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Former Yugoslav Republic of Macedonia

Stabilisation and Association Report 2003

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Stabilisation and Association Report

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1. Executive Summary

Following a largely unstable period after the 2001 crisis, the **political situation** in the former Yugoslav Republic of Macedonia has been moving steadily towards normalisation based on the Ohrid Framework Agreement. The European Union (together with its partners in the OSCE as well as with NATO and the United States) has been consistently supporting this process. The planned EU take over of the NATO military mission in March will be a further demonstration of EU commitment to peace and stability in the country. The 15 September elections have illustrated the gradual return to normal political life. The creation of a multi-ethnic coalition Government is a very positive indication of a willingness to cooperate and to compromise on later. It will be crucial that all signatories of the Framework Agreement, including the opposition parties, continue on this path until its full implementation, the only basis for further development and strengthening of the country's institutions and capacity to move closer to the EU. After initial progress, the path of reform needs to be accelerated. The political support expressed by all major political parties for European integration should also help in launching the necessary political and economic reforms. Much remains to be done and it is now up to the Government to take and implement the initiatives needed.

In 2002, the **economic performance** of the former Yugoslav Republic of Macedonia fell below expectations, even though monetary and exchange rate stability was maintained. The negative effects of the 2001 crisis stretched over into 2002 and were compounded by the weak external environment. The political uncertainty before the general elections in September and the failure to conclude an IMF agreement until February had a negative impact on the economic and business climate. The implementation of the agreement finally reached with the IMF (yet to be approved) will further build confidence in sound market-oriented economic policies to be promoted by the new Government, improving the business climate and stimulating growth. Only in this way the Government will be able to meet the costs of the reforms processes. Other key issues to be handled by the Government are the implementation of a modern Treasury system and the development of decentralised government and public finances.

With regard to the structure and functioning of the **administration**, the legal framework for the decentralisation of public administration still needs to be adopted and implemented to contribute fully to wider stabilisation of the country. As already emphasised in the SAp 2002 Report, the structure and management of the public administration has some way to go before it can adequately fulfill all the tasks required of it in a functioning democracy based on the rule of law. It is crucial that the government further develop efficient measures against corruption. Other priority reforms include the security sector and effective measures to tackle the weaknesses of the judicial system.

Rapid implementation of the Framework Agreement will also enhance progress in the **Stabilisation and Association process**, including the ongoing ratification process of the Stabilisation and Association Agreement (SAA). In the meantime, the former Yugoslav Republic of Macedonia should ensure that all obligations arising out of the Interim Agreement are fully complied with and that the preparatory works

needed for the implementation of the full SAA are completed so that work can start as soon as it enters into force.

2. Political situation

2.1. Democracy and rule of law

The implementation of the Ohrid Framework Agreement while still far from complete and delayed compared to the original timetable has allowed the restoration of peace and a gradual stabilisation and normalisation of the situation in the former Yugoslav Republic of Macedonia. The general trend towards greater stability was confirmed by the parliamentary elections on 15 September followed by the swearing in of the new coalition government on 1 November 2002 and the Census operations which took place between 1 and 15 November in a way praised by the international community .

The Government and the opposition have to work together in order to ensure the full implementation of the Framework Agreement. All communities have to play their part to make it successful. Avoiding polarisation the public opinion on legislative reforms to come is essential.

Commitments taken by the Government on reforms in public administration and decentralisation, reestablishment of law and fight against corruption are welcomed. A lot remains to be done as they must be effectively converted into actions. These are challenges to be dealt with in the coming months, in a difficult economic and social environment . It will require not only progress on the legislative front but also on implementation and enforcement.

2.1.1. Assessment of democratic institutions and of attitudes to the state.

President of the Republic: Good cooperation will be needed between the Government and the Head of State. This applies in particular to the areas of national security and external representation. During the reporting period, the President has continued to play a significant and positive role in the areas which call for wide consensus – EU integration, implementation of the Framework Agreement and enhancing regional co-operation.

Parliament: Parliamentary elections were held on 15 September 2002 and have been assessed by the international community as being largely in compliance with international standards despite a few minor problems. This was due to a generally successful revised legal framework adopted in June, successful work of the government and the State Election Commission but also the self-restraint and commitment of all political parties and the support of the international community. Some of the minor incidents reported, related to proxy voting and the voting of women, need to be tackled in future elections. The question of fair coverage by the media (in particular state-owned media) should also be dealt with.

Overall, the way the elections were held and the high turnout (73.4%) have substantially contributed to the stabilisation and normalisation of political life in the country. Parties openly campaigning against the Ohrid Agreement received only marginal support. As a result, a new coalition government was formed between “Together for Macedonia” (consisting of ten parties led by Social Democratic Union and Liberal Democratic Party, including members from various communities) and the Democratic Union of Integration (DUI), a new political party established by the former leader of the dismantled National Liberation Army.

The Assembly was constituted on 3 October 2002. Four out of five of the new Members of Parliament are newly elected. As foreseen by the Framework Agreement, parliamentary rules have been changed. Accordingly, the Albanian language is now used in Parliamentary business for the first time. These rules should be applied in a pragmatic way, especially facing a heavy work programme with tight deadlines.

Considering the role to be played by Parliament in adopting the legislation required to fully implement the Ohrid Framework Agreement and the Constitutional Amendments of 17 November 2001, it is essential that a political consensus exists for what should be a common objective between the main political parties. This is all the more important as some of the laws or decisions to be taken require a qualified (two thirds) majority e.g. the Laws on the Ombudsman or on Courts, and/or are subject to a double majority system (a majority in the Parliament as a whole and a majority of the Members of Parliament registered as belonging to minorities) e.g. the laws on culture, use of languages, education, personal documents, use of symbols. The Parliament also faces a heavy work-load following the Government programme on approximation of legislation with the EU. In this context, the boycott by the opposition VMRO-DPMNE of parliamentary proceedings for the first 100 days of the new Parliament delayed the return to normal politics.

Parliament still needs to improve its capacity to assess whether proposed legislation is compatible with international agreements and the EC acquis. This should be completed by appropriate mechanisms related to the enactment of the laws needed for approximation to the EC acquis (similar to already existing provisions in Government procedures).

There is still little progress in improving the internal democratic procedures of the political parties or in improved clarity in the legal framework for the financing of political parties. The overwhelming influence of party structures over decisions taken at governmental level remains unchanged. These problems need to be tackled quickly so as to ensure that the country moves further forward on the road to stability.

Executive: A government led by Prime Minister Branko Crvenkovski took office on 1 November. Its composition has shown a constructive sense of compromise and commitment to work together. Important ministries for the decentralisation process have been allocated to DUI which therefore will have to play a major role in its success. However, the Government has yet to establish itself as a functioning coalition.

The Government programme positively demonstrates awareness that only a stable country where the rule of law is well rooted can have the ambition of entering European and transatlantic structures. The implementation of its annual work programme in the coming months will show if these priorities and those imposed by the SAA, the National Programme for Approximation with the EU legislation (and in particular the Programme for Harmonisation of the Priority Areas as defined in Article 68 of the SAA), as well as the remaining legislative changes required by the constitutional amendments adopted on 17 November 2001, are adhered to.

Implementation of the Framework Agreement: After initial progress, the implementation of the Framework Agreement has been delayed compared to the original timetable. It is still far from complete but the Government has taken significant decisions going into the right direction.

Delayed once, the population, households and dwellings Census, a critical element of the Ohrid Agreement, was carried out on 1-15 November 2002. Overall, the holding of the Census has been an important contribution to confidence-building in the country and normalisation of conditions on the ground. The reports from the International Monitoring and Observation mission (led by the European Commission and the Council of Europe) and from the Census authorities were unanimous in concluding that it had been successful. Incidents and irregularities were isolated, not affecting the overall result. Preliminary results of the Census were announced on 15 January but did not provide data on the ethnic makeup of the population as relevant data still need to be processed. International monitoring will continue through the data-processing stages, right up to the availability of the final results.

The Government adopted on 3 February a strategy for the further implementation of the Framework Agreement (FA). The strategy, which encompasses an action plan for implementation of the FA, an operational programme for decentralisation and a draft programme for fair and equal representation of minorities in public administration and public enterprises, has shown the governing coalition's positive ambition to take the process forward at a good pace. It now needs to implement this speedily and effectively.

Decentralisation is a pivotal part of the Ohrid Framework Agreement. It will help to strengthen democracy throughout the country and to bring public services closer to citizens. The Deputy Prime Minister in charge of co-ordination of the process, and the Ministry of Self Government, will have a particular responsibility in ensuring that the process is sustained and kept under firm political guidance. Fiscal decentralisation and allocation of resources, territorial division of municipalities and institution building will be the main elements of this process which needs to be largely completed by the time of the next local elections in 2004.

Public Administration: Reforms in the organisation and management of the public administration also need to be accelerated and sustained, after little progress during 2002. Budgetary constraints should not prevent administrative reform as, largely, progress resides in efficiency and organisational improvements and on redeployment of staff. Progress in this sector is a condition for the success of the many reforms which the country must undertake to implement the Framework Agreement and to engage the country in European integration. Reforms are also a

matter of trust for all sections of the communities in the administration. Transparency and stability of the administration are still insufficient, with politicisation down to the lowest grades still the rule. This not only has a cost in terms of administrative capacity, but also facilitates corruption and nepotism and must therefore be dealt with. Competency and professionalism must be further strengthened through the establishment of a “merit”-based system and through administrative control of decision-making. Modern management and training and effective means to enforce the legislation are required. Another essential component of reform in the public sector is the need to ensure equitable participation of minorities. After slow progress, it is expected that the programme adopted by the Government should now be fully implemented. Finally, proper strategic co-ordination between policy making and implementation also needs to be further ensured. Clear and measurable objectives are needed and co-ordination needs to be ensured between Ministries. Modernising the administration also requires the full implementation of the new legal framework on civil servants which is still frequently not respected. To this end, the Civil Servants Agency in particular needs further strengthening.

