



Government of the Republic of Macedonia

D R A F T

**STRATEGIC COHERENCE FRAMEWORK
of the Republic of Macedonia
2007 – 2013**

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List of abbreviations

ALMP's	Active Labour Market Policies
APEP	Action Plan for European Partnership
BEEPS	Business Environment and Enterprise Performance Survey
CEB	Council of Europe Development Bank
CSW	Centre for Social Work
CPS	Country Partnership Strategy
DIS	Decentralised Implementation System
DPM	Deputy Prime Minister (Office for Economic Affairs)
DPL's	Development Policy Loans
EAR	European Agency for Reconstruction
EC	European Commission
ECD	European Commission Delegation
EP	European Partnership
ESF	European Social Fund
ESA	Employment Service Agency
EU	European Union
FB	Final Beneficiary
GEF	Global Environment Facilities
GoRM	Government of the Republic of Macedonia
ILO	International Labour Organization
IPA	Instrument for Pre Accession
IPARD	Instrument for Pre-Accession Assistance for Rural Development
JAP	Joint Assessment Paper
JIM	Joint Inclusion Memorandum
LFS	Labour Force Survey
LSG's	Local Self Governments
MoEPP	Ministry of Environment & Physical Planning
MoF	Ministry of Finance
MoLSP	Ministry of Labour & Social Policy
MoTC	Ministry of Transport & Communications
NAPE	National Action Plan for Employment
MoU	Memorandum of Understanding
NDP	National Development Plan
NES	National Employment Strategy
NPAA	National Programme for the Adoption of the Acquis
OP(s)	Operational Programme(s)
PPP	Public Private Partnership
RM	Republic of Macedonia
SCF	Strategic Coherence Framework
SEA	Secretariat for European Affairs
SEETO	South East Europe Transport Observatory
SME's	Small Medium Enterprises
SPIL	Social Protection Implementation Loan
SWC	Social Work Centre
TA	Technical Assistance
TOR	Terms of Reference
TWA's	Temporary Work Agencies
UNDP	United Nation Developing Programme
USAID	US Agency for International Development
VET	Vocational Education & Training
WWTP's	Water Waste Treatment Plants

1. PREPARATION OF THE STRATEGIC COHERENCE FRAMEWORK

1.1. Policy context

Considering the country's commitment for a full integration into the EU, as an ultimate and strategic goal of the Republic of Macedonia, the Strategic Coherence Framework (SCF) for the period 2007-2013 aims at **strategic programming of investments in the areas of regional and human resources development**, consistent with the EU Multi-Annual Indicative Planning Document (MIPD) 2007-2009, as well as with the National Development Plan (NDP) 2007-2009 and other strategic documents prepared by the Government of the Republic of Macedonia (GoRM). The document is complementary with the guiding principles of the EU.

At the European Council Summit in December 2005, Republic of Macedonia was granted a "**candidate country**" status. Similarly as in the case of other candidate countries before their accession to the EU, the Republic of Macedonia is entitled for the pre-accession assistance that should support the country in coping with the challenges of the European integration process. In particular, it should assist and support the country in implementing the necessary reforms; to accomplish obligations arising from the Stabilisation and Association Process and to fulfil the Copenhagen economic, political and acquis related criteria.

According to the Council Regulations 1085/2006, the EU pre-accession assistance will be channelled to the candidate countries through the Instrument for Pre-accession Assistance (IPA). As a candidate country Republic of Macedonia will be eligible for all five components of the IPA, namely for:

- Transition Assistance and Institution Building component;
- Cross-border Co-operation component;
- Regional Development component;
- Human Resources Development component and
- Rural Development component.

The EU basic policy documents for setting down the priorities for programming of the assistance under IPA are the Enlargement Strategy Paper, the MIPD, the European Partnership (EP), as well as the annual Progress Report on the EU accession, including implementation and enforcement of EU standards.

The legal basis and the objectives are set out by the **Council Regulation 1085/2006**.

The **MIPD 2007-2009**, adopted by the European Commission in May 2007 is the key multi-annual planning document covering the assistance granted to the country under IPA for the period 2007-2009. It follows the Multi-annual Indicative Financial Framework (MIFF) 2007-2010, which indicatively allocates funds per beneficiary and per component. The priorities set out in the MIPD were basis for the preparation of the SCF 2007-2013 and serve as a basis for the programming of EU funds for each of the five IPA components.

Along with the candidate status, the Republic of Macedonia also received the second **European Partnership** modified and updated according to the findings of the EC's Avis, presenting a list of short- and medium-term priorities of the country in light of its preparations for integration into the EU.

Given the fact that the preparation of the SCF (and Operational Programmes-OP's) should be based on relevant national development documents, in February 2007, the Government of the Republic of Macedonia (GoRM) adopted the **National Development Plan 2007-2009**. The National Development Plan (NDP) is a mid-term strategic document that sets out the national investment/development priorities, respecting the Community priorities set out in the MIPD 2007-2009. The SCF 2007-2013 is a strategic document covering the areas of

regional and human resources development of IPA assistance, with a longer time horizon relative to the NDP.

Having in mind that the resources under the five IPA components are governed by the so-called programming principle, it is requested from each IPA beneficiary country to develop annual and multi-annual operational programmes per components, that will consistently integrate the EU assistance into the general framework of the country's development, and will ensure that the development priorities and the policies of the country and of the EU are intertwined. During the implementation of the operations co-financed by IPA, all appropriate steps will be taken to prevent any discrimination on the basis of gender, race or ethnic origin, religion or belief, disability, age or sexual orientation.

Assistance provided in the framework of the SCF will be in full compliance with the sustainable development principles and will meet the relevant environmental norms, in particular EIA, Habitats, Birds (in order to avoid negative impacts on potential Natura 2000 sites) and the relevant environmental acquis. Investments in the environmental sector will be planned based on the integrated and strategic approaches, in particular in line with the river basin approach and waste management planning. The projects to be financed will be appraised case by case in order to be coherent with the relevant obligations of the environmental acquis. The relevant international initiatives/conventions (DABLAS and Barcelona) should also be taken into account including in the investment planning.

