

Republic of North Macedonia Country Strategy 2019-2024

As approved by the Board of Directors on 22 May 2019



European Bank
for Reconstruction and Development

Table of Contents and Glossary



European Bank
for Reconstruction and Development

Table of Content		Glossary of Key Terms			
Executive Summary	3	ABI	Annual Business Investment	NREAP	National Renewable Action Plan
North Macedonia – EBRD Snapshot	4	ASB	Advice for Small Business	NPL	Non-performing Loans
I. Implementation of Previous Engagement (2013-2018)	5	BEEPS	Business Environment and Enterprise Performance Survey	OECD	Organisation for Economic Co-operation and Development
Key Transition Results Achieved during Previous Engagement	5	CEFTA	Central European Free Trade Agreement	ODA	Official Development Assistance
Challenges to Implementation and Key Lessons	7	CoOs	Countries of Operation	ODIHR	Office of Democratic Institutions and Human Rights
II. Economic Context	8	COP21	2015 United Nations Climate Change Conference	PE	Private Equity
Macroeconomic Context and Outlook for Strategy Period	8	DTF	Distance to Frontier	PERI	Public Enterprise for Railways Infrastructure
Key Transition Challenges	9	EE	Energy Efficiency	PESR	Public Enterprise for State Roads
III. Government Priorities and Stakeholder Engagement	11	EIB	European Investment Bank	PFI	Private Financial Institution
IV. Defining EBRD's North Macedonia's Country Strategy Priorities	12	ENEF	Enterprise Expansion Fund	PIU	Project Implementation Unit
V. Activities and Results Framework	13	ESCO	Energy Service Company	PPA	Power Purchase Agreement
VI. Mapping of International Partners' Complementarity in EBRD Business Areas	16	ETI	Expected Transition Impact	PPP	Private-Public Partnership
VII. Implementation Risks and Environmental and Social Implications	17	EU	European Union	PTI	Portfolio Transition Impact
VIII. Donor Co-Financing Assessment	18	E&S	Environmental & Social	REEP	Regional Energy Efficiency Programme
Annex 1 – Political Assessment	20	FDI	Foreign Direct Investment	RSF	Risk Sharing Facility
		G2B	Government to Business	SEE	South Eastern Europe
		GEFF	Green Economy Financing Facility	SEFF	Sustainable Energy Financing Framework
		GET	Green Economy Transition	SOE	State-Owned Enterprise
		HPP	Hydro Power Plants	SME	Small and Medium Enterprise
		H&S	Health & Safety	TA	Technical Assistance
		ICA	Industry, Commerce & Agribusiness	TEN-T	EU program to support transport infrastructure
		ICT	Information and Communication Technology	TC	Technical Cooperation
		IFI	International Financial Institution	TFP	Trade Finance Programme
		IFC	International Finance Corporation	VC	Venture Capital
		IPA	Instruments for Pre-Accession	VET	Vocational Education and Training
		KfW	Kreditanstalt für Wiederaufbau	WB	Western Balkan/ World Bank
		MEPSO	Electricity Transmission System Operator of North Macedonia	WBIF	Western Balkan Investment Framework
		MSME	Micro, Small and Medium Enterprise	WEF	World Economic Forum
		NDC	Nationally Determined Contribution	WTO	World Trade Organization
				WIB	Women in Business programme

North Macedonia's commitment to and application of the political principles stated in Article 1 of the Agreement Establishing the Bank were seriously challenged for most part of the period since the adoption of the previous Country Strategy, as the country witnessed dramatic deterioration in the state of democracy due to what relevant EU reports qualified as a "state capture" by the leadership of the then governing political party. The most severe political crisis in North Macedonia since the armed conflict of 2001 adversely affected the economy and hampered EBRD's operations in the country. Its resolution, which culminated in change in government in spring 2017 to a new pro-reform coalition, led by the previously main opposition political party, stands to mark an auspicious turning point, with improvements in the area of the rule of law, restoring checks and balances in the political system and a comprehensive economic reform agenda at the core of the programme. Prospects for the acceleration of integration into Euro-Atlantic institutions, particularly EU approximation, after the decision of the European Council to set out the path towards opening EU accession negotiations in June 2019, continue to serve as a key structural reform anchor and a stabilising factor. The recent breakthrough in normalisation of relations with neighbouring Greece and improved relations with other regional neighbours are conducive to increased investor confidence.

Standing at this historic cross-road, much will depend on the actual scope and pace of reform efforts to lift the country on a sustainable and inclusive growth path. While the economy benefits from comparatively low state ownership, a reasonably diversified economy and a conducive regulatory framework for doing business, enforcement is generally weak and corruption and a sizable informal economy remain prevailing obstacles to developing the country's full economic potential. Pressing reforms will need to create an environment in which the private sector can thrive beyond the small domestic market and create employment opportunities for the country's youth. Transition gaps are particularly acute in **competitiveness** (with an economy characterised by uneven application of rules and regulation, high informality, and weak corporate management), **integration** (with slow implementation of transport and energy infrastructure projects as well as inadequate levels of institutional arrangements for trade and investment at a regional level), and **green** (with high energy intensity, increasing vulnerability to climate change, and other resource inefficiencies).

The EBRD is well positioned to help strengthen private sector performance in the country, support hard and soft infrastructure, and accelerate reform efforts for quality employment and greener growth through tailored policy and financial instruments. The Bank will continue to focus on its traditional forte of helping to deliver on the country's infrastructure agenda and raising standards in the private sector while equally exploring new angles to advance the country's transition to a knowledge-driven economy, such as promoting employability of youth, stimulating financing innovation in the context of capital market development as well as supporting digitisation and promoting ICT-related skills. Throughout, regional integration will serve as a lodestar to guide the Bank's investment and policy activities, and special emphasis will be placed on exploring synergies with the Bank's activities in neighbouring economies. Continued strategic partnership with the EU and donor support in the form of technical assistance and investment grants that can be blended with EBRD's product range will be key factor for the Bank to deliver on the following strategic priorities in North Macedonia in 2019-2024:

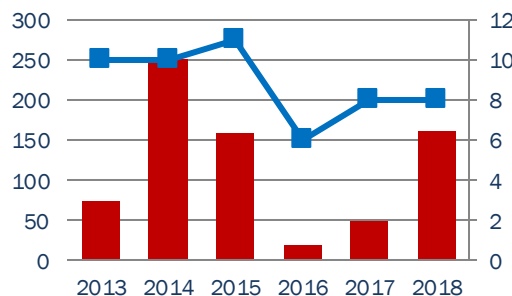
- Support **Competitiveness** by Enhancing Value Chains, Upskilling the Workforce, and Strengthening Governance;
- Strengthen Regional **Integration**, Soft Connectivity and Support EU Approximation;
- Support **Green** Economy Transition through a More Sustainable Energy Mix and Greater Resource Efficiency.

North Macedonia - EBRD Snapshot

EBRD Investment Activities in North Macedonia (end-Dec 2018)

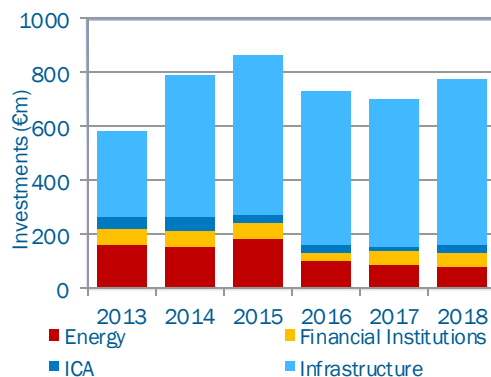
Portfolio	€781m	Active projects	46
Equity share	1.4%	Operating assets	€277m
Private Share ¹	32%	Net cum. investment	€1845m

ABI and Operations

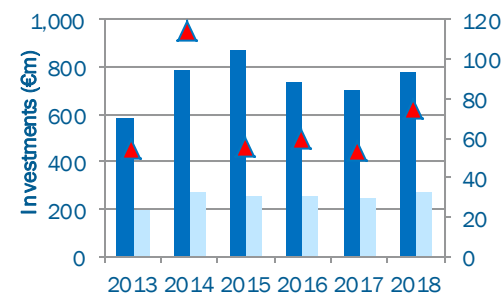


■ ABI (left axis, €m) ■ # of projects (right axis)

Portfolio Composition

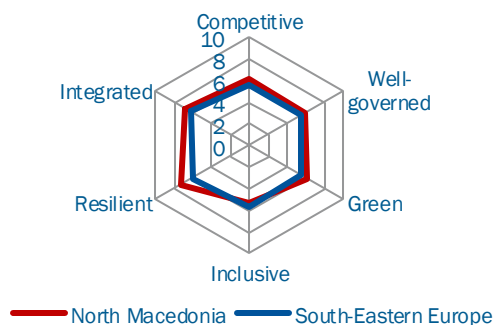


Portfolio Dynamics



■ Portfolio ■ Operating Assets ▲ Disbursements (right)

Transition Gaps²



— North Macedonia — South-Eastern Europe

North Macedonia Context Figures

Population (million) ³	2.1	2017
GDP per capita (PPP, current int. USD) ³	15,290	2017
Global Competitiveness Index (WEF)	68th (out of 137)	2017
Unemployment (% ILO est.) ⁴ <i>For comparison: Albania (13.8), BIH (25.6), Montenegro (16.0), Serbia (14.1)</i>	22.4	2017
Youth unemployment (% ILO est.) ⁴ <i>For comparison: Albania (30.0), BIH (55.4), Montenegro (33.1), Serbia (32.8)</i>	46.9	2017
Female labour force participation (% ILO est.) ⁴ <i>For comparison: Albania (47.2), BIH (35.3), Montenegro (42.2), Serbia (45.9)</i>	42.5	2017
Energy intensity (TPES/GDP) ⁵ <i>For comparison: Albania (0.2), BIH (0.4), Montenegro (0.2), Serbia (0.4)</i>	0.3	2015
Emission intensity/GDP (kgCO2/10'\$) ⁵ <i>For comparison: Albania (0.3), BIH (1.2), Montenegro (0.5), Serbia (1.1)</i>	0.7	2015

¹ Cumulative Bank Investment: 5 year rolling basis on portfolio.