Armed forces: The reform of the armed forces is designed to prepare the country for NATO membership. Progress on the definition of a National Security Strategy and strong co-ordination with the Ministry of Interior and other security agencies, as well as multi-annual planning and full civilian control in a spirit of strengthening co-ordination, is necessary. Targets for representation of all ethnic communities in the armed forces should be established and implemented.

International presence: The role of the international community remains vital to the reform process. The European Union is playing a leading role in the co-ordination of international support to the implementation the Framework Agreement, within the overall context of the SAP. The Office of the EU Special Representative, whose mandate is now extended to June 2003 has been active throughout the reporting period in helping with the implementation of the Ohrid Agreement. Co-ordination of reconstruction and return of internally displaced persons has been ensured by the Commission and the UNHCR, with the continued commitment of a number of donors as well as of the government and local authorities. As the security situation has improved (and new challenges have emerged) the NATO mission evolved from Task Force Fox to Operation Allied Harmony. As a further indication of EU commitment to the country’s full stabilisation, the European Council stated in December 2002 its willingness to lead a military operation, following the NATO operation. President Trajkovski made a formal request to the Presidency of the EU Council of Ministers, on 17 January, expressing the country’s readiness for the future deployment of a EU rapid reaction force, a decision which was subsequently taken by the Council¹.

2.1.2. Assessment of judicial system, law enforcement and respect for rule of law.

Judicial system: The weaknesses pinpointed in last year’s Report, seriously besetting the functioning of the judicial system and of law enforcement, remain.

¹ Council Joint Action 2003/92/CFSP of 27 January 2003 on the European Union military operation in the Former Yugoslav Republic of Macedonia; OJ L 34, 11.2.2003, p.26

The lack of independence of the judiciary is a persistent factor which requires effective action without further delays. As underlined in the 2002 SAp Report, the overwhelming influence by the executive power and the political parties over the courts and the Public Prosecutor's Office, mainly through the appointment process of judges and public prosecutors, must be tackled. The appointment by Parliament of members of the Republic Judicial Council should be reformed to allow depoliticisation and effective independence of the judiciary.

Another weakness, emphasised in the 2002 SAp Report, was the considerable backlogs and resulting near paralysis of the judicial system. Ongoing computerisation of the Courts should help to accelerate procedures. However, without further serious reforms, the situation will not change as procedural requirements and costs which favour lengthy procedures and insufficient case management are worsening the situation.

While most of the solutions are well known, most of the problems which have been identified remain to be tackled. The reform process needs now to be accelerated. The legislative reforms already mentioned in 2002 must not be further delayed. The introduction of an independent budget for the judicial system should be completed. In particular, changes in laws need to be complemented by changes in court administration and further training of judges, in order to guarantee that justice is delivered in a timely manner. Public funding of the training centre, currently under the aegis of the association of judges, should be considered to make it a public institution, following standard European practices. It should also be extended to the training of prosecutors. Co-ordination with police and other investigating authorities must be ensured and international and cross-border cooperation strengthened.

Police: During 2002 a major programme for return of the police in the former crisis areas was prepared and implemented with the support of the OSCE, as a part of an attempt by the authorities to regain control of all areas affected by the 2001 crisis. The re-integration of these areas, by police, is now complete. However, full re-establishment of security over the whole territory is not yet achieved as ordinary criminality has increased in recent months. Intercommunal mistrust and potential for tensions remains and feelings of insecurity are still very high. Widespread private ownership of weapons is an additional destabilising factor which must be addressed urgently. Political stakeholders in all areas, including in the ethnic Albanian communities, must take their responsibility to ensure full return to law and order.

Overall reform of the security sector is needed. While this is a process which will take some time, immediate action is needed. The process of dismantling paramilitary forces within the police is a test of the Government's capacity to enact the reforms it has committed itself to. In this context, the dismantling of the so-called Lions should be completed without further delay, as already recommended in the 2002 SAp Report. The negotiation finally agreed by the President and the Prime Minister after pressure put by elements of this unit is, hopefully, not a sign of weakness in the Government will to progress in this issue.

Other components of the required reform include a clearer distinction between police and military and stronger coordination mechanisms between all ministries involved in tackling challenges such as organised crime. Reforms should also aim at developing a public service police role and ensuring democratic control and a sense

of accountability. While trust is slowly increasing, police authority and recognition need to be more firmly rooted. The gradual integration of staff from minority communities, based on serious training programmes, should facilitate it. Training and modern management methods need to be developed. Furthermore, there is a need to make sure that corruption or misconduct issues are addressed seriously in order to strengthen public confidence. It is therefore important that an effective system of sanctioning those who misbehave or abuse power is put in place, with prosecutions pursued wherever appropriate.

Respect for the rule of law: Corruption in the public service is still a widespread problem even if it may be difficult to quantify due to only limited availability of statistical data. Problems already pinpointed in the 2002 SAP Report remain valid. After the adoption of the Law on Corruption in April 2002, little progress was reported until the end of 2002 when welcome measures were taken by the new Government. These include the declaration of assets by members of the cabinet and the beginning of the application of this principle to senior civil servants. An independent national Commission for the fight against corruption was established on 12 November 2002 with a view to implementing the law on the fight against corruption. These are positive signals of the authorities' commitment in this area. The requirement now is for the Law to be fully implemented. In addition an integrated plan to prevent and combat corruption should be developed, as pledged by the Government at the London Conference on organised crime (25 November 2002). The Commission for the fight against corruption is expected to play a key role in this respect. However, the full commitment and co-ordination of all state bodies, including the judiciary, is necessary for its success. More widely, it should be underlined that the firm establishment of the rule of law is a process in which civil society as a whole must play a part - the work of NGOs needs to be better valued.

The roots of corruption must be addressed. Urgent measures must be taken to guarantee a non-partisan and professional state administration, to strengthen the rules relating to conflicts of interest, to strengthen the role and capacities of police and prosecutors to discover and punish corruption, to screen the legal system in order to eliminate provisions which might favour corruption in particular in public procurement and to develop internal and external control of the administration. The legal framework for the financing of political parties needs to be clarified, providing for control by independent audit bodies. Much remains to be done to ensure an environment of zero tolerance in the public institutions, requiring stronger institutions with clear responsibilities in this respect. An independent multi-disciplinary anti-corruption unit with the capacity to prevent, investigate and prosecute corruption should be established, as agreed at the London Conference.

2.2. Human rights and protection of minorities

Confidence building measures are starting to have an effect, but interethnic tensions remain high. In areas where they are a majority, communities should behave towards minorities the way they are expecting to be treated in areas where they themselves are in a minority. Human rights abuses by the police are a cause of persistent concern. A zero tolerance approach is required, with sanctions uniformly

applied. The 2002 SAp Report underlined the discrepancies between the norms, which guarantee basic rights, and the practice, and called for higher standards in the application of existing rights. This still is the case, even if some relative progress can be reported in recent months.

2.2.1. Civil, political, economic, social and cultural rights

Human rights violations: The last reports by observers of violence or torture by the Police are highly worrying. The situation has not improved since last year and no significant follow up seems to have occurred to implement effectively the recommendation made in the 2002 SAp report to improve the judicial follow up to complaints. Immediate attention should be given by the public authorities to this situation, through training and effective mechanisms to seek to prevent and, when necessary, punish this kind of misconduct.

Freedom of expression: During the elections in September, the media, with a few exceptions, were reported to have provided a reasonably balanced editorial coverage of political parties and coalitions running in the election. However, a certain amount of biased coverage, primarily due to economic and political interests, was reported. During the reporting period, NGOs also reported cases of intimidation or violence against journalists. The need for radical reform, emphasised in last year's report, to guarantee independent, professional and ethical presentation of information is still on the agenda. The legal framework for print media needs to be strengthened, especially as regards the transparency of ownership and circulation data. Changes in the state-controlled media are also needed, to bring them in line with European standards on the independence of the journalists and the unbiased provision of information. The independence and professionalism of journalists should be further guaranteed and strengthened. The code of conduct of journalists must be fully implemented.

Civil society, through NGOs, seems to be more actively involved in the reform processes of society in terms of building democracy, promoting pluralism, improving justice and fighting poverty in particular. Increasingly, NGOs have platforms in which to express their views, whilst co-ordinating structures are being introduced to enable them to play a full part in the social and political process. Both during the crisis and during the Parliamentary elections these have proved to be very effective. However, NGO funding is still precarious and the legislative framework should better promote their development.

The **Ombudsman's office** also has a critical role to play in supporting the fight against bad administration and mismanagement. However, statistics show that its decisions continue to be poorly followed up (more than 50% of the Ombudsman's acts sent to administrative institutions remained unanswered or unimplemented) even if the situation has slightly improved in cases related to environment, child protection and health protection. Other parts of the administration, such as the Ministries of Justice or Interior, have not been as cooperative. The activities and reports of the Ombudsman should therefore be taken more seriously and its authority strengthened so as to guarantee efficient cooperation and appropriate follow-up of the state administration institutions. This requires a review of the legislative framework for its action.

