Brussels, 17.4.2018
SWD(2018) 134 final

COMMISSION STAFF WORKING DOCUMENT

ECONOMIC REFORM PROGRAMME

OF

THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA (2018-2020)

COMMISSION ASSESSMENT

EN EN

Contents

1. EXECUTIVE SUMMARY 2

2. ECONOMIC OUTLOOK AND RISKS 4

3. PUBLIC FINANCE 7

4. STRUCTURAL REFORMS 10

ANNEX 1: IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2017 18

ANNEX 2: COMPLIANCE WITH PROGRAMME REQUIREMENTS 22

1. EXECUTIVE SUMMARY

The economy of the former Yugoslav Republic of Macedonia was stagnant in 2017, but the outlook is now positive. The country was affected by prolonged political uncertainty in the first half of the year, which caused private and public investment to drop sharply. Together with low public consumption, this offset increases in household spending and exports. Domestic uncertainty is now receding and the external economic environment is improving. As a result, the government's Economic Reform Programme (ERP) expects a moderate acceleration of growth from 3.2% in 2018 to 4.0% in 2020, mainly driven by exports, private consumption and investment. Risks are equally distributed on both sides. On the one hand, import growth might be stronger than expected, in particular in case of higher investment. On the other hand, given the recent solid performance of the country's export industry, export growth could also be higher than projected, which would translate into a stronger GDP growth profile. The possibility of a renewed rise in political tensions and delayed implementation of important policy measures poses a further risk on the downside.

Fiscal adjustment plans are not very ambitious, in particular considering the country's strengthening recovery. The ERP expects a moderate decline in the general government deficit, to 2.3% of GDP in 2020. This is not sufficient to stabilise the public debt ratio. The main contribution to the fiscal adjustment is projected to come from subdued public consumption, while revenues as a share of GDP are expected to drop, resulting from moderate revenue growth, which prevents a faster fiscal consolidation . The programme does not provide much quantitative detail on planned revenue and expenditure measures, nor on their fiscal impact. In particular, the relatively low levels of revenue deserved a more detailed presentation.

The main challenges in these respects include the following:

- **Improving fiscal sustainability, increasing employment, and developing the domestic private sector remain key challenges for the country.** Public debt has more than doubled since 2008, mainly as a result of sustained primary deficits. Structural problems in the labour market, such as low participation rates, and a mismatch between the skills available and the skills in demand, restrict the country's growth potential. The development of the domestic private sector is hindered by a lack of legal certainty for companies. A significant brain drain is one of the consequences of poor job prospects for young people. Sustained efforts are needed to address the following issues.
- **Stabilising and reducing the country's debt ratio would require more ambitious fiscal consolidation, based on concrete measures**. The quality and efficiency of public spending could be improved by tackling the low efficiency of public administration, the poor targeting of social transfers, and insufficient capital expenditure. This would also improve economic growth. The introduction of fiscal rules and a fiscal oversight body would help strengthen the budgetary framework.
- **The business environment has improved but doing business in the country remains costly.** Challenges include frequent legal changes to the regulatory framework, a lack of systematic, efficient and transparent law enforcement including in inspections and commercial dispute settlement, and many para-fiscal charges[1] at

[1] taxes collected for a specific purpose by bodies that are not the official national tax agency

different administrative levels. These obstacles are also clearly put forward in the ERP diagnostic but they are not addressed in any measures.

- **The size of the informal sector continues to hamper private sector development**. The informal economy creates unfair competition from unregistered companies. Undeclared revenues and work also harm public revenue collection and workers' rights. The ERP does recognise the informal economy as an obstacle to growth, but does not include any measure to address this problem. Overall, the programme is weak in addressing the underlying obstacles to private sector development and competitiveness.
- **The low quality of the education system as a whole is a fundamental impediment to more inclusive economic growth in the country.** Educational reforms in the past led to improved access to education; however, the effect on the quality of education and the skills of the graduates was weak. The poor results of the country's first ever Programme for International Student Assessment (PISA) test participation outline the need for urgent quality reforms. The coverage of active labour market measures in particular for low-skilled unemployed needs to be stepped up. There is a need to ensure a better targeting of social benefits to persons at social risk of poverty.

There has been partial implementation of the policy guidance jointly adopted in the Economic and Financial Dialogue of 23 May 2017. The government adopted a medium-term fiscal framework envisaging a fiscal consolidation by 0.7% of GDP, which is not very ambitious in view of the country's expected favourable position in the business cycle. On a positive note, the new government improved fiscal transparency by swiftly publishing public sector data, such as revenue and spending performance, but also available records of public sector payment arrears. A significant step was taken with the adoption of a credible public finance management (PFM) reform programme. The use of the urgency procedure to pass legislation has been reduced and systematic stakeholder consultation through the use of the National Electronic Registry of Regulations (ENER) has improved. Activation measures for the unemployed have been strengthened, but measures targeting low-skilled or long-term unemployed are still scarce.

Overall, the ERP addresses many of the reform priorities identified by the European Commission. However, important points are missing and there is room for more focus and improved implementation. The ERP contains plans to improve the sustainability of public finances by reducing public sector deficit and debt levels. The adoption of a public finance management (PFM) strategy and plans to introduce fiscal rules are an important step in this drive for sustainable public finances.finances In addition, significant measures have been taken to improve the transparency of public finances. The planned structural reform measures do not all adequately address core needs for regulatory reform. The ERP contains a misplaced focus on subsidy disbursement to the private sector. Instead, the focus should be on more fundamental policy reforms that would alter market conditions. Major challenges such as the informal economy, business environment obstacles and basic education (pre-primary to secondary education) are not properly addressed.

2. ECONOMIC OUTLOOK AND RISKS

The programme's economic scenario expects a moderate acceleration of output growth, based on a continued benign international environment, a solid performance of real disposable income and an improving business confidence leading to a recovery in investment. As a result, ouput growth is expected to increase from 3.2% in 2018 to 4.0% in 2020, bringing average growth to 3.6% in this period. In particular in 2019 and 2020, expected output growth is above the country's annual growth potential of slightly more than 3%. Exports are forecast to increase by around 8% during 2018-20. This is in line with the country's recent export performance, as it benefits from an inflow of export-oriented investment. Private consumption is expected to be sustained by greater disposable income, resulting from low inflation and solid growth in wages and employment. Gross investments are projected to increase on average by 4.4 % annually, which appears to be a conservative estimate. Imports are also expected to increase, reflecting strengthening domestic demand. However, the overall effect of stronger trade flows on growth is forecast to remain largely neutral.

The programme presents two alternative macroeconomic scenarios for 2018-2020 based on what it views as the main risks to growth. The first scenario presumes lower-than-expected growth in the main trade partner economies. This would lead to weaker external demand, lower exports but also weaker industrial production and lower investment. In this scenario, output growth is projected to be lower by 0.8pp on average in each of the three programme years. The second alternative scenario assumes delays in investment in infrastructure and equipment. This would also translate into weaker import growth. As a result, annual output growth would be some 0.4 percentage points lower than in the baseline scenario. The programme also provides estimates of the impact of those alternative scenarios on the labour market, on inflation and on public finances.