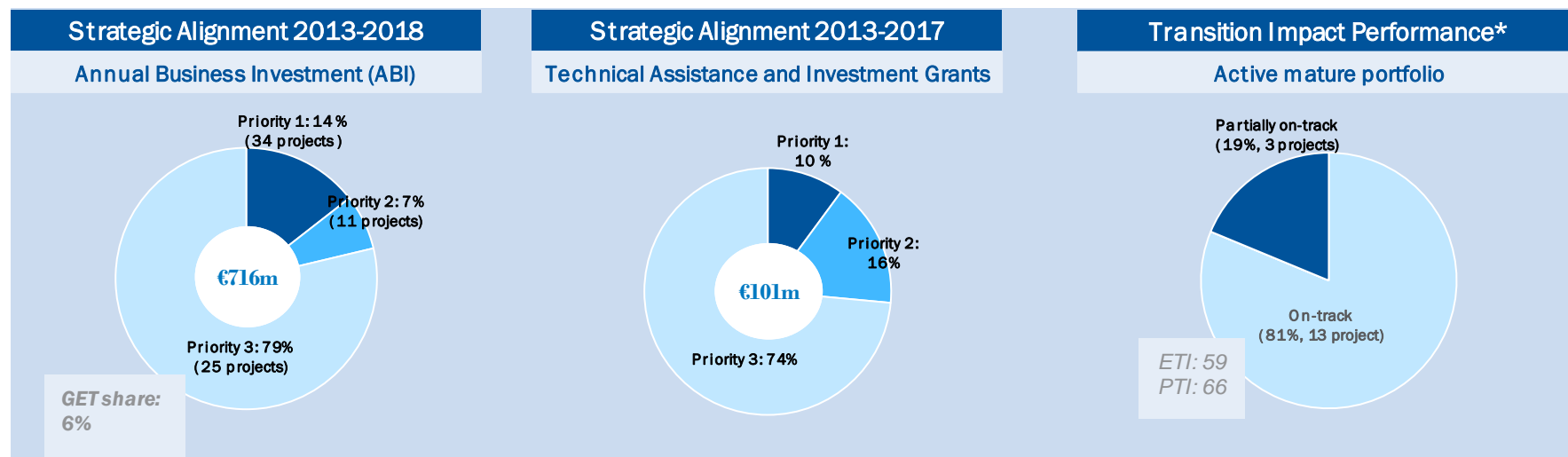
² Cf. EBRD Transition Report 2018-2019. ³ World Bank WDI. ⁴ International Labour Organisation. ⁵ IEA's Energy Atlas.

1. Implementation of Previous Engagement (2013-2018)



European Bank
for Reconstruction and Development

1.1. Key Transition Results Achieved during Previous Engagement Period



Priority 1: Enhancing competitiveness and facilitating private investment in corporate and municipal sector

Results Framework Indicators	Key Transition Results	
	2018	Since 2013
# of ASB clients reporting increased productivity	33	136
Vol. growth of MSME loan portfolio of partner banks utilising Bank's finance	+48%	-20%
<ul style="list-style-type: none"> Contributed to greater integration in global value chains through FDI support: invested €85m in companies in the automotive (Draexlmaier Group), agribusiness (Sutas Group), mining (Euromax Resources), and Property & Tourism (Skopje City Mall) sectors. Despite market over-liquidity managed to tailor SME products to facilitated access to finance: disbursed €60m credit lines, through blended funding (loan, grants, technical assistance to help prepare bankable projects) and overseeing project implementation. Provided €75m Trade Facilitation credit lines through 3 major commercial banks. Financed directly four SMEs (€13m), but demand, including under WiB credit lines, for EBRD loans remains modest due to excess liquidity. Improved SME capacities through a total of 392 advisory projects, 124 of which were with women entrepreneurs; under the Blue Ribbon Programme provided advisory support to Makprogres, a confectionary producer, and Aktiva, a supplier of metal fabricated parts. Introduced new financial instruments to the local capital market : (i) in 2014 launched the €110m Enterprise Expansion Fund (ENEF) dedicated to SMEs in the Western Balkans, (ii) provided TA to revise factoring legislation according to EU norms and procedures, (iii) provided funding and TA to the Macedonian Stock Exchange as part of the SEE link to unify several stock exchanges in the region; The Bank did not reach its full potential in engaging with municipalities, largely as a result of their borrowing restrictions and availability of cheaper sovereign funding from other IFIs. 		

* Transition impact performance reflects how likely projects are to achieve the transition impact that was expected of them at signing. Calculated based on active mature portfolio (older than two years).

1. Implementation of Previous Engagement (2013-2018)

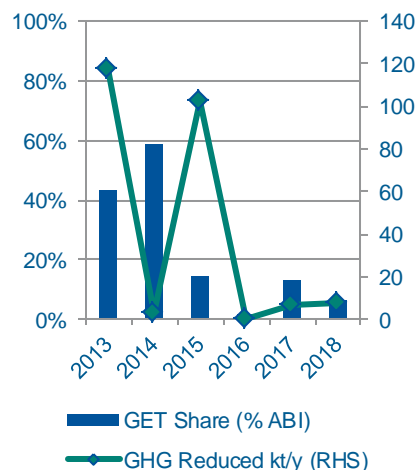


European Bank
for Reconstruction and Development

1.1. Key Transition Results Achieved during Previous Engagement Period

Priority 2: Promoting energy efficiency and sustainable energy

Green Economy Transition



Key Transition Results

- **Improved energy efficiency & green technologies across sectors through credit lines:** (i) a dedicated and highly successful SME programme under the Regional Energy Efficiency Programme for the Western Balkans (REEPWB) with €9m signed with 3 commercial banks, (ii) 3 GEFF credit lines (€5m) targeting the residential sector.
- **Improved energy grid efficiency** by providing a €25m loan to the national electricity transmission company (MEPSO) to rehabilitate existing substations. This was the first non-sovereign guarantee loan to a public energy company in the Western Balkans.
- **Promoted ESCOs:** developed a standardized template of an ESCO agreement across Western Balkan CoOs that can be utilised by private sector and municipalities. Small number of ESCO companies undermined further progress.
- **Supported energy efficiency legislation, including drafting of the energy efficiency law in compliance with EU directive,**
- **Significantly contributed to development of renewable energy:**
 - ✓ Extended a €4.1m loan to Aktual Energy Group to commission a Small Hydro Power Plant with 3MWh capacity.
 - ✓ Drafted secondary legislation and supporting implementation of competitive tender for solar and wind projects.
 - ✓ Developing Feasibility Study for new Small Hydro Power Plants (small HPPs) tenders and new PPP tenders.
 - ✓ Supported launch of private sector renewable programme by (i) providing technical support to the Market Operator of North Macedonia (MEPSO) to review the Power Purchase Agreement (PPA), and (ii) assisting local authorities in the finalisation of a market standard PPA for renewable energy projects.

Priority 3: Advancing Regional Integration

SEE Transport Corridors



Key Transition Results

- **Bank leads as IFI in terms of its investments in key transport and energy projects:**
 - ✓ Provided €270m sovereign guaranteed loans to Public Enterprise for State Roads (PESR) for the construction of the Corridor VIII road section Kriva Palanka to Bulgarian border and for the operation and maintenance of the national and regional road network connecting regional economic centres and strategic international border crossings in Albania, Bulgaria, Greece, Kosovo, and Serbia. Provided funding to finance a Digital Archiving System to support Electronic Procurements for PESR.
 - ✓ Extended a €145m sovereign loan (one-fourth of total project cost) to the Public Enterprise for Railways Infrastructure of North Macedonia (PERI) to modernise and upgrade 2nd phase of the Eastern part of the Trans-European Rail Corridor VIII. Mobilized EUR 69m investment grant for the phase 1 via WBIF.
 - ✓ Signed a €11.5m loan to the state-owned national air navigation service provider M-NAV to (i) raise its equipment to EU applicable regulatory requirements, (ii) and support the harmonization process under the European Common Aviation Area.
 - ✓ Provided a €37m loan to MEPSO to finance the first electricity interconnector between Albania and North Macedonia. The Bank mobilised a €12m investment grant under the WBIF for smart grid investments.
- All projects were complemented by €100m worth of grants and TA for project preparation and implementation, mobilized by the Bank via the Western Balkan Investment Fund (WBIF). However, disbursements of loan and implementation of large infrastructure projects have been slow as a result of low implementation capacity of key counterparts, a lack of coordination among various ministries and two years of political crisis.
- **Facilitated cross-border agreements with Serbia and Kosovo** to simplify border crossing procedures on the Corridor VIII Railway.
 - **Provided road safety capacity building, including road safety audits.**

1. Implementation of Previous Engagement (2013-2018)



European Bank
for Reconstruction and Development

1.2. Challenges to Implementation and Key Lessons

Context for implementation:

Since 2013, the Bank has delivered on all key aspects of its strategy, most notably as the lead IFI in the transport and energy sector and key contributor to private sector development, especially SMEs. Nonetheless, the Bank was not immune to the country's protracted political crisis (2015-2017), which largely overshadowed the country strategy period and resulted in a sharp drop in investment and economic reform efforts. This *de facto* limited the Bank's scope to implement key sovereign projects and support foreign direct investment. The Bank responded by scaling up its domestic private sector lending and TFP activities (largely via PFIs). More recently, the Bank differentiated itself as a key partner for green economy transition as evidenced by the strong uptake of its energy efficiency credit lines and the on-going policy advice. Looking ahead, the arrival in 2017 of the new, pro-reform government coalition stands to set the country onto a more sustainable and inclusive growth path and accelerate convergence with EU standards, while prospects for the acceleration of the EU accession process will continue to serve as a key structural reform anchor. The Bank can play a significant role in supporting the country's EU accession process also by advancing key infrastructure projects across the transport, energy and digitalisation sector.