As regards **gender equality**, the requirement to have a minimum of 30% of women on candidates' lists for parliamentary elections resulted in a better representation of women in the Parliament. The new Assembly has 22 female members whereas key posts in the Government are held by women. Some work is also being done, under the auspices of the Ministry of Labor and Social Policy, to improve the status of women in society but the capacity of the services in charge needs to be further strengthened. Increasingly worrying are the statistics on violence against women and the lack of attention given to this problem by the public authorities. In this area also, NGOs should play a crucial role, in partnership with public authorities.

In the social field, in a context of social tensions, consensus on the implementation of indispensable political and economic reforms and dialogue are key to the success of future reforms. One of the most urgent social reforms to be undertaken concerns the reform of the **education** system. This is crucial if inter-ethnic relations are to be improved, in the long term. However, this depends on the capacity of the country to develop and sustain a coherent policy in this respect. So far, frequent changes in leadership have resulted in a lack of vision and continuity in reforms and much remains to be done to develop a politically independent reform policy in this area. Another issue requiring attention is the situation of **disabled persons**. Concrete steps need to be taken to favour their integration into society, starting with removing some restrictive measures in the fields of education, employment, social and health protection.

No major problem was reported during the last few months regarding **freedom of religion**. Religious teaching has been introduced in schools. Religious dialogue could usefully contribute to an easing of cultural and interethnic tensions, so existing efforts should be further intensified.

The former Yugoslav Republic of Macedonia has not yet ratified the **European Social Charter**.

2.2.2. *Minority rights and refugees*

Interethnic relations have undeniably improved since the crisis. Confidence building measures are showing first results (such as the establishment, with the support of the OSCE, of local advisory groups to deal with daily relations between police and the public). But it is the full implementation of the commitments taken through the Framework Agreement which will further ensure the effective protection and the sense of being protected for members of **minority communities**, and should address in the most effective way the remaining potential for tension. It is therefore imperative that all communities sustain their support to the process. A few ethnically-motivated incidents have taken place during the past several months. A responsible attitude has been shown so far by public authorities but the potential for such incidents to escalate clearly remains. Polarisation of young people along ethnic lines is a serious concern and needs to be addressed on both sides of the ethnic divide.

As part of the institutional changes foreseen by the Framework Agreement, a Parliamentary Committee on Relations between the Communities has been established and should play an important role in preventing or resolving inter-communities issues.

Further measures to build confidence and promote dialogue between communities will be vital to support the on-going political process and reinforce the de facto cooperation which often, at local level, allows daily public affairs to be conducted.

In particular, a real strategy for the better integration of Roma is still lacking.

The number of **refugees** has dramatically decreased since 2001. By the end of 2002, 95% of the 170,000 people who fled their homes had returned. However the temporary protection regime applied to the refugees does not meet EU and international standards (2,756 according to the UNHCR). A proper legislation on Asylum, based on international and EC standards, should be adopted without further delay in order to give them a clearer status.

Refugees from the former Yugoslav Republic of Macedonia in Kosovo are estimated by UNHCR at 3,500 and **Internally Displaced Persons** at 8,400 (down from 17,000 last year). Confidence building measures are providing some results but, considering the complexity of the post-crisis situation in the affected regions, the issue still requires firm attention.

The issue of **Stateless** persons who do not have proper citizenship needs proper attention in the coming months. The citizenship legislation will have to be amended accordingly.

2.3. Regional Cooperation

The former Yugoslav Republic of Macedonia has continued to be an active participant in regional cooperation initiatives. Regional and bilateral cooperation should continue to be seen by the authorities as a driving force to address common problems in a pragmatic way and sustain internal reforms, while supporting the country's efforts towards further integration in the EU and in the NATO structures.

2.3.1. Multilateral relations

After some initial difficulties, cooperation between the former Yugoslav Republic of Macedonia and the **International Criminal Tribunal for the former Yugoslavia** has been satisfactory overall. However, there have been occasions when it was unclear which authority was responsible for following up on Tribunal decisions in the country. This situation should urgently be clarified through a new Law to avoid conflicts between the government, the Public Prosecutor and individual courts charged with particular cases.

On the sensitive issue of **missing persons**, the independent Commission on Kidnapped and other Missing Persons published its report on 8 July 2002. The International Commission of Missing Persons has undertaken to continue investigations concerning these cases and will need the cooperation of the authorities. The Government needs to help to solve remaining open cases as this will help reconciliation between the communities.

The cooperation of the authorities with international missions present in the country (EU, NATO, OSCE) has been very constructive, and is particularly important as the international missions continue to play an important role in stabilising the situation (especially in the former crisis areas) and in confidence building. The successful conduct of the parliamentary elections of 15 September 2002 has illustrated the positive outcome of such cooperation.

At regional level, the former Yugoslav Republic of Macedonia has continued to be an active participant in the main regional cooperation initiatives, in particular the Stability pact and the South East Europe Cooperation Process. It held the presidency of the Central European initiative in 2002. The country has also engaged in a strengthened dialogue with Croatia and Albania regarding their preparation to join NATO which should contribute to the stabilisation process in the region.

As regards the **Stability Pact** the country is on track to meet its responsibilities as it has signed its last outstanding free trade agreement with Romania on 4 December (see infra).

The successful finalisation in October of the negotiations for country's accession to the **WTO** has been a major achievement of the country in 2002. The Protocol for Accession was ratified by the Parliament on 24 January 2003.

2.3.2. Bilateral relations

The relations of the former Yugoslav Republic of Macedonia with neighbouring countries have been progressing well. The overall climate of strengthening co-operation in South East Europe, within the overall process of European integration, has continued to help overcoming remaining problems in a prevailing climate of a pragmatic approach and a spirit of co-operation.

Bilateral economic relations continued to improve in 2002. The end-2002 deadline for implementation of the June 2001 Memorandum of Understanding on Trade Liberalisation and Facilitation in the framework of the Stability Pact, played a major role. In line with the MoU and with the recommendation in the 2002 Sap Report, the former Yugoslav Republic of Macedonia has finalised all the necessary bilateral negotiations. Changes and amendments to the Free Trade Agreements with **Slovenia** and **Croatia** were signed, while the signing of the Agreement with **Romania** on 4 December 2002 completed the network of FTAs.

While still complex, relations with **Albania** are showing positive signs. Efforts have been made in particular in the field of strengthened cooperation in border controls and fight against illicit trafficking (joint patrols are going to take place). Further cooperation should be looked at, considering the many common issues to be addressed by both countries. A Free Trade Agreement was signed with Albania on 29 March 2002 and ratified on 19 June.

Relations with **Bosnia and Herzegovina** are good. Negotiations for a Free Trade Agreement between the two countries started in May 2001 and an Agreement was signed on 20 April 2002 and entered into force on 1 July, providing for a transitional period of gradual liberalisation of two and half years until 31 December 2004.

While the former Yugoslav Republic of Macedonia and the state of **Serbia and Montenegro** reached agreement on border demarcation in 2001, it has not yet been demarcated. For the moment, the security situation along the Kosovo part of the border remains too fragile for the border demarcation to proceed with the necessary co-operation of the authorities in Kosovo. However, the former Yugoslav Republic of Macedonia authorities have opened eight border crossing points to facilitate local traffic. Such a pragmatic approach is to be welcomed. On the other hand, there are serious problems with implementing the 1996 free trade agreement with the state of Serbia and Montenegro. The customs service of the former Yugoslav Republic of Macedonia systematically refuses preferential status to goods coming from Kosovo even though accompanied by the necessary documentation, while the UNMIK Customs continues to unilaterally accord preferential status to goods coming from the former Yugoslav Republic of Macedonia. This situation is in breach of the FTA and of the Memorandum of Understanding signed with UNMIK (entailing mutual acceptance of certificates of origin). It has also been reported that on repeated occasions false certificates of origin have been presented to accompany goods not originating in former Yugoslav Republic of Macedonia (e.g. bananas and sea salt) exported to Kosovo. All appropriate remedial actions should be urgently taken by the authorities. More generally, close and pragmatic co-operation with UNMIK should contribute to improved regional co-operation and solving outstanding issues e.g. in the fields of customs or trade.

Relations with **Greece** have been progressing, in the overall context of the development of the FYROM relations with the EU. However there are still bilateral issues of political or cross-border character, which require a solution. One of these is about the name of the country, on which intensive discussions are taking place. Other issues concern cross-border cooperation on environmental resources (especially the use of the waters of Lake Dojran) and the pollution of the Vardar/Axios river and should also be addressed urgently.

