the lack of suitable premises – business and production facilities. In some locations there is also a lack of basic services (electricity, water and sewage) and access - roads, railways, etc. Economic infrastructure investment can effectively address these problems.

4.1.3. Activity areas

Application of the objectives specified above will be implemented through specific policy measures and investment in the following 4 activity areas:

- Activity area No. 1: Improvement of business environment
- Activity area No. 2: Strengthening company competitiveness
- Activity area No. 3: SMEs and entrepreneurship development
- Activity area No. 4: Tourism development

Different policy measures and investments have been designed or are planned within each of 4 activity areas. Their common denominator is that they try to build on the identified strengths and opportunities of this segment of the Macedonian economy and to limit the negative impacts of the identified weaknesses and threats for the corporate sector in the country.

Another characteristic common to most of the activity areas under this priority is the following: The main burden for meeting the objectives is placed on the side of reforms and policy measures accompanied by institutional building measures. On the other hand, investment intensity of the activity areas, with a notable exception of the tourism, is rather limited, especially if compared with activity areas in some other priorities.

As far as reform and policy measures under this priority are concerned, it is generally believed that Macedonia needs to be more courageous in implementing the reforms that have been agreed. This is the only way to actually ease business operation and to make the county more attractive for business and investment. On the other hand, the authorities need to develop many more creative policies in order to stimulate knowledge accumulation,

innovation, creativity, niche markets development. Finally, the government needs to help businesses by making them more visible on the international market, via well designed and delivered investment, trade export and tourism promotion activities. In this respect, the development of tourism is foreseen as one of the investment activities in strengthening corporate sector competitiveness, because Macedonia has some undisputed, but not well presented to the world strengths, and there are lots of business opportunities in tourism sector, and in the same time, the tourism, especially if it is successful and distinctive, can be a promotional tool and produce some other lateral effects.

Activity Area No.1: Improving business environment

When compared to many of the Balkan countries, Macedonia is relatively successful in its macro-economic policies and political stability, which are the main prerequisites for sustainable development. In the years to come, the focus of economic policy activities will shift to structural and institutional reforms aimed at increasing growth and employment and reducing external imbalances. A key ingredient of these reforms is an improvement of the business environment so as that it will be more conducive to business and investment.

There are several reform sets of programs/projects underway in the country that all have one same objective – to contribute towards an improved business environment. The following four are the most important:

Business Environment Reform and Institutional Strengthening (BERIS); This program is conducted with a financial support and assistance by the World Bank. The Project aims at establishing a more efficient and transparent registration of business entities, streamlining the licences issuing procedures, simplifying inspections and better access to information about how-to-do business in Macedonia. It will also strengthen the capacity of the Government of the Republic of Macedonia in the process of policy analysis and its conformity to the business needs. A special achievement of the program will be the enhanced structure for increase of quality of Macedonian products and services on local and foreign markets, improving thus their accessibility on the local and international markets.

The following policy measures are envisaged to improve the business environment in the country:

- Regulation for business environment: institutional development and capacity building for systemic improvement of the quality of regulation shall be done by: (a) building an institutional and legal framework needed for development and an overall approach to the regulatory reforms; (b) building a regulatory management system in line ministries and central government; (c) capacity building for improving the quality of the existing and the new regulation, through their impact analysis, (d) establishment of a comprehensive and centralised register of regulation.
- Competition policy: this measure will ensure that there is an institutional capacity in place for the implementation of the competition policy in line with the EU, via development of the commission for protection of competition, the commission for state aid industrial policy.

- Access to information: This measure will imply providing assistance to NBRM with the formation of a system for maintaining information for credit users, in line with the EU legislation, respecting the consumers' data privacy and with the best practices for credit bureaus. This measure includes institutional development and capacity building for the Central Register and its regional offices for: (a) maintaining and providing access to a centralized database by the public, (b) legal framework and rules for managing the Central Register in line with the EU practices.
- In addition to the BERIS Project, there is another one, which is approaching to its completion in 2007. This is the "Technical Assistance to the Ministry of Economy and the Agency for Foreign Investments of the Republic of Macedonia for Improvement of Investment Climate" project, funded by EU, managed by the European Agency for Reconstruction. The aim of the Project is to provide technical assistance for support of the economic growth in the country through improvement of the overall investment climate and the FDI in particular. It is to assist in implementation of the new national program for reduction of barriers to investment, provide capacity building to the Ministry of Economy's sector for foreign investments and the agency for foreign investments of the Republic of Macedonia.

Reform of the cadastre and registration of immovable properties; This project is aimed at improving the ownership title registration and easing its transfer, which will enhance the property market in the country. This is essential for the stimulation of private investment and job creation. The time for the establishment of the cadastre should be decreased and the services to citizens and business should be largely improved. The aim is to achieve a registration in one day by the end of the project - 2008. Transparency in the operation of the cadastre should get much stronger. There are several components of this project:

- Completing of the cadastre of immovable property and the registration of rights in urban and peripheral areas by 2010. This involves: basic mapping; repeated measuring and updating of the cadastre maps; systematic decision-making and registration of immovable rights and making the registration procedures more efficient; rationalisation of the systematic registration procedures individual registration and conversion of the cadastre of land in the cadastre of immovable properties; and support to a public awareness campaign for systematic registration in the cadastre of immovable properties, including support to mediation and legal advice in the process.
- Institutional development and better service providing. This component means transformation of the cadastre into a contemporary and efficient national cadastre and registration administration and improving of the services in all regional offices with the aim to achieve registration in one day by the end of the project. The component incorporates the following: institutional development and capacity building of DZGR into an efficient and service oriented agency, which can be self-financed; promoting transparency and accountability of DZGR by issuing "bills of rights" to clients, establishing a hotline for client claims and enforcing internal audits and scrutiny for corruption and bad practices; improving the registration services for the public with a focus to the local DZGR offices, including public relations with the media and regular public announcements for its services; support for the development of an automated registration and cadastre system; development of strategic plan and human resource plan of DZGR, including training for the private sector geodetic professionals and upgrading of the curriculum for the geodetic engineering at the University St. Cyril and Methodius in

Skopje.

- Land policy development: This policy will provide support to the capacity building of the government for developing policies and regulatory framework for maintaining comprehensive cadastres of land and immovable properties and complete functioning of the land and immovable property markets. This component incorporates: support for the development of government capacity for policy and regulation development, through a consultation process; support for the formulation of special land and immovable property policies needed to ensure the completion of the cadastre of immovable properties and complete functioning of the land and immovable property markets.

Reform of the judiciary; A Project financed by the World Bank on institutional strengthening and reform of the judiciary has been initiated in 2006. The aim of the project is to improve the efficiency and effectiveness of the judiciary, adding to the business climate through: (a) strengthening the capacity of the Ministry of Justice, Ministry of Economy and the judiciary for systematic implementation of the strategy for reform of the judiciary and (b) improving the infrastructure of the judiciary.

The project comprises the following components:

- Strengthening the capacity of the Ministry of Justice, Ministry of Economy and the judiciary, via: (a) improving the quality of the court management and the judiciary, including: providing consulting services and training for support to the Court Council in the choice management, evaluation, promotion and disciplining of judges, in organizing specialized court departments and in preparation and declaration of press releases; and renovation of the Court Council premises; (b) establishment of a system for administrative disputes resolution via: providing consulting services and training (for: strengthening the capacity of the Administrative Inspectorate for Supervision of the Implementation of the Administrative Dispute Resolution by Public Services; establishment and support to its operation of the new Administration Court; increase public awareness for the administrative rights and the compliance with the legislative framework for administrative decisions and disputes; enhancing the legal framework for administrative and claim procedures); (c) improving the bankruptcy management and supervision (improving the capacity of the Ministry of Economy for supervision of the bankruptcy cases, establishment of Chamber of bankruptcy trustees, preparation of training programmes for bankruptcy trustees, commercial companies, creditors and relevant state institutions, improving the legislative and regulatory framework for the bankruptcy system).
- Improving the court infrastructure through: (a) preparation of feasibility studies, investment and working plans and directions for the court premises; (b) construction of a new court building in Skopje and rehabilitation of the existing premises based on the agreed criteria defined in the Guidelines for projects, (c) providing furniture and equipment for the court buildings.
- Improving the court information system through: (a) integration and networking of the diverse court systems; (b) access to the searchable database of the information system, in order to provide the users with electronic access to the laws, decrees, regulation and court resolutions; (c) establishment of a functional court information system and its installation and implementation in 25 courts; and (d) replacement and upgrade of the existing computer systems and training to the users for these systems.

Standardization; In order to be able to operate normally within the international community, standardization of products and their quality are essential. Authorities must therefore put high on their priority list establishment and proper functioning of the national institutions dealing with these issues. Well functioning institutions in the areas of metrology, standardization, testing and quality control are a must if the corporate sector would like to produce products and services that are compatible with the EU requirements in this area. Specific projects/programs foreseen by the respective line ministry in the next three years are the following

- capacity building of the Accreditation Institute of the Republic of Macedonia;_This Programme means new employment in the Accreditation Institute of the Republic of Macedonia (AIRM) and salary adjustment of some of the existing employees up to the level of adequate salaries of other state officials.
- improvement of the regulative framework;_It is needed to make improvement of the regulative framework in the accreditation field, according to the European rules, standards and best practices. In this respect amendments are needed to the Accreditation Law, compliance of other laws regulating different aspect of movement of goods with the Accreditation Law, amendments to the AIRM Guidelines, amendments to the accreditation national policy document and its compliance with the Law.
- preparation of the AIRM for signing the multilateral agreement (MLA) for worldwide recognition and acceptance with European Cooperation for Accreditation (EA); The multilateral agreement with EA will mean that the infrastructure for quality will have been established, especially in the following areas: testing laboratories, calibration laboratories, constitution of inspection bodies and certification bodies (for products, quality systems, environment management systems, HACCP certification systems, certification of products, EMAS accreditation). Technical assistance will be needed for the preparation for this kind of capacity building as elaborated within this programme.
- establishment of a national training centre for quality; It has been acknowledged that the establishment of a national training centre in the field of standardisation, metrology, accreditation, compliance assessment is a national requirement. This training centre will have a wide target group of attendance, such as the employees of AIRM and other quality assurance bodies and institutions, other ministries, market surveillance institutions, business operators etc. The programme provides for refurbishment of the needed premises, its equipment and its educational and training programmes development.
- establishment of an association of assessment compliance bodies; The aims of this association will be to provide professional support to the assessment compliance bodies, networking, protection of mutual professional interests, mutual information, exchange of experience, international cooperation, trainings. This program provides for technical assistance for the establishment of the association with its documents and procedures.

- establishment of the Macedonian Institute for Quality; The need for development and building of a national system for compliance assessment and for the adoption of the National Strategy of the development of the national compliance assessment system based on the principles of the new global approach of EU and stimulating of private initiative in that area have been well recognized and acknowledged in the Republic of Macedonia. Establishment of the Macedonian Institute for Quality would have the role of an incubator in this area and cover several areas. The establishment of the EU compliant national compliance assessment system will enable implementation of the requirements for the safety of products, which will directly increase the easiness of the access of Macedonian products in the EU. In the presence, the different legal framework has a consequence of increased costs for the producers to comply with both EU standards and local regulations standards and some of the procedures are unnecessarily repeated.
- *Metrology*; Within the BERIS project, there is a special component dealing with metrology. It comprises several measures, such as (i) metrology policy for development of the national metrology infrastructure; (ii) building up independent national competent metrological institution; (iii) establishing the national standards of SI units and Lab's, (iv) providing the basis for certificating and inspecting activities, based on the provision of adequate metrological equipment and know-how of BoM, (v) providing a framework for international recognition of the national metrological infrastructure, (vi) identification of locations of sustainable development based on the specifics of the Macedonian economy and industry in the frame of world globalization trends, (vii) informational and promotional activities of metrology, and (viii) active participation in International Metrology Organizations

It is a fact that policy instruments to be used by the authorities for making significant advancement in the business environment comprise primarily policy reforms and institutional building activities. Nevertheless the investment component of the above presented three projects/programs is also important. Table 4.2. presents “investment needs” in this activity area as articulated by the line ministries. The table indicates that the total volume of “investment needs” for the whole 2007 – 2009 period is forecasted at 33.2 million EUR. All the four sets of projects/programs combine institution building activities with the acquisition of the equipment.

Table 4.2.: Improving business environment – individual projects/programs identified as “investment needs” by respective line ministry (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
1. Business Environment Reform and Institutional Stenghtening	0.85	9.44	2.50	19.29	1.84	16.43	5.19	15.65
2. Cadastre Reform	2.20	24.43	4.40	33.96	3.70	33.03	10.30	31.06
3. Reform of the Judiciary	1.70	18.88	3.02	23.32	3.18	28.39	7.90	23.82
4. EAR Project for business environment	0.60	6.66		-		-	0.60	1.81
5. USAID/Enablig business Environment		-		-		-	0.00	-
6. Implementation of the law on construction products	0.01	0.11	0.01	0.08	0.01	0.09	0.03	0.09
7. Improvement of employment terms of staff	0.08	0.91	0.08	0.63	0.08	0.73	0.25	0.74
8. Improvement of the national employment framework	0.05	0.56		-		-	0.05	0.15
9. Preparation of IARM for signing of MLA with EA		-	0.05	0.39		-	0.05	0.15
Establishment of national training centre for quality	0.15	1.70	0.18	1.42		-	0.34	1.02
Association of bodies for compliance assessment		-		-	0.05	0.45	0.05	0.15
Establishment of Macedonian Institute for Quality	1.00	11.10	1.00	7.72	1.00	8.93	3.00	9.05
Metrology	1.89	20.99	1.24	9.57	0.87	7.77	4.00	12.06
Standardization - Fullfil the conditions for ISRM full membership in European standardization institutes – CEN and CENELEC								
Internal rules for managing the process of adoption of standards	0.07	0.78	0.07	0.54	0.07	0.62	0.21	0.63
Support the process for adoption and implementation of the international and European standards.	0.20	2.22	0.20	1.54	0.20	1.79	0.60	1.81
Establishment of active technical infrastructure of ISRM	0.10	1.11	0.10	0.77	0.10	0.89	0.30	0.90
Establishment of information and training center	0.10	1.11	0.10	0.77	0.10	0.89	0.30	0.90
TOTAL	9.01	100.00	12.96	100.00	11.20	100.00	33.16	100.00

Activity Area No. 2: Strengthening company competitiveness

This activity area consists of interrelated horizontal measures focused on the key determinants of the companies’ international competitiveness. In the most general terms the activity area comprises governmental development incentives offered directly to companies for projects that are aimed at supporting their internationalisation, inter-company linking, clustering and productivity boosting strategies.

Based under this general logic, this activity area comprises of the following four components:

Supporting preparation of industry boosting strategies; Over the recent years, policy studies for the restructuring of several sectors have been prepared. What authorities now consider as important to continue preparation of two types of strategic documents.

- First, to prepare an industrial policy study. This all-encompassing horizontal document of policies and measures should define the basic frame for the development of the Macedonian industry and should be in accordance with the conditions and

requirements of the EU industrial policy. In essence, the strategy should provide for the main directions for improvement of the competitiveness of Macedonian industry for its faster involvement in the international market. As an input that is necessary for the Study, a preparation of another document – an international competitiveness study is envisaged. The study should collect the existing data and where they are not available also to create new ones on a wide range of competitiveness indicators for Macedonia. More detailed data are needed in the following areas: growth, employment, labour productivity, economic, social and environmental prosperity; knowledge based industries - more productive activities creating higher value added, etc.

- Second, to prepare implementation documents that are needed for effective implementation of conclusions from the two sectoral studies prepared in the recent years, one for the steel sector and another one for textiles. Within this group fits also a preparation of a feasibility study that should look at the possibilities and modalities for increasing the technical wood mass for the wood industry by planting good quality quick growing trees. If successful, the project is expected to achieve the following: (i) to prepare a map of the terrain and an inventory of the free agricultural and forest areas in the Republic of Macedonia for new plants with quality trees for getting good quality wood mass; (ii) to establish potential for research based professional tree planting, by using special methods, species, time scheduling of the cutting and transportation to the production capacities, fertilizers and protection as well as to establish a professional approach for tree processing in the industrial plants; (iii) to decrease the import dependence of Macedonia and to attract local and foreign investors in planting trees, which will have positive impact to the job creation, increase of export, rural development, improvement of climate, and environmental enhancement, and (iv) to stimulate cooperation between the research and businesses in the area which is the subject of the study.

Promoting technological development and innovations; This component comprises specific activities aimed at promoting investment into technological development and strengthening of development capacities of companies through technological centres and parks. Two specific projects have been presented by the line ministry.

- The first one, creation of technological centres, aims to support technology development and knowledge transfer between the R&D providers and the business community with the final objective to strengthen competitive ability of small and medium-sized enterprises. Technological centres of this type have already been established at the universities in Skopje and Bitola while establishment of the third one in Stip, is expected soon. The Štip technological centre will be focused on two industries – textile and mining (non-metals, metals, geothermic waters). This project should demonstrate the ability of the cooperation between the academia and the businesses, use of the creativity of the students and the research personnel of the universities for the need of the business community, invest in the technical equipment of the universities (laboratories and other equipment) and technology transfer.
- Putting in place a technological park is another project in this component. The project is in fact an upgrading of the above technological centre project. The project will contain the whole set of activities that are needed for creation of the infrastructure for the technological development: technological centers, administration and policies

conducive to technologic development. Technological centers experience will be upgraded to technological parks and they will operate in concordance with the innovative firms, universities, technology agencies, innovation oriented institutions. The technological park and its network will provide support to potential business in the following areas: (i) access to research and industrial partners, (ii) premises and industrial space equipped with industrial infrastructure, warehouses, land, etc. The aim is to ease the start-up of companies by providing expertise and other needed support for increasing the competitiveness. Partners in the park can be financial partners, development foundations, technical development government programmes, investment funds etc. Parks can act in electronics, mechanical engineering, bio-health, chemical and other materials, marketing/management, law etc.

Support for introduction of ISO standards; For the time being, a very small proportion of enterprises from the Republic of Macedonia has obtained ISO certificates. As these standards are more and more important preconditions not only to penetrate on foreign markets but also for operating at the domestic market, this activity is of strategic importance for strengthening the enterprise sector competitiveness of the country. Under this program, companies will be supported in their efforts to introduce ISO standards into their operation and thus ease their access to the EU and other foreign markets.

Promotion of exports and FDI; Support of the FDI's development includes measures aimed at branding, quality certification, participation at business fairs and forums. Many of these measures and programmes are conducted in cooperation with MacInvest (Macedonian investment promotion agency). Some of them are the following:

- A GTZ funded Project; The project consists of organizing seminars on understanding FDI for local mayors and entrepreneurs, promotional activities in Germany, study trips to selected IPAs, investment promotion on individual projects, assistance to MacInvest in designing and conducting a survey of FDI, assistance in elaborating investment policy proposals and tailor-made investment services;
- Project "Stimulating Investments in Macedonia- Macedonian Promotion Agents"; an UNDP funded project. The project objective is to assist in the effort aimed to increase FDI inflow in Macedonia, by establishing a network of Macedonian promotion agents in USA, hence, to mobilize the capacities and resources of Macedonian diasporas towards development priorities of Macedonia;
- Project "Mapping of investment and development potential of Macedonian Municipalities" within the UNDP funded "Stimulating Investment in Macedonia", project; The Project consists of three components: identification of greenfield investment opportunities at municipal level, identification of companies that could be attractive for FDI and overview of the local economy and development potentials;
- MIGA/EIOP advisory support to the Macedonian investment promotion agency; this is an Austrian Development Agency (ADA) funded Project, managed by the Multilateral Investment Guarantee Agency/European Investor Outreach Program. The Project provides assistance with regard to the strategic, organizational and institutional development of ASIRM, provision of relevant training for its staff, integration of the agency within the context of MIGA's Western Balkans regional EIOP;
- Project funded by the Government of Japan managed by the Japan International Cooperation Agency (ICA); The project's main objectives are preparation of Study on the Automotive subcontractors and suppliers to the Japanese car companies in Central and Western Europe and preparation of Study on Balkan Contact Center;

- Technology Park “Macedonia”: The project’s idea originates from renowned technology parks from the Republic of Slovenia: Technology Park RITZ from Celje and Technology Park from Ljubljana with support of the Government of the Republic of Slovenia. The Project’s aim is establishing of a technology park “Macedonia”, to promote conditions for global entrance of the region in the field of technologies and competitiveness, to prepare background for inflow of technological companies in the region, to create knowledge (international university) and co-operative network based on strong development, research and educational clusters as well as international activities in the region and abroad;
- Macedonia Competitiveness Activity II; This is scheduled to be the second USAID funded project on this topic. The project’s main objective is to increase foreign direct investment in various Macedonian industries, thereby promoting enterprise development, identification of potential FDI as well as analysis of individual investment opportunities for qualified investors;
- USAID funded project, managed by Crimson Capital; The project offers permanent training of the MacInvest staff in the country and abroad, especially in the Czech Republic;
- UNDP Regional Slovak Trust Fund project; The Project consists of three main objectives: establishment of investment map for five municipalities in the Republic of Macedonia (relevant data on most developed industries, basic geographical and demographic data, percentage of man force, percentage of educated human capacity and etc.); “Municipality Bonds” project for two selected municipalities in the Republic of Macedonia (training on fruitful and pragmatical use of financial resources as foreign donations); and establishment of national sector study;
- Investment Reform Index; an OECD funded project. The aim of the project is preparation of comparative analyses between the SEE countries in seven key economic dimensions: investment policy and investment promotion, tax policy, anti-corruption, competition policy, trade policy, regulatory reforms and human capital.

Total volume of registered “investment needs” under this activity area amounts to 10 million, of which more than 7 million for promotion of exports and FDIs. This means that only 3 million EUR of “investment needs” has been reported for the remaining three components. As far as funding is concerned a large majority of funds, close to 80 per cent, is expected to come from the central budget with the rest coming from the IPA funds.

Table 4.3.: Strengthening company competitiveness – individual projects/programs identified as “investment needs” by respective line ministry (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Industrial Policy Strategy	0.57	16.35	0.15	4.66	0.15	4.08	0.87	8.36
Competitiveness indicators study	0.08	2.31		-		-	0.08	0.77
Project for the possibilities and ways of increase of the technical wood mass for the wood industry by planting good quality quick growing trees	0.03	0.87	0.03	0.93		-	0.06	0.58
Steel Programme Implementation	0.01	0.29	0.01	0.31	0.01	0.27	0.03	0.29
Technological centers	0.01	0.29	0.01	0.31	0.01	0.27	0.03	0.29
Technological parks	0.01	0.29	0.01	0.31	0.01	0.27	0.03	0.29
Implementation of the textile strategy	0.01	0.29	0.01	0.31		-	0.02	0.19
Support to ISO standards	0.85	24.52	0.50	15.53	0.50	13.59	1.85	17.85
Companies' competitiveness and export improvement programme (branding, quality certificates, fairs, business forums)	1.90	54.80	2.50	77.64	3.00	81.52	7.40	71.38
TOTAL	3.47	100	3.22	100	3.68	100	10.37	100

Activity No. 3: Promotion of SMEs and entrepreneurship

In view of the small size of the Macedonia market as well as very limited access to foreign markets to limited international competitiveness of the country's corporate sector, the potential for successful operation of large companies is small. Consequently, more than 95 per cent of all enterprises in the country are small ones. Based on these facts it is logical that SMEs development and promotion has been in the focus of economic policy of practically all governments with the aim to create jobs. The measures included support for start up of new business, programs for development of managerial skills, and various other programs for increasing effectiveness and efficiency of SMEs.

Also in the forthcoming period, development of SMEs will remain in the centre of the government policy interest. This has been confirmed by a wide range of projects/programs reported by the respective line ministry as “investment need”. These projects/programs could be classified under the following five headings: (i) institutional and business infrastructure support, (ii) financial assistance instruments, (iii) entrepreneurial and life-long learning, (iv) technological and marketing support, and (v) cross border cooperation. In the continuation of the text, each of these five groups will be discussed:

- *institutions supporting business environment*; The favourable climate will be created by upgrading of the institutional and business infrastructure needed by SMEs, and especially by the capacity building of the institutions providing assistance to the start-ups.
- *financial assistance instruments – schemes and training* ; The aim of this programme is to create specific development allowances, support for innovations, strengthening of the guarantee fund, issuing guarantees, support for new technologies introduction, creation of investment funds and micro-financing programmes for special less engaged target groups (women, young persons, farmers etc.). Specific training programs, upgrade of the voucher-for-consultants schemes, support to the export SMEs, support to arts and crafts, stimulation of horizontal and vertical networking of

firms, promotional activities, innovative development projects for enterprises, stimulating private and public dialogue, use of quality standards, clustering etc. are example of individual measures within this programme.

- *development of entrepreneurial spirit and culture;* The main emphasis of this project is to introduce the entrepreneurial learning as part of the regular teaching in schools and universities, promotion of the life-long learning principle, permanent education of entrepreneurs, support to incubators for young entrepreneurs and start-ups, nurturing the entrepreneurial climate in the education process, co-financing of post-graduate studies for entrepreneurship, knowledge transfer, training for unemployed etc.
- *technological and marketing support;* Creation of incubators, clusters, innovative projects and activities for export promotion of domestic products are supported by this project.
- *regional and cross-border cooperation;* This project enables cooperation with the entrepreneurs from the neighbouring countries and from the countries of the region as a whole.

The overall “investment needs” of this NDP’s activity area is forecasted by the respective line ministry at 14 million EUR for the whole period spread rather evenly among the 3 years. A large majority of projects/programs is relatively small in investment terms, but this is logical taking into account the projects are by and large of an institutional support character. Similarly as in the case activity area No. 2 (strengthening company competitiveness), the dominance of technical assistance and institutional building projects seems to be an explanation why among the total funding sources needed as much as 75 per cent of the total is expected to come from the IPA funds.

Allocation of the reported “investment needs” is distributed among the five headings quite unequally. On the one hand, there are two headings, financial assistance instruments and technical and marketing support, that participate with more than 2/3 in the total, while on the other hand, one heading, institutions supporting business environment, participate with only 6 per cent.

Table 4.4.: Promotion of SMEs and entrepreneurship – individual projects/programs identified as “investment needs” by respective line ministry (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Institutional and business infrastructure	0.35	8.64	0.30	6.38	0.25	4.67	0.90	6.38
-Info-point	0.15	3.70	0.10	2.13	0.05	0.93	0.30	2.13
-Observatory	0.03	0.74	0.03	0.64	0.03	0.56	0.09	0.64
-EICC	0.05	1.23	0.05	1.06	0.05	0.93	0.15	1.06
-HRDF	0.07	1.73	0.07	1.49	0.07	1.31	0.21	1.49
-IRC	0.05	1.23	0.05	1.06	0.05	0.93	0.15	1.06
Financial assistance instruments	1.10	27.16	1.40	29.79	1.70	31.78	4.20	29.79
Voucher consultants	0.80	19.75	1.00	21.28	1.20	22.43	3.00	21.28
Trainings	0.30	7.41	0.40	8.51	0.50	9.35	1.20	8.51
Entrepreneurial and life-long learning	0.40	9.88	0.60	12.77	0.80	14.95	1.80	12.77
education and training of young entrepreneurs and start-ups	0.20	4.94	0.30	6.38	0.40	7.48	0.90	6.38
post-graduate studies and internships	0.20	4.94	0.30	6.38	0.40	7.48	0.90	6.38
Competitiveness support	1.60	39.51	1.70	36.17	1.80	33.64	5.10	36.17
clusters	0.30	7.41	0.30	6.38	0.30	5.61	0.90	6.38
technology and innovation transfer	0.20	4.94	0.20	4.26	0.20	3.74	0.60	4.26
incubators and technological parks	0.80	19.75	0.80	17.02	0.80	14.95	2.40	17.02
export promotion	0.30	7.41	0.40	8.51	0.50	9.35	1.20	8.51
cross-border cooperation	0.60	14.81	0.70	14.89	0.80	14.95	2.10	14.89
TOTAL	4.05	100	4.70	100	5.35	100	14.10	100

Activity area No. 4: Tourism development

The development of tourism is regarded as an important development priority of the Republic of Macedonia both because it offers numerous business opportunities and jobs, but also because it supports the country's objectives in the area of trade, export and investment. Though tourism has grown over the last year, there are several constraints that hinder the implementation of Macedonia's full potential in this sector of the economy. Macedonia's tourism sector is characterised by narrow product range and poor quality, concentration of tourism activities in only few places in the country, and insufficient investments in the tourism infrastructure

Promoting tourism provides new and alternative opportunities for the development of various geographical part of the Republic of Macedonia. However, Macedonia' competitiveness in international tourism will be more and more dependent on its ability to provide a high-quality tourism commodity. With sustained investment in marketing, product development and tourism infrastructure, the country can improve its appeal and earning power in international markets.

Even though most of the tourism sector projects in the country are a subject of business initiatives and will therefore be financed from private sector projects, a number of large-scale scale projects are expected to be financed or co-financed from public sources.

As shown in Table 4.5., the respective line ministries identified and put into the “investment needs” pipeline altogether 12 projects. They can be broadly classified into two categories. The first include construction and/or modernization of selected tourist sites as well as development of the rural tourism. The second category includes project of so-called cultural infrastructure.

The first group consists of 5 projects. The 2 largest are both based on the winter tourism activities. The first one is the Ski centre at the Galicica National Park Galicica. A feasibility study for the construction of this tourist potential is needed as the first step. The interest of private investors has already been clearly expressed, but the state would need to broaden the road and to build the ski-lift, which will be a very attractive connection between the two most appealing lakes in the country. Another project of this kind is the construction of tourist settlement Kozjak. Due to its newly constructed lake and the natural beauties, the site has a strong potential for tourism development. In order to make the Kozjak site commercially attractive, the country will have to build an entirely new road what is also included in the project.