Table 1:

Macroeconomic developments and forecasts

	2016		2017		2018		2019		2020	
	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**
Real GDP (% change)	2.9	**2.9**	1.7	**1.6**	2.7	**3.2**	3.2	**3.5**	n.a.	**4.0**
Contributions:										
- Final domestic demand	6.5	**6.5**	2.2	**1.2**	3.1	**3.2**	3.3	**3.6**	n.a.	**3.8**
- Change in inventories	1.0	**n.a.**	-1.2	**n.a.**	-0.3	**n.a.**	0.1	**n.a.**	n.a.	**n.a.**
- External balance of goods and services	-3.6	**-3.6**	0.8	**0.5**	0.0	**0.0**	-0.2	**-0.1**	n.a.	**0.2**
Employment (% change)	2.5	**2.5**	2.2	**2.3**	2.2	**1.9**	2.1	**2.1**	n.a.	**2.2**
Unemployment rate (%)	23.7	**23.7**	22.2	**22.4**	21.4	**21.5**	21.0	**20.5**	n.a.	**19.5**
GDP deflator (% change)	4.1	**4.1**	1.4	**3.6**	1.9	**2.0**	2.3	**2.3**	n.a.	**2.3**
CPI inflation (%)	-0.2	**-0.2**	1.2	**1.4**	2.0	**2.0**	2.4	**2.0**	n.a.	**2.0**
Current account balance (% of GDP)	-2.7	**-2.7**	-2.5	**-2.0**	-2.4	**-1.8**	-2.3	**-1.8**	n.a.	**-1.9**
General government balance (% of GDP)	-2.7	**-2.7**	-2.9	**-2.9**	-3.0	**-2.7**	-3.0	**-2.5**	n.a.	**-2.3**
Government gross debt (% of GDP)	39.5	**39.5**	39.7	**39.2**	40.4	**42.4**	40.9	**44.6**	n.a.	**42.5**

Sources: Economic Reform Programme (ERP) 2018, Commission 2017 Autumn Forecast (COM)

The ERP's growth projections and the risks it identifies are broadly plausible. The programme's assumptions on the international environment and on possible trajectories of key domestic demand components are in line with the economy's historic growth patterns. Yet, household spending may surprise by being greater than expected, as disposable incomes are likely to benefit from robust increases in employment and real wages. Furthermore, the macroeconomic framework outlined in the ERP has a rather conservative estimate for the expected increase in investment (it forecasts an annual increase of 4.4% on average). It would

have been useful for the ERP to also prepare a higher growth scenario, simulating stronger investment growth and analysing the effect this would have on the country's external balances. Possible feedback loops of planned structural reforms on the country's economic performance could have been spelled out more explicitly in the ERP, as well as risks to the implementation of planned reforms stemming from the fragile political situation.

Inflation projections are plausible, although for 2019 and 2020 they are rather low. As a small open economy, the country's price level is mostly influenced by international price developments. In this context the expected inflation levels are therefore in line with the programme's assumptions on the international environment, which expect the oil price to be largely stable when denominated in the national currency. However, given that the programme expects output growth in 2019 and 2020 to be above potential, greater inflationary pressures might appear at the end of the programme period.

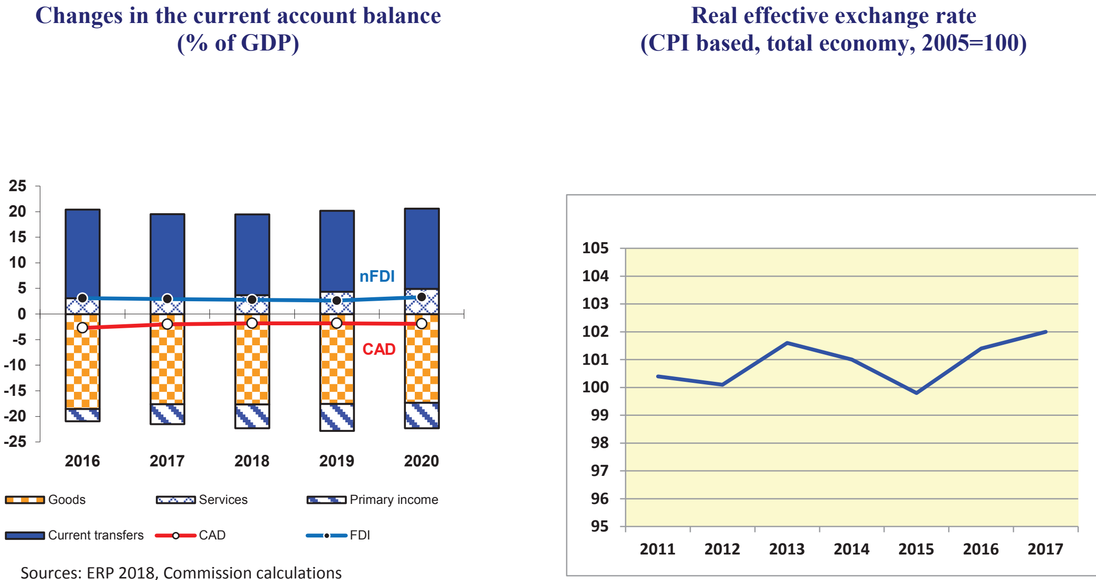
The country's external position appears sustainable. The current account deficit dropped from 3.1% of GDP in 2016 to 1.3% of estimated GDP in 2017. This was mainly due to a stronger surplus in the secondary account. This deficit was more than covered by foreign direct investment inflows, which, however, fell to 2.2% of GDP, compared to 3.1% in 2016. The government expects the current account deficit to remain at a relatively low level in 2018-2020, at 1.8%-1.9% of GDP. This is because the expected improvement in export performance is projected to counterbalance increased imports that result from stronger domestic demand. However, if investment increases more than expected, this relatively benign scenario could turn out to be too optimistic. Overall, the financing of the country's external position continues to rely on substantial remittances from people working outside the country. In the past, these remittances have proved to be very stable, in particular in times of crisis. During recent years, the country has also attracted 2%-3% of GDP in annual foreign direct investment (FDI).

Although foreign companies have become significant drivers for exports, spillovers to the domestic economy remain modest. Foreign companies established in the country accounted for more than 50% of total exports in 2017, up from 16% in 2011. They are the main drivers of export diversification and thus help increase the economy’s resilience to external shocks. Since 2012, the share of higher-value added products in the country's export structure has increased gradually as foreign direct investment started to concentrate in the chemicals, machinery and transport equipment sectors. These sectors provided about half of total exports in 2017 or almost double their share of 2011. The weight of traditional sectors, such as iron, steel and clothing, declined accordingly. However, export activity remains heavily concentrated among the top 20 exporters, about three quarters of them foreign-owned, accounting for some 60 % of total exports of foreign companies. In spite of programmes supporting the building of backward linkages between local firms and foreign companies, these relationships are mainly restricted to low-skilled service supply, rather than to technical cooperation. FDI's value-added for exports amounts to some 10% only, as these companies import most of their raw materials. Therefore the economy is not making the most of the opportunity these companies offer for productivity-raising upgrading of domestic industrial production, which is required to help the economy achieve a self-sustaining structural change towards higher-value added production.