2.4. Priority areas needing attention in the next 12 months

- Step up the fight against corruption by adopting and implementing a comprehensive strategy, in line with international and European standards and practices (including the setting up of appropriate bodies to prevent, investigate and prosecute corruption, increased transparency and objectivity in various procedures performed by the executive bodies, clarity in financing of political parties, full implementation of public procurement legislation).**
- Continue to accelerate the implementation of the Framework Agreement of 13 August 2001. The full implementation of the FA remains a key step on the country's path towards closer relations with the EU and requires sustained commitment from all communities and political stakeholders.**

* Recommendations included in the 2002 SAP Report, basically not implemented

** Recommendations included in the 2002 SAP Report, partially implemented

- Ensure that next steps in the processing of census data are carried out, with the support of the international monitoring mission, in line with international standards.
- Adopt the legislative framework which will ensure smooth implementation of the decentralisation process through offering the appropriate means to the central state bodies to manage the process, and developing the capacity of local self-government bodies to undertake the transferred responsibilities. Partnership with citizens associations and a serious communication programme will help the smooth implementation of the decentralisation process.*
- Provide the Civil Servants Agency with the means to implement civil service reform in a perspective of future integration into the EU structures, promote transparency and “merit” based organisation in the public administration and in all state bodies.*
- Pursue key reforms in the security sector, in particular in the police, to ensure a professional, modern and well-trained service, of multi-ethnic composition, trusted by the community, and able to re-establish law and order throughout the territory.
- Complete the dismantling of the police forces which display paramilitary behaviour.**
- Strengthen the fight against all violations of human rights and intensify training on human rights issues for law enforcement officials, in co-operation with international organisations.*
- Improve the functioning and efficiency of law enforcement agencies and of the judiciary, in line with international standards. Strengthen training of judges and prosecutors on EU legislation.*
- Limit politicisation of the judicial system as a part of reforms aimed at developing judicial capacity and ensure that objective professional standards for appointment and career development are fully complied with.*
- Value the role of the Ombudsman Office in the defence of citizens and strengthen its means to tackle mismanagement and bad administration, including through the necessary legislative framework, and strengthen the independence of the Audit bodies.
- Strengthen legal and constitutional guarantees on freedom of expression in line with the European Convention on Human Rights.*
- Support the development of the media sector in line with European standards.

* Recommendations included in the 2002 SAP Report, basically not implemented

** Recommendations included in the 2002 SAP Report, partially implemented

- Encourage the development of civil society, and encourage the role of local NGOs.**
- Continue efforts to enhance regional co-operation.
- Ensure full implementation of the signed free trade agreements.

3. Economic situation

3.1. Current Economic Situation

In 2002, the economic performance of the former Yugoslav Republic of Macedonia has been below expectations. The resumption in growth has been weak, as annual real GDP growth is expected to have reached only 0.3% in 2002. Public finances improved compared to 2001, but the deficit is expected to stay at around 5.9% of GDP, well beyond initial forecasts. The trade deficit widened, as imports continued to grow, while exports marked a disappointing decline. On the positive side, monetary stability was maintained. The average inflation rate remained below 3%. The negative effects of the 2001 crisis stretched over into 2002 and were compounded by the weak external environment. The political uncertainty surrounding the general elections in September and the failure to conclude an IMF agreement until February did not favour the economic and business climate. The agreement reached with the IMF, still to be formally approved, is a positive step forward and strengthened the credibility of the country's efforts to firmly address the persistent weaknesses of the economy by sound economic policies. This is particularly needed as the commitment to the Framework Agreement and reforms will have a significant cost.

The expected economic recovery of the former Yugoslav Republic of Macedonia after the 2001 crisis – when GDP fell by 4.1% - has failed to materialise in 2002. According to the State Statistical Office, 2002 **real GDP growth** is estimated to be a thin 0.3%, against more positive initial forecasts of 3-4%. Industrial production declined by approximately 5% in 2002. The fall is due to a combination of internal and external factors, such as the closure of loss-making companies and the slowdown of the world economy. Agricultural production increased by 2% but was damaged by frosts in Springtime and heavy rains in Autumn. However, a positive growth in the service sector (+ 4.1%), which represents more than half of the GDP, has avoided another year of recession. The country's economic performance has also been affected by the political uncertainty surrounding the parliamentary elections, which were held on September 15th, and by the subsequent negotiations for the formation of a new coalition government towards the end of the year. The new government needs to build confidence with sound market-oriented economic policies, in order to improve the business climate and stimulate positive growth.

In 2002, the level of officially registered **unemployment** increased to around 32% of the labour force, from 30.5% in the previous year. Taking into account the

informal sector, real unemployment figures are probably significantly lower than official data. According to the 2001 Labour Force Survey, more than 150,000 people were employed in the informal sector, a figure which represented 57% of total unemployed persons, in 2000, or around 28% of total employed persons. Another official survey, which interviewed 154 poor households, found that most of the unemployed persons were registered in the Employment Bureau, but at the same time had employment in the black market.

Nonetheless, unemployment – and precarious employment - is a pressing problem and is the most important factor behind rising poverty in the country. The 2002 National Strategy for Poverty Reduction shows that the relative poverty rate – calculated as the share of population that lives below the poverty line - increased from 19% in 1997 to 22.6% in 2000. This trend is explained by the growing inequality in income distribution and is confirmed by the number of welfare beneficiaries, which soared from around 50,000 in 1995 to about 80,000 in 2001.

Inflation has remained under control in 2002. Consumer prices increased by less than 3% on average. This positive result was achieved thanks to a tight monetary policy and the preservation of the exchange rate external anchor. The Macedonian Denar (MKD) has been de-facto pegged to the Deutsche mark and then to the euro – at around MKD 61 per euro - since full current account convertibility was introduced in 1998. There is no formal legal provision for this anchor but it has been a consistent policy of the Government and the National Bank.

In 2002, **fiscal performance** has improved, but not by as much as planned at the beginning of the year. The general government deficit is estimated at around 5.9% of GDP, well beyond the initial forecast of 3% and slightly below the 6.2% deficit which was recorded in 2001. The worse than expected outcome was due to the negative impact of some pre-electoral spending decisions, such as the increase by 10% on average in public sector wages introduced in June and the decision to reimburse depositors who lost their savings in the 1997 TAT pyramid scheme. The new Government identified a further financial gap of around MKD 5 000 million, due to the existence of arrears in payments by budget users. Revenues met the budgetary targets and the collection of VAT, in particular, was slightly better than expected. The Financial Transactions Tax, which had been temporarily introduced in the second semester of 2001, was extended for the whole of 2002 and provided a significant contribution, generating more than 10% of total revenues. The new Government has decided not to renew this tax in 2003 by cutting current expenditures and raising the VAT rate applied to utilities (electricity, water supply) and other staples from the preferential level of 5% to the higher level 18% (which was reduced from 19%).

On the **external side**, in 2002 exports were not helped by the weak economic growth in the country's main trading partners and in particular the EU, which represents the destination of almost 50% of total exports. At the end of 2002, exports declined by 4.3% compared to 2001, reaching € 2.500 million, while imports increased by 10%, totalling almost € 2 000 million. These trends resulted in a considerable widening of the 2002 trade deficit, which reached approximately € 800 (23% of the GDP). In 2001, **trade** between the former Yugoslav Republic of Macedonia and the EU started to decline, a trend which continued in the first nine months of 2002. Figures as of September 2002 show a decrease of, respectively,

13% in the exports to the EU and 9% in imports. This development is directly linked to the unsatisfactory overall economic performance of the country in 2001 and 2002.

On a sectoral level, trade between the EU and the former Yugoslav Republic of Macedonia is dominated by manufactured products, chiefly textiles (42% of EU imports and 20% of EU exports). Agricultural products accounted for 15% of EU imports. It should be noted that energy (i.e. essentially oil) accounted for roughly 15% of total EU exports to the country, the highest rate in the region.

Thanks to a strong resumption in private and official transfers, the 2002 current account deficit is significantly lower than the trade deficit and estimated at 8.7% of GDP. Foreign debt remains relatively low, around 42% of GDP in 2002, and the former Yugoslav Republic of Macedonia has recorded no significant problems in meeting its debt servicing obligations. In 2002, Foreign Direct Investments (FDI) slowed down significantly compared to 2001.

As regards relations with the IMF, in late 2001 the authorities had reached an agreement with the Fund on a six-month Staff Monitored Programme, based on tighter fiscal discipline. After the first review of the programme in May 2002, the IMF decided to freeze co-operation with the previous Government. The two parties disagreed on the impact on medium-term fiscal sustainability of the decisions to unfreeze wages in the public sector without reviewing the wage structure and to compensate depositors in the failed TAT pyramid scheme. Negotiations between the new Government and the IMF resumed in mid-November and an agreement was reached in February 2003. This should allow the finalisation of a Stand-by Arrangement by April. The importance of an agreement with the IMF goes beyond the financial impact of the Fund's credits, as it is a pre-condition for the release of substantial pledged funds from other donors and international financial institutions, including the macro-financial assistance provided by the European Community. Two major projects financed by the World Bank, the Financial and Enterprise Sector Adjustment Loan 2 (USD 40 million outstanding) and the Public Sector Management Adjustment Credit (USD 15 million), are also frozen.

As of 31 March 2002, the EBRD had signed 16 projects in the former Yugoslav Republic of Macedonia, reaching a cumulative investment of € 277 million in sectors such as telecommunications, transport, power, municipal infrastructure, banking and general industry. In the first nine months of 2002, the EBRD had signed seven projects for a total amount of around € 20 million, financing the modernisation of the air navigation services of the country and extending credit lines to some commercial banks for lending to Small and Medium Enterprises. Moreover, the EBRD, with other international shareholders, is planning to open a Micro-Finance Bank early in 2003, along a model which has often been very successful in other transition countries.

3.2. Existence of Free-market Economy and Structural Reforms

So far, the major achievements of the process of structural reforms are in the area of price liberalisation, privatisation of small and medium enterprise and adoption of a regulatory framework in the banking sector. In 2002, the reform process resumed after the temporary setback caused by the security crisis in the previous year. One of the largest state-owned loss-making firms – Jugohrom – was sold to foreign investors. The payment functions of the former Bureau for Payments Operations were completely transferred to the banking system. A new Law on the National Bank of the Republic of Macedonia was approved. Confidence in the banking system has steadily increased, but the sector continues to suffer from structural problems.