Whereas, programming for the first two IPA components, i.e. for Transition Assistance and Institution Building component and for Cross-border Co-operation component, has been based by most on the priorities defined in the EP and the National Programme for the Adoption of the Acquis (NPAA), the SCF 2007-2013 provides a frame of reference and basis for the IPA Regional Development and Human Resources Development components. These two IPA components will also be covered in details by separate Operational Programmes. In particular, the SCF and OP's are expected to outline "priority axis", i.e., global objectives that will be achieved in a particular field, and "measures", i.e., means by which the "priority axis" are supposed to be implemented.

1.2. National preparation process and timetable

Republic of Macedonia is strongly committed to become member state of the EU and in this respect it streamlines all its efforts and resources to the process of fulfilment of all necessary preconditions and requirements. Furthermore, the GoRM takes all necessary steps towards the harmonisation and implementation of the relevant EU acquis and standards.

The process of preparation of the SCF is part of the general process of preparation for utilisation of IPA funds, i.e. the process of national IPA programming. The preparations of the Republic of Macedonia for IPA started very soon after this instrument was promoted and introduced by the EC. By the end of the year 2005 the national authorities were introduced to the concept of this instrument, to the possibilities it offers and to the requirements the country should satisfy in order to start utilizing the assistance under IPA. In this context two parallel set of activities started in order to prepare the country for the programming process and for the decentralized implementation of the assistance under this new instrument. The preparations intensified in 2006 with increased dynamics in the communication between the national authorities and the Commission's services.

Adoption of the NDP 2007-2009 was important, being starting point for the preparation of the SCF 2007-2013, since NDP serves as basis for further development of strategies and programming documents.

Candidate status gave Macedonia access to all IPA components. Government of the Republic of Macedonia started the preparations for IPA at the beginning of 2006, and on December 27, 2006, in consultations with EC, it adopted draft the **National Action Plan for**

IPA preparations which was thereafter amended on June 12, 2007. The Action Plan defines the timetable for the preparation of all programming documents per components and for the SCF, as well as for the preparation for managing IPA funds. It serves as an instrument for enhancement of the coordination among the national institutions, as well as for intensification of the activities related to the programming of IPA and the preparations for its future utilisation. It sets the dynamics of the activities of the Government related to the preparation of all programming documents per each IPA component, as well as of the activities for the establishment and accreditation of the national system for decentralized management of EU funds. Until today, several planned steps were implemented, and hence the Action Plan has to be amended.

In addition, activities related to the establishment of the national structure that will deal with the programming and implementation of the assistance under IPA started in October 2006. On its session held on 9th of December 2006, the GoRM confirmed the formation of the **National IPA Structure** responsible for drafting OP's and SCF. Then, Strategic Coordinator - Deputy Prime Minister (DPM) for Economic Affairs, established the National Programming Team for SCF. The SCF and the two OP's were prepared in close cooperation between the three national programming teams assisted by the external consultants provided by EC and European Agency for Reconstruction.

In March 2007, Ministry of Finance, in coordination with the programming team, prepared the first draft of SCF, which, on 19th March 2007, was shared with DG Regio and DG Employment for preliminary comments. The relevant DG's delivered to the Government unofficial and preliminary comments and suggestions for improvement of the draft document, which were respectively taken into consideration. The revised and improved version of the document was sent back for consideration and further comments to the relevant DGs on 18th April 2007.

In the period 23-25th April, programming mission of DG Regio took place in Skopje. Within this mission, separate meetings with the Strategic Coordinator and the line ministries, on the preparation of SCF were held, and resulted with further modifications and finalisation of the document.

On the 8th of June 2007 the revised version of the draft SCF was officially transmitted by DPM and NIPAC to the EC services for considerations, interservice consultations and official comments. On the 25th of June DG Regio delivered the official comments on the draft SCF. The improved draft version of SCF incorporating the Commission's comments and remarks was submitted by DPM and NIPAC to DG Regio on 11th of July 2007. The document will be finalised within the Programming mission of DG Regional Policy and DG Employment that will take place on 24-25 July.

In parallel with the programming process, the Government is preparing itself for the conferral of management of EU funds by European Commission. GoRM is establishing the system for decentralised implementation of EU funds, and undertook the necessary activities and preparations for the accreditation process. Accredited DIS system and conferred management is precondition for the implementation of the assistance under the Regional Development, Human Resources and Rural Development components of IPA.

2. ANALYSIS OF THE SOCIO-ECONOMIC SITUATION

2.1. Recent economic developments

The macroeconomic performance of Republic of Macedonia in the last few years has been quite favourable, with average growth of around 4%; low and stable inflation rate; declining current account balance, strong growth of credit to private sector and declining trend of interest rates, as well as modest decline of unemployment rate.

According to the preliminary data provide by the State Statistical Office, quarterly data on GDP in 2006 show a real growth of 3.1% in 2006 (on annual basis)¹. The growth was mainly result of the growth in the service sector, where trade increased by 5.5%, while transport and communications grew by 7.5%. Still, achievements in the real sector are somewhat lower than the projected, due to the low industry growth and the low growth in construction sector. In particular, in 2006, industrial production increased by 3, 6%, whereas the projected annual growth was 4.1%. A significant decline was noted in the publishing (18%), furniture industry (22%) and supply of electricity gas and water (0.6%).

Table 2-1 Contribution to growth by economic sectors (2005-2006)

Production	2005				2005	2006				2006
	I	II	III	IV		I	II	III	IV	
Agriculture	0.1	0.1	0.0	-0.1	0.0	0.1	0.1	0.0	0.0	0.1
Industry	0.6	2.6	0.9	0.5	1.1	-0.2	1.2	2.0	0.4	0.8
Construction	-0.3	-0.5	-0.1	0.0	-0.2	-0.1	0.1	0.1	-0.2	0.0
Services	0.8	1.2	1.6	1.6	1.4	1.9	1.6	8.7	8.7	1.8
GDP	2.8	4.9	3.9	3.8	4.1	2.2	3.4	4.0	2.7	3.1

Note: Adding taxes, imputed banking services, and imputed rents to the table will make the sectoral growth rates to add up to total GDP growth rate.