External debt is projected to slightly increase further in 2018-2019, but to drop in 2020. In 2017, gross external debt declined by about 0.6 pps, reaching 73.6 % of GDP at the end of December 2017. The decline in public external debt was larger than the increase in private debt, which consisted mainly in a rise in intercompany loans. Over the programme period, the authorities expect an increase in external debt by some 4.5 percentage points, mainly due to higher public borrowing, which, however, will drop in 2020, due to a significant repayment due during that year. The maturity structure of external debt deteriorated slightly during the

last year, with the share of short-term debt increasing from 16.3% of total at the end of 2016 to 17.7% by end-2017. The ERP contains an annex with a sustainability analysis of external debt. This analysis is more elaborate than in past programmes and projects only a slight decline in the ratio of external debt to GDP in 2020. The share of more flexible kinds of debt (trade credits and intercompany loans) is projected to rise over the programme horizon, making external debt less vulnerable to shocks to the primary current account and to GDP growth.

Graph 1: **External competitiveness and the current account**



The banking sector has remained stable, despite a marked slowdown in financial intermediation in 2016 and 2017. Although loan and deposit growth slowed down markedly during the period of high political uncertainty, the sector's solvency, liquidity and profitability indicators remained robust. Concentration remains high and unchanged compared to previous years, with some 58% of assets held by the three biggest banks. There are 15 banks in total, most of which are foreign-owned. Liquidity was abundant, partly reflecting banks' sluggish lending and their diminished appetite for government securities. The capital adequacy ratio increased in 2017 and stood at almost double the regulatory minimum of 8% by the end of the year. Banks' profitability continued to increase, yet more slowly than in preceding years. Basel III capital standards came into force in March 2017. The quality of banks' assets improved slightly in the year to December 2017: the share of non-performing loans (NPL) in total loans to the non-financial sector amounted to 6.3% (0.3pps lower than one year earlier). However, not including the mandatory write-offs since 2016, the NPL share remains at about 10%. The central bank took further measures in 2017 to resolve the NPL problem, preparing a draft strategy for NPL resolution. However, the high share of NPL on banks' balance sheets remains an obstacle to credit extension and to the transmission of monetary policy. Further measures are necessary to address this problem.

Table 2:

Financial sector indicators*

	2012	2013	2014	2015	2016	2017
Total assets of the banking system, mEUR	5.738	6.008	6.509	6.889	7.230	7.508
Credit growth to private sector, annual change in %	7,3	4,3	8,4	9,1	4,6	3,1
Deposit growth, annual change in %	7,2	4,8	8,2	7,9	4,3	6,0
Loan- to-deposit ratio	88,1	88,8	88,1	90,6	87,0	87,7
Financial soundness indicators						
- non-performing loans (in % of total loans to the non-financial sector)	10,5	11,5	11,3	10,8	6.6**	6.3**
- regulatory capital to risk weighted assets	17,1	16,8	15,7	15,5	15,2	15,7
- liquid to total assets	32,4	31,2	29,8	28,2	28,9	27,1
- return on equity	3,8	5,7	7,4	10,4	13,6	13,5
- foreign-currency denominated loans (in % of total loans)	56,6	54,0	50,7	47,7	44,9	42,5

Sources: National Central Bank, Macrobond
**at end-year*
***including the impact of write-offs*

3. PUBLIC FINANCE

Public spending remained within the deficit targets. In July 2017, the new government adopted a supplementary budget, taking into account lower than expected nominal GDP growth, while maintaining the initial deficit target of 2.9% of GDP. The supplementary budget projected a revenue shortfall of some 1.5% compared to the initial draft budget and reduced some "non-productive" discretionary spending, such as advertising and business trips, while transfers to the pension system and other social transfers were increased. The supplementary budget also introduced subsidies for wages and employment. The government used some funds to reduce payment arrears. At 2.7% of GDP, the 2017 general government deficit remained below the 2.9% target of the supplementary budget. Both, total revenues and total spending remained 3% below target, in particular capital spending was some 16% lower than planned, at some 3.3% of GDP.

The 2018 revenue and expenditure targets seem feasible, but they are not very ambitious. On 22 December 2017, Parliament adopted the budget for 2018, envisaging a deficit of 2.7% of GDP, while expecting GDP growth of 3.2% and an increase in inflation by 2%. This deficit target is at the same level as the realised preliminary budget deficit in 2017 of 2.7% of GDP, although the underlying growth assumption is significantly more favourable. On the revenue side, the government intends to increase excise taxes on diesel fuel, but otherwise does not envisage any major changes to the tax regime. On the expenditure side, the government announced additional spending for wage and employment subsidies, but also financial incentives for successful enterprises. However, the overall amount of those discretionary support schemes is limited and, according to government estimates, will affect the budget by about 0.3%-0.5% of GDP. On capital spending, an increase of almost 1.3pps, in terms of GDP, is planned in 2018, compared to the actual outcome in 2017 (3.2% of GDP). The ERP would have benefited from an explanation of how the government intends to meet these targets in the light of significantly revised growth assumptions.

Over the medium term, the programme envisages a very moderate improvement in the country's fiscal position. The budget deficit is expected to drop to 2.3% in 2020, and the debt ratio will decline slightly only in the last year of the programme period. In the absence of concrete revenue or expenditure measures, these plans seem to rely primarily on economic growth. This approach exposes the fiscal framework to the risk of an underperforming

economy, as experienced in previous years. Because of its high share of euro-denominated public debt, the country is also exposed to exchange rate risk. However, the country's exchange rate vis-a-vis the euro has remained remarkably stable so far. The programme also calculates cyclically-adjusted deficit ratios, based on potential growth of 3%. This implies for 2019 and 2020 a positive output gap, and actually leads to an increase in the structural deficit in those two years, reaching 3% of GDP in 2020, compared to 2.6% of GDP in 2018. Given the increasing ratio of debt to GDP, and rising debt-financing costs, the government should use the opportunity of above potential growth to proceed more forcefully towards lowering budget deficits faster than currently envisaged. This requires concrete consolidation measures, in the absence of which even the modest deficit reduction currently envisaged may be too optimistic.

The government's plans to raise the efficiency of revenue collection and of spending seem to be progressing slowly. Tax rates are low and the structure of expenditure is inflexible. Given this situation, the government has declared in the 2018 ERP its intention to underpin its fiscal consolidation plans by measures increasing the efficiency of social and capital spending and by improving tax collection and administration. Social assistance programmes remain fragmented and the measures announced by the government to streamline these payments are still in the initial phase. General government capital expenditure amounted to less than 4 % of GDP on average between 2012 and 2017, a relatively modest amount among peer countries.[2] To raise its efficiency, public capital spending needs better prioritatisation from the outset, based on multi-year projections of all involved costs, including costs for maintenance of transport infrastructure projects, as well as ongoing monitoring and performance evaluation.