As regards **enterprise reform and privatisation process**, 1,688 enterprises had been privatised by the end of December 2002, while 84 state companies were left for sale, of those included in the privatisation programme which began in 1993. The pace of privatisation has slowed down: only 10 companies were privatised in 2002, of which 5 were on the original list. The 84 remaining companies represent less than 5% of the workforce and less than 2% of the equity of the state enterprises on the privatisation list.

The issue of the sale or liquidation of around 40 large loss-making public enterprises has been dragging on for several years and was identified as a critical issue at the end of 2001. Although the process was suspended before its completion, by the time of the elections, some decisive progress was made in 2002. In September, Jugohrom - the largest loss-making company among all the 40 firms covered by the Action Plan – was sold to the French company SCMM.

The conditions for modernising and strengthening the **financial sector** were laid down in the 2000 Banking Law. Although the legal framework for a proper supervision of the financial institutions by the National Bank is in place, it remains to be seen whether this role will be exercised effectively. In 2002, a few EC legal acts have been partially transposed into domestic legislation: principles of the Council Directives 12/2000, 22/93 and 6/93 on credit and investments have been transposed into the Banking Law, the Securities Law and various by-laws.

The banking sector is largely privatised and highly concentrated, with the three largest banks having a combined market share of 65%. However, the total number of banks is still quite high and further consolidation is expected. The sector continues to suffer from structural problems such as lack of lending activity, resulting in a high liquidity situation. High spreads between lending and deposit rates – around 9% in mid-2002 - show that the banking system is not competitive enough, while the volume of bad loans – around 20% of credit exposure, according to the new methodology – remains high. However, confidence in the banking sector has been steadily increasing however, thanks to the monetary stability. At the end of October 2002, Denar and foreign currency short-term deposits had soared to more than € 1 billion, rising by more than 50% on annual basis. However, total bank placements increased by only 10% year-on-year, much less than the deposit increase. Banks are not yet either willing or properly equipped, in terms of human resources, to expand their lending activity and favour economic growth.

A National Payment Card system will become fully operational at the beginning of 2003. The aim of this reform is to introduce non-cash payments on a larger scale and reduce the amount of money in circulation outside of financial institutions. This

represents a further step in the process of modernisation of financial transactions (and related tax collection), following the widespread introduction of cash registers and a network of ATMs by the commercial banks.

As of November 2002 only eight companies were listed on the first-tier market known as the “official” market of the **Macedonian Stock Exchange (MSE)**. Approximately 70 further companies are traded on the second-tier market known as the “unofficial” market. Trading activity is extremely low. In October 2002, the average number of transactions per day was 84, while the total monthly turnover of the official and unofficial market was € 4.2 million. The MSE plays therefore a very marginal role in the financing of the economy. This could change in part following a decision by the Government to make it mandatory for companies fulfilling certain criteria to be listed in the MSE, disclosing their shareholder structure and opening their accounts to public scrutiny. The Securities and Exchange Commission should be further strengthened in order to be fully in line with the standards of the International Organisation of Securities Commissions.

3.3. Management of public finances

Limited progress has been made in the area of management of public finances in 2002; the process has slowed down because of the general election and the change of government, and is now expected to resume in 2003. The key issues are the reform of the public administration, the implementation of a modern Treasury system and the development of decentralised government and public finances.

The **reform of public administration** is one of the authorities’ priorities. In April 2002, the World Bank’s Board approved a Public Sector Management Adjustment Credit (PSMAC) of USD 15 million to the former Yugoslav Republic of Macedonia, which aims to improve fiscal sustainability and enhance rationalisation, transparency and accountability of resource use. The authorities have already begun a functional analysis of Government activities in order to identify non-essential functions, which may be privatised or eliminated, as well as those which potentially need to be reinforced. The authorities are also expected to strengthen control of the wage bill and implement wage decompression in order to grant adequate incentives to public sector employees and retain technical expertise in the administration.

In 2002, some progress was made in the area of **public expenditure management**. The reform of the Treasury system was launched in 1999. At present, a single Treasury account within the Ministry of Finance is in place, identifying all budget users, as well as a system of internal auditing are being introduced but are not fully operational. However, the Treasury is still managed in a rather simple manner and its planning and analysis capabilities need to be reinforced, notably through the introduction of a two-tier commitments/payments system.

The main challenge in the area of fiscal reform is the development of **decentralised government**, which is one of the major commitments envisaged by the 2001 Ohrid Framework Agreement. The implementation of the law on local self government depends on the adoption of a new law on local government financing, which will

establish the share of fiscal resources that local governments may manage and retain, as well as on the adoption or modification of up to eighty other relevant laws.

3.4. Priority areas needing attention in the next 12 months

- The authorities should maintain a consistent macroeconomic and fiscal framework in agreement with the IMF and fully implement the programme agreed with the Fund.
- The reform of public administration should be boosted, including its downsizing by the elimination of non-essential functions.**
- The reform of the Treasury should be carried on, in order to ensure a correct execution of the budget.
- The adoption of a new Law on Local Government Financing is crucial, making possible the decentralisation of government's functions.
- The authorities should complete the implementation of the Action Plan for the liquidation or sale of the 40 large loss-making enterprises.**

4. Implementation of the Stabilisation and Association process

4.1. General evaluation

Progress has been slowed down by the election period, the change of Government and changes in the Administration. The Interim Agreement (IA), already in force, is a first indicator of the country's efforts and capacity to deal with their obligations under the Stabilisation and Association Agreement (SAA) and its commitments towards further integration in the EU structures. The Government has promised to solve the discrimination in the OKTA case, but has not yet done so. Resolution is expected very soon.

While the co-ordination structures are now in place to support further progress, administrative capacity and institution building need to be further strengthened to accelerate and sustain the rhythm of reforms needed to comply with the SAA obligations when it enters into force.

** Recommendations included in the 2002 SAP Report, partially implemented

4.1.1. *Current position*

Nine EU member states have ratified the Agreement (D, DK, ES, F, IRL, NL, O, SV, UK).

In addition to the Co-operation Agreement, the SAA and the Interim Agreement which are already ratified, the Parliament of the former Yugoslav Republic of Macedonia ratified the Trade in Textiles Agreement in June 2002.

In July 2002 the 5th meeting of the Co-operation Council took place in Skopje under the Co-operation and Interim Agreements. The Working Parties under the Co-operation Agreement and the Interim Agreement resumed their regular pace of work during the first semester of 2002. In addition, several technical meetings on customs, agriculture and accounting between national institutions and relevant Commission services were organised in the first half of 2002. In the second half of the year, however, the meetings of working parties were suspended due to the continued failure of the former Yugoslav Republic of Macedonia to comply with its obligations under the Interim Agreement, namely on the OKTA case, contrary to what had been promised at the 5th meeting of the Co-operation Council. A readjustment of the structure of the working parties to reflect the new structure under the Interim Agreement is under way.

In December 2002, negotiations on greater liberalisation of the trade in agricultural and fishery products were opened under Article 16 of the Interim Agreement.

As part of the coordination and prioritisation efforts required to meet the obligations of the SAA, a revised Programme for the approximation of the national legislation with that of the European Union was presented in July 2002. In addition, the basis for a programme for harmonisation of the legislation with that of the EU in the priority areas as defined in Article 68 of the SAA has been submitted to the Commission. Further clarifications have been requested from the former Yugoslav Republic of Macedonia with a view to establishing a co-ordinated programme as stipulated in Article 68.

4.1.2. *General assessment of administrative capacity*

In 2002, the Sector for European Integration (SEI), within the General Secretariat of the Government, has been strengthened. However, the impact of the implementation of the IA/SAA on line Ministries is not always fully assessed and the consequences not fully drawn. The existing co-ordination structure between the SEI and the European Integration Units in the line ministries, still understaffed, should be developed further on the basis of the on-going review of the current mechanisms.

The Programme for the approximation of the national legislation with that of the European Union has been revised twice since its first adoption in June 2001, a procedural manual for the harmonisation of legislation has been prepared and monitoring mechanisms are being developed. Under the auspices of the SEI, work has started on a National Strategy for European integration. EU training courses for state administration officers were organised. The Civil Servants Agency also participates in institution building programmes, and should continue to play its role in synergy with the SEI.

4.1.3. Impact of the SAA/Interim Agreement on reform

Because of the 2001 crisis and its consequences on the economic, social but also public deficit situation, it is premature to assess the impact of the reforms taken to comply with the SAA/Interim Agreement. In addition, the parliamentary elections and the formation of the new Government have slowed down progress in many areas cited below. The new legislature and executive must give renewed impetus to the transformation of the legal framework, the strengthening of institutions and capacity building of existing enforcement agencies as well as establishing new ones where necessary. Attention should be given to the fact that budgetary restraints and recommendations by international financial institutions should lead, as far as new employment in the administration is concerned, to these changes being achieved through restructuring of the civil service.

4.2. Internal market and trade

The coming accession to WTO entails additional trade liberalisation. Regarding the import of oil and oil derivatives, the former Yugoslav Republic of Macedonia continues to breach the Interim Agreement. Some reforms have been initiated in the fields of customs, competition and state aid, public procurement, intellectual, industrial and commercial property rights and standardisation. However, much remains to be done, especially as far as implementation is concerned. Further efforts must be made, given the demanding and long-term nature of the legislative approximation process.