Source: State Statistical Office and MoF calculations

In absence of comprehensive data on domestic consumption in the Republic of Macedonia, analysis of the expenditure side of GDP is based on a qualitative assessment according to the anticipated changes in each component of domestic consumption, as well as of the main indicators. This analysis points out that growth in 2006 was still higher than the one determined on the production side. The actual public expenditure growth in the first three quarters of 2006, as well as the presumed personal consumption growth on the basis of the salary rise, credit expansion to households, growth of retail trade, higher inflows from private transfers and higher import of consumption goods, point out to a growth of the final consumption in the first half of 4.5-5% and a positive effect on the GDP. At the same time, significant growth of investments in machines and equipment in the analysed period by 20.2% points out to high positive share of gross investments in GDP growth. The risk of this assumption is investments in construction, for which no preliminary data exist yet, but taking into account the results achieved in the construction sector in the first three quarters of 2006 (increase by only 0.3%), their growth is likely to be relatively low. On the basis of the preliminary data, import and export forecasts suggest a negative effect on the net export on the GDP growth by around 2-2.5%.

¹ MoF's estimation for the real GDP growth is 4%, based on the strong leading indicators in 2006: 18% growth of investment in machinery and equipment, 7.3% nominal growth of wages, 20% higher imports of investment and intermediate goods, credit to enterprises growth of 30% etc.

Growth of economic activity in 2006 led to a greater commodity trade, whereby export of goods grew by 17.5%, and import grew by around 16.5%. Such trends resulted in an increase of trade deficit by 14% compared to the last year. Such situation was largely initiated by the significant rise of oil price on the world stock markets, i.e. the share of oil in the trade deficit is approximately 51%.

Greater export activity and high inflow of private transfers in the previous period led to reduced current account deficit and pressures for appreciation of the denar exchange rate that existed on the foreign exchange market. To the end of maintaining the stability of the nominal denar exchange rate to the Euro, during the observed period, there was a surplus of foreign currency on the foreign exchange market through foreign exchange transactions of the National Bank of the Republic of Macedonia.

The real effective exchange rate is an important indicator of the competitiveness of the domestic economy. In the period 2001-2006, real effective exchange rate was relatively stable, pointing a maintained price competitiveness of national exporters on the foreign markets and external sustainability. It was mainly a result of the lower process in the domestic economy in relation to the countries that are the biggest trade partners, whereby its level in 2006 was almost unchanged compared to 2005. External competitiveness relative to the countries that are the largest trade partners from the Euro zone (the calculation included 8 countries) was also relatively stable. However, in 2006 REER appreciated by around 1% for the higher inflation in Macedonia compared to the Euro area.

Achievements in the real sector and intensification of the economic activity had a respective positive reflection in the social sector as well, i.e. on the labour market. Thus, in the fourth quarter in 2006, employment rate increased by 1.2% in relation to the same quarter last year, while the unemployment rate dropped by 0.6 percentage points. Still, taking into account the high unemployment in the Republic of Macedonia (35.9% in the fourth quarter in 2006), higher GDP growth rates, mainly through micro policies, as well as intensification of the active labour market policies are required to improve the unemployment situation.

Considering the fact that the main reason for the lower economic growth of the Macedonian economy when compared with other transition economies is the structural imbalance's of the economy and the institutions, in 2006, the GoRM presented ambitious economic program of structural reforms with final objective of acceleration of the economic growth and the process of EU integration, as well as the improvement of the living standard of the people of Macedonia.

The ambitious economic programme of the GoRM, as well as the programme on accelerating implementation of structural reforms has already shown positive economic results. The reforms in the area of entry and exit from the market (in order to create conditions for competitive business ambience), the judicial reforms, the labour market, the reforms in the education and health have already created conditions for better life of the citizens of the Republic of Macedonia.

In fact, the macroeconomic performance of the Macedonian economy at the beginning of 2007 has finally shown that the country can economically grow with high growth rate, as well as the more prosperous transition countries. According to the official data of the State Statistics Office, gross domestic product grew by 7% in the first quarter of 2007, being the highest growth in the last 15 years. What is especially important is the fact that such growth was supported by low and stable inflation of 0.8%, strong growth of the export by around 50%, industrial production growth, strong investment activity arising by both domestic and foreign investors, downward trend of the interest rates and converging to those of the EU member countries, as well as increasing foreign exchange reserves.

On the expenditure side, the growth was encouraged by the personal consumption, the export and the investments in the beginning of 2007. In fact, the real sector growth also influenced the increase of salaries in the Republic of Macedonia, whereby nominal salaries increased by 6.4% in the first four months of 2007 (by 5.6% in real terms). The remarkable

reduction of the percentage of the population which had not received personal income for the last month (It amounted to 12.8% in April, 2007) was also important, thus contributing significantly to the consumption growth. The increase at the personal consumption was also encouraged by the growth of crediting to the population, which amounted to 46% in the first five months of 2007.

Strong investment activity was noticed at the beginning of 2007, whereby the growth of investments in machines and equipment amounted to 11% in the first quarter of 2007, the growth of the import of investment and intermediate products amounted to 48%, while in line with the National Bank of the Republic of Macedonia data, the growth of the long-term credits of the enterprises (those that refer mainly to investment activity) amounted to 44%. The active promotion of the Republic of Macedonia as an investment destination has already shown results, whereby the investment of the eminent French Bank was the most significant investment in 2007, thus continuing to strengthen the banking sector in the Republic of Macedonia. In addition to all this, other important foreign investments were noticed in the insurance industry (Vardar Insurance, Tabak Insurance), the IT industry (ON-NET), Telecommunications - Mobilcom Austria, the automobile industry - Jonson Controls, Food Industry - SWEDMILK etc.

