



COMMISSION OF THE EUROPEAN COMMUNITIES

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**REPORT FROM THE COMMISSION  
TO THE EUROPEAN PARLIAMENT AND TO THE COUNCIL  
ON THE IMPLEMENTATION OF MACRO-FINANCIAL ASSISTANCE  
TO THIRD COUNTRIES IN 1999**

## List of abbreviations

CBA	Currency Board Arrangement
CPI	Consumer Price Index
DM	German Mark
EC	European Community
EFF	Extended Fund Facility
EIB	European Investment Bank
ESAF	Enhanced Structural Adjustment Facility
EU	European Union
EUR	Euro
FDI	Foreign Direct Investments
FESAL	Financial and Enterprise Structural Adjustment Loan
FYROM	Former Yugoslav Republic of Macedonia
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
IFIs	International Financial Institutions
IMF	International Monetary Fund
SAF	Structural Adjustment Facility
SBA	Stand-By Arrangement
USD	Dollar of the United States of America
VAT	Value Added Tax
WTO	World Trade Organisation

## VII. THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

### 1. Executive summary

Since the creation of the former Yugoslav Republic of Macedonia (fYROM) in 1992 the country initially suffered a significant fall in GDP followed by several years of steady if modest GDP growth. Thus, by 1999 it is estimated that the level of GDP is still well below that recorded by the time of the establishment of the independent republic.

1999 was marked by the Kosovo crisis, which gave rise to a massive refugee influx, a disruption of trade patterns and a fall in FDI. The reconstruction of Kosovo is now turning into a major source of economic growth in fYROM. Since 1992, fYROM has undertaken an encouraging economic reform programme. In 1999, however, the programme was not implemented as planned and in particular major state owned loss-making enterprises were not restructured or sold as planned. Accordingly, the IMF programme is now off track. Negotiations with the IMF are ongoing and it is expected that the new government will recreate the momentum in the reform process.

The Kosovo crisis gave rise to a large increase in refugee related government expenditure. The international community, including the European Union, reacted promptly and has undertaken to provide important amounts of macro-financial support for fYROM.

The Council decided a macro-financial assistance operation of up to EUR 80 million in November 1999.

### 2. Macroeconomic performance

In early 1999 expectations regarding economic growth were gloomy: the Kosovo crisis was having a marked negative effect on economic activity in fYROM due to disruption of trade, fall-out of FDI and the massive influx of refugees.

SUMMARY STATUS OF ECONOMIC REFORM	
<b>1. Price liberalisation</b>	Price liberalisation has been essentially completed. Price controls exist for only very few products.
<b>2. Trade liberalisation</b>	A small number of tariff and non-tariff barriers remain in place. Most temporary safeguard measures introduced in the wake of the Kosovo conflict have been removed again, but important duties remains for sugar imports. The average tariff rate is 15%. Revised customs code approved by government.
<b>3. Exchange regime</b>	From early 1994, de facto peg of the denar to the Euro; since the devaluation of July 1997 it stands at some 60.5 denar for one Euro.
<b>4. Foreign direct investment</b>	The environment for FDI has improved. However, approval from the government is still requested to carry out some types of foreign direct investments, while the absence of a properly functioning market for land are also hampering the FDI inflows. FDI inflows increased substantially in 1998 as the authorities have been more open to FDI. Overall, the capital account remains largely regulated.
<b>5. Monetary policy</b>	Monetary policy essentially based on the exchange rate anchor.
<b>6. Public finances</b>	Tight fiscal policies continued in 1999, (although public expenditure increased strongly as a result of refugee related expenditure in 1999). A deficit of some 3-4% of GDP is expected.
<b>7. Privatisation and enterprise restructuring</b>	Privatisation programme begun in 1993; some 1200 out of 1216 enterprises have finalised privatisation though only some have been restructured. Private sector accounts for more than two-thirds of GDP. Slow progress in privatisation and restructuring of agro-industrial conglomerates.
<b>8. Financial sector reform</b>	Two-tier banking system. There are 20 banks, one branch of a foreign bank and 19 savings banks. The sector is dominated by Stopanska Banka, which has been restructured and is now being sold to the National Bank of Greece. Banking supervision through National Bank. Lending to 22 largest debtor enterprises closely monitored.