In contrast to the “investment needs” for these two large projects, their combined volume is forecasted at 45 million EUR over the 3-years period, all other 5 projects in this group are much smaller in size. The first three of them presented below involve again investments into tourism infrastructure while the remaining two project are oriented to quality building issues.

- *Construction and renovation of the parking places and the tourist signalisation along Corridor 10;* The corridor is the main tourist transit artery of the country. The reconstruction, renovation and construction of new parking places accompanied with modernized tourist signalisation are considered to be very important investment for attracting the attention of transit travelers to visit some interesting sites in Macedonia;
- *Markovi Kuli – Treskavec localities;* These two tourist localities have great cultural potential and they have a dual status as a cultural monument and as a natural beauty spot and they have been proposed to receive a UNESCO registration status with the World Heritage Committee as cultural and natural treasure. Markovi kuli is one of the most impressive fortresses - cities and the monastery Treskavec, built in the 13th century has a unique architecture and fresco paintings. The proximity to Corridor 10 makes it a potential significant tourist destination;
- *Rural tourism;* The rural or country tourism is often considered an indicator of good quality regional development. Republic of Macedonia does have potentials for development of this tourism, because of the characteristic traditional architecture, favorable environment, diversity of sites to see, visit and do and the hospitality of people;
- *Promotion of a tourist brand Republic of Macedonia;* The promotion of a tourist brand of the Republic of Macedonia as a tourist destination via international tourist exchanges and via media presentation through different media around the world, which should bring affirmation of the tourist qualities and values of the country as an attractive and not-yet-discovered tourist goal.
- *HACCP Standards implementation in the catering;* The implementation of the HACCP standards in the catering, the level of services will increasingly be improved and the acceptance of the European quality standards will enrich the tourist offer of the Republic of Macedonia.

Closely associated with the tourism sector development are also project projects in natural and cultural heritage. Central government institutions own (at least partially) a large number of important objects of this kind that can be either turned by themselves into tourism

attractions or can be offered as a purely tourist attraction to be visited by tourists during their trip to Macedonia. There are five projects in this group. Their total volume amounts to 56 million EUR. Two of the projects, Macedonian philharmony and the Skopje theatre, are large with each them amounting to over 20 million EUR each.

For the funding of all these projects, the respective line ministries forecast three major funding sources. Central budget and the IPA are expected to participate with 1/3 of the total each, and loans with additional 25 per cent.

Table 4.5: Tourism development – individual projects/programs identified as “investment needs” by respective line ministry (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Construction of Ski center Galicica	2.00	6.11	5.00	14.03	8.00	20.57	15.00	13.98
Recreational parkings On Corridor 10	0.20	0.61	0.20	0.56	0.20	0.51	0.60	0.56
Cultural tourism – Markovi kuli and Treskavec	0.30	0.92	0.50	1.40	0.30	0.77	1.10	1.03
Tourist settlement Kozjak and regional road	10.00	30.53	10.00	28.05	10.00	25.71	30.00	27.96
Rural tourism	1.00	3.05	1.00	2.81	1.00	2.57	3.00	2.80
Tourism promotion	0.15	0.46	0.20	0.56	0.30	0.77	0.65	0.61
Increasing catering standards	0.10	0.31	0.15	0.42	0.20	0.51	0.45	0.42
Technical upgrade of Macedonian Philharmony	1.30	3.97	1.20	3.37	1.30	3.34	3.80	3.54
Construction of a building for Macedonian Philharmony	8.00	24.43	7.80	21.88	7.90	20.31	23.70	22.09
Construction of new theatre in Skopje, authentic to the old one	6.70	20.46	6.60	18.51	6.70	17.22	20.00	18.64
Construction of a new building for Turkish drama	1.50	4.58	1.50	4.21	1.50	3.86	4.50	4.19
Revitalisation of the old Skopje Bazar	1.50	4.58	1.50	4.21	1.50	3.86	4.50	4.19
Total	32.75	100	35.65	100	38.90	100	107.30	100

4.1.4. Overall quantification of the “investment needs” for the development/investment priority

Table 4.6. summarizes “investment needs” of all the 6 activity areas within the corporate sector competitiveness development/investment priority as identified and formulated by the respective line ministries. As shown in the Table, the “investment needs” for this NDP priority are estimated at 165 million EUR over the 3-year period with a slowly upward trend throughout the years, from 49 million EUR in 2007 over 57 million EUR in 2008 to 59 million EUR in 2009.

Table: 4.6: Summary of the corporate sector competitiveness development/investment priority “investment needs” by activity areas (in million EUR; in % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
1. Improving business environment	9.01	18.28	12.96	22.92	11.20	18.94	33.16	20.11
2. Strengthening company competitiveness	3.47	7.04	3.22	5.70	3.68	6.22	10.37	6.29
3. Promotion of SMEs and entrepreneurship	4.05	8.22	4.70	8.31	5.35	9.05	14.10	8.55
4. Tourism development	32.75	66.47	35.65	63.07	38.90	65.79	107.30	65.06
TOTAL	49.27	100	56.53	100	59.13	100	164.93	100

There is one activity area, tourism development, which stands out prominently as far as the volume of reported “investment needs” within this development/investment priority is

concerned. Tourism development accounts for almost 2/3 of the total as this is the only activity area with significant investments into physical infrastructure development. In practically all other activity areas, all or a large majority of the reported “investment needs” are technical assistance types of projects which are by their very nature less investment intensive.

Also the envisaged structure of funding of the corporate sector competitiveness priority reflects a strong technical assistance character of the “investment needs” reported under this priority. The line ministries that have provided “investment needs” data forecast or better to say hope that 1/3 of the total funding is to be provided by the central budget and the 1/3, this in nominal value means 50 million EUR, is to be provided from the IPA sources.

Table 4.7: Summary of envisaged funding sources for financing “investment needs” under the corporate sector competitiveness economic infrastructure development/investment priority (in million EUR; in % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Public sources								
Central budget	15.65	31.77	16.97	30.02	18.50	31.28	51.12	30.99
Own funds	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Local budgets	0.75	1.52	0.60	1.06	0.50	0.85	1.85	1.12
IPA	15.76	31.98	17.44	30.86	16.97	28.69	50.17	30.42
Other grants	8.91	18.08	8.50	15.04	8.30	14.04	25.71	15.59
Loans	6.19	12.56	8.94	15.82	7.68	12.99	22.81	13.83
Private sources								
Concessions	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Other private	1.54	3.13	3.60	6.37	6.71	11.35	11.85	7.18
Unidentified Funding Sources	0.48	0.96	0.48	0.84	0.48	0.80	1.43	0.86
TOTAL	49.28	100	56.53	100	59.13	100	164.93	100

4.2 Human Resource Development

4.2.1. Summary of the current situation and SWOT analysis

Knowledge is a single critically important factor of competitiveness, i.e. for the economic development of a national economy. Hence, vast investment in human resource development is critical pre-condition for transition to a knowledge-based society, for decreasing present and preventing future discrepancies on the labour market and for ensuring conditions for higher life quality and greater social justice and social cohesion. Besides that, health is also an important element of life quality, as well as for human and social capital quality. At individual level knowledge represents an important value and personal asset, whilst at social level both knowledge and health are a benefit which significantly contributes towards successful development of a society.

At present, as was presented in Chapter 2, severe weaknesses in several segments of the human resource area are a very serious and major impediment to the rapid and harmonious development of the Republic of Macedonia. Partly as legacy of long term under-investment, and partly as result of the slow path of reforms in recent years, the educational indicators for the country are not encouraging. This mostly applies to indicators of the quality of education at all levels. The situation is even more unfavorable in the R&D area, since the country is lagging not only behind less developed EU member and candidate countries, but also behind some countries in the region. The R&D sector in Macedonia is highly underdeveloped measured by practically all R&D indicators. For example, R&D infrastructure is inadequate, the volume of R&D is at a very low level of around 0.2 percent of GDP, the structure of funding sources is inappropriate as there is practically no funding from private sources, and there is, with few exceptions, weak cooperation between the R&D and both the private and the public sector.

Unemployment has been and, despite recent slight positive improvements, continues to be, together with the relatively low growth rate and external imbalances, the number one problem of the Republic of Macedonia's development. The country is not characterized only by very high level of unemployment, but also with a number of very unfavorable structural features associated with this phenomenon. High portion of the unemployed are young people, high portion have low skills, there is high proportion of long-term unemployment – those are only some of the unemployment characteristics of the country. There is also labour skills mismatch, actually a mismatch between the structure of employment seekers and the structure of jobs available on the market, which is caused at least partly by the lack of re-training and life-long training opportunities. The unemployment problems in Macedonia are also closely interrelated with rigidities of the country's labour market, especially with the, until recently, overprotective legislation in the labour area, when employment protection in the country was above the average for the countries in the region.

As for the aspects of social security and health protection, apart from results achieved through recent reforms, one of the most serious problems remains to be the expensiveness of both systems. The reforms in these two areas were implemented relatively successfully until now, but there are still important issues to be resolved.

Table 4.8.: SWOT for the human resource development priority of the NDP

Strengths	Weaknesses
<p>General</p> <ul style="list-style-type: none"> • Relatively low-cost labour <p>Education</p> <ul style="list-style-type: none"> • Basic educational infrastructure in place in most parts of the country • Basic ICT infrastructure in place • Established structure of educational institutions • Relatively good quality of primary education <p>R&D</p> <p>Employment and labour market</p> <ul style="list-style-type: none"> • New Labour Relations Law enacted in 2005 with improved labour mobility schemes <p>Social security</p> <ul style="list-style-type: none"> • Existing tradition of a social equity system • Basic reforms in social protection and pension system commenced <p>Health care</p> <ul style="list-style-type: none"> • Basic health care institutions of solid quality • Health care institutions coverage is provided all around the country <p>Public administration</p> <ul style="list-style-type: none"> • Basic public administration training already undertaken • Decentralisation commenced – basic local public administration established • E-government project already designed 	<p>General</p> <ul style="list-style-type: none"> • High level of poverty and social exclusion; they vary strongly across different regions and educational segments of the population <p>Education</p> <ul style="list-style-type: none"> • Old-fashioned (unmodernised and unreformed) educational system • Inappropriate education conditions in terms of infrastructure in some parts of the country • Shortages in vocational education • Non-existent retraining system <p>R&D</p> <ul style="list-style-type: none"> • Low level of R&D spending • Low competitiveness and international recognition of domestic R&D • Insufficient links with the business community <p>Employment and labour market</p> <ul style="list-style-type: none"> • High unemployment rates of youth and of long-term unemployed • High share of employment in the “grey economy” • Skills mismatches (between supply and demand on the labour market) <p>Social security</p> <ul style="list-style-type: none"> • Relatively expensive system of social protection • Lack of social dialogue <p>Health care</p> <ul style="list-style-type: none"> • Expensiveness of the health care system • Medical equipment badly maintained and obsolete <p>Public administration</p> <ul style="list-style-type: none"> • Low level of administrative capacity to effectively design and implement policies • Lack of qualified, motivated and committed public administration • Status and responsibilities of the employees in public administration and public services are not adequately legally regulated (the regulation is not corresponding to the needs of the public sector)
Opportunities	Threats
<p>General</p> <ul style="list-style-type: none"> • EU accession process • Potential for cost-effective increase of the labour force quality <p>Education</p> <ul style="list-style-type: none"> • Citizens consider education an investment in the future • Potential of modernisation of education system • High share of secondary and post-secondary school students will result in an increased number of educated and skilled job seekers on the labour market • Increasing number of university students • Implementation of the new European System of Transfer of Credits in tertiary (high) education • Potential from introduction of life-long learning <p>R&D</p> <ul style="list-style-type: none"> • Potential for increase of R&D cooperation between academia and businesses • Expansion of ICT services <p>Employment and labour market</p> <ul style="list-style-type: none"> • Reduction of unemployment • Increasing the activity rate of the older generation 	<p>General</p> <ul style="list-style-type: none"> • Widening welfare gap between urban and rural as well as between geographical areas of the country <p>Education</p> <ul style="list-style-type: none"> • Non-recognition of the importance of improvement and investment in education • Low dynamics of the reforms in education – widening educational gap <p>R&D</p> <ul style="list-style-type: none"> • Further marginalisation of R&D in Macedonia <p>Employment and labour market</p> <ul style="list-style-type: none"> • High unemployment (among highest in Europe) • The drain of highly educated people <p>Social security</p> <ul style="list-style-type: none"> • Lack of will to deter granted social and equity rights • Possibility of too huge expenses from public sources for social protection and equity <p>Health care</p> <ul style="list-style-type: none"> • Unsuccessful downsizing of public expenses for health protection <p>Public administration</p>

<p>based on life-long learning</p> <p>Social security</p> <ul style="list-style-type: none"> • Potential for increasing social inclusion and integration of different levels of society through ICT • Improving of the social dialogue <p>Health care</p> <ul style="list-style-type: none"> • Potential for decreasing the costs of health protection without jeopardizing the quality • Improved quality and efficiency of the health care will result in an improved health of the population <p>Public administration</p> <ul style="list-style-type: none"> • Potential from capacity building at all levels of the public administration • Development of IT in the operation of the public administration 	<ul style="list-style-type: none"> • Oversized public administration • Lack of will for a thorough reform of the public administration
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4.2.2. Objectives

To make full use of the existing and to begin the upgrading of the human resource potentials of Macedonia for strengthening its international competitiveness, as well as to increase the overall quality of life of the population is the strategic objective of this development/investment priority of the NDP. This overall strategic objective, however, can be translated into the following long-terms objectives for each of the priority's six segments:

- *education*; To secure high quality education and training for all, which will be responsive to the requirements of the labour market as well as of the requirements of a knowledge based economy;
- *R&D*; To put the R&D among the top priorities of the country's development
- *employment and labour market*; To upgrade the employability of workforce, especially of vulnerable groups (youth, long-term unemployed, etc.);
- *social security*; To begin the creation of modern and viable (sustainable) system of social protection;
- *health care*; To modernise and upgrade the quality and sustainability of the public health system;
- *public administration*; To strengthen the capacity of human resources in the public administration (to be capable for effective market regulation and supervision as well as for design and implementation of complex reforms);

On a more operational level, the objectives for the same six segments are the following:

- *education*; (i) to start the with the development of an education system which will meet the future needs of the labour market, and (ii) to increase the quality of education services and of the educational level of Macedonian citizens;
- *R&D*; To begin the creation of a leading position of R&D in the development of Macedonia;
- *employment and labour market*; (i) to promote active labour market measures for improving employability of workforce, especially of vulnerable groups (youth with insufficient education, long-term unemployed, etc.), and (ii) to speed up the transition of employees from the "grey-economy" sector to the formal sector;
- *social security*; (i) to undertake activities and measures for the creation of a viable system of social equality and of equal chances for vulnerable groups, and (ii) to

- complete the pension system reforms, and (iii) to create conditions and capacities for a coherent social dialogue
- *health care*; (i) to undertake activities to improve the health conditions of the entire population, with special emphasis on vulnerable groups, and (ii) to undertake activities to improve the health information system and to reorganize the public health care system;
- *public administration*; To undertake measures for capacity strengthening of human resources in the public administration;

4.2.3. Activity areas

Application of the objectives specified above will be implemented through specific policy measures and investment in the following 7 activity areas:

- Activity area No. 1: Improving infrastructure and quality of education
- Activity area No. 2: Education supporting employability
- Activity area No. 3: Strengthening infrastructure for labour market
- Activity area No. 4: Enhancing R&D development
- Activity area No. 5: Supporting social protection
- Activity area No. 6: Upgrading health care system and institutions
- Activity area No. 7: Enhancing administrative capacities

As has been identified in the SWOT analysis, human resources are a serious obstacle for the overall development of the country. Probably in this area the Republic of Macedonia is lagging behind the countries it would like to compare with more than in some other areas, economic infrastructure, for example. This means that special efforts should be made here in order to reduce the gap. Though reforms and policy measures will have to constitute the bulk of the program for changing the situation, they will have to be accompanied with significant investment as well. Taking into account the character of investment into human resources, a relatively small proportion of the total will be needed for investment into physical capital and equipment, though in some areas, like education and R&D, also investments of this type might be substantial. A majority of development oriented expenses for human resources development will be used directly for upgrading the human potential of the country and, consequently, they will be reflected in an increase of those public expenses that are conventionally registered as consumption. Salaries of teachers, especially at the secondary and university levels, as well as of researchers are a clear example.

Activity area No. 1 Improving infrastructure and quality of education

In order to improve both physical infrastructure in the educational sector as well as the quality of the educational process a combination of policy measures and investment activities will be needed. Among the policy measures accompanied by technical assistance the following segments are considered to be of priority importance:

- *introduction of a system of external evaluation of educational institutions*; This process will be implemented through (i) introducing of an integral evaluation of educational institutions (grants to schools from the WB Project on education modernization), (ii) introduction of a national graduation exam at the level of

secondary education (grants to schools from the WB Project on education modernization), and (iii) improving the results of international tests (PISA, TIMS, PIRLS, etc.);

- *market liberalization for educational services at all levels of education;* The following activities are to be implemented: (i) privatization of certain public secondary schools, (ii) establishment of private primary schools, and (iii) support to public educational institutions to upgrade their competitiveness;
- *creation of conditions for teaching personnel career development;* It is to be achieved through: (i) creation of a sustainable system of teaching personnel career development complemented by an adequate system of remuneration (USAID – MPEP, SEA, e-schools = app. \$ 2 mil. annually for training of teachers; WB Project on education modernization); (ii) licensing of teachers, and (iii) certification of the management in education (USAID – SEA = \$100.000 in 2007 and 2008);

In addition to technical assistance that is aimed primarily at improving conditions for teaching personnel career development, some investment into physical infrastructure mainly for building and/modernizing school buildings are also projected.

The total volume of “investment needs” reported by the line ministry for this activity area amounts to 19 million EUR over the 3-year period. Of this total, roughly one third should go for investments in school construction and/or modernization, another third for IT equipment, and the remaining third for the career development of the teaching staff.

Table 4.9: Improving infrastructure and quality of education – individual projects / programs identified as “investment needs” by respective line ministry (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Building and reconstruction of schools	5.70	58.16	0.00	-	0.00	-	5.70	30.32
Introducing IT in the education process	2.00	20.41	2.00	40.00	2.00	50.00	6.00	31.91
Creation of a sustainable system of training of educational personnel	2.00	20.41	2.00	40.00	2.00	50.00	6.00	31.91
Certification of the management personnel in education	0.10	1.02	1.00	20.00		-	1.10	5.85
TOTAL	9.80	100.00	5.00	100.00	4.00	100.00	18.80	100.00

Activity area No. 2: Education supporting employability

With policy measures, technical assistance programs and investment interventions in this activity area the authorities seek to achieve two interrelated objectives: (i) to enhance the participation of unemployed in the active labour market policy programmes, (ii) and to improve the scope and efficiency of this policy, as well as to increase the institutional capacity of the organization which is in charge of the implementation of this policy.

In order to achieve these objectives, the following three segments of interventions are being proposed:

- *Activities aimed at increasing employability of secondary and tertiary graduates;* The following specific programs are proposed:
 - *curriculum changes in secondary and tertiary education aimed at increasing the use of practical (non-theoretical) teaching techniques and methods;* this programme should cover the financing of projects (between € 300.000 to 500.000) for implementation of the Bologna Declaration Principles (introducing the European System of Transfer of Credits and Diploma Supplement, modularization of university programmes and studies, upgrading the mobility of students and faculty, etc).
 - *curriculum changes in the primary education to secure delivery of more practical knowledge (not simply studying facts);* this programme should encompass huge changes in primary education, especially the non-humanities courses, in order to allow greater practical usefulness of the acquired knowledge and skills;
 - *connection of tertiary education with end-users of highly qualified employees;* this programme should create a kind of “buyer-supplier relationships” (ordering of skills’ profiles by companies) and should secure quality of required skills of new employees;
 - *support to real and/or virtual school companies;* secondary schools are creating (or should create) “school companies”, in which students will practice and acquire entrepreneurship skills to become capable for self-employment. In secondary schools which teach economics virtual companies have been (or will be) created which perform virtual financial transactions;
 - *development of centers for professional orientation;* in secondary schools centers for professional orientation have been created, through which young people are attracted to acquire certain skills and become informed about employment opportunities;

- *Involvement of local communities in the development of educational infrastructure and network;* This will be achieved through:
 - *development of a social dialogue between the local and sector level;* no funds are envisaged for this activity, but it is possible to make a connection with the National Employment Action Plan of the Ministry of Labour and Social Policy financed through the CARDS Programme. The basic goal is to establish dialogue at local and sector levels about the needs of employers and the quality of education institutions’ services.
 - *synchronization between the central and local governments of policy measures for upgrading the educational infrastructure through joint investment (as part of a World Bank Project on modernization of education; to be implemented through grants).*

- *The creation of an institutional framework for supporting the vocational education, education for elderly people and non-formal education;* The following actions are planned:
 - *Development of Centers for vocational education and training;*
 - *Development of a system for accreditation of suppliers of non-formal education;*
 - *Development of a system of certification of non-formal education;*

The forecasted volume of “investment needs” for this activity area amounts to 11.2 million EUR for the whole 3-year period, of which as much as 8.7 million in the year 2007. All projects put in the pipeline are institutional building projects and all of them are expected to be funded exclusively through grants, mainly USAID and IPA.

Table 4.10: Education supporting employability– individual projects/programs identified as “investment needs” by respective line ministry (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Strengthening the practical education through curriculum changes in the secondary and higher education	3.00	34.48	0.00	-	0.00	-	3.00	26.79
Curriculum changes in primary education	1.00	11.49	1.00	66.67	1.00	100.00	3.00	26.79
Support to real and virtual school companies	3.00	34.48	0.30	20.00	0.00	-	3.30	29.46
Development of centers for professional orientation	0.20	2.30	0.20	13.33	-	-	0.40	3.57
Development of the center for professional education	1.50	17.24	-	-	-	-	1.50	13.39
TOTAL	8.70	100.00	1.50	100.00	1.00	100.00	11.20	100.00

Activity area No. 3: Strengthening infrastructure for labour market

In order to reduce skills mismatch and bottlenecks in the labour market, active labour market measures should be implemented by the public employment services. Implementation of different active labour market measures is of great importance to all unemployed, but especially for vulnerable groups such as young people, long-term unemployed, disabled people and elderly people.

Before embarking on these programs, authorities should prepare relevant studies, taking into account European Commission recommendations with respect to capacity building of labour market institutions, so as to ensure that development services provided by the active labour policy are targeted to the most critical problems and that they give effective results.

Two sets of activities are foreseen by the authorities under this activity area:

- *increasing the scope of active measures on the labour market;* This will be achieved through: (i) preparation of a study on the specifics of the labour market in Macedonia, (ii) implementation of active measures, especially for training of unemployed youth (in order to increase their employability and competitive positioning on the labour market), and (iii) promotion of the use of a preventive approach towards long-term unemployed;
- *capacity building of public institutions which control and upgrade the labour market conditions;* The following actions are in the pipeline: (i) preparation of a feasibility study for implementation of a labour inspection project (with the basic goal to secure a centralized data base), (ii) purchase of new hardware, software and training of Labour Inspectorate employees (which should secure improved implementation of the legislation on labour relations), and (iii) purchase of equipment and training of the employees in the Agency for Employment (which should secure the implementation

of a coherent employment strategy and monitoring of the integrated employment policy orientations; CARDS Project, phase III);

Of the total “investment needs” reported by the respective line ministry for this activity area, it amounts to 8 million EUR over the 2007 – 2009 period, 2/3 are expected to be used for the purchase of equipment the rest should be used for technical assistance projects, mainly for preparation of various labour market related studies. As in the case of the Activity area No. 2 (education supporting employability) also here foreign grants are expected to be by far the largest funding source.

Table 4.11: Strengthening infrastructure for labour market – individual projects / programs identified as “investment needs” by respective line ministry (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Application of active labour market measures project		-	1.00	52.63		-	1.00	12.12
Promotion of the use of a preventive approach towards long-term unemployed project		-	0.50	26.32		-	0.50	6.06
Study on the specifics of the labour market in Macedonia	0.05	1.49		-		-	0.05	0.61
Project on enhancing coherent social partnership on regional level		-		-	1.00	33.33	1.00	12.12
Feasibility study for implementation of a labour inspection project		-	0.40	21.05		-	0.40	4.85
Equipment and training of Labour Inspectorate employees		-		-	2.00	66.67	2.00	24.24
Equipment and training of Employment Agency employees	3.30	98.51		-		-	3.30	40.00
TOTAL	3.35	100.00	1.90	100.00	3.00	100.00	8.25	100.00

Activity area No. 4: Enhancing R&D development

In order to improve its very unfavourable R&D status, the Republic of Macedonia should intensify its efforts to strengthen its R&D institutional base and to improve its quality. Projects/programs in this activity area are aimed at starting to create the right preconditions for a more dynamic R&D development in the country. Infrastructure investments and supply of basic equipment should be closely linked with training in the R&D field. The research and study system and its supply with basic equipment will be improved in order to become more compatible with the economic development requirements as well as with the international standards. Attempts will be made that scientists and other researchers from universities, research institutions and business entities will be provided with conditions that are necessary for undertaking R&D work of international level. This is instrumental for creating new knowledge that will allow increasing the competitiveness of the national economy.

The following three sets of specific activities are planned under this activity area:

- *upgrading of the R&D competitiveness*; The following actions are in the pipeline: (i) creation of centers of excellence, (ii) renewal of the principal research equipment in public research institutions (WB credit – \$ 5 mil. from 2007), (iii) employment of young researchers, especially those returning from abroad (NATO Programme = \$

200.000 annually until 2008), (iv) strengthening of the criteria for scientific career development, and (v) creation of conditions for establishment of private research centers.

- *efficient transfer of R&D results to the business and the public sector*; This should be achieved through: (i) creation of centers for technology transfer, (ii) creation of conditions for employment of researchers in the business sector (indirect support through fiscal exemptions), (iii) development of a special government programme of priority research projects (\$ 500.000 annually, from different sources), and (iv) stimulation of the technology development of SMEs (Technology development fund = \$ 500.000 annually).
- *intensification of use of international sources for R&D*; This is planned through: (i) creation of an agency for EU Framework Programmes (EU Framework Programme = 100.000 EUR/year), (ii) intensive use of immigrant researchers, (iii) increase of participation in research programmes of NATO, COST and other multilateral programmes, and (iv) increase of the bilateral R&D cooperation;

The total volume of “investment needs” under this activity area of the NDP as reported by the line ministry is 20 million EUR for the 3-year period. Most of the money is to be spent on domestic and international cooperation research programs and a smaller part, ¼ of the total, on equipment. The structure of funding for this activity area has remained largely undetermined by the line ministry that has provided “investment needs”. For as much of ¾ of the total, funding, sources are simply not forecasted while the remaining ¼ is expected to be provided by the donors.

Table 4.12.: Enhancing R&D development – individual projects/programs identified as “investment needs” by respective line ministry (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Creation of centers of excellence	0.10	1.39	0.10	1.39	0.10	1.67	0.30	1.47
Renovation of capital research equipment	2.00	27.78	2.00	27.78	1.00	16.67	5.00	24.51
Employment of young researchers	0.20	2.78	0.20	2.78	0.00	-	0.40	1.96
Creation of conditions for private research centers	0.50	6.94	0.50	6.94	0.50	8.33	1.50	7.35
Creation of centers for technology transfer	0.10	1.39	0.10	1.39	0.10	1.67	0.30	1.47
Development of a special government programme for priority scientific projects	0.50	6.94	0.50	6.94	0.50	8.33	1.50	7.35
Stimulation of SME's technological development	0.50	6.94	0.50	6.94	0.50	8.33	1.50	7.35
Creation of an agency for EU framework programmes	0.10	1.39	0.10	1.39	0.10	1.67	0.30	1.47
Increasing the share in NATO, SOYT and other scientific programmes	3.00	41.67	3.00	41.67	3.00	50.00	9.00	44.12
Increasing the bilateral scientific cooperation	0.20	2.78	0.20	2.78	0.20	3.33	0.60	2.94
TOTAL	7.20	100.00	7.20	100.00	6.00	100.00	20.40	100.00

Activity area No. 5: Supporting social protection

Under this activity area two segments of projects/programs, both very important for the social stability in the country, have been merged. The first one is aimed at upgrading the capacity of social partners for social dialogue. Within this segment the project on *creating a coherent social dialogue and partnership at regional level* has been proposed.

