SUMMARY

1. The former Yugoslav Republic of Macedonia, a small, landlocked country of two million people with a GDP of around US$10 billion, is open to trade, with exports and imports in goods and services accounting for 127% of GDP in 2012. Despite the inherent disadvantages of small size and limited resources, the Government has established and maintained a policy framework that has had considerable success in several areas: promoting growth; stabilizing the macroeconomic and financial environment in the face of external shocks; enabling reforms to speed up EU accession and facilitate export of Macedonian products to EU markets; facilitating access to other important markets through accession to the WTO and signing free-trade agreements; as well as improving the business environment to attract foreign direct investment.

2. The country is on the threshold of EU accession, having achieved candidate status in 2005 although formal accession negotiations have not commenced, pending, *inter alia,* resolution of the name issue. The focus of economic and trade-related reform has been on adopting the *acquis communautaire,* the regulations and common policies that define the EU as a single market, with considerable achievements in movement of goods, freedom to provide services, public procurement, financial services, customs reform, food safety, transport, and agriculture.

Economic developments

3. Economic output expanded vigorously between 2006 and 2008, when it averaged 5.3% per annum. Due to the international economic crisis, growth slowed in 2009 but less than in regional neighbours. The subsequent recovery was relatively rapid, with growth reaching nearly 3% in 2010 and 2011. Due to the euro-zone crisis and weaker demand for exports, the economy contracted by an estimated 0.2% in 2012. Monetary policy has been anchored for over 15 years by the currency peg to the euro and previously to the DM. As a result, inflation was low and stable, government debt fell to under 21% of GDP while, at around 49% of GDP, external debt remained moderate. The country has made progress towards becoming a market economy and needs to continue reforms to further lower the cost of doing business, including infrastructure investments and regulatory reforms, as well as those to improve the functioning of the labour market and raise worker skill levels, given high and persistent unemployment.

4. Regarding improvement of the business climate, the country has been investing in technological industrial development zones (TIDZs), characterized by good access to infrastructure and tax incentives. These are encouraging business to invest in the country, making foreign direct investment (FDI) the cornerstone of future export-oriented growth. The authorities are aware that supportive macroeconomic policies and continued structural reforms to improve competitiveness are crucial to increasing investment and productivity.

5. Given that both domestic and foreign investment are crucial to future competitiveness, the authorities are committed to making the investment climate more stable and predictable in order to stimulate greater investment levels. Recently, the country has been successful in attracting significant greenfield FDI, in particular in the automotive components sector. The shift towards greenfield FDI reflects the country's investment-related strengths, including: low labour costs and taxes; geographical proximity to assembly plants in central and western Europe and Turkey; duty-free access to the large European market; and a number of investment incentives, including tax holidays.

Trade policy framework

6. The Ministry of Economy is the main government institution responsible for formulating and implementing policies relating to foreign trade. It is responsible for concluding and signing trade treaties and other trade-related agreements with third countries. Foreign trade policy is formulated in close contact with the Ministry of Finance, which is also responsible for cooperation with international financial institutions and policies concerning banking and credit, foreign exchange, and customs.

7. The WTO Agreements and the country's current and future trade relations with the EU are the main factors influencing the trading system. Since its accession to the WTO in 2003, the former Yugoslav Republic of Macedonia has reformed its policies in trade and related areas with

the aim of bringing domestic legislation into line with WTO requirements and with the EU *acquis communautaire*. This has entailed a broad review and the updating of almost all trade-related legislation, a process that is continuing.

8. Macedonian trade is strongly oriented towards its FTA partners. Currently, 90% of Macedonia's exports and nearly 80% of its imports are carried out under FTAs, with the EU accounting for 63% of exports and 58% of imports. Around 80% of trading is free of custom duties and 7% takes place with preferential custom duties. The FTAs allow the former Yugoslav Republic of Macedonia to be included in the system of diagonal accumulation of origin of goods concerning the EU, EFTA, the countries of central and eastern Europe, and Turkey and CEFTA (Central European Free Trade Area).

9. The Government attaches considerable importance to the Doha Development Agenda negotiations. As a landlocked country, the former Yugoslav Republic of Macedonia closely monitors progress in the trade facilitation negotiations. On agriculture, it agrees with the position of recently acceded Members that such Members should not be required to undertake reduction commitments in all pillars. On non-agricultural market access, the country supports the position that it should be excluded from further tariff reductions, considering the numerous market-access commitments undertaken during accession. Similarly, in the services area, the Government is of the view that account should be taken of the extensive market access commitments made.