Implementation Challenges

- Prolonged political crisis (2015-2017) slowed down economic growth and deterred (domestic and foreign) investors' confidence.
- Weak administrative capacity to carry through key public infrastructure projects.
- Lack of bankable opportunities in the corporate and SME sector as result of high leverage, low capacity to prepare bankable projects and excess liquidity in the market catered to by national and international development institutions.
- Foreign investment entities typically well-served by a parent bank limiting the Bank's engagement to small ticket tranches with disproportionate transaction costs.
- Wide availability and competitive pricing of IFI finance for sovereign projects.
- High coverage of Emerald and Natura 2000 sites (30% of land coverage) coupled with low equity base of renewable energy investors limit the Bank's scope for direct investments in small HPPs.

Key Lessons & Way Forward

- During the political crisis, focussed exclusively on supporting private investments directly and via credit lines to PFIs to sustain private sector development.
- Complement public infrastructure investments with stepped up institutional capacity-building, e.g. project preparation and implementation support, working in close collaboration with other contributing IFIs.
- Leverage co-investment grants and TC to selectively improve competitiveness of EBRD lending products, such as SME advisory to improve corporate governance and operating standards as well as shouldering more risks (e.g. Mezzanine, tailored portfolio risk-sharing).
- Advocate for increased private sector participation (e.g. unbundling of utilities) in key service providers to widen the potential scope of Bank's engagement.
- Continue leveraging EBRD's local presence and ability to blend investment and donor funds (e.g. WBIF), while offering donor-funded technical assistance to improve affordability; continue offering corporate loans for public utilities (e.g. MEPSO, and ELEM).
- Support a staged GET, supporting rehabilitation of existing HPPs (one-third of country's current electricity production) as well as scoping other renewable energy projects to diversify energy sources.

2. Economic Context

2.1 . Macroeconomic Context and Outlook for Strategy Period



European Bank
for Reconstruction and Development

North Macedonia - Main macroeconomic indicators

	2014	2015	2016	2017	2018 est.
GDP growth (% y-o-y)	3.6	3.9	2.8	0.2	2.0
CPI inflation (% avg.)	-0.3	-0.3	-0.2	1.4	1.4
Government balance (% of GDP)	-4.2	-3.5	-2.6	-2.7	-2.7
Current account balance (% of GDP)	-0.6	-1.9	-2.9	-0.8	-1.0
Net FDI (% of GDP)	2.3	2.3	3.3	1.8	2.0
External debt (% of GDP)	70.0	69.3	74.7	73.6	79.9
Gross reserves (% of GDP)	28.5	24.9	27.1	23.3	25.8
General government gross debt (% of GDP)	45.8	46.7	47.8	48.0	50.0
Unemployment (% pop)	28.0	26.1	23.7	22.4	20.8
Nominal GDP (\$bn)	11.4	10.1	10.7	11.3	12.4

- **North Macedonia has experienced moderate GDP growth and a stable macro environment over the past 15 years.** Average growth in the period of 2001–16 was 2.8%, compared to a 1.4% in EU, suggesting that North Macedonia has been catching up only gradually towards EU living standards. The country experienced a relatively low rate of growth over the pre-crisis 2001-08 period of just 3.4%, below regional comparators. The post-crisis period of 2009-16 was characterized by a double-dip recession, of 0.4% in 2009, and 0.5% in 2012, followed by a few relatively good years in the period 2013-15, with an average growth rate of 3.5%.
- **Growth slowed down to almost zero in 2017.** The prolonged political crisis, which started in 2015, but escalated in H1 2017, affected the country's economic performance by having a measurable negative impact on confidence and investment. The economy was in recession in the first half of 2017 but recovered somewhat in H2, leaving growth for the year as a whole at almost zero. This crisis at one point also threatened the stability of the local currency vis-à-vis the euro, and the Central Bank had to react to currency pressures during 2016 by increasing the policy rate to 4%. However, in February 2017, the Central Bank cut the rate back to its long-term rate of 3.25%. The rate was cut further in 2018, to the current 2.5%. Inflation has been low for many years, the fiscal deficit has narrowed to below 3% of GDP and public debt levels are moderate, although rising slowly.
- **Further catch-up is likely in the short term.** A recovery started in 2018, helped by political stability and the impact of the rising minimum wage and other social protection measures on private consumption as well as export growth intensification, at an estimated rate of 2.0%. Credit to the economy is expected to rise further as lending conditions ease amid the accommodative monetary policy. A further rise in exports is also expected in light of the strengthening of economic prospects in the EU, the country's key trading partner. As a result, the 2019 forecast for growth is 3.0% on the assumption of continued political stability, the unblocking of further reforms and the arrival of much-needed investments, with similar growth rates likely in the years to come.

2. Economic Context

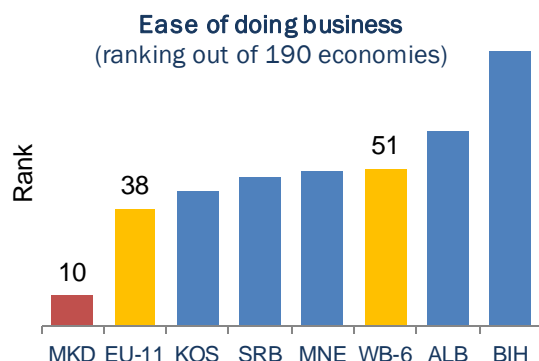
2.2 . Key Transition Challenges



European Bank
for Reconstruction and Development

Competitive (5.73)

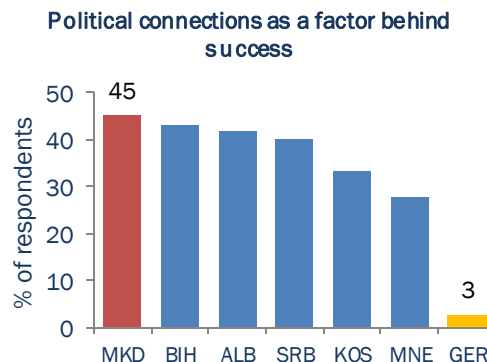
- **Most competitive among the WB-6 peers**, with excellent performance in World Bank's ease of doing business ranking – 10th among 190 countries. Enforcing contracts and resolving insolvency are the most problematic areas.
- **Productivity** is below the average for the WB-6 region, and well below EU standards.
- **Unfair competition from the informal economy** is cited as the biggest obstacle to doing business by 26% of respondents in BEEPS. The informal sector is estimated at 25% - 50% of GDP.
- Country is assessed as an **intermediate knowledge economy**, constrained by poor skill availability. 14% of firms in the BEEPS point to the inadequately educated workforce as a serious business obstacle.
- North Macedonia faces an overall **medium gap** across five dimensions of **SME development**. Non-bank financing and business skills & standards are particularly problematic.
- Enforcement of **competition policy** is weak.



Source: World Bank's Doing Business Report, 2019

Well-governed (5.78)

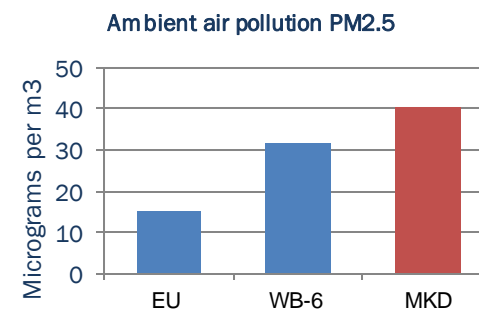
- **Public governance** has been **adversely affected** by political instability, weak rule of law and inadequate control of corruption.
- **Successful administrative reforms** in recent years have significantly reduced the administrative and regulatory burdens on firms but there has been some deterioration in the area of enforcing contracts.
- **Corruption perceptions have worsened significantly in recent years**. The country is now ranked 93rd among 180 countries, compared to 66th three years ago, possibly due to the wiretapping scandal which revealed massive wrongdoings by former public officials.
- **Political connections** are seen by many people as key to success in life; 45% of respondents in LiTS III see this factor as more important than either effort and hard work, or intelligence and skills.
- **Corporate governance** is better in North Macedonia than in many regional peers. Weaknesses remain in the oversight and transparency role played by corporate boards.



Source: Life in Transition Survey (LiTS)

Green (4.93)

- Most electricity (58%) is generated in **outdated thermal power plants** with an efficiency of 32%, fuelled by low-quality coal. Electricity generated from hydro power accounts to 33%.
- There is significant scope for energy efficiency upgrades since North Macedonia adopted the 3rd **Energy Efficiency Action Plan** in July 2017.
- Other **renewable energy sources**, especially hydro, wind and solar, are expected to become more important in the production of electricity. However, the country's National Renewable Action Plan (NREAP) struggles to achieve the country's legally binding renewable energy target of 23.9% by 2020.
- The country currently supports renewable energy projects with **feed-in tariffs** via a PPA with the market operator. A transition to a 'Contract for Difference' approach would allow for further commercialization and increase of the renewable energy penetration.



Source: World Bank, 2015

2. Economic Context

2.2 . Key Transition Challenges

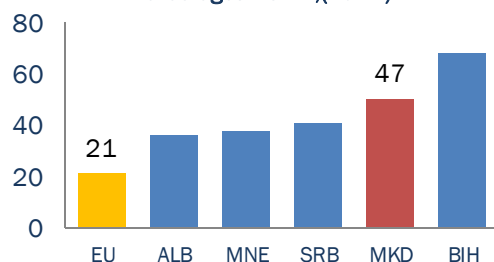


European Bank
for Reconstruction and Development

Inclusive (5.61)

- **High youth unemployment and low labour participation among women** constitute the main threats to prospects for inclusive growth.
- High level of **youth unemployment**, close to 50 per cent. 24 per cent of young people are not in education, employment or training.
- **Skills mismatch** is one of the key drivers of youth inactivity. In BEEPS V, 14% of respondents deemed an inadequately educated workforce to be a major or severe obstacle to growth.
- The skills mismatch is exacerbated by **weak work-based learning opportunities**. Although regulations are in place, implementation mechanisms do not function effectively.
- **Women's participation in the economy** is significantly **low** compared to that of men (42% for women vs 68% for men).
- Significant **gender inclusion gaps** with respect to access to finance and labour practices. This is reinforced by strong stereotypes about women's traditional role in society.