The efficiency of the social protection system will also be upgraded through achieving long-term stability of the pension system. The program should be implemented through the World Bank SPIL project;

Table 4.13.: Supporting pension reform and social inclusion – individual projects / programs identified as “investment needs” by respective line ministry (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Social Protection Implementation Loan (SPIL)	1.01	100.00	1.78	100.00	1.16	53.70	3.95	79.80
Coherent social dialogue project		-		-	1.00	46.30	1.00	20.20
TOTAL	1.01	100.00	1.78	100.00	2.16	100.00	4.95	100.00

Activity area No. 6: Upgrading health care system and institutions

Policy and institutional building measures, accompanied with investment interventions in this activity area, are aimed at: improving the national health care infrastructure, rationalisation of the structure of health care services, improvement of their quality and ensuring of regionally balanced accessibility to health services. More specifically, the following list of projects/programs has been reported by the line ministry:

- *Reconstruction and adaptation of the urgent medical center in Kumanovo; (app. € 3 mil in the period 2007-09);*
- *Implementation of a project for building and equipping of an institute for immunobiology and human genetics in Skopje; (app. € 2.5 mil in the period 2007-09);*
- *Reconstruction and adaptation of a clinic center within the medical center in Kicevo; (€ 1.2 mil in the period 2007-09);*
- *Building and equipping a clinic for malaria diseases within the medical center in Ohrid; (app. € 2.5 mil in the period 2007-09);*
- *Building of a Cardio-surgery clinic within the clinic center in Skopje; (app. € 9 mil in the period 2007-09);*
- *Reconstruction of the Military Hospital in Skopje; (€ 5 mil in the period 2007-09);*
- *Support to the transfusiology sector; (the project has started in 2005, and a total of app. € 0,3 mil in the period 2007-09 are envisaged);*
- *Upgrading the efficiency and the impact of the Programme for control of tuberculosis within process of health care decentralization in Macedonia; (app. € 1.2 mil in the period 2007-09);*
- *Implementation of a cooperation contract between the Government of RM and UNICEF in the area of health; (the implementation has started in 2005, and a total of app. € 3,3 mil in the period 2007-09 are envisaged);*
- *Implementation of a two-year contract between the Ministry of Health and SZO; (the implementation has started in 2006, and a total of app. € 0,13 Mil in 2007 are envisaged);*
- *Implementation of projects developed within the Stability Pact/Health Care Networks in SEE (app. € 0.03 mil in the period 2007-09);*

- *Upgrading the quality and development of the infrastructure for quality management of food safety in SEE* (SIDA, SWEDA, C/SLV); (app. € 1.2 mil in the period 2007-09);
- *Upgrading the control of food safety* (CARDS 2006); (€ 1.2 mil for 2007);
- *Implementation of a project for equipping the health care institutions*; (app. € 5 mil in the period 2007-09);
- *Purchase of medical equipment*; (app. € 2.6 mil in the period 2007-09);
- *Building of 10 new centers for mental health*; (€ 1.2 mil in the period 2007-09);
- *Implementation of a Programme for early detection of malign neoplasma*; (€ 1.5 mil in the period 2007-09);
- *Modernization of the dialysis centers/upgrading the technical dialysis equipment*; (€ 2 mil in the period 2007-09);
- *Implementation of a project for development of transplantation of ... and kidneys in Macedonia*; (€ 2 mil in the period 2008-09);
- *Implementation of a monitoring programme for food safety* in respect to pesticides, ... micro-organisms (planned by a change of the Law on Food Safety); (€ 1.2 mil in the period 2007-09);
- *Implementation of a project for health care management in Macedonia*; (the project has started in 2004, and a total of € 4,62 mil in the period 2007-09 are envisaged);
- *Reorganization of the emergency health care service and implementation of a single call number*; (€ 2 mil. in the period 2007-09);
- *Upgrading the health care information system*; (€ 5 mil. in the period 2007-2009);

In contrast to all other activity areas in this development/investment priority of the NDP, the health care area is much more investment oriented. The total volume of “investment needs” reported by the line ministry amounts to 59 million EUR over the 2007 – 2009 period. This is close to ½ of total “investment needs” under this priority. Reported “investment needs” could be roughly classified into three large groups: (i) investment in the construction of in new infrastructure facilities or in modernizing the existing ones, investment for purchase of the medical equipment, (iii) investment in upgrading the quality of medical services.

As far as the proposed financing is concerned, the main identified funding source are again grants with a more than 35 per cent share in the total. For a large majority of the rest, this means for roughly 40 per cent of the total, the funding sources are simply not identified.

Table 4.14.: Upgrading health care system and institutions – individual projects / programs identified as “investment needs” by respective line ministry (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Trasnfusion sector support 2005-2008	0.17	0.64	0.12	0.76	0.00	-	0.29	0.49
Increasing effectiveness and impact of the control programme of TB within decentralization of health protection in RM	0.75	2.88	0.42	2.68	0.00	-	1.18	2.00
Building a coordinated response and coordinating the prevention from a possible HIV epidemy 2005-2007	1.39	5.29	0.00	-	0.00	-	1.39	2.36
Implementation of a cooperation agreement between the Government of RM and UNICEF in health sector 2005-2009	1.11	4.24	1.11	7.06	1.11	6.58	3.33	5.66
Implementation of a two-year contract between MH and WHO 2006-2007	0.14	0.53	0.00	-	0.00	-	0.14	0.23
Implementation of projects developed within the Stability Pact/Health Care Networks in SEE	0.02	0.08	0.02	0.10	0.00	-	0.04	0.06
Upgrading the quality and development of the infrastructure for quality management of food safety in SEE (SIDA, SWEDA, C/SLV)	0.40	1.53	0.40	2.55	0.40	2.37	1.20	2.04
Upgrading the control of food safety (CARDS 2006)	1.04	3.97	0.08	0.51	0.08	0.47	1.20	2.04
Project for equipping the health care institutions	4.90	18.71	0.00	-	0.00	-	4.90	8.34
Purchase of medical equipment	2.58	9.85	0.00	-	0.00	-	2.58	4.39
Building of 10 new centers for mental health	0.30	1.15	0.70	4.46	0.20	1.19	1.20	2.04
Programme for early detection of malign neoplasma	0.50	1.91	0.80	5.09	0.20	1.19	1.50	2.55
Modernization of the dialysis centers/upgrading the technical dialysis equipment	0.10	0.38	0.90	5.73	1.00	5.94	2.00	3.40
Project for development of transplantation of ... and kidneys in Macedonia	0.00	-	1.00	6.37	1.00	5.94	2.00	3.40
Implementation of a monitoring programme for food safety in respect to pesticides, ... micro-organisms (planned by a change of the Law on Food Safety)	0.40	1.53	0.40	2.55	0.40	2.37	1.20	2.04
Project for health care management in Macedonia 2004-2009	2.14	8.17	2.08	13.24	0.40	2.37	4.62	7.87
Reorganization of the emergency health care service and implementation of a single call number	1.00	3.82	0.70	4.46	0.30	1.78	2.00	3.40
Upgrading the health care information system	0.00	-	1.98	12.61	3.00	17.81	4.98	8.48
Reconstruction and adaptation of the urgent medical center in Kumanovo	1.96	7.49	0.50	3.18	0.50	2.97	2.96	5.04
institute for immunobiology and human genetics in Skopje	0.50	1.91	0.50	3.18	1.46	8.67	2.46	4.19
Reconstruction and adaptation of a clinic center within the medical center in Kicevo	0.20	0.76	0.50	3.18	0.50	2.97	1.20	2.04
Building and equipping a clinic for malaria deseases within the medical center in Ohrid	1.59	6.07	0.50	3.18	0.50	2.97	2.59	4.41
Building of a Cardio-surgery clinic within the clinic center in Skopje	2.00	7.64	2.00	12.73	4.80	28.49	8.80	14.98
Reconstruction of the Military Hospital in Skopje	3.00	11.46	1.00	6.37	1.00	5.94	5.00	8.51
TOTAL	26.19	100.00	15.71	100.00	16.85	100.00	58.74	100.00

Activity area No. 6: Enhancing administrative capacities

The efficiency of the administration is an important element in the contemporary public administration trends. The lack of qualified, motivated and committed public administration prevents the country from implementing its new competencies in a situation of a market economy. The reforms and the restructuring of the public administration will bring about significant results, provided that considerable attention is devoted to the development of human resources and the improvement of their competences and skills, the working conditions, and the possibilities for career and motivation in particular. The appropriate integration of these elements in the overall process of public administration reform will result with qualitative improvement in the productivity and efficiency of the public administration.

The program of administration capacity enhancement will be composed of the following 5 segments: (i) establishment of standards for human resource management in the public administration; (ii) establishment and implementation of a sustainable system for continuous training of civil servants (on central and local level); (iii) improvement of ethics of public officials and administration; (iv) capacity building of inspection services; and (v) development of IT in the operation of the public administration. Each of these segments is composed of institution building activities and investment interventions. Continuation of the text will be focused on investment component.

- *the establishment of standards for human resource management in the public administration is a horizontal activity, comprised of two components;* There are two investment component programmed within this segment of reforms: (i) policy preparation for introduction of standards for employment in the public administration; and (ii) policy implementation that incorporates training provided by the bodies responsible for implementation as well as by institutions which employ public servants in order to ensure effective implementation of the planned policy. It is therefore expected that the implementation of the investment programme will ensure the development of key standards and of the quality of human resources in the public sector.
- *establishment and implementation of a sustainable system for continuous training of civil servants (on central and local level):* The aim of the proposed investment programme (activity) is the establishment of a sustainable system for continuous training of civil servants through the implementation of the National system for training coordination and professional development of civil servants in the Republic of Macedonia. The programme includes the following three activities: (i) establishing of a training centre for civil servants, (ii) preparation of a programme for training and professional development of civil servants, followed with an analysis of the necessary financial means for its implementation; (the Programme will incorporate generic training for development of skills in the areas of strategic planning, policy analysis and coordination, budgeting, EU institutions, human resource managements, public administration management, communication skills, etc. The implementation of this programme will ensure sustainable development of the horizontal and vertical coordination systems), and (iii) creation of a methodology for defining specific training needs of public institutions.
- *the improvement of ethics of public officials and administration includes the following measures:* It includes the following activities: (i) ensuring effective implementation of

the Code of Ethics of the civil servants and the procedure for determining disciplinary responsibility, (ii) analysing the existing rules and procedures for ethics in the state administration and identification of possible improvements, (iii) adopting of a Code of Ethics for ministers and other public officials with the aim of promoting ethical standards on the political level, (iv) developing handbooks, booklets, pamphlets and other promotional material directed towards implementation of ethical standards in the administration, and (v) establishing a link between the ethical behaviour and the standards and procedures for the fight against corruption, introduction of principles in the codes of conduct for all public servants for reporting of corruption suspicions.

- *capacity building of inspection services*; The aim of this investment activity is to strengthen the capacities of the inspectorates for monitoring of the implementation of the legislation. The project activities should include: (i) Introduction of procedures that will ensure coordination amongst inspectorates, (ii) development of modular training programmes, and (ii) development of planning, reporting and monitoring mechanisms in order to improve the policy creation of the Government.
- *development of IT in the operation of the public administration*; The aim of this investment activity is to develop the information society in accordance with the Strategy for development of the information society and the Action Plan defining the directions, measures and activities necessary for the support for development of this area. The segment E-Government of the Strategy includes the following measures: (i) adoption and implementation of the laws and bylaws related to IT, (ii) adopting a National policy for information and communication security and certificate for security of the ICT systems for classified information, (iii) standardisation of the documents and their unification, (iv) implementation of standard procedures, (v) creation of an Agency for IT Society, (vi) ensuring internet and e-mail access for all civil servants, (vii) improving the services on the portal www.uslugi.gov.mk, and (viii) upgrading the collaboration and electronic exchange of information between the state administrative bodies.

Table 4.15: Enhancing administrative capacities – individual projects/programs identified as “investment needs” by respective line ministry (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Establishment of standards for human resource management in the public administration	0.50	8.25	0.50	11.60	0.50	5.57	1.50	7.76
Establishment and implementation of a sustainable system for continuous training of civil servants (on central and local level)	2.00	33.00	2.00	46.40	2.00	22.30	6.00	31.02
Improvement of ethics of public officials and administration	0.50	8.25	0.50	11.60	0.50	5.57	1.50	7.76
Capacity building of inspection services	2.00	33.00		-	5.00	55.74	7.00	36.19
Development of information society	0.70	11.55	0.90	20.88	0.70	7.80	2.30	11.89
Training of the existing personnel	0.06	0.99	0.07	1.62	0.06	0.67	0.19	0.98
Purchase of IT equipment, software	0.30	4.95	0.34	7.89	0.21	2.34	0.85	4.40
TOTAL	6.06	100.00	4.31	100.00	8.97	100.00	19.34	100.00

Table 4.15. presents the total volume of “investment needs” that the respective body has reported as “investment needs” for this activity area. The total volume of this needs, they are all of institutional building character, amounts to 19 million EUR over the 3-year period. What is interesting to observe is that IPA financing is expected the sole source of their funding.

4.2.4. Overall quantification of the “investment needs” for the development/investment priority

Table 4.16. gives a summarized overview of “investment needs” of the human resource development priority of the NDP as reported by the respective line ministries and other respective bodies. As presented in the Table, the “investment needs” for this NDP priority are forecasted at estimated at 142 million EUR over the 3-year period. One half of the total amount is expected to be used in the first year while in the following two year the annual volume are lower and reach 42 million EUR by the end of the period.

Table: 4.16.: Summary of the human resource development/investment priority “investment needs” by activity areas (in million EUR; in % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
1. Improving infrastructure and quality of education	9.80	15.73	5.00	13.37	4.00	9.53	18.80	13.27
2. Education supporting employability	8.70	13.96	1.50	4.01	1.00	2.38	11.20	7.91
3. Strengthening infrastructure for labour market	3.35	5.38	1.90	5.08	3.00	7.15	8.25	5.82
4. Enhancing R&D development	7.20	11.56	7.20	19.25	6.00	14.29	20.40	14.40
5. Supporting social protection	1.01	1.62	1.78	4.76	2.16	5.15	4.95	3.49
6. Ungrading health care system and institutions	26.19	42.03	15.71	42.00	16.85	40.14	58.74	41.46
7. Enhancing administrative capacities	6.06	9.73	4.31	11.53	8.97	21.37	19.34	13.65
TOTAL	62.31	100.00	37.40	100.00	41.98	100.00	141.68	100.00

Within the structure of “investment needs” one activity area, health care, stands out most prominently. It alone accounts for almost ½ of the total. This could be at least partly explained by the fact that the health sector is the only of the 7 activity areas under this priority of the NDP with a high proportion of investment in physical assets and equipment. In all other activity areas investment in institutional building type either dominate, or at least have a very strong share and they are by its character less financially demanding. The fact that in many activity areas significant proportion of money is proposed to be spent on strategies and programs may indicate that in these activity areas projects/programs that would be ready for submission to potential financiers have not yet been developed. Lack of clear strategy accompanied by inadequate project generating capacity seems to contribute substantially to the fact that “investment needs” in some of human resource activity areas are lower than would be desirable. Lack of well prepared projects here opens the way for more financing in other development/investment priorities of the NDP, especially in the economic infrastructure priority, even though weaknesses in the human resource are represent a more significant obstacle for a sustainable development of a country over a longer period than some segments of its economic infrastructure.

As far as envisaged funding is concerned, again the largest share, this time close to ½ of the total, is under the category “Unidentified funding sources” (see Table 4.17). This simply means that some of the line ministries that have provided “investment needs” data either do not know how to finance the projects, or have simply not provided these data. Among the

identified sources there is also practically one – grants. This means that that line ministries do not see other public funds, budget and loans, as possible sources of funding this priority. This is also partly a result of the fact that most of “investment needs” are institutional building projects.

Table: 4.17.: Summary of envisaged funding sources for financing “investment needs” under the human resource development priority of the NDP (in million EUR; in % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Public sources								
Central budget	2.05	3.29	2.14	5.72	1.80	4.29	5.99	4.23
Own funds	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Local budgets	0.00	0.00	0.00	0.00	0.10	0.24	0.10	0.07
IPA	9.00	14.44	8.27	22.12	12.65	30.13	29.92	21.12
Other grants	19.06	30.59	6.57	17.56	4.01	9.55	29.63	20.92
Loans	4.96	7.96	2.08	5.56	1.60	3.81	8.64	6.10
Private sources								
Concessions	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Other private	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Unidentified Funding Sources	27.24	43.72	18.34	49.04	21.82	51.98	67.40	47.57
TOTAL	62.31	100.00	37.40	100.00	41.98	100.00	141.68	100.00

4.3. Economic infrastructure

Economic infrastructure development/investment priority as discussed within the framework of this document consists of the following four large segments: (i) transport infrastructure, (ii) energy infrastructure, (iii) environmental infrastructure, (iv) agricultural infrastructure, and (v) telecommunications and information society.

In 1995, the government of the Republic of Macedonia through the Ministry of Finance established a pipeline of public infrastructure investment projects called the Public Investment Program (PIP). The PIP includes projects/programs for which the government has made an assessment confirming that they can substantially contribute to the development of the country. In the PIP covering a three-year period and being updated annually are projects in all economic infrastructure sectors, including energy, transportation, water supply, irrigation, environment, as well as in the social infrastructure segments.

In order to enter into the PIP, a project/program must meet certain criteria. First of all, the line ministry has to explicitly confirm that the project will have a major contribution towards achieving the sector's development. Second, the preparation of the project documentation should be either completed or at least at very advanced stage of preparation. When drafting an updated version of the PIP, only those projects/programs are included for which realistic funding sources, such as central budget, own resources, credits, and grants, are envisaged. These funding sources are in accordance with the macro-economic and fiscal projections of the authorities. As an annex, the PIP also includes a list of projects/programs that are considered important by the line ministries but for which the documentation is not ready and the funding structure is not closed. The actual implementation of these projects/programs is expected to be conducted through non public sources, especially through concessions, and FDIs.

4.3.1. Summary of the current situation and the SWOT analysis

Efficient, and reliable economic infrastructure and user-oriented public utilities are an important component of a well-functioning market economy as they have a pervasive influence on the whole economy. Telecommunications and energy are, for example, used in production of virtually every sector of an economy. On the other hand, transportation is necessary for the distribution of commodities within the economy and with the partners abroad while environmental infrastructure contribute decisively towards environmentally sustainable development. The quantity and quality of economic infrastructure services is therefore an important determinant of country's overall international competitiveness.

With some exceptions and similar to other countries in transition, the economic infrastructure in the Republic of Macedonia and its infrastructural policies are not in line with the development needs of the economy. It therefore represents an impediment for faster overall development of a country even though economic development even though the situation in this segment of economy is probably less worrying than in the human capital segment.

As presented in chapter 2, economic infrastructure consists of four large segments; transportation, energy, telecommunication and environmental sectors. As presented in

the SWOT analysis, in majority of these segments and their sub-segments the country fares badly if compared with the EU member states and much better if compared with the countries from the region. These comparisons may be misleading due to measurement problems and comparability differences. It is more appropriate to measure the existing stock of the infrastructure relative to the needs. Planning of future infrastructure need must not only take into account the existing pressures but must provide answers to future demographic, economic and other challenges that will have an impact on the demand for infrastructure and its services.

Table 4.18.: SWOT for the economic infrastructure priority of the NDP

Strengths	Weaknesses
<ul style="list-style-type: none"> • Economic infrastructure in general Trans-European Corridors VIII and X that cross the country are recognized by EU as trans-national axes and multimodal directions <ul style="list-style-type: none"> • Proximity to Adriatic and Mediterranean seas • EU accession candidate country status with full eligibility for all components of the IPA funds • Transport infrastructure/services <ul style="list-style-type: none"> • Rather widespread and well developed road infrastructure network • Partly completed highways on both pan European corridors • Reasonably good air infrastructure and performance of the Civil Aviation Administration • Strong pipeline of projects ready for implementation • Regional cooperation (Established South East Europe Transport Observatory-SEETO providing project development and regional approach for transport infrastructure development) • Energy infrastructure/services <ul style="list-style-type: none"> • Institutional reorganization of the sector almost completed • Strong pipeline of ready to go projects • Involvement of private investors foreseen in several segments • Potential to increase energy efficiency • Environmental infrastructure/services <ul style="list-style-type: none"> • Relatively high connection rate for water supply and waste water collection in urban areas • EU compatible environmental legislation largely in place • Inventory of industrial hot spots prepared • Preliminary field surveys on environmental risk assessment completed • Agriculture infrastructure 	<ul style="list-style-type: none"> • Economic infrastructure in general <ul style="list-style-type: none"> • Weak economic growth over the recent years • Inadequate investment • Vulnerability as small landlocked country Lack of capacity of national authorities for improved project preparation in the areas of transportation, energy and environment High cost of infrastructure projects versus limited public funds • Transport infrastructure/services <ul style="list-style-type: none"> • Connections with all neighboring states not established in roads and railway • Limited railway infrastructure network Corridor VIII constructed only 27,6 per cent • Owing to priority construction of high-category roads, investments into low-category roads are being postponed • Land transport strongly concentrated on roads • Obsolete road and railway infrastructure and movable equipment • Restructuring of PE Macedonian Railways not yet completed • Too little investment into new infrastructure, especially in the railways • Practically monopolistic position of the oil and gas service provider • Energy infrastructure/services <ul style="list-style-type: none"> • Inadequate electricity connections with the neighboring states • Strong dependence on imported energy • High energy intensity • Too little investment in both energy production and transmission • High dependency on non-renewable sources

<ul style="list-style-type: none"> • Economically viable water resources • Telecommunications and information society <ul style="list-style-type: none"> • Relatively high level of basic telecommunications services • Almost entirely digitalized network • Relatively efficient operators • Liberalization of the telecommunications market well advanced 	<ul style="list-style-type: none"> • The inadequate use of the existing gas pipeline due to poorly developed domestic network • Energy prices do not comprise external costs • Awareness regarding efficient use of energy and exploitation of renewable energy poor • Environmental infrastructure/services <ul style="list-style-type: none"> • Poor quality of services as well as poor data on the quality of the existing infrastructure • Service providers in poor financial position • Too little investment into new infrastructure as well as into maintenance of the existing one • Existing waste disposal facilities do not comply with EU requirements • Deterioration of the quality of surface and ground waters • Commercialisation of the sector has barely started • Allocation of responsibilities among ministries not clarified • Lack of legal instruments on environmental liabilities • Poor pipeline of ready to go projects in all areas with exception of water supply • Low public and stakeholders awareness • Agricultural infrastructure <ul style="list-style-type: none"> • Low irrigation level of agricultural areas • Obsolete infrastructure and equipment • Inadequate maintenance • Lack of funding; some irrigation system have been abandoned for this reason • Telecommunications and information society <ul style="list-style-type: none"> • Penetration rate below the peer European states • Supply of telecommunications services strongly concentrated in urban areas
Opportunities	Threats
<ul style="list-style-type: none"> • Economic infrastructure in general <ul style="list-style-type: none"> • Expected dynamics of strengthened economic growth and job creation <p>Increase of foreign investments due to political and economic security via the EU and NATO membership</p> <ul style="list-style-type: none"> • An intensified EU accession process • Growing volume of EU funds available 	<ul style="list-style-type: none"> • Economic infrastructure in general <ul style="list-style-type: none"> • The country will not be ready for absorption of the EU funds • Grants from bilateral donors are on a strongly downward path • Transport infrastructure <ul style="list-style-type: none"> • Failure to construct the highways cross on time would expose the country to be eliminated from international transport

<p>under the IPA</p> <ul style="list-style-type: none"> • Technical assistance available for project preparation • Transport infrastructure <ul style="list-style-type: none"> • Availability of the IPA funds • Favourable position of the country in terms of transport for the purpose of logistic centres • Top priority of the sector, especially of its road segment, for publicly supported investment • Introduction of the competition in as many segments of the sector as possible • Interest of the private sector for investments in some segments of the sector • Energy infrastructure <ul style="list-style-type: none"> • Good possibilities for an increased role of an energy transit country • Strong potential of in the hydro power sector • Full utilization of the existing gas pipeline • Interest of the private sector for energy production and gas projects • Environmental infrastructure <ul style="list-style-type: none"> • Further approximation of the legislation • Agriculture infrastructure <ul style="list-style-type: none"> • Recognition of the potential the country has in the agriculture sector • Full utilization of existing irrigation systems • Telecommunications and information society <ul style="list-style-type: none"> • The country can become an important telecommunication integrating node for neighbouring countries (pan-corridor VIII) • Good infrastructure provide a good basis for faster information society development • Faster information society development may contribute towards more balanced regional development 	<p>flows</p> <ul style="list-style-type: none"> • Failure to construct railway infrastructure will increase the negative effects of traffic on the environment. • Failure to upgrade traffic infrastructure will result in deterioration of safety conditions • Energy infrastructure <ul style="list-style-type: none"> • Over-utilization of finite energy resources • Overdependence on energy from a single source • Fragility of the electricity system • Environmental infrastructure <ul style="list-style-type: none"> • Huge investment needs required to meet the EU environmental acquis • Industrial hot spots with potentially high environmental risks • Low consideration of environmental issues by the national stakeholders • Improved standard of living brings about bigger quantities of waste • Deterioration of water sources, rivers and the lakes; • Weak public participation in environmental policy development and decision making • Agriculture infrastructure <ul style="list-style-type: none"> • Further deterioration of irrigation systems • Large investment needs • Telecommunications and information society <ul style="list-style-type: none"> • Telecommunication services lag behind the country's needs • Failure to construct upgrade the infrastructure exposes the country to the risk of being by-passed by international telecommunication channels
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4.3.2. Objectives

The strategic objective of this development/investment priority of the NDP is to improve all segments of the Republic of Macedonia's economic infrastructure and to bring it closer in line with standards applicable in the European Union. Provision of reliable and cost effective services that will take due account to security of supply, safety of the population, rational use of energy and protection of the environment will contribute to the increase of productivity and, therefore, to increase of the country's international competitiveness.

This strategic objective of the economic infrastructure priority as a whole has different applications in each of its five segments

- *Transport infrastructure*; Key objective of the transport sector is to promote its competitiveness in the international market and to support harmonious development of the country as whole. The transport sector should provide the business sector with a reliable and cost-effective access to markets for inputs and outputs, and citizens with good passenger transport services for access to jobs, training and other activities. Based on this overall objective of the transport sector, the specific objectives of individual segments of this infrastructure sector are the following:
 - *road transport*: To enhance international competitiveness of the road transport by (i) building and/or modernizing roads on the pan-European corridors as well as roads that ensure better communication among the regional centres by implementation of a number of selected priority projects, (ii) by enhancing the safety of road traffic, and by limiting harmful effects of road traffic on the environment.
 - *railways*: To strengthen the international competitive position of the railways by (i) building the remaining parts of the network on the pan-European corridor, by modernizing the railways equipment, and (ii) by speeding up the restructuring process of PE Macedonian Railways.
 - *air traffic*: To integrate the Republic of Macedonia into the single air transport market, and to effectively regulate the air traffic service providers.
- *Energy infrastructure*; Key objective is to develop an efficient, cost-effective energy sector that will take due account to security of supply, flexibility, safety of the population and protection of environment. On a more operational level, the objectives include: (i) to increase substantially hydroelectric power generation capacity, (ii) to proceed with the gasification, (iii) to improve energy interconnection and transmission infrastructure as well as distribution networks, and (iv) to improve the investment climate for construction of new energy capacities, for improvement of the energy efficiency, and for increasing the use of renewable energy sources.
- *Environmental infrastructure*; The key objective is to create conditions conducive for pursuing an environmentally sustainable development that is at the same time consistent with the EU requirements in this area. The specific priorities include: (i) to ensure the supply of adequate amounts of drinking water and the collection, treatment and discharge of waste water (by the implementation of a number of selected priority projects and by the development of feasibility studies), (ii) to provide for the management and disposal of solid wastes by investing into new projects (again, by investment in the top priority projects and by development of the documentation for the others), (iii) to support rehabilitation of environmentally damages industrial sites, and (iv) to adopt the draft Law on Waters and development of subsequent secondary legislation.

- *Irrigation and water management*; The strategic goals of the irrigation and water management is to make sure that there is sufficient quantity of good quality water in compliance with the sustainable use of water and to ensure sustainable management and use of water resources. Further objectives are to provide an efficient system of rational use of all available sources of water - lakes, rivers, underwater, atmosphere waters; decrease the loss of non-use of the water as a national resource; ensure protection and preservation of waters; manage situations of lack of drinking water; irrigation of agricultural areas and reorganisation of the system of preventive managing of the droughts and fight with them; protection from the damaging impact of waters and protection and preservation of water.
- *Telecommunications and information society*; The main objective is to provide a high quality and cost effective telecommunication infrastructure and to establish conditions required for efficient implementation and use of ICT by all entities in the Republic of Macedonia. Within this framework, there are some more specific objectives in both areas:
 - *telecommunications*; They include (i) introduction of new technologies into the infrastructure, and (ii) the provision of universal telecommunication services throughout the country.
 - *ICT infrastructure*; They include: (i) introduction of the legal and institutional framework conducive to informational society development, (ii) investment into building up and/or modernization of the ICT physical and supporting infrastructure, such as protocols, standards, etc., and (iii) a continuous development of the ICT staff that manages and administers that infrastructure.

4.3.3. Activity areas

Application of the objectives specified above will be implemented through specific policy measures and investment in the following 10 activity areas:

- Activity areas 1 – 3: Transport infrastructure
 - *Activity area No. 1: Roads*
 - *Activity area No. 2: Railway*
 - *Activity area No. 3: Air transport*
- Activity areas 4 and 5: Energy infrastructure
 - *Activity area No. 4: Energy generation*
 - *Activity area No. 5 Energy transmission*
- Activity areas 6 and 7: Environmental infrastructure
 - *Activity area No. 6: Water supply and waste water treatment*
 - *Activity area No. 7: Solid waste management including rehabilitation of industrial hot spots*
- Activity area 8: Agriculture infrastructure
 - *Activity area 8: Irrigation and water management*
- Activity areas 9 and 10: Telecommunications and ICT infrastructure
 - *Activity area No. 9: Telecommunications*
 - *Activity area No. 10: Information society*

Policy measures; More commercial approach to economic infrastructure development is a common dominator for policy measures to be designed and put into operation in all the 10 activity areas. This approach basically includes the following:

- *financial viability of service providers;* One of the core elements of market-oriented transformation of providers of economic infrastructure services is the introduction of cost-consciousness and demand-oriented production as well as more careful pricing of services. The price reform and effective collection of tariffs are crucial in both balancing the supply and demand for infrastructure services and achieving financial viability of and accountability of infrastructure service providers. Another important condition to improve financial viability of infrastructure service providers is the operational independence of enterprises. The process has typically to be accompanied with continuous and more or less drastic restructuring of service providers.
- *increased scope for competition;* Restructuring of individual enterprises will not be successful if not accompanied with an increased scope for competition. An extremely important policy for cost-effective provision of infrastructure services is introduction of competition wherever possible. This private entry into economic infrastructure will take different forms depending on the specific characteristics of individual modes of infrastructure. The first one, *competition within the market* refers to competition where firms compete for the provision of the same service while the second one, *competition for the market* refers to competition where firms compete for the right to provide service for a given period of time under concession or lease contract.
- *regulation;* Independent yet accountable institutions in practically all infrastructure sectors are needed to oversee competition. The nature of necessary regulation depends largely on the nature of the prevailing and potential competition. In the case of competition in the market, the regulation should be less concerned with the price control, but more with the issues related to safety, environmental and technical standards. If conditions for granting licenses to operators are reasonably clear and non-discriminatory, and appropriate safety regime is enforced, than regulation of these services can be left to competition agencies. When there is a competition for the market, some amount of regulatory is absolutely necessary to monitor compliance with the concession agreements signed between public authorities and private concessionaires.
- *private sector involvement;* Closely associated with the issues of competition and regulation in infrastructure sectors are issues related to the privatisation of assets in this sector as well as to the involvement of the private sector in the financing, construction and operation of economic infrastructure projects.