Table 3:

Composition of the budgetary adjustment (% of GDP, general government)

	2016	2017	2018	2019	2020	Change: 2017-20
Revenues	30,3	31,3	31,1	30,7	30,5	-0,8
- Taxes and social security contributions	26,4	26,7	26,9	26,8	26,6	-0,1
- Other (residual)	3,9	4,6	4,2	3,9	3,9	-0,7
Expenditure	33,0	34,2	33,8	33,3	32,8	-1,4
- Primary expenditure	31,8	32,9	32,5	31,8	31,0	-1,9
of which:						
Gross fixed capital formation	3,8	4,6	4,5	4,5	4,7	0,1
Consumption	10,6	10,6	10,3	9,7	9,1	-1,5
Transfers & subsidies	17,3	17,7	17,7	17,5	17,2	-0,5
Other (residual)	0,1	0,0	0,0	0,1	0,0	0,0
- Interest payments	1,2	1,3	1,3	1,5	1,8	0,5
Budget balance	-2,7	-2,9	-2,7	-2,5	-2,3	0,6
- Cyclically adjusted	-2,7	-2,6	-2,6	-2,7	-3,0	-0,4
Primary balance	-1,5	-1,6	-1,4	-1,0	-0,5	1,1
Gross debt level	39,5	39,2	42,4	44,6	42,5	3,3

Source: Economic Reform Programme (ERP) 2018.

[2] This figure does, however, not include public capital spending by the Public Enterprise for State Roads (PESR), which was moved off-budget in 2013.

Sizeable refinancing needs lie ahead. The government expects the level of public debt guarantees to decline after 2019, as the bulk of public construction projects will have been finished by then. Repayments of sizeable external commercial loans are due to commence in 2020, followed by Eurobonds maturing in 2021 and 2023, respectively. These will require substantial refinancing, notwithstanding the government's abundant deposits at the central bank. Annual gross financing needs are estimated at about 14% of GDP on average between 2017 and 2020, rising to about 17 % in 2021 as the third Eurobond (500 million) matures. Over one fifth of total financing needs are accounted for by external debt repayments. The government plans to finance the budget deficit and maturing debt repayments by a combination of external sources (international financial institutions, commercial banks, Eurobonds) and domestic sources.

The structure of government debt has improved. To reduce risks inherent in a build-up of debt, the government has improved the debt structure in recent years, by lengthening maturities in the domestic bond portfolio and increasing the share of fixed interest rate debt, which accounts for about three quarters of total government debt. Borrowers do not hedge against foreign currency risks, mainly due to a lack of suitable instruments in the domestic financial markets. The government successfully lengthened the maturity structure of its domestic debt portfolio by issuing longer-term bonds. In the past year, there was a shift in the profile of bondholders away from commercial banks towards institutional investors, in particular pension funds and life insurance companies, reflecting the increasing weight of the mandatory second pension pillar, as well as towards foreign investors.

Box: Debt dynamics

Table 4:

Composition of changes in the debt ratio (% of GDP)

	2016	2017	2018	2019	2020
Gross debt ratio [1]	**39.5**	**39.2**	**42.4**	**44.6**	**42.5**
Change in the ratio	1.5	-0.4	3.3	2.1	-2.1
Contributions [2]:					
1. Primary balance	**1.5**	**1.6**	**1.4**	**1.0**	**0.5**
2. "Snow-ball" effect	**-1.3**	**-0.7**	**-0.6**	**-0.8**	**-0.8**
Of which:					
Interest expenditure	1.2	1.3	1.3	1.5	1.8
Growth effect	-1.0	-0.6	-1.2	-1.4	-1.7
Inflation effect	-1.4	-1.4	-0.8	-0.9	-1.0
3. Stock-flow	**1.3**	**-1.3**	**2.5**	**1.9**	**-1.7**

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual data.

Source: Economic Reform Programme (ERP) 2018, Commission calculations

General government debt is expected to increase significantly in 2018 and 2019, mainly as a result of planned infrastructure investment. In 2020, a major debt repayment will be the main driver of a renewed annual decline in the debt-to-GDP ratio (-2.1pps). Without this one-off effect, the debt ratio would drop by 0.4pps only, mainly due to nominal growth, which will reduce the debt ratio by 2.7 pps compared to the preceding year. The debt-increasing impact of the primary deficit would diminish over time by 1 percentage point. Real growth and inflation would, to an increasing extent, moderate the rise in debt. However, these effects are partially offset by the high and rising cost of debt financing. Interest expenditure is likely to add some 0.5pps of GDP to the debt ratio by 2020, compared to 2017.

The transparency of public finances has increased considerably, but the fiscal framework needs to be further developed. The government has enhanced the quality and availabilily of fiscal data in the past year. It has published a list of unpaid public sector liabilities, and is working on a clearance strategy. It has also put on its website a citizen's budget for 2017 and 2018. In order to support fiscal consolidation and discipline, budget planning and execution need to be improved, in particular by putting the recently developed medium-term expenditure framework in operation, and by swift adoption of fiscal rules.

4. STRUCTURAL REFORMS

Despite the success in improving certain legal and regulatory aspects of doing business, the business environment continues to be problematic. This constitutes one of the main structural bottlenecks to competitiveness and growth. The regulatory framework is not transparent and changes frequently. Inspections are a considerable burden to businesses as their purpose is often unknown and fines are applied inconsistently or unfairly. There is no systematic, efficient and transparent process for law enforcement or commercial dispute settlement. Companies complain that parafiscal charges are often levied without a clear rationale. The informal sector is sizeable, and estimated to account for around 17% of GDP. This poses a serious challenge to private sector competition, trust and worker's rights, and also deprives government of considerable revenues. Significant improvements were made in 2017 to the public financial management framework. It is now critical for this framework to be fully and effectively implemented. The measure to improve the VET sector is welcome but the whole education system should be modernised to match the needs of the labour market. The government improved the coverage and effectiveness of active labour market policies (ALMP) with the launch of the Youth Guarantee and the greater focus on young people not in education, employment or training (NEET). The global diagnostic is overall accurate and has been strengthened in this year's ERP, while the area diagnostics could be made more precise to discuss underlying causes.

Out of a total of 19 measures, 11 are new measures and 8 are rolled over, implying considerable adjustments. Most of the dropped measures were justifiably excluded following the Commission's assessment of their relevance for competitiveness and long-term growth in 2017. However, this is not the case for all the excluded measures. Moreover, in several instances there is no clear linkage between the diagnostics and the proposed measures, or to what extent measures have been selected on the basis of an evidence-based appraisal system. The agriculture and industry measures receive by far the highest budget allocations, along with the ALMPs and the Youth Guarantee. The new support measures for industry, included in the government's Plan for Economic Growth, consist of subsidy schemes for private companies and do not tackle underlying structural obstacles to industrial development. In addition, they raise concerns on equal treatment of companies; implementation monitoring; compliance with EU state aid rules; and fiscal sustainability, The measures focus insufficiently on improving the business environment and there is no policy initiative to directly address the informal economy. In addition to the reinforcement of the labour inspectorate, a set of facilitating measures could be set up to foster the transition towards an economy with lower labour informality.