Youth unemployment, % of total labour force ages 15-24,(2017)

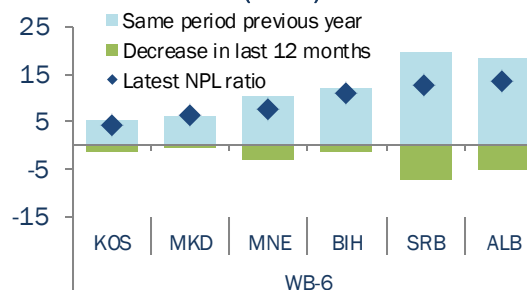


Source: World Development Indicators, World Bank, 2018

Resilient (5.72)

- **Financial sector stability has been strong**, supported by a **well-anchored monetary policy**. The Central Bank has maintained the currency peg to the Euro (previously to the DM) for more than 20 years.
- **The banking sector is well capitalised, but could profit from further consolidation**. Capital adequacy stands at 16.3% (as of mid-2018), at par with other banking systems in the WB-6, and well above the regulatory requirement of 8%.
- **NPLs** fell to ca. 5% as of mid-2018, after being stable for the past three to four years at around 10 to 11% of total loans, reflecting recent measures to write off NPLs that are fully provisioned for over two years.
- **Euroization is moderate** and largely stable; around 40% of loans and 40% of deposits are denominated in foreign currency. The Central Bank has been using macroprudential measures effectively to contain further euroisation.
- Development of **non-banking financial services** is nascent, and **stock market capitalisation** is low.

Non-performing loans, % of total loans (2017)

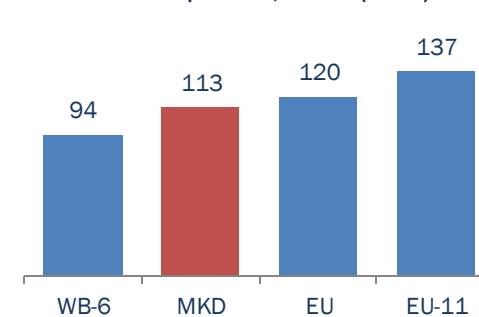


Source: National Authorities, 2018

Integrated (6.09)

- North Macedonia's five year average **trade openness** [(exports + imports)/GDP] is 107%, well above the EBRD average of 92% and close to the EU average (120%). The country has tariff-free access to the EU and to its neighbouring WB-6 countries under the CEFTA. Further progress is needed, however, in reducing non-tariff barriers.
- **FDI levels are low**; However, business-friendly policies in recent years have had positive results, attracting investments in important sectors such as car components.
- The quality of **transport infrastructure** is ranked in the WEF's Global Competitiveness Index as higher on average than in other WB-6 countries, with the highest score in air transport, and the smallest in the railways sector. Road corridor X is completed and corridor VIII is under construction.
- Cross-border **energy integration** is slowly improving. A 400 kW cross-border electricity interconnection with Albania is being constructed.

Trade openness, % GDP (2017)



Source: IMF's World Economic Outlook , 2018; Authors' calculations.

3. Government Priorities and Stakeholder Engagement

3.1. Government Reform Priorities

The **2016-2020 Economic Reform Programme** (prepared in line with the Government Programme 2017-2020, Mid-Term Fiscal Strategy and other strategic documents) lays out the following structural reform areas to pave the way to EU accession.

- **Public finance management:** strengthened budget framework, integrated IT system for public finance, improvements of public procurement, modernisation of the tax system, enhanced customs, tax administration and financial control procedures.
- **Energy reforms:** diversification of energy generation, implementation of “soft” measures within the Western Balkans region, incl. spot market development, liberalisation, and cross-border capacity allocation/rebalancing; sustainable energy and climate action measures, including development of renewable energy and energy efficiency solutions.
- **Transport market restructuring:** improved efficiency, safety and environmental impact of the sector; expansion and rehabilitation of the road and rail networks along corridors X and VIII as a basis for diversification and integration of the regional value chains.
- **Support trade, FDI and domestic investment:** industry and services sector development with a focus on agribusiness, tourism and hospitality; facilitation of technological upgrades, linkages and R&D for improved competitiveness; trade facilitation and liberalisation measures in the context of CEFTA, WTO and other trade & investment agreements.
- **Business environment and informality measures:** development of national E-services portal, improvement of administrative services, SME support, increased transparency and predictability of the regulatory environment
- **Improved skills and labour markets:** enhanced link between education and private sector needs, further development of qualification system, VET reforms and active employment programmes, in particular for youth.

3.2. EBRD Reform Areas Broadly Agreed with Authorities

- Consolidation and ownership transformation in the **banking sector**.
- **Capital market development** and improved access to non-bank financing (including factoring and leasing).
- Regulatory and institutional framework for **renewable energy and energy efficiency**.
- Request to make **Green Cities** product available for cities with less than 100,000 inhabitants
- Implementation of the **digitalization agenda**.
- Improved **employability and skills** of youth, women and underserved populations.
- Increased capacity of the **Competition Council**.
- Promote **PPPs** structures for gas distribution and solid waste management.
- Increased **safety and environmental sustainability** in **transport**.
- Implementation of EU/WTO **public procurement principals**.

3.3. Key Messages from Civil Society to EBRD

- **Governance and Anticorruption:** strengthened EBRD engagement in improving the governance of both public and private companies and fight corruption via *inter alia* transparent procurement practices.
- **Nature protection:** strengthened EBRD engagement in building national capacity on nature protection and environmental conservation (e.g. awareness raising on Natura 2000).
- **Environmental standards in protected areas:** development of environmental criteria to screen investments to be used as a reference tool for decision-making on concessions and major infrastructure projects (e.g. transport and energy).
- **Green Cities and energy efficiency:** request to consider the City of Ohrid for the Bank’s Green Cities Framework and to make energy efficiency credit lines available to housing associations..
- **Green economy:** enhanced focus on renewables (e.g. wind and solar) and support to the energy regulatory framework.
- **Stakeholder engagement and governance:** importance of meaningful public consultations on the Bank’s participation in hydro and mining projects.

4. Defining North Macedonia's Country Strategy Priorities

What needs to change? (Section 2)	Can it be changed? (Section 3)	What can the Bank do? (Section 4)	Strategic Priorities (2018-2023)	What We Want to See in 2023
<ul style="list-style-type: none"> • Low private sector productivity. • Insufficient corporate capacity to adopt innovative processes and limited integration into European supply chains/global value chains. • High barriers of access to finance, especially for SMEs, aggravated by a lack of non-bank financial institutions. • Lack of business skills and standards in the corporate sector; weak corporate governance. • Significant skills mismatches of young graduates and low female participation. • Large informal sector and weak enforcement of competition policies. 	<ul style="list-style-type: none"> • Strong economic reform momentum (new pro-reform coalition government, EU Economic Reform Programme). • Innovation, technological upgrades and value chains key government priorities. • CEFTA and EU Stabilisation and Association Agreement as external anchor for Global and Regional Value Chain integration. • Key legislation in place for strong business environment (10th in World Bank Doing Business) but weak enforcement • Youth employment key government priority. • E-governance as low-hanging fruit and high on authorities' agenda. 	<ul style="list-style-type: none"> • Well-tailored products to support SMEs and corporates (SME competitiveness programme, credit lines, ENEF). • Experience in promoting non-bank financial products, supporting equity/quasi-equity risk-taking (PE/VC), and capacity-building for capital market development. • Effective instruments to help increase corporate & business skills (WiB, ASB, Blue Ribbon) • Track record in developing work-based skills-enhancing solutions together with corporate clients. • Strong track record in supporting good economic governance (competition authority). 	<p>Support Competitiveness by Enhancing Value Chains, Upskilling the Workforce, and Strengthening Governance</p>	<ul style="list-style-type: none"> • Enhanced value chains and linkages through improved product and process innovation, and operating standards and business skills • Increased variety of non-banking financial products and services • Enhanced access to quality employment and skills, with focus on youth • Increased competition and levelling the playing field for doing business and private sector participation
<ul style="list-style-type: none"> • Poor quality of transport infrastructure, especially roads and railway. • Low integration into regional energy markets driving up energy prices. • Low ICT penetration (17.8% of population has broadband). • Insufficient enforcement and implementation of a reliable investment framework limit FDI. 	<ul style="list-style-type: none"> • Pan-European Corridors and regional transport connectivity agenda, TEN-T as key anchors. • Major gasification efforts (MoUs signed with neighbouring countries). • Digital Connectivity key government priority, including ICT skills initiatives. • Strong interest in advancing soft connectivity in view of EU approximation and alignment with regional trade and investment agreements. 	<ul style="list-style-type: none"> • EBRD's strong track record and existing partnership with authorities in providing funding to help narrow the infrastructure and energy gap while promoting private sector participation and de-risking large, long-term projects. • Growing experience in advising National Broadband/Digitisation Strategies. • EBRD's strong additionality and experience in driving regional soft cooperation (regional investment councils, business registries). 	<p>Strengthen Regional Integration, Soft Connectivity and Support EU Approximation</p>	<ul style="list-style-type: none"> • Improved quality & connectivity of key transport and energy infrastructure • Increased levels of broadband connectivity and digitisation • Improved "soft" connectivity and harmonized business practises
<ul style="list-style-type: none"> • Most energy intensive economy among Western Balkans, heavy reliance on coal and imported oil. • Water stress (e.g. agribusiness) and vulnerability to climate change (e.g. floods). • Poor water quality (63% water losses) and insufficient wastewater treatment systems. 	<ul style="list-style-type: none"> • Government commitment to deliver on NDCs under COP21 and EU accession. • Window of opportunity for renewable energy. • Sizable energy savings potential and demand for energy efficiency upgrades; adoption of second National Energy Efficiency Action Plan in progress. 	<ul style="list-style-type: none"> • Sizeable experience in supporting regulatory and institutional framework for renewable energy and energy efficiency. • Dedicated products to finance green transition investments through tailored credit lines. • Considerable experience in municipal projects with explicit environmental and resource-efficiency objectives with good access to grant funding. 	<p>Support Green Economy Transition through a More Sustainable Energy Mix and Greater Resource Efficiency</p>	<ul style="list-style-type: none"> • Increased renewable energy capacity, more diversified energy mix, and greater private sector participation in the energy sector • Increased energy and resource efficiency • Improved environmental infrastructure (water, waste, wastewater) at the local and municipal level