Investment; Application of the commercial approach to economic infrastructure development will be successful if accompanied by substantial public or publicly supported investments. In some segments of the economic infrastructure, such as telecommunication, airports and some other parts of the transportation sector, electricity and gas production, and also some segments of the environmental sector, public sector may be able to create an create condition conducive to stimulate private

sector investments, either through FDIs or concessions. There are, however, also segments of the economic infrastructure, such as railway, majority roads and environmental infrastructure, which also constitute public goods and can not generate private sector interest. These segments of investment should, of course, be financed from public sources.

Activity areas 1 – 3: Transport infrastructure

Activity area No. 1: Roads

Measures to address road transportation bottlenecks include both policy measures as well as investments in infrastructure. Among policy measures the most important are those associated with management of the road transport demand, including taxation and pricing measures, as well as measures related to the organisation of the service providers. Within this context, it is of high importance to introduce competition in all those segments where infrastructure service provision is still monopolized. An obvious example is road maintenance. Under CARDS 2005 technical assistance is provided for elaboration of Study for Restructuring the Road Sector in Republic of Macedonia, Road Investment Plan and National Transport Strategy for Roads. These studies will explore alternatives in order to increase the effectiveness and efficiency of the road sector including restructuring administrative and management arrangements for the sector, introducing competition, development of appropriate investment and maintenance plans.

**Table 4.19.: Roads – individual projects/programs identified as “investment needs”
by respective line ministry (million EUR, % of total)**

		2007		2008		2009		Total	
		mil	%	mil	%	mil	%	mil	%
Ongoing projects									
Sections on corridor VIII	M-4, Skopje Bypass	29,02	40,64	18,24	15,22	1,03	0,65	48,29	13,85
	Preparation of Main Projects for Corridor VIII	1,92	2,69	1,92	1,60		0,00	3,84	1,10
Other national regional roads	Construction of Regional Road Kuklis-Bansko and Mokrino-Smolari			0,35	0,29	0,73	0,46	1,08	0,31
	Construction of National Road Radovis-Strumica	2,07	2,90	2,86	2,39	3,01	1,91	7,93	2,28
	Maintenance of National and Regional Roads in Republic of Macedonia	21,00	29,41	21,00	17,52	21,00	13,34	63,00	18,07
	K-1-P—109 Majdan-Border with Greece			0,30	0,25	0,45	0,29	0,75	0,22
	Repair of the Roads System	11,79	16,51	10,44	8,71	10,44	6,63	32,66	9,37
Priority projects									
Sections on corridor VIII	Construction of Section Deve Bair-Kriva Palanka			8,28	6,91	10,00	6,35	18,28	5,24
	Construction of Section Gostivar-Gorna Gonovica			6,00	5,01	8,00	5,08	14,00	4,02
	Construction of Section Gorna Gonovica-Bukojcani			6,20	5,17	8,00	5,08	14,20	4,07
Sections on corridor X	Construction of new roadway and rehabilitation of Kumanovo-Tabanovce	3,80	5,32	3,80	3,17	3,80	2,41	11,40	3,27
	Construction of new carriage and rehabilitation of Demirk Kapija-Udovo-Smokvica		0,00	21,52	17,96	36,51	23,19	58,03	16,64
Other national regional roads	Construction of highway Veles-Prilep		0,00		0,00	14,82	9,41	14,82	4,25
	Reconstruction of Section Bitola-Medzitlija		0,00		0,00	3,29	2,09	3,29	0,94
	Reconstruction and Rehabilitation of the Section Skopje-Blace	0,11	0,16	1,55	1,30	4,17	2,65	5,84	1,67
	Reconstruction of Section Gradsko-Prilep	0,82	1,15	0,82	0,69	0,82	0,52	2,47	0,71
	Reconstruction of Zirovnica- Boskov Most	0,44	0,62	0,46	0,38	0,44	0,28	1,34	0,39

	Upgrading Section Bitola-Resen-Ohrid-Podmolje		0,00		0,00		0,00		0,00
	Bypass Resen		0,00	0,90	0,75	1,73	1,10	2,63	0,75
	Strategic Rehabilitation of Carriage Ways	0,43	0,60	15,17	12,66	29,22	18,56	44,81	12,85
	TOTAL	71,40	100,00	119,83	100,00	157,45	100,00	348,67	100,00

The list of “investment needs” for the road infrastructure projects in the year 2007 – 2009 is presented in Table 4.19. Investments for this infrastructure segment are forecasted to more than double in the 3-year period, from 71 million EUR in 2007 to 157 million in 2009. With a total volume of 349 million EUR in the period as a whole, road infrastructure is the activity area with largest “investment needs” not only among the economic infrastructure activity areas but also among all the activity areas of all four development/investment priorities of the NDP. It accounts for 70 per cent of all transportation infrastructure needs, for 29 per cent of all economic infrastructure, and for 20 per cent of all NDP’s investment needs.

As clearly visible from Table, the top road infrastructure investment priority is the completion of the corridors X and VIII. Currently, the ring road around Skopje is being under construction, a project worth 120 million EUR, financed by the EIB and the EBRD. The last constructed sections are: the section Smokvica-Gevgelija with length of 11.22 km, financed through EBRD and the section Negotino – Demir Kapija phase III, length 6.5 km, financed through the European Commission, CARDS Programme. As far as new investments on the two corridors are concerned, beginning of the construction of several sections is expected. On the corridor X, construction should start on sections (i) Demir Kapija -Udovo- Smokvica, (ii) Kumanovo – Tabanovci, and (iii) Bitola – Megitlija.

In addition to construction of the pan-European networks, the road and bridges maintenance, rehabilitation and upgrading are the largest investment items in this activity area that have expressed the most of the “investment needs” for the 2007 – 2009.

Activity area No. 2: Railways

In assessing potentials for the development of railways in the Republic of Macedonia in future, one should not overlook its advantages over road transportation. First, railways represent a significantly less burden on environment. Land used for railway construction is significantly smaller than land required for construction of highways. Railways transportation is also significantly less air polluting and needs less energy per unit of services performed. Second, safety on railways is much better than in road transportation sub-sector. These advantages together with cost efficiency arguments bode well for an intensified railways development in the country.

In order to transform these advantages into reality, significant restructuring of the sector, especially of PE Macedonia Railways is needed. According the recently adopted legislation, the company should be divided into two independent companies with each of them being responsible for different functions. Public Enterprise for Rail Infrastructure Macedonian Railways UnLtd Skopje will remain in the state ownership and will be responsible for the infrastructure, maintenance and protection of railway infrastructure while the other Joint Stock Company for Transport Macedonian

Railways Transport JSC Skopje will be responsible for freight and passenger transportation. An integral part of the overall transformation plan of PE Macedonia Railways will be a substantial reduction in the number of employees and other cost cutting measures, including the outsourcing of non-core business activities.

Policy reforms aimed at commercialisation of the sector will have to be accompanied by significant public investment if railways are expected to take a more important role in the Macedonian transportation sector. The overall “investment needs” of this NDP’s activity area is forecasted by the respective line ministry at 97.25 million EUR for the whole 3-year period.

Of this total, a large majority is planned for reconstruction/modernization of the infrastructure on the existing tracks. However, the actual implementation of investments in this area is further questioned by the fact that project documentation for four projects, including the rehabilitation of the Tabanovce – Greek border line as the largest one, is not yet ready for implementation. Another segment of “investment needs” are investment in the movable railway equipment, such as locomotives and wagons, of which large proportion is expected to be implemented already in the year 2007 as a part the World Bank credit.

Table 4.20.: Railways – individual projects/programs identified as “investment needs” by respective line ministry (million EUR, % of total)

	2007		2008		2009		Total	
	mil.	%	mil.	%	mil.	%	mil.	%
Projects with completed financial construction								
Track mechanization	0,29	1,64	2,61	5,83		-	2,90	2,98
Track equipment	0,90	5,08		-		-	0,90	0,93
Diesel shuntings	0,26	1,47	2,34	5,23		-	2,60	2,67
Rec. of flat freight wagons	0,06	0,34	0,54	1,21		-	0,60	0,62
CTC on Tabanovci-Gevgelija line	0,23	1,30	0,62	1,39		-	0,85	0,87
Info-system for infrastructure	0,06	0,34		-	0,54	1,55	0,60	0,62
Level crossings interlocking onSk.-Gostivar line	0,19	1,07	0,30	0,67	0,30	0,86	0,79	0,81
Thyristoration of el.locomotives	0,18	1,02	1,62	3,62	0,00	-	1,80	1,85
Thyristoration of EM TRAINS	0,13	0,73	1,17	2,62		-	1,30	1,34
Flat freight wagons	0,16	0,90	1,44	3,22		-	1,60	1,65
Rec. of Gradsko-Sivec line (LT)	0,27	1,52	0,27	0,60	0,27	0,78	0,81	0,83
Projects with uncompleted financial construction								
ALB on Klisura-Gevgelija line	0,40	2,26	0,40	0,89		-	0,80	0,82
Radio system on Sk.-Gost. Line		-		-		-	0,00	-
Autostop equipment on track and traction	0,00	-	0,27	0,60		-	0,27	0,28
corr.8-part 2-Kicevo-border R.A.	1,50	8,47	15,00	33,53	20,00	57,49	36,50	37,53
Rec. of DMTrains	0,32	1,81	0,33	0,74		-	0,65	0,67
Optical cable on Tabanovci -Gevgelija and Skopje-Gost.lines	0,85	4,80	1,40	3,13	1,41	4,05	3,66	3,76
Level crossings interlocking on other lines	0,10	0,56	0,32	0,72		-	0,42	0,43
SS.TC equipment G.Petrov stat.	0,00	-		-	0,00	-	0,00	-
Rec.of SS,TC equipment on Tabanovci-Gevgelija line	0,00	-	0,40	0,89	0,40	1,15	0,80	0,82
Rehab. of Taban-border.R.G line	1,70	9,59	5,55	12,41	1,71	4,92	8,96	9,21
Rehab. of Bitola-border.R.G line	0,00	-	0,00	-	0,00	-	0,00	-
corr.8-part 1-Kum-border R.B.	10,00	56,43	10,00	22,35	10,00	28,74	30,00	30,85
Other	0,12	0,68	0,16	0,36	0,16	0,46	0,44	0,45
Total	17,72	100	44,74	100	34,79	100	97,25	100

Activity area No. 3: Air transport

Adoption of the new legislation on air traffic compatible with that of the EU and its full implementation accompanied by an overall reform of the Civil Aviation Administration represent the corner stone of policy reforms in the area of civil air traffic. Under these reforms, the Civil Aviation Administration will be transformed into a Civil Aviation Agency which will be an independent state body, acting as a legal entity and a regulatory authority. In addition, with respect of provision of Air Navigation Services, a Joint Stock Company with one shareholder, the State-Air Navigation Service Provider will be established that will operate in accordance to ICAO, Eurocontrol standards as well as National Legislation.

As far as “investment needs” of this sector are concerned, they are forecasted at 54 million EUR for the 3-year period as shown in the Table 4.21. Of this, far the largest portion, 45 million EUR or almost 84 per cent of the total, should go for reconstruction and modernization of Skopje and Ohrid airports. Currently preparations are underway for the development of a comprehensive study for mid- and long-term development plan for the needs of the airports in Skopje and Ohrid, also comprising a project proposal for: i) upgrading Skopje airport runway category to ILS CAT III (according to ICAO) and its interdependence with the capacities of the remainder of the Skopje airport system, ii) construction of an additional passenger terminal at Skopje Airport, with minimum level of service “C” (according to IATA) and a modular concept for 1.5 million passengers, iii) adequate institutional model for both airports (with detailed explanations for the suggestions made), iv) improvement of the airports’ competitive position in the region, and v) financial support and strategy for the investment needs of both airports. The development of the study is planned to start not later than April 2007.

Another segment of air traffic “investment needs” are those ones associated with the replacement and modernization of the air control equipment. More specifically, the investments will be directed towards improving the quality of air transport services, upgrading and enhancing the safety and security standards and resolving problems related to the environment, all in accordance with the Single European Sky Regulations and European Common Aviation Area Agreement. Total volume of “investment needs” in this area is forecasted at some 8 million EUR or to between 2 to 3 million EUR a year. The funding should be provided by own resources of the reformed joint-stock company for air control and should therefore not represent a direct pressure on public finances.

Table 4.21.: Air transport – individual projects/programs identified as “investment needs” by respective line ministry (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Equipment								
Enhancement of ANS sector capacity	0.20	5.26	0.20	0.87	0.20	0.74	0.60	1.12
Supply of DME	0.25	6.58	0.25	1.09	-	-	0.50	0.93
Upgrade of ATM systems (ARTAS, FDP, ODS)	0.80	21.05	-	-	-	-	0.80	1.49
Supply/replacement of RDDP	-	-	0.40	1.74	0.40	1.48	0.80	1.49
EATC Licencing	0.25	6.58	0.25	1.09	0.25	0.93	0.75	1.39
Upgrades in AIS Services	0.30	7.89	0.30	1.30	-	-	0.60	1.12
Preparation of Study for Establishing a Model for Development of Airport Sopje and Airport Ohrid	0.60	15.79	-	-	-	-	0.60	1.12
Supply of a/p equipment	0.90	23.68	-	-	-	-	0.90	1.67
Supply and replacement of new MSSR/SKP	-	-	0.60	2.61	0.60	2.22	1.20	2.23
Supply of Doppler / Met Radar	-	-	0.50	2.17	0.55	2.04	1.05	1.95
Replacement of AWDS/ATIS/VOLMET	0.50	13.16	0.50	2.17	-	-	1.00	1.86
Physical infrastructure								
Reconstruction and Modernization of Skopje /Ohrid Airport	-	-	20.00	86.96	25.00	92.59	45.00	83.64
TOTAL	3.80	100.00	23.00	100.00	27.00	100.00	53.80	100.00

Activity areas 4 and 5: Energy infrastructure

The two main issues of the energy sector to be addressed in the future include continuation of the commercialisation of the sector, and intensification of investments. With respect to the commercialisation of the sector, the Ministry of Economy will continue to be responsible for the design of the overall policy framework for the sector while the Energy Regulation Commission, as an independent body established by the Parliament in 2003, is expected to assume a strong role in regulating the sector and in supervising the service providers. The main tasks of the Commission are: (i) to structure prices of different types of energy and services in the sector, (ii) to regulate the services and conditions related to the access to infrastructure, and (iii) to issue licenses for activities in various segment of the sector.

As far as investments are concerned, priorities are clearly focused into two segments. The first one is energy generation, and the second one is energy transport. Investments in each of the two are discussed in more details below.

Activity area No. 4: Energy generation

Within the segment of energy generation, the total volume of projects reported as “investment needs” amounts from 66 million EUR in 2007 to even 159 million EUR in 2009. With a total volume of 361 million EUR in the 3-period as a whole, energy generation is the NDP activity area with the second largest “investment needs” among all the 10 economic infrastructure activity areas. It accounts 30 per cent of all economic infrastructure “investment needs”, and for as much as 85 per cent of total energy investments needs under the NP. The line ministry further reports that documentation for all these projects is ready, and envisages that the projects will be financed from two main sources, loans and concession, with each of them participating with roughly one half.

As far as the structure of “investment needs” for energy generation is concerned, there is a strong bias towards hydro power generation, either through the construction of new capacities or through the modernization of the existing power plants. They account for roughly one half of total “investment needs” reported for energy production. Construction of the following hydro power plants is expected to begin in the 2007 – 2009 period: Matka 2 (Sv. Petka), Cebren, Galishte, and Boshkov Most. In addition to these individual power plant projects, there are also 19 small hydro-power plants to be built under the concession model, with high reported “investment needs” of EUR 120 million. The same model is expected to attract private investors for the construction of the 6 hydro power plants in the Vardar valley.

Among other energy generation projects for which “investment needs” have been articulated two need to be specifically mentioned: The first one involves a construction of cogeneration natural gas thermo-electric and heating plant for Skopje with approximately 190 MW of electrical and 150 MV of heating capacity. The overall size of the project is 137 million EUR. The project has a great commercial potential and may be considered for private sector financing. The second project involves an opening of the Brod – Gneotino mine what is absolutely necessary for an uninterrupted production of the thermo power plant Bitola.

Table 4.22.: Energy generation – individual projects/programs identified as “investment needs” by respective line ministry (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
HPP “Sv.Petka”	14.36	21.60	6.16	4.54	-	-	20.52	5.68
HPP “Cebren”	-	-	-	-	15.00	9.45	15.00	4.16
HPP “Galiste”	-	-	-	-	10.00	6.30	10.00	2.77
Small HPPs (19)	40.00	60.17	40.00	29.46	40.00	25.20	120.00	33.24
HPP “Boskov most”	-	-	5.00	3.68	10.00	6.30	15.00	4.16
Mine “Brod-Gneotino”	6.30	9.48	-	-	-	-	6.30	1.75
CHP “TE-TO”	-	-	68.75	50.63	68.75	43.31	137.50	38.09
Vardar valley (6 HPPs)	-	-	10.00	7.36	15.00	9.45	25.00	6.93
ROT	5.82	8.75	5.87	4.32	-	-	11.69	3.24
TOTAL	66.48	100.00	135.78	100.00	158.75	100.00	361.01	100.00

Activity area No. 5: Energy transmission

The total volume of forecasted “investment needs” for the energy transmission and distribution projects in the Republic of Macedonia amounts to 63 million EUR in the 2007 – 2009 period spread equally through the 3-year period. The main focus of these projects is two-fold. The first one is to complete the electricity. Within this context, construction of the 400 kW long-distance power lines Stip – Cervena Mogila (Bulgaria) and Bitola - Florina (Greece) are of particular importance, as they would enhance the stability of the Macedonia power system. The first of the two projects is already under construction should be completed by 2008. There are several other projects of the MEPSO aimed at strengthening the electricity transmission capacity of the country. Foreign loans are expected to be the main funding source for the electricity grid projects worth close to 40 million EUR for the 3-year period.

The other large segment of energy transmission projects are those ones in the gas pipeline network (main and distribution). For the time being, there is no project of this category under construction. In the years to come, however, construction of three major gas pipeline projects should commence. Two of them, Klecovce-Negotino and the gas ring around Skopje, should be initiated in 2008 while the third one, Skopje-Tetovo-Gostivar-Kicevo-(with a branch to Debar)-Struga-Ohrid, should start a year later. In contrast to the electricity grid projects, the gas pipeline projects are expected to be funded primarily through concessions.

Table 4.23.: Energy transmission – individual projects/programs identified as “investment needs” by respective line ministry (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
400 OHTL Stip-Crvena Mogila	10.91	48.71	6.09	32.78	0.00	-	17.00	26.91
Proekti AD MEPSO	7.00	31.25	8.00	43.06	4.70	21.18	19.70	31.19
Electrification of non electrified villages	0.49	2.19	0.49	2.64	0.49	2.21	1.47	2.33
Construction of Sub Stations	4.00	17.86	-	-	-	-	4.00	6.33
Main gas pipeline Klecovce-Negotino	-	-	-	-	5.00	22.53	5.00	7.92
Main gas pipeline Skopje-Ohrid	-	-	-	-	8.00	36.05	8.00	12.66
Main gas pipeline Skopje-General Jankovic	-	-	1.00	5.38	1.00	4.51	2.00	3.17
Gas ring around Skopje	-	-	3.00	16.15	3.00	13.52	6.00	9.50
TOTAL	22.40	100	18.58	100	22.19	100	63.17	100

Activity areas 6 and 7: Environmental infrastructure

Strategic objective of environmental infrastructure development in the Republic of Macedonia is to move towards a reliable and cost efficient provision of communal services which will take due account to security of supply, safety of the population and protection of the environment and which will be in compliance with the relevant EU legislation. In order to achieve this objective, a whole range of coordinated policy measures has to be designed and put into operation. Their common denominator is a more commercial approach to communal infrastructure development. Second, tariff reform will not be successful if not accompanied with an increased scope for competition. An extremely important policy for cost-effective provision of communal infrastructure services is introduction of competition wherever possible. Third, in order to improve financial viability of communal infrastructure service providers it is necessary to establish an appropriate legislation which establishes legal environment conducive for operational independence of enterprises and for private sector involvement into the provision of environmental services, especially in the form of concessions. An appropriate legal framework is a necessary but not a sufficient condition for an efficient implementation of the concession legislation. Equally important is a creation of an adequate institutional arrangement that would assist local communities (and also line ministries) in the preparation and even negotiations of individual communal infrastructure projects to be implemented in a concession form.

These policy reforms will have to be accompanied with an intensified investment in environmental infrastructure if the authorities want to improve the quality of people's live, to increase environmental protection standards and to facilitate the country's

accession to the European Union. Investments will be concentrated in two areas. The first one is water supply, and waste water collection and treatment, and the second one is solid waste management including rehabilitation of industrial hot spots. The forecasted “investment needs” as reported by the respective line ministries, especially in the waste water collection and treatment areas as well as in the solid waste management area, have a number of common characteristics: First, a rather limited number of projects in the “investment needs” pipeline are projects that are either already under implementation or their construction is scheduled in one of following three years. Second, a large majority of projects included into “investment needs” pipeline are de-facto technical assistance projects aimed at preparation of technical documentation. This clearly confirms a general lack of environmental infrastructure projects with the documentation ready for starting the investment. Third, in both areas, no private sector involvement into financing of the projects is foreseen. Investors count exclusively on public funds, especially on the funds from the central budget as well as on bilateral grants, IPA funds and loans. More detailed assessment of “investment need” in both areas is discussed below:

Activity area No. 6: Water supply and waste water collection and treatment

The total volume of “investment needs” under this activity area amounts to 104 million EUR with the annual figures increasing from 20 million EUR a year in 2007 and 29 million EUR in 2008 to 55 million EUR in 2009.

As shown in Table 4.24, the projects included into the “investment needs” pipeline can be roughly classified into three groups. The first group, water supply projects, consists of 11 investment projects. Some of them, are already under implementations while construction of others, documentation for all of them is reported to be ready, is expected to begin in various years of the 2007 – 2009 period. All these water supply projects are relatively small as their average size remains below 5 million EUR. Another important feature of this group of projects is that their relative share within the overall “investment needs” figures of this activity area is expected to be reduced by half between the years 2007 and 2009, mainly as a result of a strongly increasing trend forecasted for “investment needs” in more capital intensive waste water collection and treatment segment.

The second group consists of investment projects in the waste water collection and treatment. Out of 10 projects, construction of several of them, including those ones in Krivogastani, Kumanovo, Berovo and Gevgelija, has already started while construction on some others is expected in different years of the NDP period. The share of investments in waste water collection and treatment projects is expected to significantly increase by 2009.

Table 4.24.: Water supply and waste water collection and treatment – individual projects/programs identified as “investment needs” by respective line ministries (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Water Supply and Sewerage Project in Tetovo, Gevgelija, Gostivar, Kavadarci, Kocani, Negotino and Resen-First Stage		-	0.80	2.74	0.80	1.46	1.60	1.54
Rehabilitation and Water Supply Improvement in Skopje	1.54	7.84	7.50	25.65	7.50	13.64	16.54	15.92
Water Supply System for Kocani, Vinica and Orizari		-	0.40	1.37	0.40	0.73	0.80	0.77
Disposal of Waste Water in Tetovo		-		-	7.00	12.73	7.00	6.74
Waste Water Treatment Plant-Skopje	4.00	20.35	4.00	13.68	4.00	7.28	12.00	11.55
Water Supply Improvement in Sveti Nikole	0.96	4.88	0.64	2.19		-	1.60	1.54
Water Supply System Prilep	0.51	2.60	1.00	3.42	1.00	1.82	2.51	2.42
Water Supply in Tetovo with Intake on River Pena	1.50	7.63	1.00	3.42	0.90	1.64	3.40	3.27
Water Supply Systems in Cegrane and Forino		-		-	0.50	0.91	0.50	0.48
Regional Water Supply Pipeline Medjtlija	0.84	4.27		-		-	0.84	0.81
Main Water Supply Pipeline from the H.S.Lipkovo to Filtering Station Kumanovo		-		-	0.60	1.09	0.60	0.58
Programme for Water Supply and Sewerage Systems in Populated Areas	2.50	12.72	2.50	8.55	0.87	1.58	5.87	5.65
Water Supply in Vrapciste, Support for the Public Communal Enterprise	0.28	1.44	0.28	0.97		-	0.57	0.54
Water Treatment Plant-Filtering Station for Probstip		-		-	0.80	1.46	0.80	0.77
Construction of Sewerage Network in Krivogastani	0.50	2.54	0.50	1.71		-	1.00	0.96
Construction of Sewerage and Waste Water Treatment Plant in Cucer Sandevo	0.65	3.31	0.65	2.22		-	1.30	1.25
Construction of Waste Water Treatment Plant in Jasenov, municipality Caska	0.07	0.36	0.07	0.24		-	0.14	0.13
Development of technical documentation for waste water collection and treatment for Skopje	0.80	4.07	1.00	3.42		-	1.80	1.73
Construction of the waste water collection and treatment for Skopje		-		-	15.00	27.29	15.00	14.44
Development of technical documentation for waste water collection and treatment for Prilep	0.50	2.54	0.60	2.05		-	1.10	1.06
Construction of the waste water collection and treatment for Prilep		-		-	4.00	7.28	4.00	3.85
Development of technical documentation for waste water collection and treatment for Tetovo		-	0.50	1.71	0.70	1.27	1.20	1.16
Development of technical documentation for waste water collection and treatment for Bitola	0.50	2.54	0.60	2.05		-	1.10	1.06
Construction of System for Waste Water Treatment in Bitola		-		-	4.00	7.28	4.00	3.85
Development of technical documentation for waste water collection and treatment for Veles		-	0.60	2.05	0.80	1.46	1.40	1.35
Development of technical documentation for waste water collection and treatment for Sturmica*		-	0.40	1.37	0.60	1.09	1.00	0.96
Construction of system for waste water treatment for Berovo	3.00	15.26	2.20	7.52		-	5.20	5.01
Construction of Waste Water Treatment Plant in Gevgelija	1.50	7.63	0.50	1.71	1.00	1.82	3.00	2.89
Construction of System for Waste Water Treatment in Debar		-	3.50	11.97	4.50	8.19	8.00	7.70
TOTAL	19.65	100.00	29.24	100.00	54.97	100.00	103.87	100.00

Closely related to investments into waste water collection and treatment are technical assistance projects aimed at preparing the technical documentation for projects to be constructed in the following years. This third group of “investment needs” includes 6 projects of this kind. These preparatory projects will serve as a base to raise funds for their implementation in the forthcoming period; for some of those the funding has already been committed. The priority of these projects for actual implementation will be based on the following two criteria: (i) the extent of the degradation of river water quality resulting from the existing untreated discharges, and (ii) the extent of the reduction in the pollution loading that would be achieved by the addition of secondary treatment as required by the EU’s Urban Waste Water Treatment Directive (Council Directive 91/271/EEC), but without assuming any additional connection to existing sewerage. Based on these priorities, projects for the agglomerations of Skopje, Prilep, Strumica, Bitola and Veles will have a priority status.

Activity area No. 7: Solid waste management including rehabilitation of industrial hot spots

The pipeline of projects concerning municipal solid waste management is being prepared on the basis of the line ministry’s assumption that the minimum viable size of such a system is around 100 000 population. Based on this assumption, some 7 to 8 regional waste management systems based around the EU compliant landfills would be optimal to provide the required capacity for the country. The criteria for prioritization of regions have been defined as following: (i) reduction of the environmental risk from the current disposal site, and (ii) reduction of waste quantities inappropriately disposed off.

Following these criteria, the respective line ministry has identified as a priority five integrated regional solid waste management systems; for the following five regions: (i) Central east region, (ii) South west region, (iii) North east region, (iv) Skopje region, and (v) Polog region. As technical documentation for none of these projects has been prepared, it is logical that investment activities are feasible only several years from now. As a consequence, the total volume of “investment needs” in this area is negligible in the first year of the NDP, 0.5 million EUR. In the following years it increases as technical assistance projects are expected to be initiated for all the five regions, and as actual construction is expected to begin in two of them, namely in the South west region in 2008 and in the Central east region in 2009.

Also a rehabilitation of one of the industrial hotspots identified as a priority in terms of highest potential environmental threat is included in the “investment needs” pipeline. There are at the moment 16 industrial hotspots identified and evaluated with the proven contamination of the environment (exceeding standards for soil, groundwater and/or surface water quality) found in four of them; Bucim copper mine, Zletovo lead and zink smelte, former arsenic and antimony mine Lojane, and Silmak ferro-alloy plant. High potential environment risk comes also from the OHIS organic chemical industry.