4.2.1. Movement of goods

In the context of the coming accession of the country to the WTO, several laws were adopted. They concern industrial property, copyrights, standardisation, sanitary and phyto-sanitary measures, antidumping and protective measures, tariff valuation, rules of origin of goods, taxes, foreign currency as well as related matters. Customs tariffs must be adapted following accession, as well as some liberalisation measures in the field of trade in services without, however, abolishing protective measures especially in the agricultural and industrial sectors. In parallel, the completion by the former Yugoslav Republic of Macedonia of its obligations under the Stability Pact (see section 2.3.1) shall facilitate free trade in the region.

Following a Constitutional Court ruling in December, and a firm commitment reiterated by the Government, it is expected that the persistent application of different import duties for different importers of oil and oil derivatives, in breach of the Interim Agreement, (the so-called OKTA case) will be resolved soon. The immediate abolition of this differentiation was already promised at the July meeting of the Cooperation Council and reiterated by the new Government and should not be further delayed.

In the field of **standards**, substantial progress was called for in the 2002 Report in order for the country to approach the EC's quality levels. In order to fill the substantial legislative gap which characterised the sector until 2002, new laws governing the area of standards and certification have been enacted in mid-2002.

However, they are still not in application pending enactment of other pieces of primary and secondary legislation, or putting in place appropriate administrative structures. The legislative framework must be adopted to create the three new institutions – Institute for Standardisation, Office of Metrology and Institute of Accreditation – which must be rapidly put into place.

4.2.2. *Movement of persons, services and rights of establishment*

A change in the law on residence and movement of foreigners, adopted in June, has introduced a business visa of three years (with the possibility of extension for a further two years) to enable visits by foreigners who hold managerial, executive or specialised posts. The other change introduces a business visa of 60 days for foreigners who need to be present for negotiating and/or entering into service contracts on behalf of foreign trade companies.

Some progress can be reported on efforts required to align the legislative framework on **accounting and auditing** with that of the EC, as a new Company Law was adopted in July. It has not entered into force, however, and while it should incorporate the latest corporate governance practices, its real impact remains to be assessed. A new law on book-keeping was also adopted in July 2002.

The 2002 SAP Report stressed the major efforts needed to regulate the **insurance** sector, in particular as regards the supervision activities. Some progress has been made with the adoption of a Law on Insurance Supervision – based on the relevant Community directives – in April 2002. However, implementation of the law is hindered by the weakness of the Department for insurance supervision established in July according to the Law. Furthermore, secondary legislation is still needed to complement the new legislative framework.

With regard to **Personal data protection**, the adoption of the new Law on Data Protection (pending since 2000) should be adopted without further delay. One of the consequences of the persistent delays in adoption is the continuing absence of an independent supervisory authority, despite the existing provision under current legislation.

4.2.3. *Movement of capital*

Changes to the Law on Banking, Law on Bankruptcy, Law on Payment Operations Bureau, Law on Securities, Law on Take-over of the Shareholding Companies, Law on Payment Operations, Law on Excises, and Law on Income Tax have been adopted during the reporting period. Further approximation to EU legislation is needed to tackle efficiently the weaknesses of the sector underlined in 2002 (low degree of intermediation, high percentage of bad loans, lack of competitiveness and efficiency...). Some measures have been taken in order to control cash movement. In October, € 10,000 was set as the limit for cash to be brought in or taken out of the country. Non-residents are obliged to report any amounts higher than € 10,000 and when leaving the country they cannot take out a higher amount than reported. The same limits apply for cheques. The limit for taking out cash was further set down (€ 2000) in February.

4.2.4. Customs

Some progress has been achieved in the compatibility of tariff code with EU law and WTO rules. The harmonisation of the tariff nomenclature with the combined nomenclature has been adopted in December. Nevertheless, the necessary structural reforms to bring customs administration in line with those of the EC remain unchanged, be it customs management, adequate cross-border infrastructures or mechanisms to ensure proper revenue collection. In late 2002, the Macedonian Customs Administration carried out a review of its functioning and identified gaps between the minimum EU standards in each of the 13 sectors set out in the EU Customs Blueprints. A comprehensive modernisation effort is necessary in order to implement reforms aimed at upgrading the overall customs administration so that they can play their role of collection of taxes and of enforcement of all customs related legislation. Some progress is being made through the modernisation of the Customs Information System but organisational measures are also needed, such as the strengthening of internal controls in order to ensure better management and fight corruption which continues to be endemic in this sector.

Like the other countries in the region, the former Yugoslav Republic of Macedonia must ensure that its customs services can ensure proper application of preferential rules of origin. During 2002 the EU noted a significant overall increase in sugar imports from the countries of the Western Balkans. To ensure proper application of preferential arrangements for sugar declared as originating in western Balkans countries, the Commission published a notice to importers in June 2002 leading to precautionary measures within the Community (e.g. a deposit system and systematic import testing). This resulted in the discovery of an alleged fraud in August when traces of cane sugar were found in individual consignments declared as originating in Croatia and Serbia and Montenegro. Sugar imports from the former Yugoslav Republic of Macedonia were comparatively small. However, in view of the country's small production capacity and its growing imports of sugar, the attention of the authorities is required. More generally Customs authorities need to be in a position to manage the increasing number of preferential free trade agreements the former Yugoslav Republic of Macedonia has concluded. In this context, the former Yugoslav Republic of Macedonia is encouraged to use the EU customs blueprints as guidelines to improve administrative capacity in the field. Commission services will continue to monitor and to analyse the performance of the customs authorities throughout the region.

4.2.5. Competition and State aid

In view of its future obligations under the SAA, the former Yugoslav Republic of Macedonia has already taken some steps to gradually bring competition and state aid legislation in line with those of the EC. However, capacity building and training remain important conditions for establishing and enforcing proper competition rules. A Law amending the Law against limiting of competition was adopted on 24 April 2002 and prohibits contracts limiting competition, collusive contracts, and abusing

dominant position. Further amendments to this law will be needed to bring it into line with EU legislation. In addition, the Monopoly Registry, to be run by the Monopoly Authority, recording all approved contracts and issued licenses, still needs to be put in place. As regards state aids, no progress can be reported towards the development of a legislative framework and an administrative structure able to monitor and regulate state aids.

4.2.6. *Public procurement*

Even if aimed at transposing EC Directives, current legislation on Public Procurement would need further amendment to bring it fully in line with EC legislation. In addition, it is not appropriately implemented, the Public Procurement office still needs to be put in place and the independence of the Appellate Committee remains to be ensured. Much still needs to be done to implement effectively the existing provisions and current provisions should be strengthened.

4.2.7. *Intellectual, Industrial and Commercial Property Rights*

Concerning intellectual property, the decision taken in August 2002 to accede to the World Intellectual Property Organisation Agreement for Copy Rights, and to the Agreement for Intellectual Property of Performances and Phonograms is a positive step, to be followed up. Some progress can also be reported on the approximation of the country's legislative framework with that of the EC in the field of Industrial Property. A Law on Industrial Property revising existing legislation was adopted on 20 June 2002 but will not enter into force before July 2003. Secondary legislation is still needed and weaknesses in administrative and judicial capacities to enforce the regulatory framework persist. As regards action against piracy and counterfeiting, no specific progress can be reported and legislation on copyright still needs to be amended to fully transpose EC provisions.

4.3. Sectoral policies

4.3.1. *Industry and SMEs*

The Government has begun preparing a restructuring and conversion programme for its **steel industry** to meet the 1 June 2003 deadline in Protocol 2 of the Interim Agreement. Its implementation will be followed by a Contact Group involving the European Commission. The situation in the **textile industry** is improving slightly. It was in serious recession as a consequence of lost contracts with foreign partners during the 2001 security crisis. However an increase in exports has been registered since June 2002, which might indicate some improvement. As regards the development of **small and medium sized enterprises** (SMEs) the main obstacles hindering the operation and development of enterprises identified in last year's Report remain (weakness of the country's institutional capacity, lack of a complete and streamlined regulatory framework, severe difficulties of access to finance). A first step was achieved with the adoption of a strategy for SMEs in July 2002. On-going work on an action plan for SME promotion (including business environment support, business infrastructure support, regulatory environment and non financial services (training, entrepreneurial spirit) still needs to be finalised. Institutional strengthening and improvement of the regulatory framework should be the priority,

in parallel with increased measures to facilitate the funding of SMEs. In addition the adoption and implementation of the principles enshrined in the European Charter for SMEs is recommended, as it would further enhance the improvement of the business environment in line with good practices in EU Member States.

4.3.2. *Agriculture*

Current policies aim at promoting increases in the competitiveness of the agricultural industry through legislative reform, skill development, provision of subsidised loan capital for the modernisation of infrastructure and the improvement of product quality and land/enterprise productivity. The sector is, however, still characterised by small farms, a high level of land fragmentation, a low level of processing capacity and lack of investment in new technologies. There is, therefore, a need for substantial structural and institutional reforms, also to cope with dramatic demographic changes and competitive pressures from abroad, and to meet the challenges and exploit the opportunities offered by the market opening foreseen in the SAA and various other bilateral and multilateral agreements. In this regard, standards have been adopted and should enable the country to increase exports to the EU (an important dairy enterprise in Bitola received EU clearance for export in June 2002). Among the priorities, border inspection services and practices and veterinary legislation should be brought into line with EC standards. Statistics also need to be upgraded and effective co-ordination to guide assistance programmes needs to be developed.