However, the end of the Kosovo conflict and the quick return of most of the refugees was followed by a pickup in economic activity in FYROM, as the international relief efforts in Kosovo boosted exports and as the presence of foreign relief and military personnel in the area supported demand in FYROM. Therefore, in spite of the fall of output in spring, it is now expected that real GDP growth could be around 2.5% for the year 1999.

As for the current account deficit, it also turned out better than feared early in the year at 4.0% of GDP. As noted above, a pickup in exports linked to the reconstruction of Kosovo were instrumental in this. Still, for the year as a whole, exports are expected to have declined by just over 1% while imports may have fallen by over 7%.

Government finances have been developing broadly satisfactory. Since 1995, the government deficit has been between 0 and 2% of GDP each year. A deficit of 1.5% is likely to materialise for 1999. The refugees from Kosovo gave rise to a marked increase in public expenditure on accommodation, food, health, etc. However, an important share of this extra expenditure was covered by emergency budgetary assistance from bilateral donors and international organisations, including the European Community.

The unemployment rate remained at a very high level even if it fell slightly, compared with 1998. Thus, a labour force survey conducted in spring 1999 showed an unemployment rate of 32.4%, slightly lower than the registered average unemployment rate in 1998 of around 36%. Fears of an increased number of unemployed persons over the short term appears to slow down the necessary economic restructuring of large state-owned loss-making companies, thereby continuing a misallocation of resources in the economy (see below).

### **3. Structural reform**

In many areas structural reform is quite advanced in FYROM. Price liberalisation and institution building are areas in which important progress has been made at an early stage of the economic transition process. Also, trade liberalisation is advanced, even if the Kosovo crisis triggered the introduction of temporary safeguard measures and an import license system in 1999. After the crisis, most measures were abolished, but a number of safeguard measures remain in place and specific duties for sugar imports have been introduced.

With respect to privatisation of large state-owned and often loss-making companies (most often agro-industrial conglomerates), progress in the past two years has been unsatisfactory. As a direct result of the reluctance on the part of the government to conduct the necessary restructuring through sale, closing, privatisation or a combination hereof the ESAF programme agreed with the IMF is now off track. This three-year programme will expire in April 2000 and negotiations between the Fund and the newly formed government are currently ongoing with a view to establishing a new IMF programme. It is to be expected that the negotiations will involve conditionality regarding at least some of the 12 state owned loss-making enterprises, which should have been closed by now.

The continuously loss-making companies are likely to constitute a constant capital drain on the economy, thus hampering more innovative and efficient companies' access to the necessary capital via the domestic capital market. A constant misallocation of resources is the result, reducing both economic output and employment.

Earlier, an attempt to privatise the largest bank (the Stopanska Banka) had failed. Currently, however, it appears that the sale of this bank will go through in 2000. If successfully completed, this could constitute an important step towards the creation of a functioning, market based financial sector in FYROM.

#### **4. Implementation of macro-financial assistance**

As a direct result of the Kosovo conflict and the high resulting refugee related expenditure, the European Commission and the World Bank organised a joint G-24/Consultative Group meeting on 5 May. At the meeting donors pledged close to USD 250 million in total. The Community pledged up to EUR 25 million of exceptional budgetary support to help the country cope with the costs related to the inflow of refugees and indicated its willingness to consider further exceptional macro-financial assistance. The first tranche of the assistance of EUR 12.2 million was disbursed on 16 June.

On 8 November the Council decided to provide up to EUR 80 million of supplementary macro-financial assistance to FYROM. Exceptionally, in view of the fragile economic situation in FYROM, in particular with regard to foreign debt levels (around 40% of GDP), the Council decided to provide part of the macro-financial assistance (up to EUR 30 million) in the form of grants.

One essential condition for the implementation of this supplementary macro-financial assistance is the establishment of a new IMF programme. As mentioned, negotiations are ongoing and agreement on a new programme is expected to be reached by mid-2000.

In August 1998, the World Bank endorsed a new Country Assistance Strategy (CAS) for FYROM from mid-1998 to mid-2001, which supports the government's national development strategy. This CAS outlines a USD 200 million programme of new lending to facilitate reforms and economic development and in order to reduce unemployment and poverty. However, the lending programme is currently stalled due to FYROM's non-compliance with the attached conditionality. To date, the World Bank has made four adjustment operations totalling USD 254 million.