Public finance management

Public finance management (PFM) has long been problematic, especially in medium-term budget planning, public procurement management, fiscal transparency, and assessing the budget impact of policy proposals. However, the PFM framework has now improved. The ERP diagnostic identifies or refers to these shortcomings, and also notes in particular the lack of public procurement harmonisation with the EU *acquis*. However, the government has made clear progress in this area in the past year, such as improving the coverage and quality of fiscal data, including on public sector arrears. A comprehensive PFM reform programme was adopted at the end of 2017. This programme now needs to be swiftly and fully implemented.

The two new measures envisage the harmonisation of the public procurement legal framework with the EU *acquis* and the improvement of internal financial control. The public procurement measure is likely to play an important role in better use of public funds and improve business conditions by increasing transparency, legal certainty and fair

competition. However, there is no discussion of the specific impact on private sector competitiveness, such as a possible reduction in corruption and informality. The internal financial control measure is not directly linked to competitiveness, but rather to public finances and this policy belongs more in section 3 of the ERP. There is little or no discussion of implementation risks, such as inter-institutional coordination and developing the capacity of the Public Procurement Bureau.

Energy and transport market reform

The economy is characterised by high energy intensity, inefficiency in the ageing energy production system, and in inefficiency of energy consumption. The transport market is heavily concentrated on road transport only. There has been a significant lack of progress in regulatory reform, market liberalisation and inadequate regional connectivity in both energy and transport markets. This poses a problem, as does the poor implementation of Energy Community commitments, notably on the Sustainability Charter. The ERP diagnostic acknowledges these shortcomings. The transport market diagnostic notes the dominant position of road transport although it is not explicitly described as a key constraint. The analysis would have benefitted from a discussion of the significant financial and environmental side-effects of this dominance. The economy requires alternative transport modes, notably rail transport. The programme refers to an upcoming national transport strategy plan which still has to be finalised and adopted. It also notes a project to liberalise rail transport, but makes no reference to the Trans-European Network for Transport (TEN-T) framework coordinated by the South East Europe Transport Observatory (SEETO).

The two new measures on energy correctly focus on regulatory reform of the energy market. Only one of the 2017-2019 ERP infrastructure-building measures was included in the 2018-2020 ERP in accordance with the Commission assessment recommendations and guidance note. The other measures were replaced by two measures on regulatory reform to increase the competitiveness of the electricity market. The measures are relevant as they at least partly tackle key constraints and could help increase security of energy supply by starting to address the country's problems with its ageing lignite power generation plants and unstable energy production, and dependence on imported Russian gas. Addressing these issues is part of the obligations under the Third Energy Package, the Renewable Energy Sources Directive and the Energy Efficiency Directive.

The adoption of a new energy law, which aims to set up a more liquid and organized electricity market, will allow for more competition on the energy market and will stimulate cross-border regional energy market integration and connectivity. As this region consists mostly of small unconnected markets, integration and connectivity is particularly important. One problem not discussed in the ERP is that the legal basis for the Energy Regulatory Commission has not been adapted to the Third Energy Package. It is also important to urgently transpose the EU *acquis* to ensure that the energy regulator can operate effectively. The ERP does not specifically discuss price deregulation, an important issue as prices are likely to increase to more correctly reflect costs. The increased burden on low-income households will require targeted support.

The new measure on renewable energy sources (RES) and energy efficiency will help diversify energy generation and contribute to energy supply security, with positive effects on the economy. This measure consists of both regulatory aspects (incl. adoption of the law on energy efficiency) and plant capacity building. It would be further strengthened if the country implemented additional regulatory reforms to reduce environmentally harmful subsidies or increase green taxes. It remains unclear whether the energy efficiency activities being implemented will only benefit public buildings. If so, their impact on competitiveness

will be limited. At the same time, it must be underlined that energy efficiency and the use of renewable energy cannot be achieved without full compliance with the relevant EU *acquis*.

Implementation of the measure to construct a joint railway border station with Serbia is underway. The description of the measure refers to joint border procedures on a 'one-stop-shop' principle. However, there is no discussion of specific plans to set up these procedures, which would certainly make the reform more effective. The measure is part of the railway Corridor X rehabilitation project and identified within the connectivity reform measures (CRM), although full implementation of the measures identified in the latter is not referred to in the ERP. The measure seems relevant to increase competitiveness in particular by facilitating cross-border freight traffic. The ERP also indicates that the new crossing will encourage more train operators to operate at the crossing, but does not explain how. In addition, the measure relies on external funding for construction but does not provide a budget for maintenance investment.

Sectoral development

Agricultural sector development

The relatively large agricultural sector consists of highly fragmented private-sector and state-owned land parcels, with low productivity and competitiveness and poor irrigation infrastructure. Overall, the sector accounts for 10% of GDP and 18% of employment in 2015 but in some regions these shares are considerably higher. In the diagnostic, the ERP emphasises the excessive fragmentation in agricultural land. Private farms operate mostly on subsistence level and they are too small to take advantage of economies of scale or invest in new technologies. At the same time, within the large share of state-owned land most state farms do not function well, or at all. The ERP underlines how climate change could adversely impact the sector, especially through increasing water deficits. Economic cooperation between farmers and the development of agro value-chains are still in its early stages. Moreover, migration from rural areas continues and a significant part of the land is abandoned.

As stated already in last year's assessment, the three measures are appropriate and address main structural constraints facing the sector. These include land fragmentation, increasing shortages of irrigation water and the lack of modern technology and tools. But further regulatory reform is needed. The three measures complement each other in that coordinated implementation would strengthen their effectiveness. However, there have been problems with implementation in all three measures, and this lessens their effectiveness in removing structural constraints to growth. Also, the relatively high levels of untargeted agricultural subsidies further reduce incentives for structural adjustment in the sector.

The measure to improve irrigation systems is based on a clear diagnostic and assessment of future requirements. These requirements include those arising from climate change and the growing need for additional irrigation, water management and flood protection structures and the rehabilitation of existing infrastructure due to poor maintenance. The ERP sets out timelines and a general impact estimation but there is little by way of quantitative projections. It provides a considerable budget, although not all described projects seem to be covered (e.g. the Slupchanska dam). Given the size of construction works and the varied impacts they will have, it would be helpful to have an explicit description of how to directly involve affected in the measures.

The measure on consolidation and defragmentation of agricultural land is a highly relevant and complex reform. It could potentially have a significant positive impact. However, the ERP does not explicitly discuss developing proper legislation to deal with abandoned land, efficient monitoring of the use of state-owned land (using up-to-date

statistical data) or amending the law on land consolidation to incorporate state-owned land into the process. At the same time, the planned activities are more related to preparation for land consolidation than consolidation itself, and often could be further specified. It is difficult to appreciate the expected impact on competitiveness. The discussion is in general terms and does not contain quantitative objectives or estimates. For example there are no targets for x% of agricultural land consolidated by a specific date. The ERP does clearly note possible risks and actions to prevent or counter-act such risks.