4.3.3. *Environment*

As mentioned in the 2002 SAp Report, major efforts will be needed to progressively approximate the country's legislative system with the Community environmental acquis. A second Plan to take into account the country's efforts to come closer to EU environmental policies, and accompany the implementation of the SAA, and a comprehensive medium to long-term strategy are still lacking. Work on a methodology for devising a National Sustainable Development Strategy has started and some improvements in resource allocation have been made. However, enforcement of environmental legislation remains weak and requires further training of the judiciary and increased administrative capacity (the independent environmental agency and inspectorate have not been set up). Further restructuring to better identify and allocate responsibilities among all stakeholders involved in the area is needed. Regulations for an effective transfer of environmental management responsibilities to municipal governments under the Law of Local Self Government must be adopted and the process supported through skill development for municipal staff and appropriate resource allocation.

At international level, the former Yugoslav Republic of Macedonia has ratified the European Convention for the Protection of Vertebrate Animals used for Experimental and Other Scientific Purposes and The UN Convention to combat Desertification. Two bilateral Memoranda of Understanding on Cooperation on Environmental Issues were signed with Croatia and the state of Serbia and Montenegro.

4.3.4. *Infrastructure*

Limited but encouraging progress, in view of the considerable delays suffered after the crisis, can be reported in the improvement of **transport** connections with neighbouring countries and the modernisation of the main North/South communication routes. The countries whose territories are crossed by Corridor VIII signed a Memorandum of Understanding in September which should speed up the implementation of the several infrastructure projects foreseen for this important artery for South-East Europe. In the country, some upgraded sections of this route (namely the Skopje-Tetovo highway and the Tetovo bypass), have been inaugurated in 2002. Concerning Corridor X, works are in progress around Negotino.

The diversification of sources of **energy** as well as the restructuring and construction of energy infrastructure is still on the government agenda but no significant progress in the last months can be reported. Alternative energy resources are being investigated. The privatisation of the integrated monopoly, *Electric Power Company of Macedonia* (ESM) should be part of the efforts required to restructure the energy sector in order to prepare for the country's integration into common European practices and moves towards a progressively liberalised sector. Successful privatisation will require unbundling of ESM into separate generation, distribution and transition companies and the setting up of an appropriate regulatory environment.

In the **telecommunications** sector, no substantial progress can be reported on the effective regulation of the market as the regulatory framework still needs to be developed and the national regulatory authority provided with adequate resources, backed by efficient Court procedures. There has been good progress with modernising the infrastructure but the investment environment needs to be improved if Universal Service is to be achieved. The former Yugoslav Republic of Macedonia has committed to the objectives of the eSEE Agenda signed at ministerial level for the development of the Information Society and resources now need to be identified for effective implementation of these commitments.

4.4. **Cooperation in justice and home affairs**

Progress in the reforms of the Justice and Home Affairs sector is a pivotal issue for full stabilisation of the country and helping it to move closer to the EU. However, little progress can be reported in this sector for the last twelve months. Work has started to gradually improve border management but essential reforms remain still to be launched and implemented. Some progress has been made in strengthening the state's capacity to fight money laundering. In view of a worsening situation, much more would be needed however to allow the state to challenge efficiently the evils of organised crime, corruption, and drug trafficking.

4.4.1. *Visa, border control, asylum and migration*

The former Yugoslav Republic of Macedonia introduced a reciprocal visa regime for countries that have already introduced visa requirements for Macedonian citizens. Its negative list of countries for which visa is needed is not in line with EU legislation. The country made a noticeable move forward in facilitating relations with Kosovo

by abolishing visa requirements for Kosovo residents holding UNMIK travel documents and also accepting the car license-plates issued by UNMIK. An agreement between the Ministry of Interior and UNMIK was also reached on issuance of seasonal ID cards for Kosovo residents owning land near the frontier.

The former Yugoslav Republic of Macedonia is considering to abolish the system of delivering visas at the borders. This would be a positive change as it makes no sense in terms of effective pre-clearance and thus failed to meet European standards. Additional safeguards are still needed for the “tourist” visa sticker. Further dedicated training on visa matters for the consular staff should be developed and a central database could be considered to facilitate visa control.

On **asylum**, the adoption of the proper legislation should not be further delayed as it will help clarify the status of asylum seekers, refugees and “temporarily protected persons” (see 2.2.2). The capacity to process asylum applications will also have to be improved, and the independence of the second instance will have to be ensured. Integration mechanisms for recognised refugees will have to be established within the relevant ministries and authorities

Reform of **border management** is another area requiring priority action. The demilitarisation of border control (the Army is still responsible for green and blue borders while the police are responsible for border checkpoints) is a priority, through the development of the standards and capacity of the border police. An Integrated Border Management Strategy, to efficiently monitor cross-border flows, detect and deter illegal cross-border activities and establish professional border bodies (involving all agencies concerned, Police, Customs and health controls) must be further developed in line with European practices and standards, and introduced through a carefully designed Action Plan.

4.4.2. Money laundering

After the positive step taken with the creation of the Directorate Against Money Laundering in the Ministry of Finance, the full effectiveness of the Directorate has not yet been ensured as some of the envisaged departments still need to be equipped and made fully operational, in particular through appropriate training and specialisation. So far, only one case reported to the Directorate Against Money Laundering has been completed and transferred to the Ministry of Interior for further action. Co-operation with the Ministry of Interior, Customs Administration, Public Prosecution Office, National Bank is crucial to enable the Directorate to perform its duties. Work has started to allow the former Yugoslav Republic of Macedonia to join the Egmont Group, which should help the country to attain a higher standard. The capacity for meeting requests for mutual assistance must be strengthened.

4.4.3. Drugs

Drug trafficking and abuse has been worsening in the former Yugoslav Republic of Macedonia as, increasingly, the country is not only a transit but a consuming country (in particular marijuana and ecstasy). Those below 30 years of age are particularly endangered. Recommendations made in the 2002 SAp Report remain valid and should be part of a national plan against drugs. Further measures to ensure

proper coordination between law enforcement are needed. On the preventive side, the prevention schemes in the education system, health care system and the Agency for Youth and Sports function poorly.

4.4.4. *Fighting organised crime and terrorism*

Reports confirm that organised crime is increasingly challenging state authority and putting at risk both the stability and the development of society in the former Yugoslav Republic of Macedonia. Urgent action is needed to better fight organised crime in a comprehensive manner, both at strategic and operational levels. Some priorities have been identified at the London Conference on Organised Crime of 25 November 2002 and should be followed up properly. The former Yugoslav Republic of Macedonia pledged to develop national strategies for combating organised crime and corruption and must now demonstrate commitment in their implementation (fight against money laundering, measures against proliferation of small arms and light weapons, preventive measures, regional cooperation and mutual legal assistance). In the specific field of trafficking in human beings, reports suggest a worrying increase. The changes made in the criminal code to criminalise trafficking in human beings should be followed by prosecutions and the National Action Plan for Combating Illegal Trafficking in Humans and Illegal Migration adopted by the government on 5 February 2002 must be swiftly implemented.

Structural weaknesses in the means to combat efficiently organised crime have to be tackled. The use of special investigative techniques should be made possible as these are crucial for an efficient fight against corruption, financial crime and organised crime in general. Capacity building must be enhanced, also with a view to guaranteeing the effective flow of information and cooperation among law enforcement authorities and between law enforcement authorities and judicial institutions, and professional police intelligence structure must be developed. As regards the fight against terrorism, while committed to the efforts of the international community against international terrorism the former Yugoslav Republic of Macedonia is still constrained by the weaknesses underlined in the 2002 Report.

4.5. Priority areas needing attention in the next 12 months

- Remove quantitative restrictions (or measures with equivalent effects) on oil and oil derivatives in accordance with the Interim Agreement by Spring 2003.*
- Continue legislative and administrative reforms needed to facilitate the implementation of the SAA obligations when it has entered into force, in parallel

* Recommendations included in the 2002 SAP Report, basically not implemented

** Recommendations included in the 2002 SAP Report, partially implemented

with the implementation of the Ohrid Framework Agreement, and having in mind the need for equitable representation of different communities. A need for new employees has to be primarily met through reorganisation and redeployment from other administrative bodies in line with conditionality imposed by the IFIs for decreasing the total number of civil servants.