Table 4.25.: Solid waste management, including rehabilitation of industrial hot spots – individual projects/programs identified as “investment needs” by respective line ministries (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Solid waste management								
Development of technical documentation for integrated WM system in Central east Region		-	0.50	4.76		-	0.50	1.48
Installation of the first phase of the integrated WM system in Central East Region		-		-	7.25	32.58	7.25	21.48
Development of technical documentation and implementation of accompanying activities for the integrated WM system in South West region	0.50	50.00	0.50	4.76		-	1.00	2.96
Installation of the first phase of the integrated WM system in South-West region		-	7.00	66.67	8.00	35.96	15.00	44.44
Development of technical documentation for integrated WM in North-East region		-	0.50	4.76		-	0.50	1.48
Development of technical documentation for integrated WM system in Skopje region		-		-	0.50	2.25	0.50	1.48
Development of technical documentation for integrated WM system in Polog region		-		-	0.50	2.25	0.50	1.48
Rehabilitation of industrial hot spots		-		-		-		-
Rehabilitation of industrial hot spots	0.50	50.00	2.00	19.05	6.00	26.97	8.50	25.19
Total	1.00	100.00	10.50	100.00	22.25	100.00	33.75	100.00

Activity area 8: Agriculture infrastructure (irrigation and water management)

Irrigation provides a significant contribution towards stable and competitive agricultural production in the Republic of Macedonia. In 2005, about 21% of the whole arable land was under irrigation systems. The total arable land with irrigation potential is 400,000ha, which is about 69% of the total arable land (including the existing area under irrigation systems). The main irrigation facilities, according to their original technical specifications, can provide irrigation for 144,894ha agricultural land in a year with medium aridity. However, due to incomplete detailed reticulation in the larger systems (about 12,442ha), and the areas with permanent infrastructure facilities, the non-drainable areas and the saline soils, the real capacity of the irrigation network is assessed as only 123,864ha of agricultural land.

Generally, all the irrigation systems have functional difficulties. The most common problems are the obsolete equipment and infrastructure, inadequate maintenance because of lack of funds and transitional processes in the water economy and the agriculture sector. Presently, about 33,000ha are without irrigation due to neglected systems.

In such a situation, investment in infrastructure obtains the status of the most important precondition for achieving the main goals of the country in the agriculture, but also in other related fields. Within its specific perspective, the strategic goals of the irrigation and water management is to ensure sustainable management and use of water resources; to make sure that there is sufficient quantity of good quality water in compliance with the sustainable use of water; to have an efficient system of rational use of all available sources of water - lake, river, underwater, atmosphere waters; decrease the loss of non-use of the water as a national resource; to ensure protection and preservation of waters; to manage situations of lack of drinking water; irrigation of agricultural areas and reorganisation of the system of preventive managing of the

droughts and fight with them; protection from the damaging impact of water and protection and preservation of water.

Several programmes will be conducted in the future: They can be broadly classified into two large segments. The first one involves preparation and/implementation of water management policies. There are the following 5 projects of this category forecasted by the respective line ministry for the next 3-year period:

- *Implementation of measures for efficient use of waters;* This programme implies maintenance of the key objects and system parts for the use of waters for water supply and irrigation; upgrading and expansion of irrigation systems; improvement of the protection against the damaging effect of waters; preparation of technical documents for these projects; monitoring.
- *Flood protection measures;* This measure involves the following: participation in the construction of parts or whole of water regulation objects; preparation of technical documents for these projects; preparation of floods protection plans.
- *National strategy on waters;* The National strategy on waters is a legal obligation in order to run a consistent policy for water resource management.
- *Preparation of water economy data and register;* This comprises the following: Gathering information and preparation of inventory of waters; gathering data and preparation of Aquaculture component; register of concentrated water polluters; updating of the cadastre of constructed water objects.
- *Capacity strengthening of the Water economy administration;* The new functions of the Water economy administration require that its capacity be strengthened.

The second category of projects consists of irrigation physical infrastructure projects. There have been 4 projects put into the “investment needs” pipeline by the respective line ministry:

- *Project for rehabilitation and restructuring of the irrigation;* This project provides for construction works for the rehabilitation and restructuring of irrigation systems and technical assistance as needed, administering and monitoring of the project, preparation of the technical documentation for rehabilitation of hydro-systems. The goal of this project is to provide the needed facility to individual farmers, through recovery of the three hydro-melioration systems (Tikves, Bregalnica and Polog), improved management of the irrigation through restructuring of the water management organizations and introduction of a process of management on the basis of participation. This project began in 1997. In addition to the budget sources, the Project for recovery and restructuring of irrigation is funded by a loan from the World Bank and a grant from the Dutch Government
- *Construction of Dam Lisice;* The construction of the dam with accompanying buildings is intended to be finished in 2007, while further activities are

planned for construction of an irrigation system for 4,000 hectares of new land and for 2,100 hectares on the left bank of the River Vardar. The funds for the construction of Lisice dam, are provided by the budget and a loan from the Kingdom of Spain, the later being mainly intended for construction and finishing of the project and for hydro-mechanical equipment.

- *Irrigation system of South Vardar valley*; The project for irrigation of South Vardar Valley refers to the restructuring and modernization of the irrigation systems for agricultural areas in the southern Vardar river region. The goal of this project is to provide for sustainable increase of agricultural production and productivity of the irrigation systems, as well as improvement of living conditions of the rural population in the Southern Vardar River Valley. On the basis of the proposed projects for financial cooperation with the German Government, the project was approved in 1999.
- *Hydro system Zletovica* The aim of the project hydro-system „Zletovica” is to provide a multi-purpose system for water supply to the population and industry in the following municipalities: Kratovo, Probistip, Stip, Sveti Nikole, Zletovo, Karabinci and Lozovo; irrigation; construction of access road and dam with accompanying facilitates and facilities for the water supply system. The majority of the funds, around 2/3 of them are provided by the Japanese Government.

Table 4.26 shows that 93 per cent of total “investment needs” reported by the line ministry is aimed for the infrastructure projects. Of this, two large projects, Lisice and Zletovica, participate with as much as 85 per cent in the total. Roughly ½ of resources is expected to be provided from the budget and ½ from loans.

Table 4.26.: Irrigation and water management – individual projects/programs identified as “investment needs” by respective line ministries (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Measures and activities for efficient use of waters	0.54	1.31	0.54	1.76	0.54	1.45	1.63	1.49
Measures for protection against flood	0.68	1.65	0.68	2.20	0.68	1.82	2.04	1.87
National strategy for waters	0.08	0.19	0.08	0.26	0.09	0.24	0.25	0.23
Watersupply register	0.11	0.27	0.11	0.36	0.11	0.30	0.33	0.30
Rehabilitation and restructuring of water supply	2.08	5.04	0.10	0.32	1.10	2.95	3.28	3.00
Irrigation system Lisice	5.61	13.61	10.00	32.39	15.00	40.24	30.61	27.99
Lisice Dam	2.07	5.03		-		-	2.07	1.90
Irrigation project South Vardar valley phase 1	3.60	8.73	0.00	-	0.00	-	3.60	3.29
Irrigation project South Vardar valley phase 2		-	0.10	0.32	1.10	2.95	1.20	1.10
Hydro system Zletovica	26.45	64.16	19.26	62.38	18.65	50.04	64.36	58.85
TOTAL	41.22	100.00	30.87	100.00	37.27	100.00	109.36	100.00

Activity areas 9 and 10: Telecommunications and ICT infrastructure

Activity area No. 9: Telecommunications

Based on the existing legislation which has practically fully liberalized all segments of the telecommunications market intensification of the competition processes is expected to continue. By adoption of by laws and harmonization of the existing concession contracts that is expected to be completed by the first half of 2007, telecommunications market will be fully liberalized. One of the main challenges for authorities in the years to come is to put in place a highly competent regulatory body that will be able to supervise the developments on the market and to guide its development taking into account the overall development objectives of the country.

As far as investments of the telecommunications sector in the following years are concerned, they are expected to be concentrated on the introduction of new technologies permitting the provision of new services. In more specific terms, this means infrastructure investment based on the GPRS for mobile telephony, and on broadband internet and voice over IP for fixed telephony as well as introduction of other third generation technologies. Also provision of access to the minimum package of telephone services throughout the country will remain high on the priority list of investments in the future.

Though the total volume of investments into the telecommunications sector is expected to be substantial during the 3-year period of the NDP, the respective authorities have failed to provide data about the sector's actual "investment needs" in the forthcoming period.

Activity area No. 10: Information society

Implementation of the recently adopted Strategy for Information Society Development will constitute the core of the government's policy measures in this area. In addition to measures that are mainly of a legislative and institutional character, introduction and development of public e-services also involves large investment. They include investment associated with the e-government as well as investment into various segments of mainly publicly financed services where education and health sectors feature most prominently.

As shown in Table 4.27., total public sector "investment needs" broadly associated with the information society objectives are forecasted at 30 million EUR over the 3-year period with a clear upward trend with respect to annual investments. The figure includes primarily investments into e-government which is much more than application of new modern ICT-technologies. E-government actually represents a fundamental transformation of the Government's manner of operation and the way the public administration is reasoning and acting, in order to create high quality services for citizens, businesses and public administration. Within this context investment are forecasted for various purposes, including introduction and/or modernization of the physical infrastructure, design, introduction and maintenance of information systems, and also training.

Table 4.27.: Information society – individual projects/programs identified as “investment needs” by respective line ministries (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
1. Upgrade of current ICT systems and knowledge	1.90	32.76	3.90	33.33	3.70	30.58	9.50	32.09
Building ICT knowledge (500 employees/year, 100 150 ICT staff/year, Microsoft - EA and other sources)	0.40	6.90	0.50	4.27	0.50	4.13	1.40	4.73
Public finance (Ministry of Finance)	0.00	-	0.90	7.69	0.20	1.65	1.10	3.72
<i>Ministry of Finance (included in other MF expenditure: eTreasury, eBudget, eDebt Management, CUSTOMS (TFS), PRO (Big tax office)) = covered by MF, (need confirmation from MF)</i>		-		-		-	0.00	-
<i>PRO (VIES, TAXUD)</i>		-	0.9	7.69	0.2	1.65	1.10	3.72
Centers for transfer of technology	0.5	8.62	1	8.55	1	8.26	2.50	8.45
Other institutions (upgrade current systems, new institutions)	1.00	17.24	1.50	12.82	2.00	16.53	4.50	15.20
2. Common government networks and infrastructure	2.40	41.38	4.80	41.03	5.40	44.63	12.60	42.57
Definition of Interoperable framework (technical policies & standards, security, cyber crime, personal data protection)	0.1	1.72	0.1	0.85		-	0.20	0.68
Development of government network (logical and physical)	0.5	8.62	1	8.55	1	8.26	2.50	8.45
PKI infrastructure, CA, Icard in PA	0.5	8.62	1	8.55	1.5	12.40	3.00	10.14
Common functions (infrastructure support)	0.1	1.72	0.3	2.56	0.5	4.13	0.90	3.04
Common registers and databases (data infrastructure)	0.1	1.72	0.3	2.56	0.3	2.48	0.70	2.36
Introduction of ICT training modules for the PA	0.1	1.72	0.1	0.85	0.1	0.83	0.30	1.01
Educational network (schools)	0.5	8.62	1	8.55	1	8.26	2.50	8.45
University network (MARNET - GEANT)	0.5	8.62	1	8.55	1	8.26	2.50	8.45
3. Telecommunications, data communication infrastructure, services	0.50	8.62	1.00	8.55	1.00	8.26	2.50	8.45
4. ICT diffusion (regional development)	1.00	17.24	2.00	17.09	2.00	16.53	5.00	16.89
TOTAL	5.80	100.00	11.70	100.00	12.10	100.00	29.60	100.00

It should be underlined that “investment needs” for information society included into Table 2.27. do not represent the total volume of information society “investment needs” the Macedonian public sector forecasts for development purposes over the next 3-year period¹³ as due to its strongly horizontal character (computerization is becoming the way of operation in all segments of public administration) some “investment needs” of this character are incorporated into other investment/development priorities of the NDP. The total volume of development oriented “investment needs” of the country in the information society area for the 2007 – 2009 is therefore significantly larger.

¹³ At least two large segments of information society investment are not subject of the NDP and are therefore excluded: First, investments into e-business; it is funded by the corporate sector itself. Second, those public sector investments into information society which are associated with the “sovereign state functions”, such as investments of the ministries of defence, internal affairs, and foreign affairs.

4.3.4. Overall quantification of the “investment needs” for the development/investment priority

Table 4.28. summarizes “investment needs” of the economic infrastructure development/investment activity as identified and formulated by the respective line ministries. As shown in the Table, the “investment needs” for this NDP priority are estimated at over 1 billion EUR over the 3-year period with a strongly upward trend throughout the years, from 215 million EUR in 2007 over 371 million EUR in 2008 to 481 million EUR in 2009.

Table: 4.28.: Summary of economic infrastructure development/investment priority “investment needs” by activity areas (in million EUR; in % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Transportation infrastructure								
1. Roads	71.40	28.62	119.83	28.25	157.45	29.89	348.67	29.04
2. Railways	17.72	7.10	44.74	10.55	34.79	6.60	97.25	8.10
3. Air Transport	3.80	1.52	23.00	5.42	27.00	5.13	53.80	4.48
Energy infrastructure								
4. Energy-Generation	66.48	26.65	135.78	32.01	158.75	30.14	361.01	30.07
5. Energy-Transmission	22.40	8.98	18.58	4.38	22.19	4.21	63.17	5.26
Environmental infrastructure								
6. Water supply and waste water treatment	19.65	7.88	29.24	6.89	54.97	10.44	103.87	8.65
7. Solid Waste Treatment including rehabilitation of industrial hot spots	1.00	0.40	10.50	2.47	22.25	4.22	33.75	2.81
Agricultural infrastructure								
8. Irrigation and water management	41.22	16.52	30.87	7.28	37.27	7.08	109.36	9.11
Telecommunication and information society								
9. Telecommunications								
10. Information society	5.80	2.32	11.70	2.76	12.10	2.30	29.60	2.47
TOTAL	249.47	100.00	424.24	100.00	526.77	100.00	1200.48	100.00

There are two segments of the economic infrastructure, transport and energy, where a large majority of all economic infrastructure “investment needs”, around ¾ of the total, has been concentrated in the 2007 – 2009 period. There is also a strong concentration of the reported “investment needs” within these two segments. Investment into road infrastructure accounts for 80 per cent of all transport segment’s “investment needs” while investments into energy production participate with practically the same proportion in the overall energy sector “investment needs”. Environmental and agricultural investments figure with around 10 per cent each in total economic infrastructure “investment needs”

As far as envisaged funding is concerned, the largest share, 1/3 of the total is under the category “Unidentified funding sources” (see Table 4.29.) This simply means that some of the line ministries that have provided “investment needs” data either do not know how to finance the projects or have simply not provided these data.

It is interesting to observe that among the identified funding sources, loans and concessions feature most prominently. Certain infrastructure segments, such as

airports, gas and energy production, are expected to be financed almost exclusively through concessions. On the other hand, roads, railways, environmental infrastructure, agricultural infrastructure and information society investment continue to rely almost exclusively of public funds, be it from domestic budget resources, loans, and grants. The later ones are expected to be particularly important for environmental infrastructure financing.

Table: 4.29.: Summary of envisaged funding sources for financing “investment needs” under the economic infrastructure development/investment priority (in million EUR; in % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Public sources								
Central budget	43.91	17.60	50.58	11.92	80.31	15.25	174.80	14.56
Own funds	22.35	8.96	28.30	6.67	40.30	7.65	90.95	7.58
Local budgets	0.55	0.22	0.82	0.19	1.54	0.29	2.91	0.24
IPA	7.70	3.09	30.72	7.24	46.61	8.85	85.04	7.08
Other grants	13.51	5.41	21.01	4.95	24.36	4.62	58.87	4.90
Loans	105.54	42.30	112.22	26.45	87.98	16.70	305.73	25.47
Private sources								
Concessions	45.82	18.37	84.87	20.01	132.00	25.06	262.69	21.88
Other private	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Unidentified Funding Sources	10.09	4.04	95.73	22.57	113.68	21.58	219.49	18.28
TOTAL	249.47	100.00	424.24	100.00	526.77	100.00	1200.48	100.00

4.4. Agriculture, including rural development and irrigation

4.4.1. Analysis of the current situation and the SWOT

The agriculture has traditionally been one of the most significant industries of Macedonian economy. Unlike some of the transitional economies, in which the agriculture suffered loss of its importance in certain periods, Macedonian agriculture has constantly maintained its position in the economy during the overall transition. Forty nine percent of the Macedonian territory is agricultural land, or around 1.27 million ha in 2004. This land comprises mainly pastures (55 per cent), then cultivable land (44 per cent) and around 1 per cent of the total agricultural land are swamps and fish ponds. A further 37 per cent of the country (950,000 ha) are forests.

The agriculture accounts for around 12 per cent of Macedonian GDP and with the food processing industry, this contribution increases to around 16 per cent of GDP. Agriculture is an important contributor to the foreign trade and is a significant employer in the country. Its main component is the production of crops, accounting for 3/4 of the total agricultural production and the livestock products are the second most important agricultural goods

Forty five percent of Macedonian population is rural population and it has higher poverty levels than in urban areas, although there has been some convergence in recent years. An agricultural census has not been performed since 1964, so that much of the data in the agriculture have been derived by estimation. This is largely needed for enhancing planning for EU accession. In the absence of a census, many agricultural data have been generated by estimates based on other, related sources of statistics. The estimates about people engaged in agriculture are that around 100.000 persons are full-time engaged in agriculture, 20.000 are engaged as part time engagement and there is a significant number of seasonal workers, on whom there are no data whatsoever.

Macedonia has some comparative advantages in agriculture, which comprise in fertile soils, a range of favourable micro-climate, natural upland pastures convenient for production of some crops and lamb. Some analyses have demonstrated that Macedonian producers are relatively competitive in some products at the farm level. Macedonia's climate is characterized by uneven rainfall, dry summers with water deficiencies in most of the country, and occasional droughts.

As already discussed in Chapter 2, the agriculture and rural development sector in the Republic of Macedonia plays a significant role in the overall social and economic development. In the following period greater level of activities is expected, both in terms of the approximation of the European legislation and in terms of the institutional building and creation of new institutions in this field. The adoption of the Law on Agriculture and Rural Development, as the highest legal act in the agriculture is the starting point of the reforms and the basis of the development not only of the sector, but also of the Macedonian economy as a whole. The basic principles of the Law are planning the agricultural development and development of the rural areas, measures of the agricultural policy and the beneficiaries of those measures, minimum quality and designations of the agricultural products, establishment of a database and surveillance over the implementation of those measures. There are also investments scheduled to be made in irrigation and water management, and this is considered to be

an important prerequisite of a more efficient agricultural development, and they have been presented in the economic infrastructure part of this report.

Table: 4.30.: SWOT of Macedonian agriculture and rural development priority of the NDP

Strengths	Weakness
<ul style="list-style-type: none"> • Fertile soil • Favorable micro-climate • Natural upland pastures convenient for production of lamb • Recognized products, although not branded: lamb, peppers, tobacco, vegetables, grapes, fruits • Comparative advantage in the production of certain products • Good results in the wine • Appealing landscapes which, together with a better organized agricultural production, can be a good bases for a sound rural development • Economically viable water sources • Existence of tradition for agriculture • Early vegetables come a month earlier than in neighboring countries 	<ul style="list-style-type: none"> • Production sensitive to climatic changes • Deployment of not proper agricultural practices degrading some of the soil, waters, air • Low level of value added in the production • ownership status of the land not settled completely and the land market not developed yet • A modest vegetables and fruit processing capacities (in comparison to the potential), which usually show losses • There is very low level of agricultural training • Agriculture support environment is very weak • Low irrigation levels of the agricultural areas • Problems in the distribution and marketing of products • No integrated systems of data collection and management of registers and databases to support the creation and implementation of the agricultural policy: long absence of agricultural census • Agriculture is slow to adapt to the demands of the EU market, especially in terms of quality and technology • Insufficiently structured agricultural policy • The share of farmed land in areas suitable for agriculture is decreasing
Opportunities	Threats
<ul style="list-style-type: none"> • Performing an agricultural census in order to be able to design and implement a better agricultural policy • Protection of geographical indication, appellations of origin and traditional markings on agricultural and food products; • Branding of products (Macedonian lamb, wine, cheese, certain vegetables etc.) • There is enough quality agricultural land, which could, with adequate business processes, generate more value added • Clustering • Adaptation of agriculture to market conditions and co-operation may help domestic farmers to penetrate into large markets where it is important to find market niches • Harmonization of agricultural legislation with the Acquis sets proper framework for the development of agriculture and rural areas in general • Preparing better organization of agricultural produce distribution • Establishment of advisory and expert bodies for support of the agricultural policy • Regulation of the markets of certain agricultural and food products; • Rural Development Support Policy • Support for scientific and research projects in the area of agriculture • Agricultural Information System (AIS) • Orientation of agriculture to services like landscape management and natural resources management can increase and secure income (maintenance of cultural landscape, environmental friendly agriculture) • Develop opportunities in hunting, wildlife exploring <ul style="list-style-type: none"> • Develop organic production 	<ul style="list-style-type: none"> • Droughts, hail and other natural disasters • A further deterioration of agriculture and rural areas would seriously affect the Macedonian economy • Due to emigration from rural areas and employment in more profitable sectors, large agricultural areas may become abandoned and eventually die out • Another reason for abandoning agriculture may lie in the alternation of the use of farming land – mainly for construction • Too great dependence on state aids stimulate further abandonment of farming land and slows down the growth in value added

4.4.2. Objectives

The main objective for the agriculture and rural development in Macedonia for the period 2007-2009 is to create preconditions for better use of agricultural potential of the country through better land management, optimum use of land resource in an ecologically sustained manner and institutional capacity building of the sector, through strengthened rural development, and through establishing conditions for safe food production and trade. In objective is fully in line with the strategic objective of the NDP, i.e., to achieve sustained economic growth accompanied by higher employment and increased international competitiveness of the country.

At a more operational level, the priority has the following objectives:

- To increase agricultural production returns and the competitiveness of the agricultural production and provide a better access to domestic and local markets.
- To develop the agricultural land market and increase the efficiency of the use of land in an ecologically sustained manner.
- To define and implement an efficient policy for development of the agriculture and rural areas in accordance with the Common Agricultural Policy of the EU.
- To ensure health protection of the animals against diseases that can be transferred to people, health and hygienic safety of the animal originated food, welfare of animals, veterinary protection and advancement of the environment and the nature.
- To prevent spreading plant diseases, to enable international trade of healthy plants and plant originated products; to use eco-toxicologically safe products for protection and fertilization of plants; to develop good standards for the seeds quality.
- To ensure sustainable development of the forests and wildlife in the Republic of Macedonia.

4.4.3. Activity areas

Several programmes, activities and measures have been designed in order to achieve the agriculture and rural development objectives. These programs, activities and measures have been deliberated in a way to upgrade the strengths and fight against the weaknesses and to try to explore as much as possible of the opportunities identified. They have been aggregated into the following 6 activity areas

- Activity area No. 1: Development of agriculture and capacity enhancement of the
Ministry of Agriculture, Forestry and Water Management
- Activity area No. 2: Agricultural land management
- Activity area No. 3: Rural development
- Activity area No. 4: Veterinary development
- Activity area No. 5: Phyto-sanitary development
- Activity area No. 6: Forestry development

Activity area No.1: development of agriculture and capacity enhancement of the Ministry of agriculture, forestry and water management

Main objectives of the development of agriculture and capacity enhancement of the ministry of agriculture, forestry and water economy activity are the following: increasing agricultural production returns, increasing the competitiveness of the agricultural production and better access to domestic and local markets, optimum use of land resource in an ecologically sustained manner.

Several programmes have been envisaged for the implementation of this activity.

- *Support programme for development of agriculture;* The programme for agriculture development is scheduled to comprise the following: programme for production of crops (cereals, industrial crops, vegetables); programme for development of the fruit production, with a special emphasis to the erection of new fruit trees; programme for development of the vineyards production, with a special emphasis to the erection of new vine plants; programme for production in green houses; programme for development of livestock production and implementation of the National Breeding Programme for Livestock Production in RM 2000-2009; general and common measures: trainings, seminars and provision of information; programme for integrated agricultural production: compensation payment for introduction of systems of good agricultural practice on the farm level; compensation for certification and laboratory analyses of soil, water, produce; compensation of costs for work of committees for integrated production. Being the broadest programme among all others within this activity, the programme for development of agriculture accounts for 2/3 of the “investment needs” for funds within the activity for development of agriculture and capacity enhancement of the MAFWE.
- *Support programme for tobacco production;* The support programme for tobacco production will incorporate a programme for increasing incomes of tobacco producers and programme for R&D in tobacco production.
- *Support programme for organic agricultural production development;* The organic agricultural programme will be supported by several measures: education of producers, assistance with promotion and advertising, assistance at the conversion of conventional to organic production land, control and certification of organic production, laboratory analysis of organic farms, laboratory analysis of organic farms, programme for the work of a committee for verification of organic production systems.
- *Programme for education and training of individual farmers;* The programme for education and training of individual farmers will be mainly directed towards training and educating young farmers, but also towards assisting at the provision of accounting services to agricultural associations.
- *Programme for agro-ecological production;* Because of the negative impact of the past practices to the environment, a special attention will be paid to the conformity of agricultural production with environment. This will be

supported by a preparation of a programme for decreasing of negative impacts of the agricultural production on the environment, preserving the biodiversity, soil fertility and traditional cultural landscape by diverse forms of support for the maintenance of the biodiversity and for the revival of specific to the location crop and animal species, support of the production in protected areas.

- *Programme for fishery production;* The programme for fishery production will be designed and implemented via two sub-programmes: programme for sustainable development of fishery and maintaining of the fishing fund and programme for fishing tourism development.
- *Programme for promotion of agricultural - food processing industry;* The programme for promotion of agricultural and food processing industry will comprise the following: programme for fairs and other events, programme for introduction of trademarks and geographic indications of origin of the agricultural production, programme for printing promotional and market information.

Table 4.31.: Development of agriculture and capacity enhancement of the Ministry of agriculture, forestry and water management – individual projects/programs identified as “investment needs” by respective line ministries million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Support programme for development of agriculture	20.00	64.31	24.00	67.99	28.00	69.83	72.00	67.61
Support programme for tobacco production	8.00	25.72	7.00	19.83	6.00	14.96	21.00	19.72
Support programme for organic agricultural production development	0.80	2.57	1.10	3.12	1.60	3.99	3.50	3.29
Programme for education and training of individual farmers	0.10	0.32	0.15	0.42	0.20	0.50	0.45	0.42
Programme for agro-ecological production	1.60	5.14	2.30	6.52	3.30	8.23	7.20	6.76
Programme for fishery production	0.50	1.61	0.60	1.70	0.80	2.00	1.90	1.78
Programme for promotion of agricultural - food processing industry	0.10	0.32	0.15	0.42	0.20	0.50	0.45	0.42
TOTAL	31.10	100.00	35.30	100.00	40.10	100.00	106.50	100.00

Activity No. 2: Agricultural land management

The agricultural land management is a very important activity, which is expected to develop the agricultural land market and increase the efficiency of the use of land in a sustainable manner, in order to increase the agricultural producers' competitiveness and returns. This activity will be conducted by a project for management of state owned land, via a preparation of a geographic information system and a preparation of a plan for natural resources management; introduction of a land identification system and orto-photo maps. A map of cultivated land will be prepared, which will be used for agricultural activities, as a basis for the annual and mid-term needs for different purposes, such as water requirements, land users, etc. A new Law on agricultural land shall be enacted, which should provide a legal framework for establishing of a full database on land, its actual utilization, computer cadastral management, trade, keeping of files on leases, etc. The current situation regarding the keeping of records

on the public land and pastures is not satisfactory. By virtue of a specific project, and within a specific period of time, the following should be accomplished: maintenance of a digital cadastre of land, provide a source of measurable data on the users of public land, records on the public pastures, records on leases for the use of land and pastures etc.

Table 4.32.: Agricultural land management – individual projects/programs identified as “investment needs” by respective line ministries million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Programme for state owned agricultural land management	2.00	49.75	3.00	50.00	3.00	60.00	8.00	53.26
Introduction of land identification system and ortho-photo maps	2.00	49.75	3.00	50.00	2.00	40.00	7.00	46.60
Enactment of a Law on Agricultural Land	0.02	0.50		-		-	0.02	0.13
Total	4.02	100.00	6.00	100.00	5.00	100.00	15.02	100.00

Activity No. 3: Rural development

The Ministry of Agriculture, Forestry and Water Economy (MAFWE) is the managing organization for rural development in the Republic of Macedonia. It is entrusted with the programming of the activities, monitoring and programme assessment, coordination of activities and institutions and supervision of the rural development related financial functions. The pilot programme for rural development 2006 has been already adopted by the Government and it is already operational. The measures are in line with the measures and procedures applied in EU.

A National Strategy for Agriculture and Rural Development is being prepared, containing the operational plans for its implementation (National Programme for Development of Agriculture and National Programme for Rural Development. The aim of the strategy is to define an efficient policy for development of agriculture and the rural areas in accordance with the Common Agricultural Policy of EU.

An inter-ministerial group for rural development will be established. This inter-ministerial group will be established by the government and it will be the body responsible for the design of integrated national policy of rural development.

A plan for pre-accession support of the agriculture and rural development of the Republic of Macedonia will be prepared - the IPARD plan. This document will describe the measures and activities in the agriculture and rural development that need to become subject to the financial support. This measure is envisaged to consume the majority of funds in the rural development activity – more than 90 per cent of the total “investment needs” of this activity.

There will also be a need for adjustment of the administrative structure to meet the requirements of the work with EU rural development instruments. The basic condition

for the use of funds of the pre-accession EU funds is the establishment of an institution for the implementation of measures of financial support of the agricultural and food sector.

MAFWE will need to start preparation for the setting in place the basic instruments for management with the Common Agricultural Policy (CAP), especially the establishment of the payment agency in accordance with EU and the Integrated Administrative and Control System (IACS). There should be efficient management, monitoring, control and audit systems established in order to properly implement the IPA programmes in the environment of their decentralized implementation. Capacity building of the relevant institutions will also be performed.