The measure to set up agricultural cooperatives has the potential to further promote rural development and investment, and improve competitiveness and employment in the agri-food processing industry. The ERP provides a detailed description and feasible timeframe. It is nevertheless unclear to what extent differently-sized cooperatives would receive similar support, and how cooperatives would operate and provide services to farmers. Overall, a more systematic approach to the implementation of measures would be helpful. The country should also link the measure to the EU alignment process on producer groups and common market organisations. As was the case with the measure on land consolidation, the expected impact on growth and competitiveness is not sufficiently considered and the impact of the measure is difficult to grasp.

Industry sector development

The main obstacles to competitiveness in industry include low investment and innovation, limited export diversification, underdeveloped enterprise clusters, inadequate entrepreneurial skills, and a poor match between education and labour market needs. There has been some shift towards higher value added production and exports in recent years. Nevertheless, traditional products such as iron, steel and textiles still make up a large share of exports. Linkages between domestic industry and international production chains -including in the technological industrial development zones- remain weak. The ERP diagnostic makes reference to these main bottlenecks to industrial competitiveness, and states that the existing industrial policy strategy for 2009-2020 is being revised to address these issues in the future.

Three new measures focus on stimulating industrial investment, promoting exports and developing new markets. However, these measures mainly rely on financial subsidies to the private sector. The measures are part of the government's Plan for Economic Growth. The planned activities mainly rely on a series of financial incentives, including subsidies for investment, salaries, training and product development. These support measures do not address any underlying structural constraints and they raise questions on equity and efficiency. One such question is why beneficiary companies would not themselves hire more staff, or why they would be unwilling to use their own funds to grow and innovate or attract alternative private financing sources. It also raises the question why the private sector e.g. in the form of chambers of commerce does not offer relevant support services to small and medium-sized enterprises (SMEs). In addition, the three measures seem to partly overlap.

The objective of attracting foreign and domestic investments and further integrating businesses in international value chains is relevant. However, the diagnostic does not suggest that the key obstacle constraining such integration is access to finance and a need for subsidies. Direct state subsidies to SMEs further raise concerns in terms of WTO- and EU *acquis* rules on state aid, and on the fiscal sustainability of such measures. It is of utmost importance to effectively monitor the outcome of these schemes, ensure coordination of the numerous financing activities and agencies to avoid overlap, and set up an exit plan for these subsidies.

Service sector development

The service sector accounts for over half of employment and over 60% of GDP and faces similar key constraints as industry. These constraints include weak entrepreneurial skills; gaps between skills and labour market needs, an often unpredictable regulatory environment, the absence of systematic law enforcement, and a large informal sector, particularly in construction. The ERP does not present a sector-wide diagnostic that discusses the structural obstacles to growth and competitiveness for services. Instead, it focuses on tourism and identifies the following key constraints inadequate absorption capacity of investment, weak management, poor coordination and cooperation and lack of resources among the various stakeholders and agencies.

The measure to increase competitiveness in the tourism and hospitality sector could have a significant impact on the sector. However, the scale of the impact is unclear as outputs are unquantified. This measure is also subject to multiple risks. The reporting in the ERP on the implementation of the measure in 2017 is difficult to assess since the activities were not specified or quantified. At the same time, the measure seems to have been significantly scaled up compared to the previous year and now includes financing from the national budget; but the measure still lacks details. Although it could potentially have considerable impact on both employment and gender equality, this is not specified. The measure is still not embedded in a more strategic approach and this may explain why there have been long delays in programme implementation in the past. Further delays cannot be ruled out: completion of the tourism strategy could be complicated by the lack of proper stakeholder consultation so far, a risk also mentioned in the ERP.

Business environment and reduction of the informal economy

Development of the private sector is impeded by the large informal sector, an often unpredictable regulatory environment, the absence of systematic law enforcement, business inspections conducted for unclear reasons, non-transparent parafiscal fees. Entrepreneurial skills and financial literacy in SMEs are generally weak. The regulatory framework is insufficiently transparent and is frequently changed. However, the government now obliges all ministries to use the National Electronic Registry of Regulations (ENER) for stakeholder consultation of draft legislation, and it has increased the length of the stakeholder consultation period. Inspections are a considerable burden to businesses as their purpose is often unclear, and rules and fines are inconsistently applied. The many parafiscal charges are also levied in a non-transparent way. The considerable size of the informal economy in output and employment distorts private-sector competition, undermines societal trust and deprives the government of significant revenues. The weak links between FDI and local businesses should have been addressed in the programme.

The measure aimed at developing a national web portal for the electronic delivery of state services could help businesses. However, the measure is limited in its potential to address the key challenges facing companies. In spite of the many obstacles to competitiveness, the ERP contains only one measure in this area. This measure seeks to develop a national portal for e-services to simplify doing business and strengthen transparency. This would support SMEs and others by decreasing administrative burdens. Although this would indeed help enterprises, the activities planned for 2017 have only been partially implemented. This measure has now been under implementation for five years and it is difficult to establish what progress it has achieved. The measure is complex and covers several enterprise policy areas, and involves combining and streamlining many procedures and institutions. Its implementation therefore requires improved inter-agency cooperation, interoperability of standards and regulations and information exchange. It also requires appropriate hardware, software and training. The main risk is therefore a lack of institutional

willingness and skills to use this portal. Furthermore, given recent experience of this and other IT projects, the budgeted costs seem too low. The expected impact on competitiveness could be substantial but in the EPR this impact is described in general terms with no quantitative targets.

Research, development and innovation and the digital economy

Key obstacles to growth in the research, development and innovation area include a lack of innovation infrastructure and weak cooperation and coordination between academia, the private sector and the government. The ERP diagnostic shows that, despite progress in innovation policy and implementation in recent years, there is a lot of room for improvement. The country still ranks as only a 'moderate innovator'. This is in turn linked to very low total R&D expenditure (0.44% of GDP in 2015), consisting mainly of public expenditure with marginal private-sector input. The diagnostic rightly underlines the strong correlation between investment in R&D and competitiveness and economic growth. It further points out two other issues: the weak research base and low absorption capacity of SMEs. However, it does not specify reasons for the weak cooperation between universities and the private sector. There is also no discussion of the digital economy and a lack of strategies on key digital policy areas such as digital skills and telecommunications and broadband development. All of these are necessary to ensure transformation towards a digital economy and to significantly improve competitiveness.

The measure on improved infrastructure and access to finance for research aims to provide funding for several stages of the innovation cycle. This partially addresses a key constraint. Although this measure continues to be relevant, its implementation so far has been problematic due to long delays. For this reason, activities planned for 2017 were only partially implemented. The measure is especially targeted at SMEs to support innovation and competitiveness. However, the low funding absorption capacity of SMEs is a serious constraint, as is the poor coordination capability of the agencies in charge. The expected impact on competitiveness is considered only briefly and the discussion is in broad terms and does not contain further quantified targets. In last year's assessment the Commission positively evaluated the measure on creation of a 'Triple Helix Partnership' between academia, private sector and government. Despite this, this measure was dropped from the ERP because of implementation delays, even though it had a clear link to a key constraint faced by the economy.