Proof of the acceleration of the economic activity in 2007 was the high growth of the volume of the foreign trade. In fact, export of goods and services grew by 51.5% in the period January-May 2007, with a simultaneous increase of the import by around 31.7%, contributing to the reduction of the deficit in the trade with abroad in real terms (in nominal terms, the deficit grew by only \$ 6 million). Stable level of private transfers at the beginning of 2007 showed that the current account deficit would not exceed the expected 2% to 3% of GDP.

Positive trends in the external sector have their positive influence in on the foreign exchange reserves as well. The foreign exchange reserves amounted to EUR 1.4 billion at the end of June 2007, being a small increase compared to the end of 2006. Thereby, the level of foreign exchange reserves was lower than the expected one due to the activities of the Ministry of Finance for early repayment of the external debt (EUR 77 million for early repayment to the Paris Club, as well as EUR 103 million for early repayment of the credits from the World Bank and the European Investment Bank).

Such positive trends did not have the expected strong positive influence on the inflation rate. In fact, the costs of living grew modestly by 0.9% in the first half of 2007, thus pointing out to the fact that the inflation rate was supported not only by the increased demand, but also by the increased supply (supply side driven), in line with the increased real growth of the production.

Low and stable inflation was also supported by growth of industry productivity, which amounted to 15% in the first quarter of 2007 (productivity growth amounted to 5% in 2006).

2.2. Socio-economic analysis

Geographical location of the country

Macedonia is a small country, with 25,713 sq. km. and a population of about 2 million. It is also a landlocked country, located in the heart of the Balkan Peninsula, bordering one EU member state in the South - Greece with a mainland border 246 km long, one EU member state in the East - Bulgaria with border 165 km long, Serbia (including Kosovo) in the North (232 km) and Albania in the west (151 km). Half of the territory, 49% is agricultural land, while forests account for additional 37% of the territory. According to Census of population, households and dwellings in the Republic of Macedonia, 2002, total population of the Republic of Macedonia according the ethnic affiliation is following: Macedonians 64.18%;

Albanians 25.17%; Turks 3.85%; Roma 2.66; Serbs 1.78%; Bosniaks 0.84%; Vlachs 0.48%; and other 1.04%.

Transport infrastructure

Republic of Macedonia is geographically situated at the intersection of the Pan-European corridors VIII and X. A more developed transport sector would facilitate goods and labour mobility; increase competitiveness of the Macedonian economy and its economic growth; create jobs and intensify the integration of the RM into the EU.

However, with some exceptions, the transport infrastructure and infrastructure policies in the Republic of Macedonia are not in full compliance with the development needs of the economy. In other words, the insufficiently developed transport sector and infrastructure currently seem to be an impediment for a faster overall development of the country.

The country's basic road network is composed of over 13,278 km of roads, including 209 km of motorways, 906 km of national roads (548 km are "E" designated roads), 8,566 km of local roads and 3,806 km regional roads. The backbone of the country's road network is represented by the two Pan-European corridors VIII and X identified as major trans-national axes by the European Commission (High Level Group)². The effective use of these corridors is strongly dependent on the construction of the parts that have not been finished yet, as well as on the development and maintenance of the regional network.

The Pan-European Corridor X is the most important element of the core transport network, linking countries from Turkey and Greece through Bulgaria, Macedonia, Serbia, Croatia and Slovenia to Austria. The present average annual daily traffic of 15,000 is set to increase at 6% per annum to over 20,000 and to 40,000 by 2020. The E-75 is mostly four lane motorway, tolled in Croatia, Serbia and Macedonia. A high proportion (25%) of it is regional or international³.

Concerning the construction of **road infrastructure** along the corridor X, of the 172 km long pan-European Corridor X passing through Macedonia in the North – South direction, 70.1% has been already constructed at modern highway standards with the remaining 29.9% being ready for construction. The latter include the Demir Kapija-Udovo-Smokvica and Kumanovo-Tabanovce sections of the corridor.

The **railway line** along the Pan-European Corridor X is 215 km long and starts from the border crossing Tabanovce in the north and ends in the south with the border crossing Gevegelija, including the branch Xd of the Corridor X that starts in Veles and ends at the border crossing Kremenica by Bitola. The railway connection, along the Corridor X provides for speed of 100 km/h, and at some points the speed is drastically limited. Taking into consideration that large proportion of the transport is performed on the Corridor X, special priority is given to the increase of speed on certain sections to 130 km/h and to improve the level of infrastructure, with an aim to achieve technical conditions on a level of a Corridor, supported by the initiative SEECF- South-East European Cooperation Process.

The Pan-European Corridor VIII spans over the South Eastern European area where transport infrastructure is traditionally weak. It is connecting the Adriatic with the Black Sea through Italy, Albania, Macedonia and Bulgaria linking Greece and Turkey.

From an economic point of view, with the trans-European networks the European Commission aims at enhanced access to EU countries, and increased mobility of people/goods, following the single market objectives and the principles of sustainable mobility. From a transport point of view, Corridor VIII is a multi-modal transport system along the East-West axis comprising of sea and river ports, airports, multi-modal ports, roads and railways, with a total extension of 1270 kilometres of railways and 960 kilometres of roads.

² Report from the High Level Group Networks for Peace and Development, November 2005.

³ SEETO Five Year Multi-annual Plan 2006-2010, May 2006.

The Pan-European Corridor VIII is passing through the territory of Macedonia from East to West with a total length of 304 km. Concerning the **road infrastructure** along the Corridor VIII only 27.6% of the total is already built at modern highway standards with another 8.7% being currently under construction (The Skopje Bypass).

The **railway line** along the Pan-European Corridor VIII is in total length of 315km, whereas only 50% of the railway line has been constructed so far. At the moment, the country does not have railway links with the two neighbouring countries Republic of Albania and Republic of Bulgaria. The Eastern part of the corridor VIII towards Republic of Bulgaria requires another 89 km to be built (29 % of the total), while on its Western section towards Republic of Albania another 66 km need to be constructed (21 % of the total).