Trade policy instruments and practices

10. In addition to making extensive trade-related commitments in the WTO, trade and investment policies have been oriented towards the goal of accession to the EU. The country has made progress with adopting the *acquis,* in line with its candidate status, and has initiated new and amended legislation in several domains, including company registration, customs, government procurement, standards and SPS measures, competition policy, and intellectual property. The overall trade-related regulatory framework has improved significantly in recent years, and the Government is focusing on consolidating and effectively implementing the recently adopted and amended laws and regulations.

11. Imported goods are generally subject to customs duties, excise duties, and value-added tax. As a share of total tax revenue, customs duties declined steadily from 9.4% in 2006 to 5.7% in 2012, reflecting the trend in trade liberalization and tariff reduction. Although revenue from customs duties has been in decline, trade-related taxes (customs duties + VAT on imports + excise duty on imports) overall accounted for 58% of the country's total tax revenue in 2006 and 68.9% in 2012, due to the growing importance of VAT and excise duties on imports.

12. The simple average applied MFN tariff declined from 11.1% in 2004 to 8.5% in 2013. While average tariffs are low, dispersion of rates is relatively high, ranging from zero to 70%. Prepared foods, footwear and headgear, arms and ammunition, and vegetable products, have average tariff rates above or well above the average. All non-preferential partners are subject to MFN treatment. The former Yugoslav Republic of Macedonia bound 79.4% of its tariff lines in 2003, increasing to 100% by 2012, and with acceptance of sectoral tariff harmonization agreements, thousands of tariff lines were eventually bound at zero. Agricultural products are bound at 17.5% and industrial products at 6.2%.

13. Upon accession to the WTO the former Yugoslav Republic of Macedonia undertook to eliminate and not reintroduce or apply quantitative restrictions on imports, or other non-tariff measures such as licensing, quotas, bans, permits, prior authorization requirements, licensing requirements, and other restrictions having equivalent effect, that cannot be justified under WTO rules. The authorities maintain that the current import licensing regime is in full compliance with WTO rules.

14. The Government committed itself to ensuring enforcement of its WTO obligations in its (then) free economic zones, which meant eliminating any requirements for use of local goods or for export performance. In addition, goods produced in these zones with imports and imported inputs free of tariffs and certain taxes, would be subject to normal customs formalities when entering the rest of the country's territory, including payment of tariffs and taxes. These basic principles continue to apply to the TIDZs, established to provide favourable conditions for the

development of business activities by offering prepared industrial sites with investor-ready physical and legal infrastructure, support services, and tax, customs, and other incentives. The zones are established to develop modern technologies and efficient resource utilization by applying high environmental standards.

15. The Government has mostly harmonized its technical standards legislation with the relevant EU Directives and the country has achieved a high level of transposition of the European technical legislation into domestic legislation, related, *inter alia,* to the horizontal legal framework concerning standardization, accreditation, metrology, conformity assessment, and market surveillance.

16. In the WTO, the former Yugoslav Republic of Macedonia committed itself to amending existing legislation to comply with the SPS Agreement in the area of veterinary and phytosanitary measures, with regard to: new regulations on animal protection based on World Organization for Animal Health (OIE) recommendations and standards; new regulations on plant protection in conformity with International Plant Protection Convention (IPPC) standards; examination and harmonization of national legislation with Codex Alimentarius (CA) standards; reorganization of a national reference laboratory in compliance with ISO/IEC standards; and preparation of a national food safety programme. This has increasingly allowed the country to accept the principle of equivalence, to perform control, inspection, and approval procedures consistent with WTO rules, and to take account of risk-assessment techniques developed by the relevant international organizations.

17. In the area of food safety and veterinary policy, the country has achieved a high level of harmonization of its legislation with international SPS standards. In terms of phytosanitary policy, new regulations on plant protection in conformity with IPPC standards have been adopted and several others are slated for adoption in 2013/14. The authorities recognize that training is need for relevant bodies on implementing SPS measures. In addition to assuring consistency with WTO rules, the Government has focused in recent years on improving the capacity of the competent authorities to implement the EU *acquis* regarding: field inspection services, food and feed safety, animal disease control, plant health and plant protection products, control of veterinary medicinal products, and enhancement of border-post import control.

18. Privatization of state-owned enterprises (SOEs) was relatively rapid and largely completed during the 1990s, mostly through sales to the management and employees of the companies. Out of around 2,000 SOEs, fewer than 70 are still not privatized; according to the authorities, state capital in these enterprises as a share of GDP is approximately 15%. State capital remains concentrated in the energy sector (power generation and transmission companies are state-owned), public utilities, and public enterprises associated with the railways. The State also owns a significant minority stake in the profitable telecommunications company, Makedonski Telekom. Competition law is well developed and the focus is on strengthening the competition authority to implement it.