Trade-related reforms

Key constraints in this area are the trade impediments faced by SMEs. These impediments are linked to non-tariff barriers, including technical standards and administrative obstacles. Barriers also include relatively high logistical and customs costs and a lack of managerial, financial and technical skills. The ERP highlights several of these constraints but does not discuss the weak linkages between FDI and domestic companies.

The measure on trade facilitation to simplify inspections and clearance procedures has the potential to improve competitiveness. This new measure focuses on speeding up all trade that requires veterinary and phytosanitary certificates issued through the EU Trade Control and Expert System (TRACES). The resulting improved data exchange between customs authorities would lead to faster and cheaper trade flows. Swift and rigorous implementation of all trade facilitation commitments under AP5 would indeed be significant steps to address key constraints and strengthen governance. This would in turn stimulate trade and attract investment. The ERP provides a quantitative assessment of the expected impact on growth and competitiveness. The budgeted costing needs further clarification as it is quite small and it is unclear to what extent all activities required by the measure have been costed.

Education and skills

Key indicators in education and skills area remain below the EU average despite a general improvement in the main education outcomes over the years. Although the share of early school leavers is above the EU average, the main challenge for the country is the low quality of the primary and secondary education system. Indeed, the PISA survey[3] highlighted worrying results. Higher education is also not without shortcomings as almost one third of recent graduates have a job not matching their field of study. In addition, the VET system is insufficiently connected to the labour market needs and is not in a position to ensure a smooth transition from school-to-work. There is a generally poor image of the VET sector, although VET students account for almost 60% of all students at upper secondary education. The labour market has difficulties finding the appropriate skills. The ERP diagnostic mentions some of these challenges but does not properly analyse the pre-primary, primary or secondary education. This is a major weakness.

The measure to further develop the qualification system in VET may help contribute to the targets set in the Employment Strategy 2016-2020. However, improving the match between education and labour demand will require continuous commitment of all stakeholders. There is a need to modernise the education system as a whole, not just in VET, and this will require substantial resources. Only an improvement of overall quality of education will provide the relevant quality basis for creating a sustainable and inclusive economy. The capacity of the Ministry of Education and Science should be increased substantially to meet the targets, and a better coordination with the Ministry of Labour and Social Policy should also be ensured.

Employment and labour markets

The employment rate has been increasing steadily from 45.8% in 2011 to 53.7% in 2017. However the rate of young people not in employment, education or training (NEET) remains high at 24.3% in 2016 compared to the EU average at 11.5%. It does not show any clear trend in the period 2012-2016. It should also be noted that women experienced the largest decline in the unemployment rate in 2017 which was at 21.4% and thus 1.2% lower than the male unemployment rate. The unemployment rate of low educated people is the highest although it marked the largest decline. Despite a decreasing trend over the years, about 18.5% of employed persons are working informally, in particular in the agricultural sector.

The two measures on upgrading active labour market policies (ALMP) and the introduction of the "Youth Guarantee" are ambitious in scope. The National Authorities follow up their ALMPs with impact evaluations and use the findings when designing the ones for the following year. The ALMPs clearly address the bottlenecks identified in the ERP. Last year's recommendations were taken on board in this year's measure: the coverage increased from 6,000 to 16,000 and will include the profiling of unemployed as well as preparation of individual employment plans. Further development of the "Occupational Outlook" is envisaged to fine-tune next year's ALMPs. Meanwhile, the political will of national authorities to tackle youth unemployment is clear. The country-wide introduction of the "Youth Guarantee" by 2019 is the first initiative of this kind in the Western Balkans. However, the final impact of these initiatives might be lower than expected considering the administrative capacity of the Employment Service Agency. While its capacity to carry out

[3] PISA is a triennial international survey which aims to evaluate education systems worldwide by testing the skills and knowledge of 15-year-old students.

profiling and personalised counselling of job seekers has been strengthened, the continuity and sustainability of reform efforts still need to be consolidated. Outsourcing the activities is not a long-term or sustainable solution; the Employment Service Agency should be able to commit and implement the required activities with its own resources.

Social inclusion, poverty reduction and equal opportunities

AROP (At Risk Of Poverty) before social transfers and pensions affects 41.6% of the population in 2016 despite some improvements since 2013. Pensions and social transfers play a very important role in reducing the poverty rate by almost half (21.9%) in 2016**.** Unemployed and other inactive persons are especially affected. It is particularly worrying that poverty impacts children more (28.6%) than adults (21.3%). Unemployed persons are also facing a very large material and social deprivation rate (65.5% of unemployed in 2015 compared to the employed persons 35.9%) The ERP recognises the need for significant reforms to reduce the poverty level below 16% by 2020. The social system is facing performance challenges and its spending is inequitable and directed towards categorical programmes. The system requires a profound reform both in terms of the financial entitlements and the assistance and support service to the most vulnerable.

The measure mainly aims at better targeting of those at risk of poverty and social exclusion. It includes the adoption of a new law on Social Protection, which is under preparation with the different stakeholders and should be adopted in 2019. This law aims to better target those at risk of social exclusion, to allow an adequate level of social benefits and to improve the services to them. It should represent a substantial improvement of the social safety net and help the government to achieve its objective of reducing the level of poverty.

ANNEX 1: IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2017

2017 policy guidance	Summary assessment
PG 1: Develop a proper fiscal consolidation strategy by defining and costing concrete revenue and expenditure measures on a multi-annual basis, whilst protecting growth-enhancing spending. Improve the efficiency and effectiveness of public spending by streamlining and better targeting transfer payments.	There has been **limited implementation** of PG 1: • **No implementation**: The ERP and the Fiscal Strategy 2018-2020 aim at fiscal sustainability and gradual fiscal consolidation, maintaining macroeconomic stability, boosting competitiveness of the economy and increasing employment. A gradual reduction of the budget deficit is foreseen from 2.7% of GDP in 2018, to 2.5 in 2019 and 2.3% in 2020. However, a durable multi-annual fiscal consolidation plan relying on both revenue- and expenditure-based measures has not been developed. The plan is all the more urgent given the increased fiscal risk deriving from the subsidy-based new economic growth plan. Consolidation in the past has focused on one-off measures such as under execution of capital expenditure or accumulation of arrears that the government is resolute to repay. To conclude, merely announcing an ambitious deficit target over the medium term with no accompanying active policies (such as operating measures, programme measures or other permanent savings) to improve the fiscal position is not regarded as a consolidation plan. • **Limited implementation**: The country has announced some measures to streamline and better target transfer payments. However, there is no reference to the implementation in 2017. For social assistance, better targeting and reallocation within the current envelope would improve social inclusion. The ERP includes a new measure (N 19) to streamline the payment of social financial transfers. In addition, it includes labour activation components (N17). Sizable efficiency and effectiveness gains can also be achieved through the rationalization of untargeted budgetary subsidies, particularly to the agricultural sector, but there is no reference to this in the ERP.
PG 2: Improve budget planning capacity, in particular through the introduction of a medium-term expenditure framework. Enhance fiscal transparency by including information in the budget documentation on the composition of deficit financing; the budgetary impact of new policy initiatives; payment arrears; and spending and borrowing by state-owned	PG 2 has been **partially implemented**: • **Partial implementation**: The country has adopted measures to introduce a medium-term expenditure framework. An EU twinning project has supported the process of strengthening the capacities for medium term planning. The Minister of Finance has announced that the MTEF will be operational from 2019. The preparation of a new organic law is under way. • **Substantial implementation:** The country has adopted measures to address this recommendation.The government has taken concrete steps to enhance fiscal transparency,