5. Activities and Results Framework

Priority 1: Support Competitiveness and Inclusion by Enhancing Value Chains, Upskilling the Workforce and Strengthening Governance

Key Objectives (Outcomes)	Activities (Outputs)	Tracking Indicators
Enhanced value chains and linkages through improved operating standards and business skills	<ul style="list-style-type: none"> Provide direct and indirect financing (including risk-sharing) and advisory to corporates and SMEs with a focus on ICT, agribusiness, manufacturing, property and tourism. Support domestic companies, adopting innovative practices and technologies, increasing productivity and expanding regionally through direct financing and targeted long-term advisory (via SME Competitiveness Support Programme and Blue Ribbon). Finance FDI and domestic anchor investors, with a focus on regional value chains integration and innovation transfer to local suppliers. Dedicated financing facility and technical advice to agribusiness sector. Support cross-border investments of corporate clients (including with EU countries such as Bulgaria and Greece). 	<ul style="list-style-type: none"> No. of clients introducing new technology No. of clients with enhanced competitiveness by expanding and upgrading its processing capacities
Increased variety of non-banking financial products and services	<ul style="list-style-type: none"> Support consolidation of the banking sector via equity investments. Expand product range and services to increase access to non-banking finance, including mezzanine financing and bond issues (exploring ways to capitalise on Bank's operations with regional capital markets). Participate in early stage enterprise development programme through the Regional Accelerator programme. Support factoring via policy advisory on the legal and regulatory framework. Scale up trade finance programme (including through the Trade Ready training) to support regional expansion and export promotion of local companies. 	<ul style="list-style-type: none"> Total number of new non-banking financial products/services introduced, expanded or followed on
Enhanced access to quality employment and skills	<ul style="list-style-type: none"> Develop vocational training together with corporate clients to achieve improved employability and skills for youth, women and as well as populations living in underserved area. Follow principles of inclusive procurement to improve employability and skills for youth and women. Collaborate with public clients in developing training programmes and promoting job creation as part of procurement. 	<ul style="list-style-type: none"> No. of people receiving new/improved skills as a result of training No. of trainings delivered
Enhanced national corporate governance frameworks and increased competition	<ul style="list-style-type: none"> Support the Inspections Council in the implementation of the new Law on Inspections Supervision. Provide capacity building to the Competition Authority and support the creation of a Regional Competition Authorities Forum to share best practices. Promote private sector involvement via PPPs structures in energy and municipal infrastructure. Work with selected SOEs to improve financial transparency and corporate governance via CGAPs (Corporate Governance Action Plans) Promote the use of e-procurement platforms. 	<ul style="list-style-type: none"> Legal / Regulatory / Institutional improvements to improve competition

5. Activities and Results Framework

Priority 2: Strengthen Regional Integration, Soft Connectivity and support EU Approximation

Key Objectives (Outcomes)	Activities (Outputs)	Tracking Indicators
Improved connectivity and integration of key transport and energy infrastructure	<ul style="list-style-type: none"> Advance completion of the core transport networks under the TEN-T: <ul style="list-style-type: none"> Finance and provide advisory to finalise the railway Pan-European Corridor VIII; Finance last road sections of Corridor VIII and regional road linkages; Support the introduction of modern tolling systems on Corridor VIII and X road sections. Mobilise TC funds to support project preparation and implementation, with a focus on detailed design, Project Implementation Units (PIU) support and contract supervision. Provide technical assistance for privatisation of the Railway Transport Company. Support development of a corporate plan to improve the operational efficiency of the state roads company by strengthening its maintenance and revenue collection practices. Support establishment of a road safety agency including a road traffic accident database and road safety auditing and inspection rules and procedures, in cooperation with other IFIs financing transport corridors Facilitate investments in gas interconnectors and gas transmission/distribution networks. Improve resilience in transport and energy infrastructure to climate change and promote decarbonisation through technological enhancements to reduce emissions. 	<ul style="list-style-type: none"> Target infrastructure network extended as measured by increase in network capacity
Increased levels of broadband connectivity and digitisation	<ul style="list-style-type: none"> Policy advisory for implementation of the digitalisation agenda Provide direct and indirect financing and advisory for ICT adaptation of the private sector with focus on SMEs. Support e-government initiatives for G2B services (e.g. feasibility studies and/or action plans, capacity-building of key agencies). Support the Western Balkan Digital Connectivity Agenda promoted by the EU via advisory and funding. 	<ul style="list-style-type: none"> Number/volume of SME loans/sub-loans for digitisation provided
Improved “soft” connectivity and harmonized business practises	<ul style="list-style-type: none"> Facilitate conclusion of joint border crossing agreements with neighboring countries (e.g. railway border crossing, joint border control), in cooperation with other IFIs financing transport corridors. Support development of regional business platforms (Regional Business Registries) and facilitate harmonization of related business practices. Support Government to adhere to WTO (World Trade Organization) rules, including harmonization of existing legislation. Support EU accession via technical assistance and legislative reforms in the infrastructure sector (transport, energy, MEI). 	<ul style="list-style-type: none"> Legal, institutional or regulatory frameworks for improved integration

5. Activities and Results Framework

Priority 3: Support Green Economy Transition through a More Sustainable Energy Mix and Greater Resource Efficiency

Key Objectives (Outcomes)	Activities (Outputs)	Tracking Indicators
Increased renewable energy capacity, more diversified energy mix, and greater private sector participation in the energy sector	<ul style="list-style-type: none"> • Provide financing for renewable energy projects through direct financing and risk-sharing facilities, and providing advisory for scoping the potential of renewable energy technologies. • Policy engagement to support transition from Feed-in-Tariffs to auction-based model, starting with technical assistance for competitive auction systems in solar and wind projects. • Provide finance and technical assistance for new large Hydro Power Plant (HPP) capacity, and support rehabilitation and climate resilience of existing HPPs. • Promote the switch to cleaner generation sources, including coal to gas, coupled with technical assistance to advance gasification. 	<ul style="list-style-type: none"> • Total renewable electricity installed (MW)
Increased energy and resource efficiency	<ul style="list-style-type: none"> • Provide energy and resource efficiency credit lines through partner banks under the REEP+ regional framework with focus on SMEs and the residential sector. • Support private investment in the recycling industry and investments of private companies in resource efficiency solutions. • Support development of solid waste sector across the waste management cycle, including collection, recycling, and waste-to-energy solutions. 	<ul style="list-style-type: none"> • Volume of EE or Resource Efficiency loans extended by PFIs supported by EBRD • Energy saved (GJ/y)
Improved environmental infrastructure (water, waste, wastewater) at the local and municipal level	<ul style="list-style-type: none"> • Support increased efficiency and sustainability in the water sector, including water distribution and sanitation and sewage treatment, and irrigation. • Support climate resilience in municipal and regional infrastructure and services, incl. flood control. • Promote sustainable municipal investments with a strong focus on capacity building and fiscal efficiency as well as in helping cities to address environmental challenges (e.g. Green Cities framework, district heating, solid waste management) including energy efficiency in buildings and street lighting. • Support municipal mobility with a focus on urban transport systems and traffic control. 	<ul style="list-style-type: none"> • Total Water saved (m3/y)

6. Mapping of International Partners' Complementarity in EBRD Business Areas



European Bank
for Reconstruction and Development

EBRD BUSINESS AREAS																						
		Sectors															Other					
		Corporate				Energy	Infrastructure				Financial				Green Transition			Inclusion				
Indicative annual investment average for period (2015-2018) unless otherwise specified, excluding budget support)		Agribusiness	General industry	Real estate	ICT	Natural resources	Electric power	Water and wastewater	Urban transport	Roads	Railways	Banking	Insurance	MSME finance	Private equity	Capital markets	Water efficiency	Materials efficiency	Sustainable energy	Gender	Youth	Regional development
EU*	€99m	€P	€P		€P				€P	€P		€P		€			€P	€P	€P		€P	€P
World Bank	€65m							€P		€P						€P						€P
EIB*	€36m						€P		€P	€				€			€P		€P			
KfW	€28m					€	€	€P						€P				€P	€P			€
USAID	€5m													P					P		P	
IFC	€3m		€															€				
EBRD	€97m	€	€	€	€P		€P	€P		€P	€P			€	€	€P	€P	€P	€P		€P	
<div><div><div>€</div><div>Area of significant investments</div></div><div><div>P</div><div>Area of significant policy engagement</div></div><div><div>●</div><div>Focus mostly on private sector</div></div><div><div>○</div><div>Focus mostly on public sector</div></div></div>																						

Potential Areas of Cooperation



Green:

Co-operate with **KfW** on energy & resource efficiency with municipalities; build on **USAID**'s work on energy legal framework



Competitive:

Leverage **EU** and **USAID** efforts in governance and business environment improvements and participate in IFI & donors coordination meetings led by the Government and sectoral working groups organized by EU.



Integrated:

Cooperate with **EIB** and **World Bank** on large connectivity infrastructure projects in transport, energy and gas; leverage and contribute to **EU** connectivity agenda in cooperation and coordination with the other IFIs via WBIF.



Resilient:











Build on **USAID**'s policy work in the factoring sector and finance factoring and leasing companies

Note: IFI activity mapping based on publicly available information.