19. The former Yugoslav Republic of Macedonia has a relatively comprehensive and recently updated legal framework for intellectual property (IP) protection, which includes the Law on Industrial Property (covering patents, trademarks, industrial designs, appellations of origin, and geographical indications) and the Law on Copyright and Related Rights, which are in accordance with relevant EU Directives and pertinent international conventions. However, progress in IP rights protection has been uneven and intermittent and further work is required to enforce IPRs in a transparent and consistent manner. Although a solid track record on investigation, prosecution, and trials of IPR-related cases has yet to be established, a promising basis was created in 2012, when a methodology was adopted for the collection and processing of statistical data for enforcement purposes.

Sectoral policies

20. The economy is characterized by a large services sector, a medium-sized industrial sector, and a small agriculture sector. Services contribute over half of GDP and engage over half of the employed labour force, while nearly a quarter of GDP is generated by the industrial sector, which is dominated by iron and steel, garments, construction, and mining.

21. Regarding agriculture, upon WTO accession the country committed to the termination of quotas (other than tariff quotas in existing free-trade agreements), abolition of variable levies and export subsidies, phased reduction of import tariffs, and reform of the State Office for Commodity Reserves. The border protection regime is more restrictive for agriculture than for industrial products, similar to the pattern in many other countries. MFN tariffs on imports from some preferential and non-preferential partners remain relatively high. Periodically, the Government has introduced export restrictions, including temporary export bans on wheat flour to prevent serious shortages in the domestic market, resulting from insufficient production of wheat in the country. Instruments used for domestic support are being harmonized with those of the EU with most of the funding going to income support measures.

22. Manufacturing accounts for the large majority of exports and over one-sixth of total employment if food production and processing is included. Its strengths are in the areas of ferrous and non-ferrous metallurgy, the machinery, automotive and electrical equipment industry, the chemical industry, the textile industry, processed food and beverages, and the construction industry. The strategy of attracting FDI is starting to show positive results as new investments in manufacturing located in the TIDZs are transforming the country's export basket. Chemicals have become a significant export sector (after metals and apparel), accounting for an estimated 10% of total exports in 2010. This is a direct consequence of new investment for production of emission control catalysts, which is contributing to diversification towards more competitive products.

23. Despite its small share in world services trade, the former Yugoslav Republic of Macedonia made commitments in 115 of 155 services sectors (the same overall number as the EU) when it acceded to the WTO. It scheduled extensive commitments, including on financial services, telecommunications, transport, tourism, and professional services.

24. In relation to the overall economy, the size of the financial sector is considered to be broadly consistent with Balkan region norms in terms of deposits (53% of GDP in 2012), stock market capitalization (24% of GDP), and insurance (insurance premiums were 1.5% of GDP in 2012). The critical ratio of bank credit to GDP (47% in 2012) is lower than the regional average and lags far behind the more developed eurozone region, which is used as a global benchmark. In 2012, the intermediation rate (measured as total assets/GDP) rose to 86%, which is considered relatively low by regional standards. Access to financial services is difficult and apart from banks, the financial sector remains relatively unsophisticated, and plays a limited role as an engine of economic growth. The leasing market is underdeveloped and the share of savings houses in the total assets of the banking system remains low at around 1%, while other institutions providing financial services have a total market share of around 10%.

25. The country is aiming to establish efficient transport services and logistics, which are critical for a land-locked country. However, significant challenges such as poor road safety, low competitiveness of railway operations and infrastructural shortcomings mean that limited progress has been achieved in transport policy. The small Macedonian air transport sector has gradually resumed growth and the Government has overhauled the institutional framework and concessioned the two airports to a private operator. More frequent and cheaper flights would help promote inbound tourism, which currently generates around 6% of the country's services exports.

Outlook

26. The short-term outlook for the former Yugoslav Republic of Macedonia is uncertain given the current global turmoil and doubts about recovery in the eurozone. Growth is expected to pick up to around 2% for 2013, and possibly to subsequent rates of over 3%, provided that global conditions improve significantly and the authorities continue to pursue structural reforms and supportive macroeconomic policies, and realize planned FDI to further diversify the export basket. Reforms to improve competitiveness will be key to further boosting investment and increasing productivity. Continuing reforms that aim to lower costs for business, including infrastructure and regulatory reforms, as well as those that improve the functioning of the labour market, are also central to future growth. However, the downside risks may be significant, with any further deterioration in the external environment likely to spill-over into the former Yugoslav Republic of Macedonia mainly through trade and investment channels, possibly leading to stagnant or even declining economic output.