Insufficient road infrastructure quality contrasts sharply with the relatively high importance of this mode of transportation in the Republic of Macedonia. In particular, road transportation accounts for by far the largest share of total transportation of goods and passengers in the country. Within the total road transport of the goods, internal transport participates with a dominant share while the rest is distributed between international transport and transit. With reference to passengers transport, road transportation is even more dominant, as only a negligible percent of all national passengers travels are by railways. One of the priorities foreseen for the future is also the development of a multimodal terminal for connecting the different transport modes.

Development of the Core Regional Transport Network of South-East Europe is considered to be one of the most important policies for bringing economic prosperity to South-East Europe. This has been acknowledged by signing the Memorandum of Understanding (MoU) for the main Regional Transport Network of South-East Europe in June 2004. The MoU was signed by Albania, Bosnia and Herzegovina, Croatia, Macedonia, Serbia, Montenegro, Kosovo/UNMIK (UNSCR 1244) and the European Commission. The aim of the MoU is to cooperate on the development of the main and ancillary infrastructure on the multimodal South East Europe Core Regional Transport Network and to enhance policies in this area which facilitate such development. The development of the Network should include maintenance, reconstruction, rehabilitation, upgrading and new construction of main and ancillary infrastructure as well as its operation and use with a view to fostering the most efficient and environmentally friendly transport modes on a regional scale.

The Core Network has been defined to include road, rail and inland waterway links in the seven SEE entities, together with a number of designated seaport, river port and airport nodes. The main international links include three road and rail arteries (Pan-European Corridors) plus one international waterway (the Danube), all of which connect with other European countries in each direction. These are defined as Corridors in the SEETO network. In addition, seven regional road arteries and six regional rail arteries have been included in the network, defined as Routes. The Core Network also includes seven seaports, two river ports and eleven airports.

In order to strengthen the development of the Core Regional Transport Network, IPA interventions will be concentrated on the Pan European Corridors crossing through the territory of Republic of Macedonia.

Environment infrastructure

During the period of the 1980s and 1990s, the Republic of Macedonia has made some important progress in the environmental protection. The most significant achievements include:

- improvement and enlargement of water supply systems in urban areas, connection of rural settlements to regional water supply systems and construction of local water supply systems;

- construction and extension of waste water collection systems in urban areas and construction of sewerage networks in rural areas;
- construction of waste water collection and treatment facilities in the areas of three protected natural lakes, Ohrid, Prespa and Dojran; and
- establishment of an organised municipal waste collection in most urban areas.

These positive developments with respect to the provision of environmental services are result of a high priority and importance the authorities have given to this subject. However, an impediment to a further improvement in some areas of environmental infrastructure is the unclear division of responsibilities for the environmental policies. In particular, the competences for the development of the sector are shared (overlapped) among several line ministries. Considerable investment is needed to improve environmental management infrastructure (wastewater, solid waste, rehabilitation of industrially contaminated sites etc.). In addition, investments in Ministry of Environment & Physical Planning staff in order to improve their quantity and quality.

The **water connection** rate in the municipalities, range from 82 to 100%. The available data indicate average connection rates of about 70%. About 1.2 million inhabitants are connected to a public water supply system. In rural areas, however, connection rates exhibit a spread between only 10% and up to 100%.

The total length of the **sewage collection** network in Macedonia is 1,239.1 km. In average, 60% of dwellings are connected to a public sewage system, whereas 21% of the dwellings have septic tanks, and another 12% have only a system of uncontrolled waste water discharge. Though, sewerage network cover approximately 65% of the population, while only 12.5% is connected to the waste water treatment plants. The only 12.5% is facilitated by the waste water system. The surface water pollution in the country can be mainly attributed to the discharge of untreated municipal waste waters.

There is no monitoring of the waste water being discharged by municipal sewage systems, except for those equipped by Waste Water Treatment Plants (WWTP's) in operation (in Ohrid, Prespa, Dojran, Makedonski Brod, etc.). There are WWTP's which are out of operation (e.g. Sveti Nikole) due to high operating costs and inappropriate maintenance. WWTP in Krivogastani is in the final phase of implementation while WWTP in Kumanovo started with operation in the end of 2006. Construction of WWTP in Gevgelija is expected to start in near future.

Water supply and waste water services in the Republic of Macedonia are by and large provided by public enterprises established by local authorities. Until now, there has been no involvement of the private sector in the water supply and waste water services, as well as in the construction of infrastructure in these areas. Municipal enterprises experience financial problems because they cannot cover the full cost of operation and maintenance from the charged tariffs. In particular, level of tariffs and the collection rates are low. In addition, there is a cross-subsidisation among various activities performed by the utilities, so that good performers are "punished". Given the financial problems, investments of public enterprises are almost entirely financed by the state budget, infrastructure is poorly maintained and quality of services is inadequate. For example, water losses in some municipalities are high and overpass 50%.

Regular **waste collection** services are mainly limited to urban areas, providing up to 90% coverage in cities and outskirts. About 70% of the total population in Macedonia receives regular waste collection services, while the remaining population, mainly from rural settlements far from the main collection areas, manage wastes on their own. Regular separate collection of municipal waste does not exist, except for some separate bulky waste collection in Skopje. Some recycling activities are undertaken by the informal sector for recyclables as metals, paper, plastics, car batteries and accumulators, waste oils. The recovery of the various types of potentially recyclable materials is considered not financially

viable under prevailing conditions. Scrap metals represent the biggest part of the collected recyclables, and are being processed by the steel factory “Makstil” in Skopje. Moreover, there is a well-established network of collectors and/or brokers, as well as a strong and stable market for recovered scrap metals. It could be estimated that scrap metals represent almost 80% of the collected commodities.

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

The past practices of complex technical documentation preparations, concerning the construction of existing waste water treatment facilities have not been properly revised. Moreover, the socio-economic effects from the operation of these facilities have not been thoroughly assessed. Apart from this, their operation has not been accompanied by proper regulation of prices for the service provided by public enterprises. Namely, operators of these systems lacked appropriate prior estimates and basis for the service price regulation. Under this component, each planned investment will be preceded by development of technical documentation which will include, apart from preliminary solution and feasibility study, socio-economic studies with the relevant estimates of socio-economic implications. Cost-benefit analyses and affordability analyses of the service price and its prior calculation based on justification of defined levels will be carried out as well, in order to provide future sustainability and proper operation of environmental infrastructure.