Table 4.33.: Rural development – individual projects/programs identified as “investment needs” by respective line ministries million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Rural development program (national budget)	3.00	88.76	-	-	-	-	3.00	5.77
IPARD program	-	-	20.80	97.33	26.60	97.79	47.40	91.24
Institutional building IPARD program	0.38	11.24	0.57	2.67	0.60	2.21	1.55	2.98
TOTAL	3.38	100.00	21.37	100.00	27.20	100.00	51.95	100.00

Activity No. 4: Veterinary development

Veterinary development consists of: health protection of the animals against diseases that can be transferred to people, health and hygienic safety of the animal originated food, welfare of animals, veterinary protection and advancement of the environment and the nature. The main programmes in this activity are the following: (i) veterinary component of the Project for structural and legal reforms of MAFWE, (ii) national system for identification and registration of animals: II phase, (iii) education and professional training of the veterinary administration staff, (iv) programme for enhancement and improvement of the regulatory, legislative and institutional structure in RM (the programme aims at improving the regulatory, legislative and institutional structure in RM in relation to production, trade and use of animal feed and the production, trade and use of veterinary-medical materials), (v) programme for health protection of animals (the programme for health protection of animals will have as a constituent part the preparation of the programme for epidemiologic studies for zoonoses and economical important diseases in the preparation of recommendations for preparation of programs for prevention/control), (vi) monitoring of residues of certain substances, veterinarian medicines, and contaminants in live animals and in animal originated food, and (vii) strengthening the regulatory, legislative and institutional structure of RM in relation to production, trade and use of animal feed

Table 4.34.: Veterinary development – individual projects/programs identified as “investment needs” by respective line ministries million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Project for structural and legal reforms in MAFWE, veterinary component		-		-		-	0.00	-
National system for identification and registration of animals, II phase	1.30	76.92	0.89	60.54	0.94	79.66	3.13	72.12
Programme for education and professional upgrading of the Veterinary Administration staff	0.10	5.92	0.10	6.80		-	0.20	4.61
Programme for strengthening and improving the regulatory legislative and institutional structure of RM in relation to the production, distribution and use of animal feed and veterinary - medical materials to animals	0.05	2.96	0.24	16.33	0.08	6.78	0.37	8.53
Programme for health protection of animals - Sub-programme Epydemiologic studies for zoonoses and economically important deseases and preparation of recommendations for preparation of programmes for prevention / control	0.08	4.73	0.08	5.44		-	0.16	3.69
Monitoring and control of residues of certain substances, veterinarian medicines, and contaminants at live animals and in animal originated food	0.16	9.47	0.16	10.88	0.16	13.56	0.48	11.06
Programme for strengthening and improving the regulatory legislative institutional structure of RM in relation to production, distribution and use of animal feed and veterinalry medical materials to animals		-		-		-	0.00	-
TOTAL	1.69	100.00	1.47	100.00	1.18	100.00	4.34	100.00

Activity No. 5: Phyto-sanitary development

The phyto-sanitary development deals with several elements: prevention of spreading plant diseases; international trade of healthy plants and plant originated products; use of eco-toxicological safe products for protection of plants; developing good standards of the fertilizers; establishment of a new official station for testing the quality of the seeds, according to the procedures of ISTA and similar matters.

The phyto-sanitarian administration has the legal authority to monitor the health of crops, to design and implement measures and impose obligations in relation to crops and crop related products diseases, prevention, biological prevention of crops, to create and maintain information system, decide on costs and compensations, communicate with authorities, authorized institutions, bodies and deal with other issues. There is a Programme for crops health, enacted in 2006 and together with the Law for Crops Protection they should regulate the trade and use of pesticides and protective products with a proscribed quality.

The professional work on the production, preparation for trade, trade, packing, certification of seed and seed materials comes under the authority of the Seeds and Seed Material Administration within the MAFWE. This Administration enacts annual programmes for seed and seed material. The MAFWE is preparing a Programme for seed and seed material that will define the specific policies and measures in this matter. Some of the priorities will be to start with the operation of the official station for seed quality assessment, under the ISTA procedures; establishment of pre and post control research fields for the overall seed material being reproduced in Macedonia; creation of possibilities to test diversity, uniformity and stability of sorts; official certification and labeling of the total seed and plant material produced in Macedonia.

Table 4.35.: Phyto-sanitary development – individual projects/programs identified as “investment needs” by respective line ministries million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Structural reforms in the MAFWE - phytosanitary component							0.00	
Plant protection against diseases: monitoring, prognosis, recommendation, interventions	4.00	33.28	3.00	33.22	1.50	19.43	8.50	29.54
Control phytosanitary import and export system	5.00	41.60	4.00	44.30	2.00	25.91	11.00	38.23
System of approval, control of use, and residues in the primary agricultural production of products for protection of plants	2.00	16.64	1.00	11.07	3.00	38.86	6.00	20.86
Regulatory system and standards and control of fertilisers	0.80	6.66	0.80	8.86	1.00	12.95	2.60	9.04
Seed and seed materials program	0.22	1.83	0.23	2.55	0.22	2.85	0.67	2.33
Total	12.02	100.00	9.03	100.00	7.72	100.00	28.77	100.00

Activity No. 6: Forestry development

MAFWE prepared a Strategy for sustainable development of the forestry in RM, containing measures to be performed in the period 2007-2009. The aim is to provide sustainable development on the forests and wildlife in the Republic of Macedonia.

The total area under forests in the Republic of Macedonia is 955,300 ha, that is 37 per cent of the territory of the country. The estimate of the annual woodcutting mass is about 1.3 million m³, 70 per cent of which is used in the year. Out of the total annual woodcutting mass, the share of firewood is 80-85 per cent. The state owned forests account for 92 per cent of the whole territory with forests. Although the economic importance of the forestry sector is relatively small, the forests in the Republic of Macedonia have a large broader non-economic importance, especially for maintenance of biodiversity and the eco-systems in the country, because of which they are subject to variety of programmes and policies.

Main directions of the sustainable development of forestry in the Republic of Macedonia are the following: expansion, quality improvement and protection of the forestry volume; multifunctional management of forests and sustainable development of forestry; defining conditions to provide forestry development national and international funds; defining the main direction of forestry sector regulation, national interests and international responsibilities in this area.

The following programmes are foreseen within this activity area:

- *Plan for operation of forests, for a period of 20 years;* In 2004, a project to develop a long-term Sustainable Development Strategy for Forestry in the Republic of Macedonia was approved by FAO (the United Nations Food and Agriculture Organization). The project goal was to develop a Sustainable Development Strategy for Forestry for a period of 20 years, aimed to create sustainable development capacities and protect and manage the forestry

resources of the country. Additionally, this document will define the economic, the environmental and the sociological aspects of forestry sector in the Republic of Macedonia in the effort to strengthen profitability, competitiveness and sustainability of forests in the Republic of Macedonia. The process of preparation of the Strategy is based on the principles of participation of all stakeholders and of integrating forestry into the national development strategies and plans. The strategy will be implemented by means of a well- defined Action Plan which will include measures and activities for future development of the forestry sector within a determined time dynamic and an assessment of necessary material and human resources for its fulfillment.

- Inventory of forests in RM
- Acquisition of 37 specialized land vehicles for localising and extinguishing forest fires
- Certification of 30% of the high forests in RM

Table 4.36.: Forestry development – individual projects/programs identified as “investment needs” by respective line ministries million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
General plan for forestry development in the next 20 years	0.07	1.38	0.07	2.81	0.07	2.81	0.21	2.09
Register of forests in RM	2.80	55.12	1.60	64.26	1.60	64.26	6.00	59.64
Purchase of 37 specialised vehicles for localising and putting off forest fire	2.10	41.34		-		-	2.10	20.87
Certification of 30% of the high wood forests in RM	0.11	2.17	0.82	32.93	0.82	32.93	1.75	17.40
Total	5.08	100.00	2.49	100.00	2.49	100.00	10.06	100.00

4.4.4. Overall quantification of the “investment needs” for the agriculture and rural development/investment priority

Table 4.37. summarizes “investment needs” of the agriculture and rural development/investment activity as identified and formulated by the respective line ministries. The “investment needs” for this NDP priority are estimated at EUR 217 million over the 3-year period with a somewhat upward trend throughout the years, from 57 million EUR in 2007 over 76 million EUR in 2008 to 84 million EUR in 2009.

Table: 4.37.: Summary of agriculture and rural development/investment priority “investment needs” by activity areas (in million EUR; in % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
1. Development of Agriculture and Capacity Enhancement of the Ministry of Agriculture, Forestry and Water Management	31.10	54.29	35.30	46.66	40.10	47.91	106.50	49.16
2. Agricultural Land Management	4.02	7.02	6.00	7.93	5.00	5.97	15.02	6.93
3. Rural Development	3.38	5.90	21.37	28.24	27.20	32.50	51.95	23.98
4. Veterinary Development	1.69	2.95	1.47	1.94	1.18	1.41	4.34	2.00
5. Phytosanitary Development	12.02	20.98	9.03	11.93	7.72	9.22	28.77	13.28
6. Forestry Development	5.08	8.87	2.49	3.29	2.49	2.98	10.06	4.64
TOTAL	57.29	100.00	75.66	100.00	83.69	100.00	216.64	100.00

The majority agriculture and rural development “investment needs”, around 1/2 of the total, has been concentrated in the development of agriculture and capacity enhancement of the Ministry of Agriculture, Forestry and Water Economy in 2007 – 2009 period. The second investment activity is the rural development where the IPARD programme accounts for more than 90 per cent of the total.

Table: 4.38.: Summary of envisaged funding sources for financing “investment needs” under the agriculture and rural development/investment priority (in million EUR; in % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Public sources								
Central budget	38.81	67.74	43.08	56.93	48.65	58.14	130.54	60.26
Own funds	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Local budgets	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
IPA	9.74	17.00	14.77	19.52	14.93	17.84	39.45	18.21
Other grants	5.15	8.99	5.37	7.10	4.79	5.72	15.31	7.07
Loans	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Private sources								
Concessions	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Other private	1.90	3.32	10.97	14.50	14.13	16.88	27.00	12.46
Unidentified Funding Sources	1.69	2.95	1.47	1.94	1.19	1.42	4.35	2.01
TOTAL	57.29	100.00	75.66	100.00	83.69	100.00	216.64	100.00

The sources of funds are presented in Table 4.38. More than ½ of the funds are scheduled to come from the central budget, whereas 17 per cent would be funded by IPA, and the remaining funds are envisaged to come from other sources, including private sources (12 per cent), grants and “Unidentified funding sources”. The last category mainly relates to the veterinary development activity needs.

Chapter 5: Matching the NDP's investment needs with the funds available for their financing

5.1. Overall quantification of the NDP's "investment needs"

Table 5.1. provides a consolidated quantification of the "financial needs" for all the four development/investment priorities of the NDP as they have been identified and reported by respective line ministries and presented in details in the Chapter 4¹⁴. As shown in the Table, the overall "investment needs" for the NDP's priorities are estimated at 1,724 million EUR for the whole 3-year period. On the annual basis, they increase from 418 million EUR in 2007 over 594 million EUR to 712 million EUR in the year 2009.

Table 5.1.: "Investment needs" of the NDP by development/investment priorities (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
1. Corporate sector competitiveness	49.27	11.78	56.53	9.52	59.13	8.31	164.93	9.57
2. Human resource development	62.31	14.89	37.40	6.30	41.98	5.90	141.68	8.22
3. Economic infrastructure	249.47	59.63	424.24	71.44	526.77	74.03	1,200.48	69.64
4. Agriculture and rural development	57.29	13.69	75.66	12.74	83.69	11.76	216.64	12.57
TOTAL	418.34	100.00	593.83	100.00	711.57	100.00	1,723.73	100.00

This strongly upward trend of overall "investment needs" of the Republic of Macedonia hides important differences in the expected dynamics of individual NDP priorities. In contrast to economic infrastructure priority where extremely high growth of "investment needs" are reported, "investment needs" for the other three priorities reported a much weaker positive and even a negative dynamics. While annual volumes of "investment needs" for the agriculture and rural development and the corporate sector competitiveness priorities do show an upward trend, in the human resource development priority the annual volume of "investment needs" even

¹⁴ The "investment needs" concept is not clearly defined in methodological sense. It includes all those development/investment interventions that are deemed important to a line ministry/another public institution for implementation of the policy objectives in a particular area of its competence. There are at least two methodological deficiencies of the "investment needs" concept that should be clearly recognized in the process of policy design and/or implementation.

- First, how realistically has an "investment need" for a particular project/program been determined? Is the project/program that is included in the NDP "investment needs" pipeline by a line ministry really necessary for achieving the ministry's stated objective in a particular area (in this case, it is reasonably to argue that the project/program represents a justified "investment need") or is the relationship between the project/program and the objective it should achieve much less clear or does not exist at all (in this case, it would be more appropriate to talk about "investment wishes" than about justified "investment needs").
- Second, the concept does not distinguish among (i) physical investment (fixed assets, equipment), (ii) investment in institution building, and (iii) investment in project/program preparation. In the data provided by the line ministries and included into the "investment needs" pipeline all the three categories are included. .

declines. As a consequence of these divergent “investment needs” trends among the four development/investment priorities of the NDP, the share of economic infrastructure in total “investment needs” increases over the 3-year period while share of all the other three priorities, both consolidated and on an individual basis, shrinks.

- *Economic infrastructure;* An extremely strong growth “investment needs” has been reported for the economic infrastructure development even though investments in this segment of the economy dominate the public investment scene of the country already now. Annual volume of “investment needs” is forecasted to more than double in the next 3 years, from 250 million EUR in 2007 to even 527 million EUR in 2009. With such a dynamic growth, the share of economic infrastructure within total “investment needs” of the country would increase from 60 per cent to close to almost 70 per cent. The respective ministries, especially the Ministry of Transportation, claim that documentation for a large majority of projects that have been put into “investment needs” list is either prepared or almost prepared. In addition, there is a strong interest of foreign partners, particularly the EU and the IFIs, for intensive investment activity in this area especially with respect to the transportation links on the European corridors sectors. And last but not least, many of the economic infrastructure projects are strongly anchored in the PIP pipeline
- *Agriculture and rural development;* According to the line ministry responsible for this area, consolidated “investment needs” for this NDP priority increase from 57 million EUR in 2007 to 84 million in 2009. With this nominal growth, the agriculture and rural development priority loses its share within total “investment needs” from 14 to 12 per cent in the same period. When analyzing “investment needs” in this priority it becomes obvious that almost ½ comes from one activity area, namely the development of agriculture and capacity enhancement of the Ministry of Agriculture, Forestry and Water Management. It should be underlined that in some activities areas of this NDP priority, rural development is a clear example of this kind, investment projects and programs are not prepared what raises certain doubts whether their implementation could actually start in the years reported by the line ministry.
- *Corporate sector competitiveness;* Though at a lower nominal level than agriculture and rural development priority, this NDP priority also registers a slightly upward trend of its annual “investment needs”. With an annual increase from 49 million EUR in 2007 to 59 million EUR in 2009 the share of this priority would decline from 12 to 8 per cent of the total NDP “investment needs”. The facts that 2/3 of the priority’s “investment needs” are earmarked for ready to go projects in the tourism sector and that a majority of projects in other activity areas of this priority are being prepared within the framework of cooperation with the IFIs and bilateral donors may suggest that programming of the reported “investment needs” projects/programs has been more realistically made than in some other areas.
- *Human resource development;* Inadequacies in the human resource development area have been identified as one of the major bottlenecks for faster development of the Republic of Macedonia (see Chapter 2). Based on

this fact and taking into account the objective of the NDP (see Chapter 3), one would expect that investment project/programs within this priority will feature more strongly in this NDP than they actually do. Unfortunately, the reported “investment needs” for this priority do not match this expectation. On the contrary, this is the only of the four NDP priorities where the reported annual volume of “investment needs” is actually expected to decline, from 62 million EUR in 2007 to 42 million EUR in 2009. As a consequence, their share in total “investment needs” would fall from 15 to only 6 per cent of the total. It is more than obvious that lack of ready made projects is an important weakness this area. As reported by the line ministries, with notable exception of the Ministry of Health, a very limited number of projects worth more than 1 million EUR has been identified.

Table 5.2. gives an consolidated view of forecasted funding sources for the four priorities of the NDP as reported by the line ministries when they have submitted the “investment needs” data. As shown in the Table, for more than $\frac{1}{4}$ of total “investment needs”, in nominal terms 445 million EUR, the line ministries have not identified potential funding sources. This may mean either that they don’t have their own view about possible sources of financing or that they simply failed to provide data.

Among the identified public sources, the following three stand out most prominently: (i) domestic budgetary resources (central and local), (ii) grants (IPA and bilateral), and (iii) loans.

- *Domestic budgetary resources (central and local)*; This source of funding is expected to cover 21 per cent of total “investment needs” under the four NDP’s priorities what in nominal volumes amounts to 362 million EUR over the 3-year period. It is interesting to compare this figure with a much higher figure on “domestic funds” available for the same period (see Table 5.12.). This may suggest that the line ministries do see other sources of public funds, primarily grants and loans, as more important source of investment funding than domestic sources available in particular in the central budget.
- *Bilateral grants*; This category of funding is expected to provide 8 per cent of funds that would be required to meet the “investment needs. This in nominal terms means 130 million EUR over the 3-year period; between 41 and 47 million a year, and is more than twice as high as the realistically forecasted inflow of bilateral grants for the NDP purposes (see Table 5.12.). In this source of potential funding we observe not only a big discrepancy between the needs and availability of funds for the 3-year period as a whole. Another problem is the dynamics of this availability/needs ratio. While in the year 2007, forecasted inflow of bilateral grants will still cover more than $\frac{1}{2}$ of needs for this source of funding as expressed by the line ministries, in 2009, this ratio is expected to fall to $\frac{1}{3}$. This is simply a result of the fact that expressed needs for grants remain at more or less unchanged annual level over the 2007 – 2009 while the forecasted inflow of funds from this source is expected to almost halve in this period.
- *IPA*; Even larger disproportion between the needs for this source of funding and realistically projected available funds for the NDP financing relates to the IPA funds. While line ministries expressed needs for this source of funding

amounting to 205 million EUR, realistically forecasted figure is estimated at 69 million EUR over the 3-year period (see Table 5.12.). Again, the problem has its dynamic component as well. While line ministries forecast an inflow of IPA funds equivalent to as much as 42 million EUR already in 2007, it is realistically to forecast that funding from this source will start flowing into the country only a year later. It should be mentioned, however, that in 2007 still some 13 million EUR is expected to come from the CARDS program.

- *Loans*; Line ministries forecast that 20 per cent of total “investment needs”, in nominal terms this means 337 million EUR over the 2007 – 2009 period, will be financed from loans raised from IFIs and from other creditors. However, these forecasted loans by the line ministries are 1.4 times greater than the available loans of 236 million EUR in Table 5.12..

Table 5.2.: Sources of funding for the NDP’s “investment needs” as forecasted by the line ministries (million EUR, % of total)

	2007		2008		2009		Total	
	Volume	%	Volume	%	Volume	%	Volume	%
Public sources								
Central budget	100.43	24.01	112.76	18.99	149.26	20.98	362.45	21.03
Own funds	22.35	5.34	28.30	4.77	40.30	5.66	90.95	5.28
Local budgets	1.30	0.31	1.42	0.24	2.14	0.30	4.86	0.28
IPA	42.20	10.09	71.21	11.99	91.16	12.81	204.57	11.87
Other grants	46.62	11.15	41.45	6.98	41.46	5.83	129.53	7.51
Loans	116.69	27.89	123.24	20.75	97.26	13.67	337.18	19.56
Private sources								
Concessions	45.82	10.95	84.87	14.29	132.00	18.55	262.69	15.24
Other private	3.44	0.82	14.57	2.45	20.84	2.93	38.85	2.25
Unidentified Funding Sources	39.49	9.44	116.02	19.54	137.16	19.28	292.66	16.98
TOTAL	418.34	100.00	593.83	100.00	711.57	100.00	1,723.74	100.00

5.2. The underlying scenarios

The underlying scenarios of the NDP reveal the government’s view about the most feasible path for the Republic of Macedonia’s economic development in quantitative terms over the period of next three years. The medium-term projections reflect a consistent vision of the authorities with respect to the economic and social restructuring as set out in the medium-term planning documents of the government as well as in the 3-year agreements signed by the government with the IMF and the World Bank in the second half of the 2005. The scenarios presented below are based on the following basic policy orientation:

- to accelerate economic growth and increase job creation,
- to reduce the external imbalance, and
- to safeguard past gains in macroeconomic stabilisation.

This policy orientation relies on intensified structural reforms aimed at strengthening the overall competitiveness of the country. The core of the policy reforms in the years to come are therefore ambitious structural reforms accompanied by an improvement in the quality of institutions. At the same time, fiscal policy should remain restrictive in order to prevent overheating of the economy.

5.2.1. Macroeconomic and investment scenarios

In the last three years, i.e., between 2004 and 2006, economic growth of the Republic of Macedonia has been accelerated to around 4 per cent/year driven mainly by strongly increased exports. As shown in Table 5.3., average export growth rates for the year 2005 and 2006 were more than twice as high as the corresponding GDP rates.

Table 5.3.: Macro-economic indicators (real growth rates; in %)

	2005	2006	2007	2008	2009	Average 2007-09
GDP	3.8	4,0	6.0	6,0	6,5	6,2
Inflation	0.5	3.2	3,0	2,5	2,5	2,7
Employment	4.2	4.0	4.0	4.0	4,0	4,0
Productivity	1.6	2,0	2,0	2,5	2,0	2,2
Exports of goods/services	7.9	10,1	9,4	9,3	9,0	9,2
Imports of goods/services	0.5	14,6	7,9	7,2	6,8	7,3
Public consumption	3.1	3,0	3,0	3,0	3,0	3,0
Private consumption	2.5	5,9	4,9	3.4	3,7	4,0
Gross investment	6.4	7,0	11,0	15,0	15,0	13,7

Closer relations between the Republic of Macedonia and the European Union, as well as the strong commitment of the Macedonian Government to implement needed structural reforms, give an impetus to the economic growth on the medium-run, forecasted at 6-7 per cent. From the production side, main contributing sectors to the projected growth will be both industry and services, whereas on the expenditure side, growth will be export- and investment-led. Gross investments are projected to grow at an average annual level of around 13 per cent, well above the forecasted output growth, with a significant contribution expected from the FDI inflow. The projected increase of the share of gross investment in GDP will bring the investment activity closer to the levels of the investment/GDP ratio observed in the more advanced transition countries. The fiscal policy in the following period will remain prudent with general government deficit of around 1 per cent of GDP, contributing to a further reduction of the interest rates and trade deficit. Maintained macroeconomic stability together with the intensified structural reforms on medium term will contribute to an annual average employment increase of around 4 per cent along with a productivity growth of 2.2 per cent.

Despite the highly realistic assumptions behind the projected real GDP growth rates, we do follow a conservative approach and base our macro-financing calculations on a more cautionary macroeconomic framework (Table 5.4.). In particular, we assume real GDP growth rate of 4.0 per cent for 2007, and 4.5 per cent for 2008 and 2009, so that the GDP figures and its components (expressed in EUR million) used for the subsequent calculations are somewhat lower than those in Table 5.3. This ensures sufficient flexibility in the investment scenarios, significantly lowers the risk of under-financing of certain projects and defines a more plausible investment path.

Table 5.4.: Structure of the GDP (in EUR million –current prices)*

	2005	2006	2007	2008	2009
1. GDP (1 = 4 + 5 + 8)	4,523	4,840	5,160	5,500	5,862
2. Exports of goods and services	2,131	2,380	2,542	2,712	2,899
3. Imports of goods and services	2,950	3,371	3,596	3,816	4,048
4. Foreign trade balance (4 = 2 – 3)	-819	-991	-1,053	-1,103	-1,149
5. Final consumption (5 = 6 + 7)	4,344	4,734	5,027	5,323	5,633
6. Private consumption	3,415	3,737	3,976	4,187	4,409
7. Government consumption	929	996	1,050	1,135	1,224
8. Gross investment (8 = 9 + 10)	999	1097	1,186	1,280	1,378
9. Total fixed investment	831	918	996	1,077	1,161
10. Change in stocks	168	179	190	203	216
11. Exchange rate (Denars/EUR)	61.3	61.3	61.3	61.3	61.3

* CPI used as deflator except for exports, imports and change in stocks data

Cross-country analysis made by the IMF shows that an increase of the investment/GDP ratio provides a rather limited scope for GDP growth. In contrast, a country like the Republic of Macedonia characterized with high unemployment rate offers significant scope for boosting output through an employment generated growth. Nevertheless, experiences further show that rapid economic growth of a country cannot be achieved and later on sustained without a major improvement in total factor productivity.¹⁵

The NDP does not deal with the overall investment activity to be carried out within the Republic of Macedonia over the next 3-year period. In fact, a large majority of investment activity in any country are investments financed by the private corporate sector and by the household sector. These two segments that typically account for between $\frac{1}{2}$ and $\frac{3}{4}$ of a country's total fixed investment, are not subject of the NDP. This document therefore deals only with a relatively small proportion of total fixed investment. More precisely, it deals with those segments of investments in the Republic of Macedonia that meet the following two criteria. First, that they are financed or co-financed from general public sources, domestic and foreign. And second, that they are used for development oriented purposes.

Table 5.5. shows that fixed investment from the general government budget is forecasted to represent between 26 and 30 per cent of total fixed investment of the Republic of Macedonia over the next 3-year period. Under an assumption that 15 per cent of these investment is used for the so-called "sovereign functions" of the state¹⁶, it is reasonably to forecast that investments subject to this NDP will account for somewhere between 22.1 and 25.1 per cent of the country's total fixed investment what would be equivalent to between 4.3 and 5.0 per cent of its GDP^{17 18}.

¹⁵ According to the IMF staff estimates, sources of the Republic of Macedonia's average annual growth rate of 2.5 per cent in the 1996 – 2005 period were the following: (i) employment – 0.1 per cent, (ii) physical capital – 0.4 per cent, and (iii) total factor productivity – 2.0 per cent.

¹⁶ The assumption is based on the Table 5.5..

¹⁷ This figure should be increased for those fixed investment that are being carried out by incorporated publicly owned institutions, and are therefore not integrated into the general government budget of the country.

¹⁸ There is another methodological issue to be mentioned at this point. This NDP takes into account only those development oriented investment of the general government finances that go into fixed investment. It therefore does not include some important development oriented expenditures of the general budget, for example spending for human resource development. They are conventionally

Table 5.5.: Total fixed investment and fixed investment from the general government budget (in EUR million – current prices; in %)

	2006	2007	2008	2009
1. GDP	4,840	5,160	5,500	5,862
2. Total fixed investment	918	996	1,077	1,161
3. Total fixed investment/GDP (3 = 2 : 1)	19.0	19.3	19.6	19.8
4. Fixed investment from the general government budget	275	259	296	342
5. Fixed investment from the general government budget sources/GDP (5 = 4 : 1)	5.7	5.0	5.4	5.8
6. Fixed investments from the general government finance/ Total fixed investment (6 = 4 : 3)	30.0	26.0	27.5	29.5

A rough indication of the structure of fixed investment from the general government budget in the year 2005, for both “NDP development purposes” and “sovereign purposes”, is provided in Table 5.6.. The data show roughly 85 per cent of the total was allocated for “NDP development” oriented investments that are of direct importance for the NDP. Of this total, by far the largest proportion, 42 per cent, was channelled for investments into the economic infrastructure sector. Roads and irrigation and water supply were the single most investment intensive sub-sectors in this area. In contrast, only 11 per cent of general government fixed investment went for social infrastructure projects and programs, of this more than half for the education.

Table 5.6.: Structure of fixed investment in the central government financing in 2005 (in % of the total)

Type of fixed investment	Share in the total
For the “NDP development purposes”	84.9
Economic infrastructure	42.1
- <i>Energy</i>	<i>1.3</i>
- <i>Environmental infrastructure</i>	<i>1.3</i>
- <i>Transportation, of this</i>	<i>28.7</i>
- Roads	22.6
- Railways	0.9
- <i>Agriculture infrastructure</i>	<i>10.8</i>
Social infrastructure	11.1
- <i>Health</i>	<i>3.4</i>
- <i>Education</i>	<i>6.2</i>
- <i>Culture</i>	<i>1.5</i>
Others	31.7
- VAT, custom duties and commodity reserves	28.7
- Land cadastre and less-developed areas	2.9
For the “sovereign purposes”	15.1
Army, police, justice, courts, prisons	9.8
Common services of the government	5.3
TOTAL	100.0

The Table further shows that almost one third of total fixed investment is classified as other development purpose investment. The category includes a wide variety of

included into current expenditure even though they have or at least should have a development oriented character.

investments and investment related expenditures, including VAT payments associated with capital investments, purchase and servicing of various kinds of equipment required by the administration, and also investment in commodity reserves.

5.2.2. Fiscal scenario

Though faced with substantive fiscal challenges in the years associated with increased EU accession costs, reform of the pension system, and continued trade liberalization, the government remains committed to continue with implementation of its restrictive public finance policy. The authorities remain committed to the arrangement with the IMF whereby the general government budget deficit should be kept within the 1 per cent of GDP target.

In order to meet this objective, the government forecasts significant changes in the expenditure side of its general government balance. As shown in Table 5.7., total expenditures as proportion of the GDP are expected to decline from 39.0 per cent in 2006 to 36.4 per cent in 2009. Major adjustment is projected to be made with some of the current expenditure items. Their total volume expressed as a percentage of GDP should continuously decline, altogether for almost 3 percentage points during the same period; from 33.3 to 30.5 per cent.