Significant IFI investment defined as projects exceeding 5% of annual investment and signed from 2015 onwards. Exchange rate used is of 8 June 2018

* EU and EIB will significantly step up their financial support via the IPA III programme and Resilience Initiative with targeted investment of €1bn for the next 5 years.

7. Implementation Risks, Environmental and Social Implications

Risks to the Strategy Implementation	Probability	Effect	Environmental and Social Implications
<ul style="list-style-type: none"> Weak administrative capacity could delay reform implementation as well as critical large-scale sovereign projects. 			<ul style="list-style-type: none"> Assessment and Management of E&S Impacts, Stakeholder Engagement: Ensure that direct, indirect, cumulative and transboundary E&S impacts of projects are appropriately assessed and mitigated, meaningful stakeholder engagement is carried out. Consider environmental and social capacity building to ensure adoption of good international practice.
<ul style="list-style-type: none"> Political volatility and insufficient reform progress could undermine investor confidence. 			<ul style="list-style-type: none"> Labour and Working Conditions: Ensure that clients' HR policies and labour practices comply with EBRD requirements, particularly in respect of addressing labour terms and condition requirements; contractor management, potential discrimination in the workplace and promotion of equal opportunities.
<ul style="list-style-type: none"> Insufficient donor co-financing and grant levels could undermine competitiveness of key EBRD products. 			<ul style="list-style-type: none"> Resource Efficiency and Pollution Prevention and Control: Develop capacity building initiatives in the infrastructure sector; identify and develop water resources efficiency projects and technical assistance initiatives as part of GET mandate. Explore potential capacity building and policy dialogue initiatives to introduce knowledge of Best Available Techniques for industrial pollution prevention and abatement in line with EU Industrial Emissions Directive.
<ul style="list-style-type: none"> Vulnerability to climate change can delay key infrastructure projects. 			<ul style="list-style-type: none"> Health and Safety: Improve occupational and community health and safety with specific focus on activities which are considered common accidents reported on the Bank's projects. Additional emphasis will be placed on road safety by requiring road safety audits, capacity building and raising awareness within communities at risk.
<ul style="list-style-type: none"> Shrinking fiscal space is raising risk of default and repayment difficulties of public entities. 			<ul style="list-style-type: none"> Land Acquisition, Involuntary Resettlement and Economic Displacement: Ensure that any projects requiring acquisition of land comply with compensation and livelihood restoration requirements of the Bank, with special attention on informal land users and vulnerable groups. Biodiversity Conservation and Sustainable Management of Living Natural Resources: Develop capacity building initiatives for robust biodiversity assessments that will ensure that species and habitats of conservation importance are protected where projects could encroach upon nature protected areas, proposed Emerald sites and/or Key Biodiversity Areas. Cultural Heritage: Work with clients to identify and consult with key stakeholders relating to projects within areas recognised as culturally important and protect sensitive cultural heritage. Financial Intermediaries: Ensure that FI partners have adequate E&S capacity and risk management procedures in place. Monitoring and supervision: Work with clients to monitor E&S performance and address legacy issues associated with the Bank's portfolio.

8. Donor Co-Financing Assessment

8.1. Grant Needs Assessment

Additional donor funding will be required to achieve the strategic objectives for 2023, including support for:

- Infrastructure development in line with the WB connectivity agenda in both the transport and energy sectors (including gas);
- Infrastructure development under the Green Cities framework (incl. urban transport and water/wastewater treatment facilities);
- SME development and access to finance;
- TA for the digital sector to improve ICT connectivity;
- Risk-sharing instruments to expand EBRD's work to new PFIs in order to achieve greater transition impact. More generally, grant funding will be required to target inclusive growth, including through new initiatives for youth employment and social enterprises;
- TA for legislative reforms in areas such as concessions and PPPs, decentralization of the municipal sector, increased competitiveness of the electricity market, harmonization of public procurement with the EU acquis and WTO.

Selected Affordability Indicators		
		EBRD regional percentile rank ¹
GDP per capita (PPP, current int. \$) ²	14,914	42 nd
ODA Country	YES	N/A
ODA as share of Gross National Income (%) ³	1.38%	36 th
ODA per capita (USD - current prices) ³	71.98	52 nd

Sources: ² IMF (2017), ³ OECD (2017)

1. Simple percentile rank reported as the share of EBRD countries (ODA CoOs in the case of ODA indicators) that are represented below North Macedonia.

4. The 2013-2015 TC data is based on commitments as at the end of March 2016 (the latest available date before data migration to a new Donor Funds System). 2016-2018 TC data is based on earmarks at the project level. Co-investment grants and concessional loan amounts are based on client signings.

5. Estimated grant funding needs are based on the operational needs reported by banking teams for projects to be implemented in 2019. Estimated funding needs generally exceed actual grant use as some needs may not materialise, may be delayed, or may be split into several years of fundraising efforts due to operational needs and realities.

8.2. Potential Sources for Grant Funds

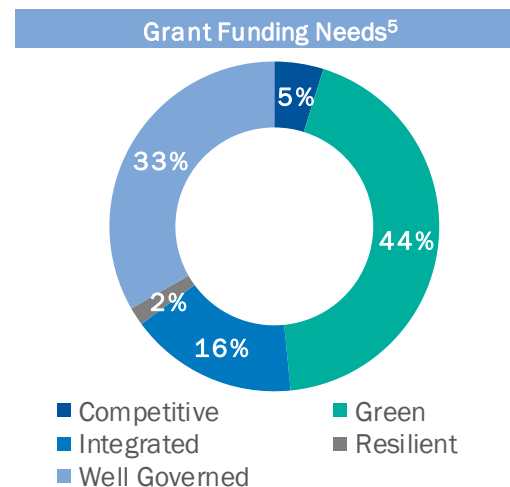
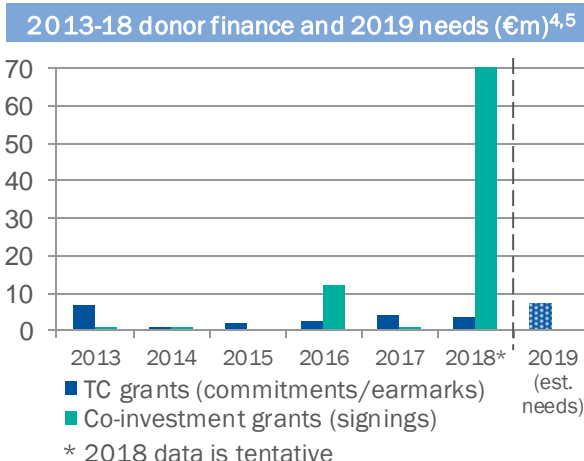
Western Balkans Investment Framework (WBIF - a joint initiative of the beneficiary governments, the EU, bilateral donors and IFIs): grants for priority infrastructure investments across the transport, energy, digital, environmental and social sectors. To date, the WBIF Steering Committee has approved €93m worth of grants from the European Western Balkans Joint Fund for EBRD projects in North Macedonia. A national sector strategy and regional angle are prerequisites to be eligible.

EU: priority areas under the Instrument for Pre-Accession include private sector development, energy efficiency (REEP Plus) and connectivity infrastructure. EDIF platform to be used for SME financing and capacity building. Additional contributions are expected for the Residential Energy Efficiency Financing Facility and Small Business Advisory services.

Funding can be available from the **Green Climate Fund** and the **Global Environment Facility** to support projects under EBRDs' Green Economy Transition Initiative.

Bilateral Donors: support via bilateral EBRD accounts and multi-donor special funds (for TFP guarantees).

The **EBRD Shareholder Special Fund:** A complementary facility to donor resources, where advancing transition remains a priority area.





ANNEX

Annex 1 – Political Assessment in the Context of Article 1



European Bank
for Reconstruction and Development

North Macedonia's commitment to and application of the political principles stated in Article 1 of the Agreement Establishing the Bank were seriously challenged for most part of the period since the adoption of the previous Country Strategy, as the country witnessed dramatic deterioration in the state of democracy due to what relevant EU reports qualified as a “state capture” by the leadership of the then governing political party. The new reform-oriented coalition government formed in 2017 following early general elections has taken crucial steps to restore checks and balances in the political system, strengthen democracy through a more inclusive political dialogue, and re-establish the independence of the judiciary.

The legislative framework for a pluralistic parliamentary democracy has remained in place, including constitutional provisions for the separation of powers, fundamental rights and protection of minorities, and free elections. However, while the legal framework remained generally in line with European and international standards as assessed by the Council of Europe and OSCE, there was considerable gap between legislation and practice. The period since the adoption of the previous Strategy saw the most severe political crisis in North Macedonia since the armed conflict of 2001. The “wiretapping scandal” (publication, at regular intervals since February 2015, of a large number of intercepted communications between the top officials) brought to fore systematic wrongdoings by the regime then in power, in a wide range of areas. The Conclusions of the Council of the European Union in June 2015 pointed to “breaches of fundamental rights, judicial freedom, media freedom, elections, corruption, politicisation of state institutions and state/party blurring...”¹

The analysis of the situation by the special Senior Experts Group recruited by the European Commission and chaired by the retired Director, Reinhard Priebe (“Priebe Report”), led to few recommendations as regards changes in the legislation. Most of them, on the contrary, concerned actions within the existing legal framework. There are ongoing criminal investigations triggered by the work of the Special Prosecutor appointed in order to specifically address the wrongdoings revealed by the above-mentioned wiretapping scandal and establish legal accountability. But the root cause is what another EU document qualified as a “state capture” by the leadership of the ruling political party.² At issue is gradual corruption of the regime that stayed in power from 2006 to 2017, which particularly intensified towards the end of this period, aggravated by some features common to many Western Balkans countries, including relatively weak institutions and overall weak rule of law, uneven culture of political dialogue and lack of stable professional merit-based depoliticised civil service.

The new reform-oriented coalition government formed in June 2017 after early general elections held in December 2016, led by previously the main opposition political party, centre-left SDSM, put the improvements in the area of the rule of law and the comprehensive reform agenda at the core of its programme. The new authorities have taken crucial steps to address the above-mentioned “state capture” by gradually restoring checks and balances and strengthening democracy through a more inclusive political dialogue, and by restoring the independence of the judiciary.