Adoption of the relevant environmental legislation is also an important step towards the implementation of projects that put in place EU requirements concerning wastewater collection and treatment, as well as solid waste management. Further more, it provides basis to overcome deficiencies with respect to overlapping of responsibilities in the environmental sector.

With respect to the water sector, draft Law on Waters, aside of introducing the approach of an integrated water management, provides for a clear division of responsibilities. Law on Waste Management prescribes that public utilities need to be adjusted to the condition set in the law in the next three years. At the moment, number of ongoing activities is oriented towards strengthening the capacities of public utilities, as well as their adequate organization. Requirement for institutional strengthening, adjusting the organizational set-up and efficient performance of public utilities, is ever more becoming a precondition for successful working, as well as receiving state guaranties for possible IFIs loans and donor investments.

The focus of number of measures that are to be undertaken is especially on more profitable, commercial and competitive way of public utilities performance, as stipulated in the National Action Plan for Decentralisation.

Even though current involvement of the private sector is limited, it should be pointed out that private sector has been expressing great interest in further involvement. Law on Waste Management allows for participation of the private sector in waste management, while the proposed amendments to the Law on Concessions and Law on Public Utilities will stimulate the public-private partnerships.

Main sources of **air pollution** in Macedonia are stationary sources and mobile sources of air pollutants, such as: energy production and transformation, fuels combustion, heat production for industry and heating for residential and administrative buildings. As a result of obsolete equipment and lack of modern technologies, industrial sector is the major air polluter. The main pressures derive from activities in the metallurgy sector, and the chemical industry.

By 2000, air emissions decreased, mainly due to the overall transition, which had the greatest impact on industry. Since then, however, the trend has been slowly reversing, leading to modest, but steady, increases in the level of industrial activity, and mild increase in the emissions of SO₂, NO_x and dust. Air quality problems are particularly encountered around the bigger cities, thus potentially affecting 60% of the total population.

Almost two thirds of the total annual SO₂ emission derives from the energy combustion and transformation, while energy generation and mobile sources are the major sources of emissions of NO_x. With regard to dust, individual industrial production processes are the main sources, while road traffic is the major source of CO emissions. Energy generation from thermal power plants (REK Bitola covers approximately 75% of the total national electricity demand) and heat production facilities are other sectors, the activities of which severely affect the air quality. Level of air emissions from mobile sources depends not only on the level of activity, but there is also a direct relation to the quality of fuel used.

Law on Ambient Air Quality⁴ regulates the adoption of limit values; margins of tolerance; target values; and upper and lower assessment thresholds for individual pollutants as specified in the EU Framework Directive 96/62/EC. Development of secondary legislation on ambient air quality provides for further harmonization with the Framework Directive on Air Quality 96/62/EC, and with the related daughter Directives.

With regard to the current situation in the Republic of Macedonia, monitoring of air quality is performed automatically by means of monitoring stations (13 fixed air quality monitoring stations, one mobile and one traffic pollution monitoring station), and by manual sampling at several predefined measuring points. Monitoring stations measure environmental parameters (carbon monoxide, sulphur dioxide, nitrogen oxides, ozone and PM10 - suspended particles in the air with a size of 10 micrometers), as well as meteorological parameters (wind velocity, wind direction, temperature, humidity, pressure, global radiation). Four high volume and six low volume samplers have been installed for the purpose of analysing the composition of suspended particles of 10 micrometers, i.e. detecting the presence of heavy metals in the air. As part of the system, there is a calibration laboratory used for analysers calibration.

With regard to emissions, Cadastre for Air Emissions and Polluters was prepared for 2004, and it covered around 600 individual sources - companies and around 1000 collective or minor sources of emission from the traffic on the territory of the Republic of Macedonia. In the field of emission inventory, CORINAIR (CoR Inventory Air Pollution) methodology has been introduced as national methodology applied on the inventory development.

Main objective in this area is improvement of air quality by reducing emissions of major pollutants from relevant sectors, while monitoring of both air emissions and air quality establishes the basis for undertaking the protection measures. Following future needs have been identified, aimed at achieving this objective in line with the requirements of the relevant Directives: upgrading (extension) of automatic monitoring system; introduction of data quality assurance and quality control system; maintenance and updating of national Cadastre and Registers of polluters and polluting substances, as well as institutional strengthening.

In this area, development of National Air Quality Management Plan is confirmed as priority, as well as the Programme for air pollution reduction and ambient air quality improvement. Definition of assessment criteria for ambient air quality and lists of zones and agglomerations are also included among the obligations that have to be implemented in the forthcoming period.

⁴ The Law establishes grounds for laying down ambient air quality limit values and alert thresholds, emission limit values for exhaust gases and vapours from stationery sources, emission limit values for exhaust gases from mobile sources, and contents of harmful substances in fuels (Official Gazette of RM No. 67/04)

Regional competitiveness

Improving regional competitiveness is one of the Government's priorities in the forthcoming period aimed at higher growth and capacity building to withstand future competitive pressure in the EU.

Cross-country studies show relatively weak competitiveness of the Macedonian economy. According to the Country National Competitiveness Report for 2006, prepared by the National Council for Entrepreneurship and Competitiveness, the Global Competitiveness Index (Global CI) for the Macedonian economy has improved from 3.84 in 2005 to 3.86 in 2006, but the ranking of the country has dropped from 75th to 80th position.

SME's and Business environment

Small and medium sized enterprises (SME's) are dominant type of enterprises in Macedonian economy, with a 98.8% share in total number of enterprises in 2005. However, there are 21.1 SME's per 1000 inhabitants in Macedonia, which compares unfavourably with the EU – 15 average of 52.8. SME's are mainly concentrated in retail and wholesale trade. An analysis of the spatial distribution of SME's activity indicates a lower concentration in the eastern parts of the country.