enterprises. Adopt fiscal rules, as an ordinary budget law if their constitutional embedding proves difficult.	such as publishing on the MOF website the list of public sector arrears, and drafting citizens' budgets for 2017 and 2018. Fiscal data is available in tabular format on the website. However, implementation of the other points contained in this recommendation is still pending. • **Limited implementation:** The country has announced that fiscal rules will be included in the new organic budget law that is under development.
PG 3: Continue efforts to further strengthen the use of the local currency and to further foster NPL resolution by developing a comprehensive strategy to these ends, with the participation of all relevant stakeholders. The monetary policy stance should remain consistent with the exchange rate peg, using available scope within this framework in line with safeguarding price stability.	PG 3 has been **substantially implemented**: • **Partial implementation:** The NBRM has prepared draft strategies both for NPL resolution and for strengthening the use of the local currency, which include a comprehensive set of policy measures. However, the draft strategies still need to be consulted with other ministries and agencies (they have been already consulted with the Ministry of Finance) and adopted. • **Partial implementation:** See previous paragraph. • **Full implementation:** The central bank maintained a monetary policy stance consistent with the exchange rate peg and in line with safeguarding price stability.
PG 4: Adopt a comprehensive and credible public finance management reform programme. Prioritise public investments against clear policy objectives. Increase the transparency on the selection criteria for investments and on their impact on economic growth and on the fiscal path.	PG 4 has been **substantially implemented**: • **Full implementation:** The country adopted a comprehensive and credible PFM programme in December 2017. • **Limited implementation:** The adopted PFM programme encompasses conducting a Public Investment Management Assessment (PIMA) with IMF support. The PIMA will include an assessment how to improve the capacity to prioritise public investment against policy objectives. The PIMA will also aim to improve transparency of selection criteria for public investment and their impact on growth and the fiscal path.
PG 5: Reduce the use of the urgency procedure for legislation Make full use of the National Electronic Registry of Regulations (ENER) to ensure proper and systematic consultation of the stakeholders	PG 5 has been **substantially implemented**: • **Full implementation**: In September 2017 the government decided to limit the use of urgent and shortened procedures and to more systematically consult stakeholders for draft legislation. • **Substantial implementation**: In July 2017 the government obliged all ministries to publish all draft legislation on

Reinforce the independence and the capacities of commercial courts.	ENER. In August 2017 the government adopted new Rules of Procedure doubling the number of consultation days to 20. • **Partial implementation**: In 2017 the country adopted a strategy and action plan for reform of the judiciary for 2017-2022. The strategy aims to ensure an independent, impartial, transparent and efficient judiciary. The institutional capacity of the courts to uphold contracts and resolve commercial disputes *for now* remains inadequate, with time-consuming and costly procedures and not necessarily free of political interests. However, the strategy and action plan are promising.
PG 6: Strengthen the outreach and coverage of active labour market policies towards the long-term unemployed, youth, and the low-skilled. Improve the qualifications of teachers and increase enrolment in pre-school education. Stimulate work-based learning in both initial and continuous vocational education and training.	PG 6 has been **partially implemented**: • **Partial implementation:** In August 2017 the country adopted the Employment and Social Reform Programme 2018-2020. it aims at reaching out to the most vulnerable categories of unemployed persons such as the youth and the long-term unemployed. The target for 2018 is coverage of 16,000 people (compared to 6,551 in 2016). • **Partial implementation:** The Ministry of Education and Science has adopted the Strategy for Education that includes Teacher Training Programmes. The ERP reports that more than 350 teachers in 3-year and 2-year vocational education and training have been trained on new modularized curricula. 421 mentors in companies where the students perform practical classes have been trained, out of which 400 are certified mentors; 161 teachers in practical training are trained in companies, and a programme for vocational and didactic training of the trainers has been prepared by employers where practical training is realized. • **Limited implementation:** The Ministry of Education and Science has adopted the Strategy for Education that includes measures to increase the enrolment in pre-school education. • **Substantial implementation:** A three-year dual vocation education project based on the German model started to prepare secondary vocational schools' students for work in selected companies. The legislation was amended to facilitate practical trainings by companies. The VET strategy and draft bylaws were prepared. Mentors in companies were

	trained, a register for the recording of training created as well as a register for the concluded agreements between schools and companies. A national body for the systematic implementation of work-based learning has been established.

ANNEX 2: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The Economic Reform Programme (ERP) 2018-2020 was submitted by the government on 30 January 2018. It is broadly in line with the medium-term fiscal strategy and the 2017 Budget Law. No components of the ERP are missing.

Inter-ministerial coordination

The preparation of the ERP was centrally coordinated by the Ministry of Finance. The programme was formally endorsed by the government. An inter-ministerial ERP working group involving seven ministries, several agencies and other offices worked on its preparation.

Stakeholder consultation

As part of the consultation process, the draft ERP was posted on the website of the Ministry of Finance for the period 27/11/2017 to 10/12/2017, when it was open to comments/recommendations by external stakeholders, including social partners and invitations were sent to interested parties for written contributions. The government also held a public consultation in Skopje on 05/12/2017. For the first time, the draft ERP was discussed at a session of the Economic and Social Council. The contributions are included as an annex to the ERP.

Macroeconomic framework

The macroeconomic projections are more realistic than in previous years. The programme presents two alternative scenarios compared to the baseline, assuming lower growth in trade partner countries, and lower investment. An analysis of external debt sustainability is provided as an annex.

Fiscal framework

For 2017, the programme is based on the most recent budget projections following the second budget revision and on fiscal data available at the end of the third quarter. In spite of the revised economic growth assumptions, the programme adheres to the fiscal targets of previous years, but it does not present concrete measures underpinning the planned consolidation. Compared to the 2017 fiscal outcome, the revenue projections, and the envisaged increase in capital expenditure for 2018-2020 seem plausible. The programme would have benefitted from information on the expected budget impact of policy changes. The programme includes an analysis of the budget deficit's sensitivity to lower GDP, lower revenue, and higher expenditure growth, and of the sensitivity of public debt to changes in interest rates and exchange rates.

Structural reforms

The structural reforms sections (4, 5 and 6) follow the guidance note. The measure descriptions usually provide annual activity timelines, budget estimations (except measure 19), expected impact on competitiveness, and expected impact on employment but in general terms only. However, only two elaborate on the impact on gender. Most measures briefly discuss implementation risks, and most (11 out of 19) include mitigating actions. The reporting of the implementation of the policy guidance and the structural reform measures from the 2017-2019 ERP (table 12 in annex) is sufficient, but not always up-to-date. The ERP respects both the measure and page limits. Tables 9-11 of the annex are filled in appropriately