Efforts in restoring the functioning of democracy in North Macedonia and in advancing the reform agenda, as well as in improving inter-ethnic relations within the country and those with regional neighbours, including the resolution of the name-related dispute with Greece, have been duly reflected in the assessments by the EU. The new Strategy for the Western Balkans released in February 2018, the report on North Macedonia by the EC in April 2018, and the Conclusions of the Council of the EU of 26 June 2018 qualified the progress achieved in the above-mentioned areas as “significant”. On this basis, the EC issued the recommendation to open the EU accession negotiations with North Macedonia. The Council of EU, at its meeting on 26 June 2018 agreed to respond to it positively by setting out the path towards opening EU accession negotiations in June 2019, pending the endorsement by the European Council.³

1. Council of the European Union, Council conclusions on the former Yugoslav Republic of Macedonia, Press Release, 23 June 2015.

2. European Commission, The former Yugoslav Republic of Macedonia 2016 Report, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. 2016 Communication on EU Enlargement, 9 November 2016.

3. European Commission, 2018 Communication on EU Enlargement Policy, 17.04.2018 ; GAC, Enlargement and SAP, Council Conclusions, 26.06.2018.

Representative and Accountable Government

Free, fair and competitive elections

Between 120 and 123 members of parliament (MPs) are elected for a four-year term through a proportional representation system. 20 MPs are elected from each of the six in-country electoral districts. As a result of the 2015 amendments, up to three additional MPs are elected in a single out-of-country district. The Central Election Commission is an independent permanent body, appointed by the parliament for a four-year mandate. The Electoral Code provides for domestic and international election observation at all levels of election administration.

The existing legal framework enables a sound basis for democratic elections, provided the authorities and political parties exercise sufficient will to implement it. The legal framework benefited from a series of reforms over the years. Most recently, it was revised in 2015 and 2016, as part of the EU-brokered agreement between the government and the opposition designed to overcome the severe political crisis. These amendments addressed many previous recommendations by the OSCE Office for Democratic Institutions and Human Rights (ODIHR) and by the Venice Commission of the Council of Europe (Venice Commission), including crucial measures for the separation of party and the state, composition of the State Election Commission (SEC) and media coverage. At the same time, despite the improvements in the Electoral Code, some long-standing issues remain, including the ambiguous character of certain provisions and their conflict with other laws and rules. Among other recommendations, the latest OSCE suggestions include a comprehensive review of the Electoral Code for the sake of harmonization.⁴

As in many other areas, the key problem though is a gap between legislation and practice. While historically the OSCE considered elections generally competitive and the candidates able to campaign freely, several elections of the last decade were noted for the “blurring of line between the party and state activities”. There were during that period recurring allegations regarding pressure and intimidation. There is also a history of electoral violence. The early general elections held in 2014 triggered particular concerns regarding numerous irregularities involving the authorities, which were later confirmed by the revelations as part of the 2015 wiretapping scandal. There are ongoing investigations.

This difficult past has led to a decrease of public trust in the country’s institutions and in the credibility of the electoral process. Against this background, the last general elections, which took place in December 2016, and the last local elections, held in October 2017, were important steps in the right direction. Despite continuing allegations of vote-buying, voter intimidation and pressure on civil servants, the 2016 elections, which were essential in resolving the deep political crisis, took place without major incidents. OSCE noted that “contestants were able to campaign freely” and that “fundamental freedoms were generally respected”.⁵ Municipal elections, held in October 2017, contributed to strengthening public confidence in the democratic process. OSCE Election Observation Mission stressed “competitive environment”, “unbiased media coverage”, and “orderly conduct”.⁶

4. OSCE/ODIHR, *the former Yugoslav Republic of Macedonia, Early Parliamentary Elections 11 December 2016*, OSCE/ODIHR Election Observation Mission, Final Report, 28 February 2017.

5. OSCE/ODIHR, *the former Yugoslav Republic of Macedonia, Early Parliamentary Elections 11 December 2016*, OSCE/ODIHR Election Observation Mission, Final Report, 28 February 2017.

6. OSCE/ODIHR, *International Election Observation Mission, the former Yugoslav Republic of Macedonia, Municipal Elections, State ment of Preliminary Findings and Conclusions*, 15 October 2017.

Separation of powers and effective checks and balances

The constitutional and legislative framework for a parliamentary democracy – underpinned by the separation of powers and checks and balances in the political system, independent legislature and procedures of legislative oversight in prescribed domains of decision-making – is enshrined in the Constitution and laws in North Macedonia largely in line with international and European standards, as assessed by the Council of Europe and EU. The scope of powers of the legislature to hold the government to account and to exercise parliamentary oversight is largely in line with international standards. However, there was over the last decade a considerable gap between legislation and practice. The deficiencies came to the fore during the 2015 wiretapping scandal. The European Parliament noted in its Resolution in March 2017 that “the recent political crisis has illustrated the lack of an effective system of checks and balances in the Macedonian institutions”.⁷ Among the most disturbing cases revealed by the wiretapping scandal have been recurring political interferences in the work of the judiciary. The political crisis underlined the weaknesses of the parliament and that of independent regulatory and supervisory bodies to perform their oversight functions. Since summer 2017, the new reform-oriented government has taken steps to gradually restore checks and balances, strengthen democracy and rule of law.

Effective power to govern of elected officials

North Macedonia has established institutional, legal, and financial arrangements for elected officials to exercise effective power to govern that are not constrained by non-democratic veto powers or other undue influences. As in many other transition countries, there has long been a close relationship between business and political elites.

Civil Society, Media and Participation

Scale and independence of civil society

There is a satisfactory legal framework for civil society organisations (CSOs). More than 14,000 CSOs are currently registered in the Central Registry of Macedonia, based on a simple and transparent procedure for registration. A decision to establish a Council for Cooperation between the Government and Civil Society was adopted in May 2016, only two working days after it was initially presented to CSOs and not allowing for additional consultations. The Office for Cooperation with Non-Governmental Organizations in the General Secretariat of the Government has since held consultations with CSOs on the revision of the decision in order to create a functional and widely accepted Council for Cooperation. As elsewhere in the Western Balkans, CSOs remain heavily dependent on foreign funding. CSOs do not receive special benefits as non-profit entities, but they are allowed to engage in commercial activities, as long as their revenue is aligned with their statutory goals. As of 2015, CSOs have to pay income tax on revenues from commercial activities.

Some CSOs are highly professional in their respective areas of expertise, particularly those specialised in EU integration related issues, environment, media, and gender. CSOs are active in the social field, including protection of vulnerable and marginalised groups, and in election observation. Among the weaknesses is the development of civil society at the local level, especially in rural areas.

7. European Parliament, Report on the 2016 Commission Report on the former Yugoslav Republic of Macedonia, Committee on Foreign Affairs, 6 March 2017

Although CSOs were affected by the backsliding in democratic standards during the rule of the previous regime and the environment in which they operate significantly worsened during that period, many of them maintained commitment to promoting democracy. Civil society has played an important role in bringing about the change that culminated in the fall of the discredited regime in 2017. CSOs have continued supporting democratic processes since then. Since the summer of 2017, the climate in which they operate has significantly improved and the government has shown commitment to dialogue and inclusion.

Rights to form trade unions is enshrined in law and respected in practice. However, trade unions in general lack stable finances. The Economic and Social Council plays an increasingly active role in the social dialogue.

Independence and pluralism of media operating without censorship

There are over 130 radio and television channels operating in a relatively small market, dominated by electronic media. The main media outlet is the public broadcaster, Macedonian Radio-Television (MRT), with its three national channels, one satellite channel, and three national radio stations. Media outlets, including printed media, whose circulation is relatively low, are divided along both political and ethnic lines reflecting the overall polarisation in society.

The internet penetration rate has been growing steadily, with 69 per cent of citizens having web access in 2016 compared to 29 per cent in 2006.⁸ Social media is playing an increasingly important role with around one million Facebook users in 2016.⁹

Although the legal framework is largely in place and in line with international standards, the concerns in the past traditionally were with regard to self-censorship and lack of editorial independence due to political and business interests. The latter took a new dimension as part of the 2015 wiretapping scandal, which revealed shocking examples of political interference in media.

The 2015 EU-brokered agreement to overcome the political crisis envisaged a number of measures in the area of media reforms. Since summer 2017, there has been extensive stakeholder consultation on changes in media regulations. Under the new reform-oriented government the climate for media freedom has improved significantly, with more open political debate. Government advertising has ended and there has been decrease in pressure on journalists.

Multiple channels of civic and political participation

Multiple channels of civic and political participation are in place, although they were seriously undermined in the past by what the EC qualified as “capture of the state” by the leadership of the ruling party. There are certain rules and procedures regarding public consultations, but they are not always enforced. For example, an advanced system for electronic registry of all newly prepared draft laws, envisaged by the rules, is not widely used in practice. While CSOs are sought to provide their expertise by parliamentary committees this is often done on ad hoc basis. The new authorities have taken significant steps to reach out to all stakeholders and restore an inclusive and transparent democratic process.

8. Internet Live Stats: <http://www.internetlivestats.com/internet-users/macedonia/>

9. Internet World Stats: <http://www.internetworldstats.com/europa2.htm>

Freedom to form political parties and existence of organised opposition

Six political parties and five coalitions participated in the last general elections in North Macedonia. The freedom to form political parties is both guaranteed by the Constitution and implemented in practical terms, highlighted by the existence of a significant opposition able to campaign freely and oppose government initiatives. The main opposition political party currently holds more than 40 per cent of seats in the national parliament, its representatives chair several key committees, and they hold the majority in several municipalities.

Rule of Law and Access to Justice

Supremacy of the law

Although the legal provisions are in place, the overall backsliding in democratic standards during the rule of the previous regime, manifested in blurring of state and governing party, adversely affected the principle of supremacy of the law. The new authorities have started reversing the backsliding, notably by restoring the independence of the judiciary. One of the key areas in the “Urgent Reform Priorities” adopted by the new government is securing the autonomy of independent regulatory, supervisory and oversight bodies.