- Further develop administrative co-ordinating structures for all European integration issues including approximation of legislation (especially linking the approximation of legislation process with legal reform and codification and policy making and economic reform), and further develop appropriate management tools to support the overall process, such as glossaries, training programmes etc.**
- Increase staffing of the Units of Ministries and other administrative bodies dealing with European integration issues, in particular in those Ministries with immediate responsibility for the implementation of the SAA.*
- Apply the obligation of checking of compatibility of all new legislation with the 'acquis communautaire' (in particular through the mechanism existing in the government) and develop corresponding mechanisms in the Parliament.**
- Continue training courses for officials (Government, Assembly and local government) in European integration matters.
- Further prepare introduction of key EU legislation in the field of competition, intellectual property, standard and certification, public procurement, data protection (listed as "priority" in Art. 68.3 of the SAA) and implement the first stages. Ensure enforcement through the setting up of appropriate executive bodies charged to implement or monitor its implementation.**
- The authorities should further promote the development of small and medium enterprises, establishing a favourable environment for the growth of the private sector, entrepreneurship and the integration of the informal sector.**
- Upgrade the Customs Service performance, in line with the EU blueprints, and develop it also with a view to offering the necessary reassurances on the ability of customs to handle preferential trade regime.
- Finalise and implement a national strategy for integrated border management (border checks and border surveillance), based on institution building and provision of technical equipment, aiming in particular at reducing illegal migration flows and the various forms of trafficking and to facilitate trade.*
- Full alignment with EC visa list.
- Adopt a new asylum law including adoption of the secondary legislation, and improve capacity to process asylum applications, establish an independent second instance.*
- Strengthen the fight against organised crime, including by establishing comprehensive plans to prevent and fight against organised crime and

corruption, taking decisive actions to demonstrate that crime does not pay, strengthening co-operation between different law enforcement bodies, developing crime intelligence and reliable statistical data, increasing administration capacity.*

- Address the obstacles which forbid the use of any kind of special investigative techniques.
- Establish and ensure proper implementation of a national Plan against Drugs.
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Introduce legislation on the protection of personal data and set up an independent Agency charged with its enforcement.*

5. EC Financial Assistance

Between 1992 and 2002, the former Yugoslav Republic of Macedonia benefited from total European Community assistance of approximately € 610 million. During the year 2002, € 41.5 million of EC funds was allocated to the country under the CARDS programme, on the basis of the priorities set in the Country Strategy Paper for the former Yugoslav Republic of Macedonia for the period 2002-2006 and the Multi-annual Indicative Programme for the period 2002-2004, adopted by the European Commission in December 2001.

Assistance has focused on institutional reform and development in order to favour the gradual integration of the country into European structures while also taking into account the needs arising from the 2001 crisis.

As in 2001, the **2002 CARDS Programme** (€ 41.5 M) has been based on the principles and priorities of the SAP i.e. with the aim of helping the country prepare for full and effective implementation of the SAA. It also addresses some of the country's post-crisis needs such as de-mining operations and the development of inter-ethnic relations. The main focus of the 2002 programme was on the following sectors: Democracy and Rule of Law (inter-ethnic relations and support to civil society), Economic and Social Development (private and financial sector development, trade, local infrastructure development, social cohesion and education), Justice and Home Affairs (integrated border management, immigration and asylum, fight against crime) and Environment.

In June 2002 a total of € 3.6 million was re-allocated from the 2001 CARDS National Programme for housing reconstruction purposes. The funds will enable the reconstruction of some 200 heavily damaged houses in former conflict areas, in addition to the over 900 houses already previously reconstructed with EC funding.

* Recommendations included in the 2002 SAP Report, basically not implemented

The **CARDS Programme 2003** (€ 42.5 M), in the process of being adopted, will reflect the main priority sectors set out in the Multi-annual Indicative Programme and is to a large extent designed to ensure follow on activities to those of the 2002 programme.

In addition, the former Yugoslav Republic of Macedonia benefits from the CARDS Regional Programme. Besides this, the EC has continued to provide funding under specific budget lines in the fields of environment, Justice and Home Affairs, and the VI Framework Programme in Research under which the country can benefit on a case-by-case basis.

In December 2001, the Council approved the decision to provide up to € 18 million in grants for **macro-financial assistance**. This was in addition to the package of up to € 80 million (€ 30 million in grants and up to € 50 million in loans) that was approved in 1999, of which a first tranche of € 30 million (€ 20 million grant and € 10 million loan) had been released in December 2000. A second tranche of € 22 million (including € 10 million in grants) was disbursed in January 2002. The conditions for the disbursement of the remaining macro-financial assistance (€ 46 million) have been set out in a Supplemental Memorandum of Understanding (SMoU) between the European Community and the former Yugoslav Republic of Macedonia authorities, signed in September 2002. The third tranche (€ 10 million loan and € 10 million grant) will be released upon the approval by the IMF Board of a new arrangement with the former Yugoslav Republic of Macedonia authorities. The fourth and last tranche (up to € 18 million loan and up to € 8 million grant) will be released thereafter subject to the fulfilment of the economic policy conditions set in the SMoU, which focus on progress in the area of public administration reform, public administration management and fiscal reform, enterprise restructuring and private sector development, and financial sector reform.

EC **humanitarian assistance** (ECHO) in the former Yugoslav Republic of Macedonia during 2002 amounted to € 3 million. These interventions were focused on the alleviation of the consequences of the 2001 crisis and in particular on the basic humanitarian needs of internally displaced persons and vulnerable local populations. It also continued to implement the ongoing and programmed non-crisis-related activities such as water and sanitation interventions in remote rural areas throughout the country, assistance to the caseload of refugees from Kosovo (mainly Roma) remaining from the 1999 crisis, and food assistance to the most vulnerable social case families. Due to the overall improvement in the humanitarian situation in the country, ECHO is progressively phasing out its activities by March 2003.

As of end of December 2002, the **European Investment Bank** had supported projects in the former Yugoslav Republic of Macedonia for a total of € 207 million, of which € 98 million had already been disbursed. EIB projects are concentrated in the area of transport – in particular road construction – and small and medium enterprise financing.

Implementation of assistance has been taken over by the European Agency for Reconstruction whose mandate was extended to the former Yugoslav Republic of Macedonia with effect from 1 January 2002 for the management of emergency assistance provided in 2001, and from 1 March 2002 with respect to the implementation of past and future programmes/projects. The management of

CARDS funds allocated to the customs sector, to the TEMPUS programme, as well as those allocated through the Regional Programmes has remained centralised at Commission Headquarters. Centralised implementation also applies to any funds allocated through the EIDHR budget line.

A total of € 26.5 M (€ 13.7 M CARDS and € 12.8 M Rapid Reaction Mechanism) of exceptional Community assistance were provided in 2001 to support the country in its efforts to overcome the political and security crisis. The funds were devoted to housing reconstruction, reconstruction/rehabilitation of local infrastructure, assistance to families hosting Internally Displaced Persons and confidence building measures. Over 90% of the funds have been disbursed and virtually all funds (99.8%) have already been contracted thus ensuring a rapid and effective response to the needs arising from the crisis. In particular, the Emergency Assistance Programme has provided a major contribution to getting 95% of the Internally Displaced Persons to return to their pre-crisis dwellings.

In March 2002 the EAR took over a total of € 131 million of financial assistance committed under PHARE/CARDS annual programmes between 1997 and 2001. It has made good progress in implementing this backlog which is now steadily decreasing - out of the € 102 million in uncontracted funds more than a quarter has now been contracted.

The European Commission organised in March 2002, jointly with the World Bank, a Donors' Meeting in order to mobilise funds to help the country face the needs arising from the security crisis of 2001. A total of € 307 million was pledged by donors for macro-financial support, reconstruction efforts and assistance to the implementation of the Framework Agreement. A further € 271 million was also pledged for general economic development.

Donor co-ordination needs to be improved. The EC Delegation, with the technical assistance of the International Management Group, has been performing successfully the co-ordination of donors' activities with respect to the pledges for reconstruction purposes made at the Donors' Meeting. However, in general, donor co-ordination is not effective and needs to be strengthened. In particular, the government should develop a better capacity in this respect. The Sector for European Integration has continued to play a very active and effective role of policy development and inter-ministerial co-ordination. The creation, within the government secretariat, of a Unit for the Co-ordination of the Implementation of the Framework Agreement has also been a positive development in this direction.

6. Perception of the EU

The continued commitment of the EU and the support given to the peace process as well as its significant financial assistance, especially in relation to the post-conflict reconstruction, and the interest on the part of the population to be part of Europe, have all strengthened the EU's image.

The new Government has repeatedly expressed its determination that the former Yugoslav Republic of Macedonia's future lies in the EU and gave its programme a clear EU orientation by committing itself to develop the necessary conditions to implement the Framework Agreement and the Stabilisation and Association

Agreement. All major political parties have also demonstrated European orientation during their pre-election campaigns. Media provided extensive coverage of all EU related events, including the Vth Cooperation Council with the EU (July) and the visits of Commissioner Patten and HR Solana in July, December and January. Understandingly, the decision taken by the European Council in Copenhagen on the future enlargement of the EU has also made the headlines.

A research survey on EU awareness carried out by the EC Delegation in summer 2002 among general and specific target groups (public administration, political parties, academia, media and NGOs) showed a relatively high knowledge about the EU, relations with the EU as well as EU assistance, and a substantial interest both among the general and the more expert public about the EU and the Stabilisation and Association Agreement. Four out of five respondents expressed a positive opinion about the goals and activities of the EU and also interest in additional information on the structure and functioning of the EU institutions. However, there is also a considerable gap in the understanding of the European integration process and the Stabilisation and Association process. The unreserved desire for the SAA to move faster could be a decisive factor for mobilising civil society in favour of the necessary political and economic reforms to allow the country to reach European standards. Respondents expect this process to bring economic development, peace and a safer future as well as more personal expectations (improvement of the living standard, bigger employment opportunities). A large number of respondents expressed their wish to find more information in the media about the SAp.

The Government and media have a major role to play in providing information on the EU and the Stabilisation and Association process. No efforts should be spared to provide the necessary training to civil servants, journalists, in the Education system, to explain the content and importance of the SAp to the general public. In this context, the Government initiative to organise an open debate with local NGOs and media representatives on its information strategy on the country's integration in the EU can be praised.