The importance of the SME sector is mirrored in the employment figures, where in 2005 over 75% of the total employment is in SME's. The average size of SME's in 2005 in terms of employment was 6 persons per SME. The number of active SME's in the RM has been growing steadily over the last 5 years at rates between 3.8% and 7.5% p.a., with an average annual growth rate of 5.7%. The share of the SME's sector in the gross value added was increasing steadily throughout the years and reached 72.0% in 2004. Given the size of the SME's sector in Macedonia, and based on international experiences, a further development of the SME's sector is one of the main preconditions for improvement of the regional competitiveness of the country. In this regard, a national SME's observatory was established with an aim to prepare a SME's analysis, propose measures to stimulate their development and follow on the European Charter on SME's.

There are no national analyses at company level, but according to the World Bank's Business Environment and Enterprise Performance Survey (BEEPS) conducted in 2002 and 2005, large progress has been made in the business environment, especially in the following areas: macroeconomic stability, reduction of the organised crime, reduction of the uncertainty in the regulatory policy and customs and trade regulation. However, a survey of firms' perception in 2005 reveals that the largest obstacles for their activity are still the corruption, court system, non-competitive behaviour, cost of and access to financing, and transport.

Starting from 2005, there has been a continuous improvement in the business environment in several areas. First, given the inefficient court system and long-lasting disputes, in December 2005 the Parliament approved a series of Constitutional amendments aimed at making the judiciary more efficient and reducing the extent of political influence. Second, in order to ease market entry, reforms have been conducted to reduce time and financial resources to register a business. In this respect, a "one-stop shop" for the registration of businesses came into force in January 2006, significantly reducing the time and money needed to start up a business. Third, market exit was facilitated by the new bankruptcy legislation from March 2006 that streamlined and shortened bankruptcy procedures and reduced their costs. Forth, the new Government started a regulatory reform aimed at simplifying and minimizing regulatory requirements and burden on businesses. Fifth, given the effect of tax system on businesses both from administrative and financial point, starting from 2006, the Government has undertaken several measures to improve this system. Towards the end of 2006 the Government started reforms in the area of taxes and social contributions to further reduce the burden on enterprises. In particular, it reduced the corporate tax from 15 to 12% in 2007 and 10% in 2008. A flat personal income tax was introduced instead of the previous progressive system with 3 rates (15, 18 and 24%), with a

reduced rate of 12% in 2007 and 10% in 2008. In the area of social contributions, reforms, agreed with the IMF, already started in terms of harmonisation of basis for calculation of contributions, introduction of same minimum contribution base, and establishment of a single collection point of all social contributions, that is Pension and Disability Fund.

Facing a small domestic market, SME's in the Republic of Macedonia must increase their presence on the international markets as a means to achieve economies of scale and increase their sales and profitability. Hence, the importance of their competitiveness depends on a set of regulatory and institutional factors. The National Council for Entrepreneurship and Competitiveness has been established, which is a three-party entity that facilitates the dialog between the private, public and the civil sector. Within the Council five clusters have been established: for lamb and cheese, tourism, IT, wine and textile.

In order to support the entrepreneurship at the regional level, the Agency for Entrepreneurship Support operates through 9 regional centres (electronically connected), 8 Incubators, 4 Centres for transfer of technology, 5 Clusters, 77 Offices for local economic development, as well as chambers and associations. There is also Euro info correspondence centre, as well as Fund for Development of Human Resources.

The support to the SME's sector development is defined in the Programme for Support of SME's (2007-2010) which should enhance the efficiency of enterprises and their competitiveness. This will be achieved through support of innovations, strengthening of the guarantee fund and issuing of guarantees, support for introducing new technologies, creation of investment funds, expansion of mortgage instruments, program for micro-financing of specific vulnerable groups (women, youth, students, farmers, single parents, handicapped, long-term unemployed).

R&D

In the area of R&D and innovation, with a 4 scientists per 1000 inhabitants and only 0.25 of GDP in 2004 spend on R&D, Republic of Macedonia fares internationally relatively poor. R&D expenditures come mainly from the universities, whereas the private sector participation is very low. According to data from the Central Registry, during 2004 only 2 small, 21 medium and 31 large enterprises invested in R&D activities in total amount of € 1.24 million.

In addition, there is still low level of awareness among businesses about the importance of science and technology for their productivity and competitiveness. However, establishment of a knowledge-based economy and enhancement of regional competitiveness raises a need to expand and strengthen the innovation capacity, both organisationally and spatially, to make innovation widespread and information technologies and market knowledge directly channelled to economic agents.

These are the main objectives identified in the Government Programme for Development of Entrepreneurship, Competitiveness and Innovation of SME's (2007-2009). They will be achieved through a combined approach of targeted support of investments in innovation and ICTs, improvement of management systems, improvement of production processes through advanced technologies, greater industry-university cooperation, establishment of technologically-industrial development zones, etc. The Programme budget is approximately 500,000 EUR and it also envisages establishment of at least one technology park focusing on software production, computer chips and other ICT-related aspects.

ICTs

Macedonia has the highest prices for internet access in the region and, with a 6.2% internet penetration, holds the second to the last position in the region. Most Macedonian SME's are not capable of utilizing ICT for their daily business. In 2006, 92% of enterprises with more than 10 employees owned computers and 72.3% had internet access. The use of ICT and Internet declines with the size of the firms.

In 2005, a National Strategy for Information Society Development was prepared with an overall objective to enable efficient implementation and use of ICT by all entities in the Republic of Macedonia. This broad objective is expected to be achieved through the completion of numerous policies and measures, mainly setting up an institutional framework for an ICT society, raising public awareness for the needs and advantages of the information society advancements, better access to internet for all citizens, etc.

The GoRM has a twofold role in establishment of Information Society. In particular, on the supply side, the GoRM role is to enhance the development of a fast and cost-effective communications, infrastructure and technologies. On the demand side, the GoRM will improve its services through development of e-business, e-government, e-education, e-health, and e-citizen.