Table 5.7.: General government expenditures (in EUR million; in % of GDP)

	2006		2007		2008		2009	
	EUR mil	% of GDP	EUR mil	% of GDP	EUR mil	% of GDP	% of GDP	EUR mil
Current expenditures	1,613	33.3	1,661	32.2	1,739	31.6	1,789	30.5
- <i>Wages</i>	415	8.6	432	8.4	447	8.1	450	7.7
- <i>Social transfers</i>	819	16.9	828	16.1	856	15.6	883	15.1
- <i>Purchases of goods and services</i>	278	5.8	294	5.7	322	5.9	338	5.8
- <i>Interest payments</i>	53	1.1	54	1.1	60	1.1	60	1.0
- <i>Subsidies</i>	48	1.0	52	1.0	54	1.0	58	1.0
Fixed investment (capital expenditures)	275	5.7	259	5.0	296	5.4	342	5.8
TOTAL	1,888	39.0	1,919	37.2	2,035	37.0	2,131	34.4

The pattern of forecasted fixed investment is significantly different. After a drop of more than half of a percentage point in the first year, from 5.7 per cent of GDP in 2006 to 5.0 per cent in 2007., general government investment are expected to pick up rapidly in the following two years. In 2008, its share in GDP should already overcome the level achieved in 2006. This confirms the development orientation of the authorities' fiscal projections in the years to come.

5.3. Quantification of the “availability of funds” for the NDP financing and the resulting NDP “funding gap”

5.3.1. Methodological introduction

Table 5.8. provides an analytical framework for making a forecast of overall volume of public sources, domestic and foreign, available for financing the NDP development/investment project and programs identified in the Chapter 4.

Table 5.8.: Classification of funding sources available for the NDP financing

Funding source
I. Funds included into the general government capital expenditure (fixed investments)
- <i>Local government capital expenditures</i>
- <i>Central government capital expenditures; of this</i>
- IPA
- Bilateral grants
- Loans (multilateral/bilateral)
- Domestic sources
II. Funds outside the general government budget
- <i>CARDS</i>
- <i>Bilateral grants not integrated into general government capital expenditures</i>
- <i>NATO</i>
- <i>Loans (multilateral/bilateral) not integrated into general government capital expenditures; loans to public enterprises</i>
- <i>Loans for SME financing</i>
TOTAL

In addition to the methodological inconsistency related to the commitment/disbursement issue (some of the funding sources discussed in the Table are presented as commitments and others as disbursement), there is a need for some other methodological clarifications.

- First, there are two main categories of public funds, domestic and foreign, that may be tapped for projects and programs under the NDP.
 - Funds that are integrated into the general government public finances, i.e., in the country’s central budget as well as in the budgets of local communities. By far the largest source of funds in both, local budgets and the central budget, are funds coming from domestic budget revenue sources (taxes, customs, etc.). The central budget, however, incorporates also those funds of foreign origin that are being channelled to their end users via the budget. With some exceptions this rule applies to grants as well as to loans, coming from bilateral and multilateral sources.
 - There are some groups of funds, mainly of foreign origin, that are being channelled to end-users in the Republic of Macedonia directly and not through the budget. The largest source of this off-budget financing for development purposes is the EU assistance provided

under the CARDS¹⁹. Funds provided by the NATO for rehabilitation of bridges damaged by heavy military vehicles during the post 1999-crisis period are also in this category. Off-budget financing applies also to that segment of bilateral grants that is being channelled directly to the end users in the Republic of Macedonia. Last but not least, also loans to public sector companies are registered as off-budget form of financing.

- Second, data for fixed investment from the general government budget, i.e., from the central budget and the local communities' budgets, provided by the Ministry of Finance, have been calculated directly from the government's 2007 – 2009 Fiscal Strategy of the Republic of Macedonia.
- Third, data for the IPA, provided by the Ministry of Finance, take into account only those segments of the EU funds to be available for investment purpose, i.e., funds from the IPA components III, IV and V. The calculation takes into account the absorption capacity of the Republic of Macedonia as forecasted by the Ministry of Finance.
- Fourth, calculation of bilateral grants, those included into the general government finances and those ones presented as off-budget, is based on the data provided by the Secretariat for European Affairs and summarized in Table 5.9..

Table 5.9.: Forecast of bilateral grants by the purpose (in million EUR)

Purpose	2006	2007	2008	2009
I. NDP development/investment priorities	50.5	36.3	27.6	19.7
- <i>Enterprise sector competitiveness</i>	12.2	10.3	8.8	5.9
- <i>Human resource development</i>	24.1	18.0	12.8	7.4
- <i>Economic infrastructure</i>	6.6	3.4	3.3	3.0
- <i>Agriculture and rural development</i>	7.6	4.6	2.7	3.4
II. Other priorities	23.2	16.2	13.2	4.5
Total	73.7	52.5	40.9	24.2

As said above, bilateral grants for investment priorities are being channelled into the Republic of Macedonia partly through the general government budget and partly outside the budget. The forecast for the first category of bilateral grants has been provided directly by the Ministry of Finance while the forecast for off-budget bilateral grant inflows is provided in the Table 5.10..

¹⁹ In contrast, the IPA which will succeed the CARDS from 2007 on will be fully integrated into the budget

Table 5.10.: Calculation of bilateral grants for NDP purposes not integrated into general government capital expenditures

	2006	2007	2008	2009
1. Total bilateral ODA	73.7	52.5	40.9	24.2
2. Total bilateral ODA for the NDP priorities	50.5	36.3	27.7	19.7
3. 2 :1 (in %)	68.5	69.1	67.7	81.4
4. Total bilateral ODA incorporated in the budget	16.0	23.0	15.0	16.0
5. Bilateral ODA incorporated in the budget for investment purposes	8.0	14.0	9.0	10.0
6. 5 : 4 (in %)	50.0	60.8	60.0	62.5
7. Total bilateral ODA incorporated in the budget for NDP Purposes (4 x 3)*	11.0	15.9	10.2	13.0
8. Total bilateral ODA for NDP purposes not incorporated in The budget (2 – 7)	39.5	20.4	17.5	6.7
9. Bilateral ODA for NDP purposes not incorporated in the budget (8 x 6)**	19.8	12.4	10.5	4.2

* Calculated as 4 multiplied by 3. For example, for the year 2006, 16.0 multiplied by 0.685 = 10.96 (rounded at 11.0).

** Calculated as 8 multiplied by 6. For example, for the year 2006, 39.5 multiplied by 0.50 = 19.8.

- Fifth, calculation for both categories of the debt financing, the one included into the general government budget and also of the one presented as off-budget financing, available for the NDP financing is based on the data provided by the Ministry of Finance and summarized in Table 5.11..

Table 5.11.: Calculation of debt financing for the NDP purposes

	2006	2007	2008	2009
Included into the general government finances	109	119	115	117
- External Borrowing *	60	62	50	44
- Corporate sector competitiveness	3	4	9	10
- Human resource development, including R&D	2	1	3	2
- Economic infrastructure	53	54	38	32
- Agriculture and rural development	2	3	0	0
- Borrowing for other purposes	0	0	0	0
- Domestic Borrowing*	49	57	65	73
Public enterprises (excluded from general government budget)	65	51	38	21
- External Borrowing	65	51	38	21
- Corporate sector competitiveness	0	0	0	0
- Human resource development, including R&D	0	0	0	0
- Physical infrastructure	65	51	38	21
- Agriculture and rural development	0	0	0	0
- Domestic Borrowing	0	0	0	0
Total	174	170	153	138

* The difference between the amount of External borrowing included in General Finance in this Table compared to Table 5.12 is due to the fact that in Table 5.12 just the part of the External borrowing related to the fixed investments is included while in this Table the total amount of External Borrowing planned within the General Government is included.

The Table indicates that the total volume of debt financing available to the authorities is expected to have a downward trend in the years to come, at least partly as a result of the government's policy orientation to reduce the public debt/GDP ratio from 40 per cent in the year 2006 to 35 per cent in the year 2009.

5.3.2. Actual data about “availability of funds” for the NDP financing

Table 5.12. provides an overview of all available public sector financial resources that are forecasted to be used in the 2006 – 2009 period for the four development/investment priorities under the NDP. As shown, the total amount of available funds is expected to drop sharply in the first year of the NDP, from 434 million EUR in 2006 to 351 million EUR in 2007. In the following two years, the volume should slowly pick up to a level of 367 million EUR in 2009. This sluggish growth of funds available for NDP financing in the 2007 – 2009 period means that in relative terms, as percentage of GDP, they would even decrease, from 6.8 per cent to 6.2 per cent.

Though the total volume of funds available for the financing of the NDP priorities, it amounts to 1,081 million EUR, is expected to stay at more or less the same annual level throughout the 3-year period, significant changes in the structure of the funding sources is forecasted. The most important among them is that the share of funds not integrated into the general government budget will be drastically reduced; from more than 1/3 of the total in 2006 to not more than 7 per cent in 2009.

Table 5.12: “Availability of funds” for financing development/investment priorities of the NDP

Funding source	2006		2007		2008		2009	
	mil	%	mil	%	mil	%	mil	%
I. Funds included into the general government (capital expenditure/ fixed investment)	275	63	259	74	296	82	342	93
- Local government capital expenditures	78	18	68	19	76	21	80	22
- Central government capital expenditures (o/w)	197	45	191	54	220	61	262	71
- IPA	0	0	0	0	28	8	41	11
- Bilateral grants	8	2	14	4	9	2	10	3
- Loans (multilateral/bilateral)	52	12	48	14	39	11	31	8
- Domestic sources	137	32	129	37	144	40	180	49
II. Funds outside the general government budget	159	37	92	26	67	18	25	7
- CARDS	54	12	13	4	1	0	0	0
- Bilateral grants not integrated into general government capital expenditures	20	5	12	3	11	3	4	1
- NATO	5	1	10	3	15	4	0	0
- Loans (multilateral/bilateral) not integrated into general government capital expenditures; loans to public enterprises	65	15	51	15	38	10	21	6
- Loans for SME financing	15	3	6	2	2	1	0	0
TOTAL	434	100	351	100	363	100	367	100

There are four important reasons why funds not integrated into the general budget are forecasted to practically disappear as a potential source of the NDP financing in the following three years.

- While EU funds under the CARDS program are channelled into the Republic of Macedonia outside the general government finances the EU funds under the IPA arrangement will be integrated into the country's budget.
- Loans from bilateral and multilateral sources channelled to public sector enterprises, they are not an integral part of the country's general government budget, will be drastically reduced mainly due to the fact that some of these companies are expected to be privatized in the years to come. While in 2006 these loans still account for 65 million EUR, they are forecasted to be only 21 million EUR in 2009.
- Total volume of bilateral grants, both those ones channels off- budget and those ones integrated into the general government budget, are on a clear downward path. Their total volume is forecasted to be almost halved between 2006 and 2009; from 26 to 14 million EUR.
- And fourth, grants from the NATO and loans for SMEs will both be phased out by the year 2009.

5.3.3. The NDP “funding gap”

Data from Table 5.1. (“investment needs” of the NDP) and Table 5.12. (“availability of funds” for the NDP financing) provide a good basis for the quantification of the difference between the two (NDP “funding gap”). Table 5.13. shows that the NDP funding gap for the whole period 2007 – 2009 is estimated at an average annual level of 214 million EUR what is equivalent to some 3.9 per cent of the GDP.

Table 5.13.: The NDP “funding gap” (million EUR, % of GDP)

	2007			2008			2009			Total		
	Needs	Funds	Gap	Needs	Funds	Gap	Needs	Funds	Gap	Needs	Funds	Gap
Volume	418	351	67	594	363	231	712	367	345	1,724	1,081	643
% of GDP	8.1	6.8	1.3	10.8	6.6	4.2	12.1	6.3	5.9	10.4	6.5	3.9

With respect to the time horizon, the “funding gap” is forecasted to increase sharply over the next three years. As the annual volume of available funds remains almost stagnant in the years 2007 to 2007, the growing gap is almost exclusively a result of an almost doubled annual level of investment needs.

Why the “funding gap” is widening so sharply? There seems two be at least two important reasons explaining this trend.

- The first one deals with an inadequate programming capacity within the country, at least in some segments of the administration. Because of this, the line ministries do not have on stock project/programs that would be ready for immediate implementation. Rather low funding gap in the first year of the

2007 – 2009 period is to certain extent caused by the lack of adequately prepared/projects/programs. For the following years, however, the line ministries obviously assume that through intensification of project preparation activities the importance of this deficiency will be reduced significantly. Consequently, the ministries forecast that the trend of their investment needs will take a strongly upward trend.

- The second reason emerges from the pure budgetary planning. It is a fact that investment projects/programs proposed by line ministries are for the next year planned more realistically than for the third year from now. This means that “investment needs” reported for the year 2007 reflect rather realistically the expectations of the line ministries for investment funding from budgetary sources. Besides, funds for many projects/programs to be funded next year are already predetermined for various reasons (projects underway; projects agreed to enjoy a priority status; projects agreed with either creditors or donors). With the planning horizon extending over longer period of time also the link between the investment needs, sometimes they more reflect wishes than actual needs, and the realism of the budgetary logic becomes weaker.

5.4. The “desired” and the “proposed” allocation of available NDP funds among the development/investment priorities of the NDP

The “funding gap” discussed above points clearly to the need of designing criteria and benchmarks that will be applied for matching the “investment needs” with the “availability of funds” for financing the NDP’s development/investment priorities. With an objective to design a proposal for allocation of highly limited volume of funds available for the NDP financing among its four priorities a two stage selection process is being applied.

In the first stage, based on the country’s development needs and on the benchmark experiences of some old and new EU member states, the “desired” or optimal allocation of available funds among the NDP’s development/investment priorities will be sought for. In the second stage, this “desired” mix of the funding allocation among the four competing priorities will be exposed to some very practical and pragmatic criteria. By applying these criteria a more realistic allocation of available NDP funds will be suggested. In the design of this “proposed” allocation the following criteria will be taken into account: (i) the existing structure of publicly financed investments in the country, (ii) availability of ready made projects/programs in each of the four NDP priorities in view of the rather short time horizon of the NDP, and (iii) preferences of foreign donors and creditors to support projects/programs in areas that reflect their individual priority orientations.

5.4.1. Development/investment priorities of the NDP correspond to the ones in the programming documents of the benchmark EU member states

Based on the assessment of the current development position of the Republic of Macedonia presented in the Chapter 2, it is not surprising that four investment/development priorities, corporate sector competitiveness, human resource development, physical infrastructure, and agriculture and rural development, have been selected for the NDP. These four priorities correspond to the same groups of priorities as articulated in the programming documents of several EU member states, both old ones and new ones.

With some specifics among individual countries, the programming documents of all these countries typically have three or four investment priorities.

- The first investment priority deals with the competitiveness of the corporate sector. It is namely well recognized that public intervention in this area is of crucial importance for increasing economic growth and competitiveness, for employment generation as well as for the promotion of regional development. In some countries, this priority includes not only investments in the manufacturing and services sectors but also investments in the agriculture sector.
- The second investment priority in the programming documents of all old and new member states is human resource development. In order to address numerous structural weaknesses in their labour force all the countries have provided substantial support for investment under this heading.
- The third priority are investments into physical infrastructure. With the objective to catch up with the core EU members, substantial investment support of less developed EU member states has been typically provided for projects under this heading. This is even more the case with the new EU member states characterized with marked inadequacy of basic infrastructure, as investments in this area had been neglected in the decades before the countries joined the EU.
- The last of the four priorities is agriculture and rural development, though in some of the countries, i.e., in those ones where this sector is of rather small importance and/or has a limited development potential, this priority has been integrated into the first one.

5.4.2. The “desired” allocation of available NDP funds among the development / investment priorities

What would be a “desired” or optimal allocation of scarce financial resources among the four development/investment priorities depends on the assessment of the country’s strengths, weaknesses, opportunities and treats presented again in the Chapter 2. A possible benchmark for the Republic of Macedonia may be the programming documents of other countries. Tables 5.14. and 5.15. present how the programming

documents of selected old and new EU member states have allocated their available resources among their three/four priorities.

Table 5.14. provides an overview for the three old EU member states, Portugal, Greece and Ireland. In all the countries with exception of Ireland the largest proportion of funds has been allocated to physical infrastructure, between 35 and even 55 per cent. The rest has in a bit different proportions been channelled to the remaining two priorities, human resource development and productive environment with the later one incorporating also investments to the agriculture.

Table 5.14.: Structure of the EU funding by priorities in the old EU member states, 1994 – 1999 (% of total)

	Greece	Ireland	Portugal
Productive environment	23.4	26.5	30.1
Infrastructure, including environmental infrastructure	54.3	34.9	40.7
Human resources	20.8	35.7	24.8
Technical assistance and other	1.5	3.0	4.4
Total	100.0	100.0	100.0

Source: The impact of structural policies on economic and social cohesion in the Union 1989-1999. European Commission, 1997.

As far as the new EU member states are concerned, a good reference for allocation of funds could be the national development plans of the two Baltic states. In their NDP for the 2004 – 2006 period, Estonia and Latvia have articulated the same four development/investment priorities as the ones formulated in the NDP of the Republic of Macedonia. The Table 5.15. summarizes the distribution of funds among these four priorities for the both Baltic states. Similarly as in the case of the three old EU cohesion countries, also these countries have allocated the largest portion of available funds to physical infrastructure, close to 40 per cent of the total. The rest was distributed among the remaining three priorities in more or less equal shares, with each of participating with around 20 per cent in the total.

Table 5.15.: Allocation of funds in the NDPs of the three new EUR member states, 2004 – 2006 (% of total)

Priority	Estonia	Lithuania
Corporate sector competitiveness	19.2	24.9
Human resource development	19.5	17.9
Physical infrastructure	35.7	37.8
Agriculture and rural development	21.6	16.4
Technical assistance	3.8	3.0
Total	100.0	100.0

Based on the SWOT analysis of the Republic of Macedonia and based on the above presented benchmark experiences of selected EU member states, the following allocation of available NDP funds by development/investment priorities, they include

investments for institutional building and for project/program preparation, would seem appropriate (see Table 5.16.).

- The biggest share, i.e. 40 – 50 per cent of the total, is to be allocated for investment aimed at upgrading *economic infrastructure* in the country. Over the recent year, the Republic of Macedonia has put significant efforts to upgrade its infrastructure, but a large majority of funds for this purpose has been put into only one segment – road infrastructure. Taking into account the geographical position of the Republic of Macedonia and corresponding interest of the EU member states and other international factors it is reasonable to forecast that strong investment flow in roads will continue. There are, however, large investment needs also in other transportation segments, especially in the railways, as well as in the environmental sector (waste water treatment, solid waste management) and in the energy sector
- *Human resource development* is the next important development/investment priority to be funded by the NDP. Taking into account the importance of investment in human resources, i.e., capital expenditure as well as certain current expenditures on education, R&D and labour market development, and bearing in mind the current state of affairs in the Republic of Macedonia in this area, it is suggested that some **15 – 25 per cent** of the NDP funds should be allocated for investment in this segment of economic and social development.
- Investment in *corporate sector competitiveness* is considered to be another funding priority of the NDP. It is suggested that some 15 – 25 per cent of the total is earmarked for this priority. This is an area where, on the one hand, major investment efforts are needed, in tourism, for example, if the country wants to achieve higher and sustainable economic growth, and on the other hand, this is an area where the Republic of Macedonia is lagging behind not only vis-à-vis the new EU member states but also behind some countries in the region.
- Taking into account a strong potential of the Republic of Macedonia for agriculture production, some 10 – 20 per cent of the resources available for the NDP’s priorities should be allocated for the *agriculture and rural development priority*.

Table 5.16.: The “desired” allocation of available funds for the NDP by development/ investment priorities (% of total)

Development/investment priority	%
- Corporate sector competitiveness	20 (15 – 25)
- Human resource development	20 (15 – 25)
- Economic infrastructure	45 (40 – 50)
- Agriculture and rural development	15 (10 – 20)
Total	100 (80 – 120)

5.4.3. The “proposed” allocation of available NDP funds among the development / investment priorities

It is not realistic to project that the “desired” mix of NDP financing by development/investment priorities is achievable in the period of 3-years. As this is extremely short period for investment type activities, the “desired” allocation should be rather considered as a longer-term goal or benchmark for the country to which it will try to approach in the years to come.

For more operational purposes of this NDP a more realistic structure of development/investment priority mix is more appropriate (see Table 5.17.). This suggested or “proposed” allocation of available NDP funds takes the “desired” structure as a benchmark but adjusts it in line with the following operational criteria:

- *the existing structure of publicly financed investment associated with the relatively short time horizon of the NDP;* Taking into account that economic infrastructure has dominated the overall structure of the country’s publicly financed investments, it is neither possible nor desirable to change this structure drastically in a rather short period of time covered by the NDP. If not for other reasons, there are infrastructure investments under implementation that must be completed in the years to come and there are commitments with respect to certain infrastructure projects already taken vis-à-vis foreign creditors and donors. There is no doubt that large investments in economic infrastructure are needed. But on the other hand, these investments should always be assessed from the national economy’s trade-off point of view. Which investments in other segments of the economy have been dropped from the national investment priority list because of over investments in economic infrastructure. The benchmark analysis clearly argues that the Republic of Macedonia should allocate higher proportion of its investment potential to other development/investment priorities, especially to human resource development and to corporate sector competitiveness, as the backlogs here are even larger than in the economic infrastructure sector. This, of course, means that relative importance of economic infrastructure in the “desired” structure of NDP investments is significantly below that one in the existing structure of publicly financed investment. During the 3-year period of the NDP, the Republic of Macedonia should start approaching to this benchmark, what is reflected in the “proposed” structure.
- *project generating capacity/availability of ready to go projects;* In the templates contained in “Requests for contributions”, the line ministries and other providers of “investment needs” data have been asked to provide data about individual projects to be funded from public sources in the years 2007 to 2009. In some segments of the economy, for example in the rural development area, in education, R&D and labour market activities as well as in the area of corporate sector competitiveness, there have been either no projects identified, or if identified, they are not ready for implementation. This means that investments in these segments of the economy, even though they are extremely important for achieving the key objectives of the NDP, can not be significantly increased in a rather short period of time. So for investments in these segments of the economy, the major obstacle is inadequate project generation capacity and not financial resources as such. It is for this reason

why less funding is suggested in the “proposed” allocation of funds for these segments than would be suggested by the “desired” allocation of NDP funds among the priorities. In contrast, project generation capacity is reported to be higher in the economic infrastructure priority. This accompanied with high “investment needs” reported in this priority argues for allocation of more resources to physical infrastructure than would be appropriate according to the “desired” allocation of NDP investments.

- *preferences of foreign donors and creditors to support projects/programs in areas that reflect their individual priority orientations;* Over the recent years, the Republic of Macedonia has been a recipient of significant inflows of credits from IFIs and bilateral grants. Even though both these sources of potential NDP financing are forecasted to decline significantly in the 2007 – 2009 period (see Table 5.11.) they nevertheless have an impact on the priority structure of available NDP funds. With the years to come, the country will be faced with growing importance of the EU funds through the IPA arrangement. Because of the national cofinancing requirement associated with the use of these funds, they are expected to become by far the most important foreign funding source in terms of their influence on the overall investment activity of the country. With the volume of the IPA funds available for investment purposes, i.e., for the components III, IV and V, increasing over the years to come also the policy relevance of this instrument will have a strongly upward trend.

Table 5.17.: The “proposed” allocation of available funds for the NDP by development/ investment priorities (% of total)

Development/investment priority	%
- Corporate sector competitiveness	10
- Human resource development	15
- Economic infrastructure	60
- Agriculture and rural development	15
Total	100

Table 5.18. summarizes in quantitative terms the process of matching the NDP’s investment needs” with the “availability of funds” for these purposes. As shown in the Table, the “proposed” allocation of available resources forecast no funding gap for the human resource development priority. This means that funding should be available for practically all investment project/programs that have been reported as “investment needs” for this priority. Financing should therefore not be considered as a major constraint for human resource development priority providing that the proposed project/programs are actually prepared well and on time (see sub-chapter 5). The lack of well prepared project/programs is a consequence of either not clear strategic orientation for the development of the sector or poor project/program generating capacity (or a combination of the two).

On the other hand, lack of financing will be the major limiting factor for the physical infrastructure development/investment priority of the NDP. Some 70 per cent of the total amount of funds asked for in “investment needs” reports will actually be available for project/programs in this priority. Even though project generation

capacity varies among different segments of the priority, this capacity is in general terms much better than in the human resource development priority. Consequently, the lack of well prepared projects should be less of a problem for economic infrastructure priority. Based on specially designed criteria, authorities will have to make a prioritization of infrastructure projects, both among the sub-sectors as well as among individual projects.

As far as agriculture/rural development and corporate sector competitiveness priorities of the NDP are concerned, there is a kind of a mixed picture. Both priorities show a surplus of “investment needs” over the availability of funds for their respective priorities. However, it should be emphasized that this surplus is de-facto a consequence of large “investment needs” reported in a limited number of activity areas, like tourism sector in the case of the corporate sector competitiveness priority. On the other hand, there seems to be a significant lack of ready made projects in some other activity areas of both NDP priorities. For these activity areas, similar as for the human resources development priority, the main problem is the lack of strategic guidance for the sector development, weaknesses in the institutions responsible for the sector development and/or inadequate project/program generation capacity.

Table 5.18.: Matching “investment needs” with ““availability of funds” by the NDP development/investment priorities (in million EUR; in % of total)

Needs – allocation/ NDP priority	Existing allocation*	“Desired” allocation	“Proposed” allocation		“Investment needs”	“Funding gap”
	%	%	%	Volume	Volume	Volume
- Corporate sector competitiveness	4	20	10	108	165	57
- Human resource development	12	20	15	162	142	-20
- Economic infrastructure	69	45	60	649	1,200	551
- Agriculture / rural development	15	15	15	162	217	55
Total	100	100	100	1,081	1,724	643

* Calculated from Table 5.6..

5.5. Criteria for selection of individual project/programs to be financed under the NDP²⁰

Selection of individual projects/programs to be financed under the NDP has to be based on the list of projects/programs reported as “investment needs” by the line ministries. By being included in this “investment needs” pipeline, project has become eligible to be considered for funding under the NDP. Eligibility status is therefore *necessary* but at the same time not also *sufficient* condition²¹.

²⁰ The sub-chapter applies for the selection of those projects under the NDP that are looking for financing from public funds, domestic and foreign. It is therefore is not applicable, at least not the whole of it, for those projects to be financed from private sources, including concessions.

²¹ A procedure should be established how a project that has at this stage not been reported as an “investment need” enters into this pipeline later.

There are several stages each project in the “investment needs” pipeline has go through before it is actually being financed. The first stage relates to project documentation. If available project documentation is not sufficient to make at least a very general evaluation of the project, then this project can not progress into the next stages of the selection process. A reasonable well prepared project documentation is therefore a precondition for a project to be a serious candidate for financing.

In the next stage of the project selection process, projects are exposed to so-called “general level criteria”, i.e., to criteria that all projects to be financed within the framework of the NDP must adhere. These criteria are the following:

- Project must comply with the strategic objectives of the NDP and other strategic documents of the Republic of Macedonia
- The project must demonstrate consistence with both other projects and objectives of the NDP’s development/investment priority under which funding is applied for;
- Project must be relevant in terms of its content and timing;
- Project must be cost-effective (value for money), financially sustainable and must create permanent or long-term value added.

For those development/investment priorities of the NDP where “investment needs” largely correspond with availability of funds for this very priority the selection process of individual projects ends. This is, however, not the case with projects in those NDP’s development/investment priorities where “investment needs” largely surpass fund availability. Projects in the economic infrastructure priority are the most obvious example of this case.

Projects in these priorities will move in the third and last stage of the selection process where they will be exposed to so-called “specific criteria”, i.e. to criteria aimed more of priority specific requirements. For the environment infrastructure the following additional criteria would seem appropriate (there are not listed by priority):

- *projects under implementation*; Those project that are already under implementation should be either finalized or at least built to the economically justified (in case of project being done through phases).
- *status of the project in the PIP*; Projects that are included in the PIP should have higher priority that those ones that do not figure in the investment programming document of the government.
- *status of funding arrangements with potential creditors and/or donors*; In the process of selection a priority should be given to projects for which (i) the funding package has already been designed or is in at advance stage of preparation, and/or (ii) an international accepted commitment of the authorities exists. This criteria is has a particular relevance in the context of the short-term time horizon of the NDP.

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SWOT analyses for the regions of the Republic of Macedonia²²

This annex presents the SWOT analyses for all 8 regions in the Republic of Macedonia.

1. East Region

Strengths	Weaknesses
<ul style="list-style-type: none"> • Highly educated HR • Border zone (Bulgaria) • Existence of Local Economic Action Plans • Well developed system of primary and secondary schools • Good conditions for agricultural development • Protected environment • Inexpensive labour • Existence of industrial capacities (construction and wood-processing) • Developed mountain tourism • Relatively good road network • Existence of irrigation systems • Safety and low criminal rates 	<ul style="list-style-type: none"> • Lack of managerial education • Schools in bad condition, No university center, Brain drain • Insufficiently developed banking system, lack of acceptable credits • Lack of extension support in agriculture, • Farmers aren't well organized • Fragmentation of agricultural land • Old technologies • Problems with marketing of local products • Not well developed businesses and dysfunctional market mechanisms, No business associations • Long and bureaucratic procedures • No plans for attraction of new investments • Weak promotion of the tourist opportunities • Low economic power of local population • Unemployment problems • Insufficient cooperation between local and central government • Old and damaged infrastructure • No efficient solid waste management systems
Opportunities	Threats
<ul style="list-style-type: none"> • Potential for establishment of a university center • Capacities for introduction of good agricultural practices • Good potential for future agricultural development • Potential for construction of small hydropower plants • Existence of industrial zones which can be restored • Opportunities for increased foreign investments in the region • Potential in young and educated people • Improvement of trans-boundary cooperation 	<ul style="list-style-type: none"> • Insufficiently educated entrepreneurs • Not well developed financial services • Weak interest for development of new businesses • Problems related to the transfer of responsibilities (decentralization) • Overuse of natural resources, especially forests • Visa regime • Frequent strikes and blockages • Inefficient juridical system

²² Prepared by the UNDP network of local experts on the basis of data compiled from municipalities.