Independence of the judiciary

The independence of judiciary is guaranteed by the constitution and the country has a comprehensive set of rules which, if observed, should ensure a high standard of the judiciary and its full independence. However, the revelations in the framework of the wiretapping scandal demonstrated a gap between the legal framework and practice, including evidence, based on interceptions, of political interference in the nomination and appointment of judges. The report on North Macedonia by the EC in 2016 noted “no progress in ensuring the functional independence of the justice system” despite the EU-brokered agreement between the government and the opposition.¹⁰ After the change of the regime in summer 2017, the backsliding of the previous years has started to be reversed. Concrete progress has been achieved in restoring the independence of the judiciary. The country adopted a new judicial reform strategy for 2017-2022 and related Action Plan providing the basis for further reform. The Council of EU in its Conclusions of 26 June 2018 encouraged the authorities to continue the implementation of this strategy in order to ensure that the judiciary can function independently.¹¹

Government and citizens equally subject to the law

Although North Macedonia has a comprehensive set of rules which, if observed, should ensure consistent implementation of this principle, the backsliding during the previous regime affected it as well. The wiretapping scandal revealed numerous cases of abuse of power and authority, diminished accountability and disrespect for professional ethics. Since summer 2017, the new authorities have started work on reversing this backsliding and demonstrated genuine desire to restore democracy and rule of law. A new Council on Judicial Ethics was established in January 2018.

10. European Commission, *The former Yugoslav Republic of Macedonia 2016 Report, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions*. 2016 Communication **PUBLIC** EU Enlargement Policy, 9 November 2016.

11. GAC, *Enlargement and SAP, Council Conclusions*, 26.06.2018

Effective policies and institutions to prevent corruption

Corruption remains prevalent in many areas and the situation worsened during the last years of the previous regime. The wiretapping scandal revealed numerous cases of corruption, including high level corruption, involving top government and party officials. The latest (2018) Transparency International Corruption Perceptions Index (CPI)¹² ranked North Macedonia 93rd among 176 countries, which is a notable drop compared to the situation a few years ago when the country was placed 66th among 168 countries, but an improvement compared to 2017.

The institutional and legal framework for fighting corruption is in place. According to the Council of Europe's Group of States against Corruption (GRECO), the legal framework covers most of the areas under review in GRECO's Fourth Evaluation Round. However, GRECO noted that despite sound legal framework, the effective implementation and enforcement of legislation remains an issue of concern and needs to be addressed as a matter of priority.¹³ In its latest evaluation report of 2014, GRECO addressed to North Macedonia 19 recommendations related to corruption prevention with respect to members of parliament, judges and prosecutors. In its compliance report of 2016, GRECO concludes that North Macedonia implemented satisfactorily or dealt with in a satisfactory manner only three of the 19 recommendations contained in its fourth round evaluation report.¹⁴

The State Commission for Prevention of Corruption (SCPC) remains the main institution responsible for prevention of corruption. Its integrity has been compromised during the previous regime and efforts will be needed for making it genuinely independent from political parties. A Special Prosecutor's Office established under the EU-brokered agreement between the government and the opposition at the height of the political crisis in 2015, is an important tool in the fight against corruption. There are now several high level corruption cases before the courts, and a number of first verdicts have been issued.

Civil and Political Rights

Freedom of speech, information, religion, conscience, movement, association, assembly and private property

North Macedonia is a signatory to all major international human rights instruments. The high level of ratifications of the conventions of the United Nations, Council of Europe, and regional human rights instruments represents a significant achievement. North Macedonia has also put in place the institutional framework for the protection of human rights, which includes the Ombudsman. The latest assessment of the track record of North Macedonia in the area of human rights in the framework of the United Nations Universal Periodic Review (UPR) was adopted in 2014. Among the top recommendations were those related to minorities (22 per cent of recommendations), rights of the child (20 per cent) and freedom of the press (14 per cent). North Macedonia accepted 91 per cent of a total of 136 recommendations made through the review process.¹⁵

12. Transparency International, *Corruption Perceptions Index (CPI)*, 2018.

13. GRECO, *Fourth Evaluation Round, Evaluation Report, The Former Yugoslav Republic of Macedonia, Corruption prevention in respect of members of parliament, judges and prosecutors*, published on 17 March 2014.

14. GRECO, *Fourth Evaluation Round, Compliance Report, The Former Yugoslav Republic of Macedonia, Corruption prevention in respect of members of parliament, judges and prosecutors*, published on 12 October 2016.

15. United Nations, *Universal Periodic Review (UPR), North Macedonia, and UPR Info Statistics*, available at https://www.upr-info.org/database/statistics/index_sur.php?fk_sur=101&cycle=2

The Constitution and relevant laws prohibit discrimination on grounds of sex, race, language, religion, national or social origin, property or social status. The Constitution guarantees the basic freedoms and rights of citizens recognised in international law, while international treaties are directly enforceable by domestic courts and their status is superior to the domestic law. Freedom of speech, information, religion and conscience, movement, association and assembly, and private property are therefore fully guaranteed. The Constitution also requires the state to supplement private initiative and responsibility in relation to certain “social objectives”, such as the provision of care to persons with disabilities, the aged and orphaned.

While the legal framework for protecting human rights is broadly in line with European standards, the 2015 wiretapping scandal revealed serious violations of the fundamental rights, highlighting the gap between the legislation and practice. The new government formed in June 2017 has committed itself to reverse any backslidings in the area of fundamental rights during the previous years.

As regards property rights, progress has been made in returning property confiscated under the communist regime. Property which could not be returned was compensated for in the form of bonds.

Political inclusiveness for women, ethnic and other minorities

The legislative framework for the protection of ethnic minorities is broadly in place. The country has a complex ethnic composition. According to the 2002 census, ethnic Macedonians are 64.2 per cent, ethnic Albanians 25.2 per cent, ethnic Turks 3.9 per cent, Roma 2.7 per cent, ethnic Serbs 1.8 per cent, ethnic Bosnians 0.8 per cent, and Vlachs 0.5 per cent. The attempts to organise a census in 2011 failed due to the disagreements on methodology between the ethnic communities.

North Macedonia has a history of ethnic tensions. However, it has made progress since the 2001 armed inter-ethnic conflict in addressing both the roots and the effects of this conflict. These efforts included legislative reform and practical measures designed to ensure equitable representation of minority communities in public administration and their integration into society and promotion of inter-ethnic reconciliation. The interests of minority communities are protected at different levels, starting with basic constitutional guarantees (ethnic communities are explicitly mentioned in the Constitution) to the special mechanism ensuring protection of their interests in the parliament and measures to protect their cultural, linguistic and religious identities. The most tangible results in this respect have been achieved in protecting the interests and ensuring equitable representation of the largest ethnic minority, Albanians. More remains to be done to protect smaller ethnic minorities, such as the vulnerable Roma community.

Despite the progress achieved, inter-ethnic tensions persist, especially at the local level. Political parties are largely divided along ethnic lines. The implementation of the Ohrid Framework Agreement (OFA), which prominently includes inter-ethnic reconciliation, remains indispensable. It continues to support political stability, which is highlighted by the smooth functioning of the current multi-ethnic governing coalition. The new government established in mid-2017 has taken a number of important steps to build greater trust among ethnic communities. Among them is adoption of the new law on the official use of ethnic languages in the public administration.

Regarding Roma, several measures have been taken, notably to address the issue of persons without documents and to integrate internally displaced people (IDPs) and Roma refugees from Kosovo. The Roma health mediator programme started in 16 municipalities. Education projects continued to be implemented leading to an increase in the enrolment rates of Roma children in education (currently 78 per cent of the Roma school age children enrol in compulsory education). However, implementation of existing strategies, including the Roma inclusion strategy for 2014-2020, needs to be strengthened. High unemployment rates persist, while access to unemployment benefits and basic health services remains problematic. Stereotyping against Roma persists, including in the media.

The key legislative elements for gender equality are in place in North Macedonia. In December 2017, it ratified the Council of Europe Convention on preventing and combatting violence against women (Istanbul Convention). By regional (and wider international) standards women have over the past decade had an impressive representation in the national parliament. It peaked at 35 per cent in the previous parliaments, and is 31.6 per cent in the current parliament. In line with enhanced quota for women's participation enforced by the Electoral Code (increase from 30 to 40 per cent), 41 per cent of candidates in the last general elections were women.

At the local level, however, the situation is different. There are few female Mayors. During last local elections, only six per cent of Mayoral candidates were women. Discriminatory customs and stereotypes are still present in the rural areas, undermining women's basic rights.

The new Prime Minister and members of his government have publicly expressed support for the rights of LGBT persons and are committed to making progress in this area. However, societal prejudice continues and hate speech is present against LGBT in the media and social networks.

Freedom from harassment, intimidation and torture

Constitutional guarantees against harassment, intimidation, and torture are in place and are largely upheld in practice. A delegation of the Council of Europe's European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment (CPT) last carried out an ad hoc visit to North Macedonia in December 2016. The primary objective of the visit was to look into the conditions of detention and treatment of inmates at Idrizovo Prison, in which around two-thirds of the country's prisoners are held. For many years, the CPT repeatedly criticised the situation in this establishment, stating that the conditions in certain wings could be described as amounting to inhuman and degrading treatment. CPT retained in its last report that the systemic problems that had been identified at the time of its previous visits were still not addressed. For this reason in the report's conclusion the Committee qualified the quality of its relationship with North Macedonia "as profoundly unsatisfactory".¹⁶ The new government has committed itself to addressing the recommendations of the CPT and to making progress on the prevention of torture and ill-treatment. A strategy for zero tolerance of ill-treatment has been adopted.

16. Council of Europe, European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment (CPT), Report to the Government of "the former Yugoslav Republic of Macedonia" on the visit to "the former Yugoslav Republic of Macedonia" by CPT from 6 to 9 December 2016, published on 12 October 2017.