Regional disparities

In the Republic of Macedonia, according to the NUTS classification there are eight NUTS 3 regions (see Map B3 in the Annex) - Pelagonia region, Vardar region, North-East, South-West, Skopje region, South-East, Polog region and East region and further into 84 municipalities and the City of Skopje.

Analysis of the available disaggregated economic data demonstrates significant disparities among regions, especially if we compare Skopje region with others.

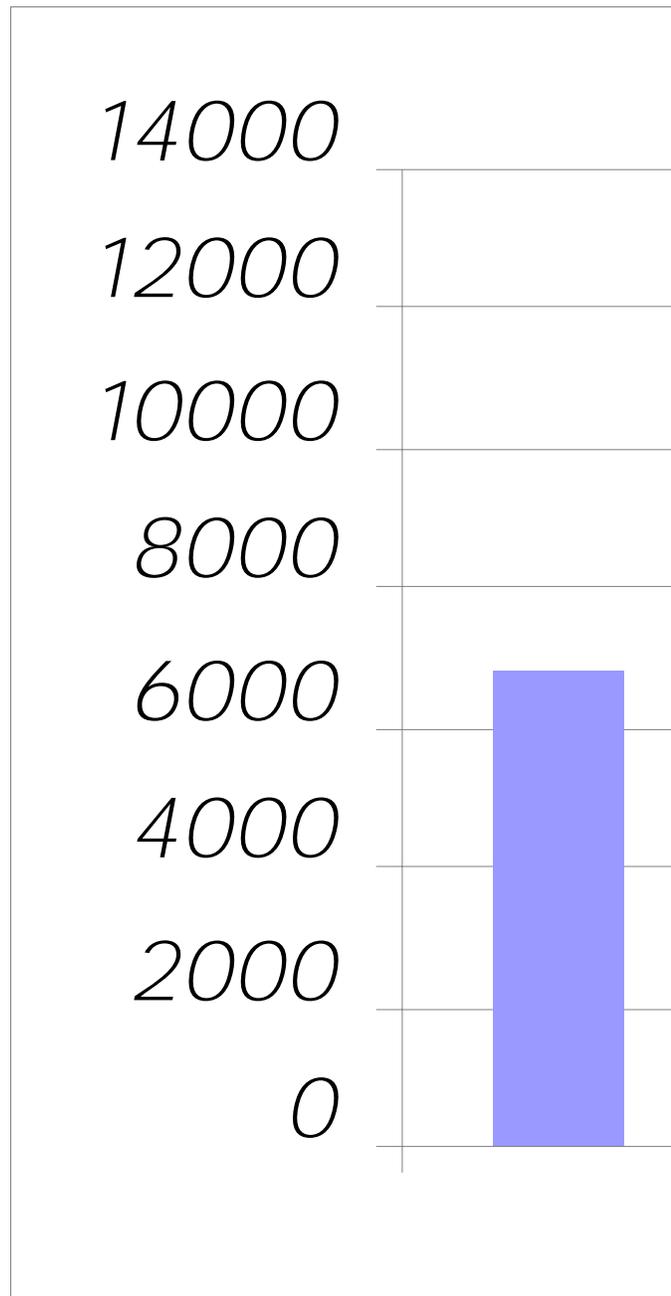
Table 2-2 Regional disparities, 2002

	Population	Employed	Unemployment rate	GDP (PPP in \$)	GDP per Capita (PPP in \$)	% of country's average	Average GDP per capita growth rate 1998-2002
Macedonia	2022547	460544	38.1	13854081	6850	100	5.2
Pelagonia	238136	62551	39.9	1644320	6905	101	2.4
Vardar	133180	31672	43.9	744617	5591	82	2.3
North-East	172787	30841	48.7	611910	3541	52	-1.0
South-West	219741	39589	42.4	921123	4192	61	2.8
Skopje	578144	154914	30.4	6916835	11964	175	8.7
South-East	171416	50559	34.4	1036996	6050	88	4.1
Polog	305930	35638	49.9	941066	3076	45	1.4
East	203213	54779	34.5	1037213	5104	75	1.9

Source: State Statistical Office and UNDP

Skopje region with GDP per capita (PPP) of \$11.964 is far ahead compared with the others regions and the average of the country (\$6.850). Furthermore, GDP per capita of Skopje region is around 50% of the EU average (which is higher than most new EU members). The same pattern is present when the other indicators by regions (NUTS 3) are compared.

Figure 2-1 GDP



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Table 2-6 SWOT analysis covering

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- Pan-European corridors VIII and X that connect the EU as trans-national axes and multiple
- Regional cooperation in the area of transport infrastructure. The Europe Transport Observatory-SEETO provides a regional approach for transport infrastructure
- Relatively developed national road infrastructure with high coverage

Oppor

- Geographical proximity to the m
- Proximity to Adriatic and Medit
- Geographical location favourable
energy resources within the re
- Availability of the IPA funds as

Table 2-7 SWOT analysis covering

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- Recent trend of increase in the and of graduated students
- Labour costs in terms of gross
- Established institutional framework strategies and implementation
- Basic educational infrastructure including the VET schools

- EU accession process
- Labour force potential which ca
- Modernised educational system
productive workforce with a po

3. OBJECTIVE

3.1. Objectives Resources

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Priority axis 3:

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5. INDICATIVE UNDERLYING ACCORDANCE

5.1. Regional D

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6. KEY ELEMENTS

6.1. Sectoral approach

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7. ANNEXES

7.1. Tables

Current account deficit millions of \$ U

- Current account deficit (% of GDP)

Foreign direct investments

- Foreign direct investments (% of G

Table A3 Parti

National average
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Table A6 Emp

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Self – employed
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Source: LFS, vari

Table A8 Soci

Social Work Centres
Total
Berovo
Bitola
M.Brod
Valandovo
Vinica
Gevgelija
Skopje

Table A9 Num

Total
Macedonians
Albanians
Turks
Roma
Serbs
Vlaches

Map B2: Pan E