2. North East Region

Strengths	Weakness
<ul style="list-style-type: none"> • Qualified human resources • Existence of Ngo's • Geo-strategic location (corridor 8 and 10) • Developed road infrastructure • Access to Airport • Established industrial zones • Multi-ethnic environment • Potential for Gasification • Spa's, water potential • Developed Private business primarily SME • Cross-border region (est. 3 Euro Regions) • Existence of sport facilities • Excellent cultural and historical heritage • Developed light industry (over 4000 employees) • Diaspora • Advanced custom service and terminals • Established cooperation among Municipality, NGO and business sector • Existence of media • Existence of functional irrigation infrastructure • Ecologically clean environment • Possibility for development of the rural tourism and fishery • Possibility for development of the agriculture and processing of agricultural products including eco-producing • Possibility for development of the alternative agriculture (mushrooms, honey, ...) 	<ul style="list-style-type: none"> • Uncompleted privatization and company restructuring • Underdeveloped infrastructure • Lack of border crossing points on north • Slow construction of the corridor 8 • Existence of old technology within economic sector • Lack of capacities of the local government(s) • Unemployment and low living standard • Lack of strategy for business sector • Lack of managerial and entrepreneurial skills • Underdeveloped labor market • Incompatible sewage and irrigation channel • Existence of the grey economy • Not regulated river bangs • Not utilized industrial natural potential • Lack of maintenance of the cultural and historical capacities • Non-existence of mechanism for supporting the business sector • Non-existence of "one-stop-shop" on local level • Non-existence of the centre for v • Lack of tradition on urban planning • Lack of cooperation with local and central authorities • Understaffed local authorities • Lack of tax payment • Non-existence of the communication system with citizens • Lack of tourist offer • Lack of banking services
Opportunities	Threats
<ul style="list-style-type: none"> • Utilization of the existing capacities • Finalization of the infrastructure for corridor 8 and 10 • Increased maintenance of the existing infrastructure • Development of the tourism and cross-border cooperation • Establishment of the free economic zones • Further decentralization • Creation of the investment funds • EU accession • Regional economic networking • Stimulating investment from Diaspora • Continuous increase of capacities and skills • Assistance from the donors • Transfer of the land into municipal ownership • Establishment of the regional waste disposal facility 	<ul style="list-style-type: none"> • Difficult access to investment/capital • Unemployment and poverty • Non-simulative fiscal policy • Lack of resources of the local governments • Complicated legal policy on foreign investment • Political influences • Threat from various natural disasters • Dissimulative agriculture policy • Slow decentralization • Unreformed fiscal and credit policy • Urban planning • Immigration • grey economy

<ul style="list-style-type: none">• Development of eco and ethno-tourism• Establishment of capacities for agricultural production and food processing• Standardization and certification of the product, including eco-products• Utilization of the water potential• Utilization of alternative sources of energy• Further strengthening the capacities of management, entrepreneurship and business sector	
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3. Pelagonija Region

Strengths	Weaknesses
<ul style="list-style-type: none"> • University center with many faculties • Well developed banking system • Fertile soil • Well developed construction industry • Good climate conditions (appropriate for tourism development) • Good business relations • Border zone • Well maintained basic infrastructure (main roads, water supply and sewerage systems) • Existence of mines and natural resources • Harmonized inter-ethnic relations • Well preserved environment • Tradition and potential in various crafts • Existence of NGO network • Well developed communication network 	<ul style="list-style-type: none"> • Inefficient banking system, high interest rates, little number of banking services, lack of guarantee funds • Unorganized marketing of agricultural products • Low agricultural productiveness, fragmentation of agricultural land, old machinery • Old and damaged irrigation systems • Unsolved ownership relations • Absence of tourist offer and lack of tourism capacities • Lack of cultural events • Absence of tourism bureaus • Weak financial standings of the tourism companies • Old infrastructure, damaged and/or incomplete water supply and sewerage systems • Insufficient educational and professional capacities of the employees in the Local Government • Polarization of political relations • Insufficient cooperation with the central Government • Old debts and weak financial capacity • Low living standard • Undeveloped public health system
Opportunities	Threats
<ul style="list-style-type: none"> • Potential in young and educated people • Improvement of trans-boundary cooperation • Implementation of defined actions from the Local Economic Action Plans • Free industrial zone • Regional agricultural stock exchange • Further development of specialized capacities for mineral industry • Possibilities of linking education with industries (mineral industry in particular) • Foreign direct investments • Further tourism development, areas under special status (UNESCO) • Introduction of integrated and organic agricultural development • Use of alternative energy sources 	<ul style="list-style-type: none"> • Migrations, Brain drain phenomenon • Insufficiently educated and old HR • Uneven distribution of the labour force • Inappropriate policy on bank credits • Diseases in agricultural/livestock production • No preparedness for quick respond to weather conditions affecting agricultural production • Incomplete privatization • Weak cooperation between Government and the business sector • Weak statistical databases •

4. Polog region

Strengths	Weakness
<ul style="list-style-type: none"> • Qualified human resources • Existence of Ngo's • Geo-strategic location • Developed road infrastructure • Established industrial zones • Multi-ethnic environment • Access to natural resources • Developed Private business primarily SME • Cross-border region • Excellent cultural and historical heritage • Diaspora • Finalized privatization • High-quality communication network • Ecologically clean environment • Possibility for development of the tourism and fishery • Possibility for development of the agriculture, cereals, cattle breeding and processing of agricultural products including eco-producing • Possibility for development of the alternative agriculture (mushrooms, honey, ...) • Established and functional inter-municipal cooperation 	<ul style="list-style-type: none"> • Weak infrastructure and access • Lack of cooperation between municipalities and branches of the respective ministries • Lack of capacities of the local government(s) • Unemployment and low living standard • Lack of strategy for business sector • Weak investment promotion • Lack of managerial and entrepreneurial skills • Underdeveloped labor market • Incompatible sewage and irrigation channel • Existence of the grey economy • Not utilized industrial & natural potential • Lack of media coverage • Non-existence of mechanism for supporting the business sector • Lack of tourist offer and tourism strategy • Lack of financial institutions • Absence of urban documentation in the populated place • Garbage collection
Opportunities	Threats
<ul style="list-style-type: none"> • Utilization of the existing capacities • Finalization of the infrastructure for corridor 8 and 10 • Development of textile and wood processing industry • Increased maintenance of the existing infrastructure • Development of the tourism and cross-border cooperation • Establishment of the free economic zones • Further decentralization • Established inter-municipal cooperation • Corridor 8 • Regional economic networking • Stimulating investment from Diaspora • Continuous increase of capacities and skills • Development of eco and ethno-tourism • Establishment of capacities for agricultural production and food processing and branding 	<ul style="list-style-type: none"> • Difficult access to investment/capital • Unemployment and poverty • Non-simulative fiscal policy • Lack of resources of the local governments • Complicated legal policy on foreign investment • Political influences • Threat from various natural disasters • Dissimulative agriculture policy • Slow decentralization • Unreformed fiscal and credit policy • Urban planning • Immigration • Uncontrolled logging • Nonfunctional train station • Custom terminal and free economic zone • Ineffective administration • National strategy for agriculture • Infrastructure maintenance • grey economy

<ul style="list-style-type: none">• Utilization of the water potential• Utilization of alternative sources of energy• Further strengthening the capacities of management, entrepreneurship and business sector	
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5. Skopje

Strengths	Weaknesses
<ul style="list-style-type: none"> • Relatively good infrastructure (roads, detailed urban plans, water, electricity in urban areas) • Industry (textile, construction + qualified labour force, food processing, artisans) • Industrial zone • Available construction land (Aerodrom) • Domestic investments • Easy access to markets / in the market • Easy access to services • Good life quality compared to other Macedonian municipalities • Presence of international community in the region (shopping, employment) • Natural resources (forests, arable land and thermal water for SPA in the periphery of urbanized areas) • Cultural and historical heritage • Agriculture production near to the market 	<ul style="list-style-type: none"> • Lack of competitiveness and entrepreneurial spirit/ businesses' education • Absence of strategic plan for private sector development • High unemployment / de-motivated labour force • Weak infrastructure towards and in the periphery of the urban areas (roads, urban plans, electricity, water supply and sewage, water management and atmospheric waters/floods, waste management, landscaping) • Low environmental sensibility • High density of population in the city center • No social (health and sport centers) and cultural facilities in the periphery • Land ownership and management (illegal constructions) • Inter-municipal cooperation • Absence of banking sector in the periphery • Low investments • Low technical / IT knowledge, skills and utilization • Inefficient municipal administration • Daily migrations (opportunity?)
Opportunities	Threats
<ul style="list-style-type: none"> • Inactive industrial zone in periphery • Credit rating of municipalities • Development of week-end tourism using natural resources and through improved infrastructure (construction of sport facilities in periphery, SPA, Golf, hunting, hiking/mountain/forests/ Skopje Monte Negro, cultural visits, shopping) • Development of agriculture in periphery • Waste recycling • Public Private Partnerships (ownership of resources) • Inter-municipal cooperation • Improvement of social services ('social enterprises') • Twinning • Promotion of investment opportunities abroad • Gasification (infrastructure/energy) • Land ownership and planning • Strategy for development and support to businesses • Ongoing construction of the by-pass road linking corridors 8&10 	<ul style="list-style-type: none"> • Land contamination/water treatment/environment • Public financial resources • Land ownership and management • Communication between national institutions and municipalities • Mortgages/interest rates on credits • Competitiveness of business sector • Judicial and legal issues - inspection/corruption • Administrative barriers to give impetus to entrepreneurship • Environment • Shadow economy • taxation • brain drain

6. South East region

Strengths	Weaknesses
<ul style="list-style-type: none"> • Good geographical position and connection to European borders and markets (border crossing points in Gevgelija, Dojran, Novo Selo) • Transport infrastructure (motorways and railways, organized public transport in urban areas, airport 70 km²) • Euro region • Greek investments • Natural resources (Lake, Forests, Thermal waters, Minerals) • Cultural and historical heritage (Cultural activities: Strumica Carneval /archeological sights: Gevgelija) • Favorable climate conditions and quality arable land • Clean environment • Identified agricultural region • Identified brands in Strumica micro-region • Technologies and equipment for growing early vegetables • Strong commitment for inter-municipal cooperation in the area of economic development • Designed General Urban Plans for urban areas • Economic zones • Productive SMEs in urban areas • Presence of banking sector in urban areas • Social services infrastructure • Potable water and water supply system • Dwellings • Developed NGO network • Human resources/labour force • Utilization of basic IT technology (Strumica) • Lake (tourism, fishing, tourist info point) 	<ul style="list-style-type: none"> • Insufficiently developed transport infrastructure (roads towards rural areas) • Insufficiently developed economic and cultural cross border cooperation for some municipalities (Valandovo, Radovish) • Insufficient utilization of natural resources (water) • Poor skills of public institutions (employees) • Inefficient public administration • Little direct investments • Insufficient promotion of tourist potential • Inactive tourist facilities (Dorjan) • Poor condition of local cultural establishments and undefined legal property relations • Absence of municipal brands (Radovis) • Small local green markets • Absence of organized and standardized agricultural production and market • Poor water and forest management • Absence of irrigation system in Dorjan • Inadequate waste management including waste waters • Low business and managerial skills of farmers • Fragmented farms • Insufficient number of processing plants • Inadequate professional orientation • Absence of strategic economic development planning for some municipalities • Absence of integrated quality data base • Absence of detailed Urban Plans for new industrial zones • Absence of business and info centers in Gevgelija • Grey economy • Insufficient inter-sector cooperation • Insufficient coordination between educational system and private sector • (Lack of raw materials for canning industry) • Low utilization of IT technology • Brain drain • Lack of skilled labour force (Radovis) • Absence of one stop shop • Absence of financial institutions in rural areas • Absence of standardized production • Poor life quality in rural areas
Opportunities	Threats
<ul style="list-style-type: none"> • Cross border cooperation • Possibility for development of regional infrastructure • Potential for improving the infrastructure including inter-municipal road structure, regulation of riverbeds • Possibilities for new economic zones 	<ul style="list-style-type: none"> • Introduction of visa's regime for future members of EU • Inefficient central authority • Centralized management of resources • Land ownership and management • Inadequate grouping of municipalities in administrative regions (Gevgelija)

<ul style="list-style-type: none"> • Potential for founding a University/higher education • Development of social facilities (sport centers) • Creation of organized Agro market • Possibilities for utilization of natural resources (minerals)/transformation into commodities • Development of alternative energies, solar energy and hydro and geo-thermal power • Possibility for agricultural development, including Mediterranean fruit and vegetables • Production of ecologically clean food • Introduction of standards into production lines • Increased access to foreign markets • Attracting foreign and domestic direct investments • Potential for development of tourism/tourist offer (including hunting, fishing, village tourism) • Potential for development of the banking sector • Institutionalizing of the LED partnership • Decentralization and the new competences of the units of local self-government 	<ul style="list-style-type: none"> • Absence of National Development strategy • Slow implementation of decentralization • Unfavorable macroeconomic environment (credit lines, subventions, tax exemptions for businesses) and inadequate economic and agricultural policies • Globalization • Shadow economy • High prices of repro materials • Absence of sources of own energy • Poor environmental management and sensibility • Area with high seismological risks, and floods • Stagnating growth of population • Aging active population in primary sector • Brain drain of human resources and youth emigration from rural areas • Rural – urban migration • High level of unemployment • Slow adjustment of educational programmes with the needs of the private sector • Emerging youth delinquency (alcohol, drugs, violence) • Disrespect of rule of Law
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7. South West region

Strengths	Weaknesses
<ul style="list-style-type: none"> • Good geographic position (Ohrid lake, Corridor 8); • Natural resources (water, forests, pastures, minerals, unpolluted environment); • Educated and professional human resources; • Cultural and historical heritage; • Tradition in handicraft; • Relatively good base of business entities; • Existing NGOs/CSOs; • Existence of LED offices; • Relatively good infrastructure (roads, telecommunication, water supply); • Suitable conditions for further tourism development; 	<ul style="list-style-type: none"> • Lack of urbanistic plans; • Not defined land ownership and management; • Lack of high schools; • Lack of sport facilities; • Inadequate conditions for primary education (old buildings); • Inadequate care for historical and cultural facilities; • Low quality of drinking water (lack of water purifying plants); • Inadequate usage of natural resources (not using at all or destroying the resources); • Lack of investments; • Lack of administrative infrastructure (inadequate set up and functioning of local government); • Negative population growth rate; • Insufficient knowledge and usage of IT; • Substandard infrastructure conditions; • Underdeveloped and unorganized private sector (lack of management skills and knowledge, lack of association of business, undeveloped public-private partnership); • Lack of regional road infrastructure; • Insufficient municipal budget; • Low promotion of tourism opportunities; • High unemployment; • Lack of strategy for economic development; • Low education of population
Opportunities	Threats
<ul style="list-style-type: none"> • Development of tourism (best utilization of natural resources; existing tourist centres); • Further development of agriculture and stock-breeding (organic food, wild fruits, poultry); • Diaspora investments; • Development of region (improvement of infrastructure, regional roads and railway, Corridor 8); • EU funds; • Existence of young, qualified and cheap labour force; • Cross-border cooperation; • Enforcement of private companies through their associating; • Decentralisation: transfer of competences in LED; • Strengthening of the SMEs (business services and training); • Re-starting of industrial capacities; • Improvement of local-central government cooperation; • Construction of new energy capacities; 	<ul style="list-style-type: none"> • Weak and slow implementation of decentralisation; • Bureaucracy; • Corruption; • Shadow economy; • Monopoly of big companies; • Migration of population; • Brain drain • Lack of professional human resources; • Unfavourable policies of central government for LED (mortgages rates on credits, not completed privatization, macroeconomic policy, business climate); • Lack of national development strategies; • Impossibility to follow the pace of technology; • Political instability of Balkan region; • Poor communication with central government; • Unfavourable demographic development (ageing of population)

8. Vardar region

Strengths	Weaknesses
<ul style="list-style-type: none"> • Good geographic position (Central Macedonia, Corridor 10, vicinity to the capital, to the airport, to the border with EU country); • Natural resources (water, forests, pastures, minerals); • Educated and professional human resources; • Cultural heritage (archaeological sites); • Tradition in entrepreneurship and handicraft; • Motivated HR in municipal administration; • Good transport infrastructure (road and railway); • Developed vinery and brand products 	<ul style="list-style-type: none"> • Lack of urbanistic plans; • Not defined land ownership and management; • Insufficient knowledge and usage of IT; • Underdeveloped and unorganized private sector (lack of management skills and knowledge, insufficient support of SMEs, non-existence of free economic zones); • Insufficient municipal budget; • High unemployment and low standard of living; • Lack of strategy for economic development; • Lack of statistical data; • Bureaucracy at local level; • Lack of high-level education institutions; • Old production technology; • Pollution of environment; • Uncompleted infrastructure; • Unutilized and ruined facilities; • Lack of GIS Cadastre; • Low % of population with tertiary education; • Insufficient services.
Opportunities	Threats
<ul style="list-style-type: none"> • Development of tourism (wine tourism, transit and recreational tourism); • Further development of agriculture and stock-breeding (organic food); • Development of region (improvement of infrastructure, regional roads and railway, Corridor 10); • EU funds; • Cross-border cooperation; • Enforcement of private companies through their associating; • Strengthening of the SMEs (business services and training); • Re-starting of industrial capacities; • Introduction of one-stop shop; • Increased usage of IT; • EXPOs on regional level; • Start-up of new educational institutions; • Revitalization of artisans; • Public-Private Partnership; • Suitable locations for investments; • GIS; • Development of sport and culture 	<ul style="list-style-type: none"> • Weak and slow implementation of decentralisation; • Bureaucracy; • Corruption; • Shadow economy; • Monopoly of big companies; • Unfavourable policies of central government for LED (mortgages rates on credits, not completed privatization, macroeconomic policy, business climate); • Lack of national development strategies; • Political instability of Balkan region; • Poor communication with central government; • Unfavourable demographic development (ageing of population); • Dependence of the private sector on donors and local government; • Low growth and development of the country; • Inefficient implementation of laws; • political pressure on private sector; • Low price of agricultural products; • Unbalanced distribution of population; • Low interest of foreign investors

Development / investment priorities of the regions in the Republic of Macedonia²³

This annex has two-fold objectives, first, to present development / investment priorities as articulated by the 8 regions of the Republic of Macedonia, and second, to present a summarized quantification of the “investment needs” reported by the municipalities.

1. Development / investment priorities by regions

1.1. East Region

East region is currently in a dramatic economic and social condition, mainly due to the extreme number of socially vulnerable as well as unemployed people. This is the main reason for the frequent strikes and road blockages in this part of the country. There is an increased disappointment of local population, which usually results in migration to foreign countries, especially the young population.

With respect to **infrastructure**, it can be stated that it isn't sufficiently developed. Moreover, its condition is deteriorating due to the inadequate maintenance. For example there are still a serious number of people in this region who use wells for water supply. These problems have forced local people to spend their limited funds to development of suitable projects (technical designs), mainly for solving the water supply problems.

The condition of the public health system are also far below the European standards. The problems related to solid waste management are appropriately solved, and not even one of the municipalities has integrated solid waste management service on its whole territory. The wastewater problem is also one of the most important ones, because most of the households still aren't connected to the sewerage network. Actually this whole process is stopped due to the lack of funds.

In order to better develop the **human resources** in the region, most of the municipalities propose establishment of a university which will meet local communities' educational needs. Apart of Stip, the other municipalities don't have faculties. Also the primary and secondary schools are in bad condition, and don't respond to the pupils needs. Business also don't have appropriate educational basis, despite the relatively good number of highly educated people. The brain drain phenomenon is one of the problems that have long-term negative effect for the whole region.

In terms of **competitiveness**, this region is recognizable for its tradition in agricultural production. However, the constant decline of prices of agricultural products, this economic branch is under serious threats. There are excellent natural conditions which include access to water, fertile soil, good climate etc., but what is required are

²³ Compiled by the UNDP network of local experts on the basis of inputs provided by municipalities.

investment in new equipment and machinery, transfer of information on prices and trends of agricultural products on world markets, educational of local farmers mainly on the EU standards etc.

This region also has very good conditions, suitable for tourism development. Special potentials lie in the mountain, winter and village tourism. This requires major investments in many new infrastructure projects, as well as renovation of the old ones. The promotion of the region as a tourist destination is also one of the main objectives for future tourism development.

Rural development is also one of the priorities of the municipalities, which they believe will be better addressed after the finalization of decentralization process in the country, especially in the area of properties and finance. The basic concepts for rural development are based on development of tourism, as well as small and medium enterprises and local industry.

1.2. North East Region

- Insure sustainable economic development of regional economy based on tourism, agriculture and specific industries as well as investment promotion
- Insure further development and Improvement of infrastructure (local, regional including corridor 8 & 10)
- Improved business environment (taxation, business support services, SME's, start-ups and self employment, business networks, trainings/retraining) including tax collection for public utilities.
- Development of social infrastructure (schools, centers for persons with special needs)
- Insure environmental sustainability
- Capacity building of municipal administration, improved services to citizens including increased inter-municipal cooperation
- Reduce unemployment and include active trainings

1.3. Pelagonija Region

Pelagonija region is one of the less developed regions in Macedonia. The whole region, including both urban and rural areas is facing serious problems related to incomplete or not well maintained infrastructure, such as water supply, sewerage systems, irrigation schemes etc. Therefore this region needs immediate interventions directed towards its more intensive **infrastructure development**. This region is also facing problems related to the solid waste management including inappropriate and non-sanitary solutions of the solid waste landfills.

One of the most important potentials of this region is the **human resources development**. There is a functional university center which continuously produces educated people. However, due to the old curricula, the absence of so called “life learning”, and the insufficient integration of theory and practice, the results aren't as expected. The educational system is especially weak in terms of development of business skills. Because of these problems, the region needs investments in “life

learning”, establishment of productive links between theory and practice, as well as introduction of programs which correspond with the requirements of the labour market.

With respect to the **competitiveness**, the region traditionally is mainly focused on agriculture development, tourism and mining. Unfortunately, the changes caused by the transition period have negatively affected the overall region’s economy, due to the strong competition of foreign companies, which is continuously overtaking the traditional markets outside the country, but the domestic markets as well. Industries and agriculture are striving to find out a solution of the current situation, but they are facing with many problems on their way such as: old technologies, weak information flow, lack of appropriately educated people, fragmentation of agricultural land, absence of functional agricultural stock exchange and no capacity for following the development trends at present.

Moreover, the weak support of the government, insufficient cooperation between the local and central government, as well as the difficulties caused by the unfinished decentralization process are mentioned among the most important problems affecting the competitiveness. Also the privatization process isn’t yet completed.

The opportunities for development of competitiveness in Pelagonija lie in creation of technological capacities and industrial zones, renewal of the equipment as well as improvement of the knowledge.

Rural development is also one of the strategic objectives of all municipalities within Pelagonija region. The basic identified prerequisites for further rural development are mainly in the area of infrastructure development. This is one of the most important conditions for improvement of quality of life which is essential for continuing the life in rural areas. Because of this reason, most of the infrastructure projects have an objective to support the undeveloped areas. Also economic development projects, for which extensive analyses are required, are one of the priorities for which is expected that will secure future rural development. The alternative types of tourism, especially village tourism are seen as an opportunity for promotion of rural development.

1.4. Polog region

- Insure sustainable economic development of regional economy based on tourism, agriculture, textile and specific industries as well as promotion of investment opportunities.
- Insure further development and Improvement of infrastructure (local, regional including corridor 8)
- Improved business environment (taxation, business support services, SME’s, start-ups and self employment, business networks, trainings/retraining) including tax collection for public utilities.
- Development of social infrastructure (schools, centers for persons with special needs)
- Insure environmental sustainability
- Utilize national resources and promote rural development

- Capacity building of municipal administration, improved services to citizens including increased inter-municipal cooperation
- Reduce unemployment and include active trainings
- Insure social integration and improve living standards

1.5. Skopje

- Sustainable local economic development (preparation of strategies and inter-municipal cooperation)
- Improved business environment (taxation, business support services, SMEs, start-ups and self employment, business networks, trainings/retraining)
- Development of agriculture, tourism and investment promotion
- Development of social infrastructure (schools and centers for persons with special needs)
- Improve the quality of environment /ecologically clean
- Reduce unemployment /trainings
- Improved management of natural resources hydro-power
- Development of infrastructure (water supply and sewage, management of atmospheric waters and roads)
- Tax collection for public utilities
- Capacity building of municipal administration
- Improved services to citizens and businesses
- Gasification

1.6. South East region

- Developed local economy based on tourism, agriculture and specific industries
- Improved infrastructure
- Improved social infrastructure
- Sustainable employment (entrepreneurship and human resources development)
- Globalization of local businesses

1.7. South West region

- Support of SME
 - Education and training of entrepreneurs;
 - Establishment of resource centres for SMEs (business council, linkage of science and business, business database etc.)
- Rural and agricultural development
 - Processing of agricultural products;
 - Associating agricultural producers for common market approach;
 - Education of food producers;
 - Setting quality standards for products;
 - Controlled usage of natural resources (water, forests, minerals);
 - Building of small processing capacities for agricultural and stock-breeding products;

- Construction of irrigation systems;
- Dairy and meat processing industry;
- Establishment of vet centres, centres for support of agriculture, agricultural pharmacies
- Increasing investments
 - Stimulation of domestic and FDI
 - Start-up new industrial capacities
 - Establishment of economic zones
 - Improvement of business environment
- Human resources development
 - Establishment of Centres for vocational training, improvement of skills
- Improvement of infrastructure
 - Construction of sewage system;
 - Construction of water supply system;
 - Road infrastructure
- Tourism development
 - Preparation of Tourism development strategy;
 - Utilization of archaeological, cultural and ethnological monuments-objects (revitalization);
 - Promotion of folklore, theatre, painting exhibition and seasonal cultural events;
 - Resource centre for tourist development (Specialized training for tourist workers, preparation of packages and programs);
 - Establishment of cluster for promotion of regional tourism.

1.8. Vardar region

- Support of SME
 - Establishment of resource centres for SMEs (business council, linkage of science and business, business database etc.);
 - Administering the project and grant procedures for SMEs
- Rural and agricultural development
 - Construction of irrigation systems;
- Increasing investments
 - Stimulation of domestic and FDI
 - Establishment of economic zones
- Human resources development
 - Efficient service of public administration;
- Improvement of infrastructure
 - Construction of sewage system;
 - Construction of water supply system;
 - Improvement of road infrastructure
 - Improvement of services
 - Construction of land fills
- Tourism development
 - Resource centre for tourist development (Specialized training for tourist workers, preparation of packages and programs, alternative tourism offer);
 - Wine vaults for promotion of wine tourism;

- Promotion of available capacities
- Improvement of municipal services
 - Development of one-stop shop
 - Development of GIS;
 - Improvement of health services
 - Modernization of educational system

2. Quantification of development / investment needs by the regions

An integral part of the “Request for contributions” distributed to all local communities was also a template for providing information on individual projects / programs that are in view of local communities instrumental for implementing their development priorities (see sub-chapter 1).

Table A summarizes data on 1003 investment projects / programs that have been reported by local communities. In value terms, the total volume all these investments amount to 1,132 million EUR. This means that an average size of an investment is around 1.1 million EUR. If, there are 3 to 5 large infrastructure projects excluded from this list, the average size of an investment would be around 0.8 million EUR.

For classification of projects by development / investment priorities the priorities identified at a national basis have been taken as a basis. The submitted project data clearly show that a dominant proportion of all investment projects / programs are from the economic infrastructure priority. Submitted projects from this priority amount to as much as 997.6 million EUR what is equivalent to 88.1 per cent of the total. Average size of the project / program here is above average – 1,7 million EUR. The most typical projects within this priority are projects for water supply systems, wastewater treatments, sewerage, roads, streets, sport recreation centers, feasibility studies for infrastructure, etc..

The total volume of submitted project / program proposals from all the remaining three development / investment priorities of the NDP amount to 122 million EUR what is equivalent to 10.8 per cent of the total. Of this total, project / programs in the human resource development priority (projects include support to the education process, trainings, seminars, employment of new teaching staff, and also reconstruction of school buildings, playgrounds, etc..) participate with 19.5 million EUR or 1.7 per cent in the total, projects / programs in the competitiveness priority (projects include economic zones, parks, business incubators, SME development projects, tourism, e-market projects, etc..) participate with 35.0 million EUR or 3.1 per cent of the total, and projects / programs in the agriculture and rural development priority (projects include food production, local markets, rural development projects, etc..) participate with 67.5 million EUR or 6.0 per cent of the total

Into category “Other” all those projects are included that do not fit into any of the four priorities of the NDP Construction of a municipality building or urbanization plan are projects of this kind. Total volume of project / program under this category amounts to 12.7 million or to 1.1 per cent of the total.

Table A: Investment needs as identified by individual regions of the Republic of Macedonia for the 2007 – 2009 period

Region / Investment priority	Competitiveness		Physical infrastructure		Human resource development		Agriculture and rural development		Other		Total	
	Amount in 000 EUR	Number of projects	Amount in 000 EUR	Number of projects	Amount in 000 EUR	Number of projects	Amount in 000 EUR	Number of projects	Amount in 000 EUR	Number of projects	Amount in 000 EUR	Number of projects
East	9,740	8	225,880	109	3,222	10	1,200	1	1,742	10	241,784	138
NorthEast	2,154	25	65,860	75	2,348	36	7,184	29	3,429	5	80,975	170
Pelagonija	4,500	2	120,611	117	1,111	9	5,825	13	500	2	132,547	143
Polog	826	28	18,350	23	741	10	4,600	26	506	16	25,023	103
Skopje	720	4	73,805	44	1,060	6	60	2	1,600	2	77,245	58
SouthEast	6,047	3	384,443	132	2,239	8	27,065	6	3,313	24	423,107	173
SouthWest	7,668	37	63,127	67	1,324	18	21,559	33	1,113	18	94,791	173
Vardar	3,342	4	45,533	37	7,500	3	0	0	500	1	56,875	45
TOTAL	34,997	111	997,609	604	19,545	100	67,493	110	12,703	78	1132,347	1003

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