

EN

EN

EN



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 08.11.2006
SEC (2006)1387

COMMISSION STAFF WORKING DOCUMENT
The Republic of Macedonia* 2006 Progress Report
EN

{COM (2006) 649 final}

EN

EN

* The Secretariat for European Affairs intervened in the text by replacing the reference "former Yugoslav Republic of Macedonia" with the constitutional name "Republic of Macedonia"

TABLE OF CONTENTS

1.	Introduction.....	4
1.1.	Preface.....	4
1.2.	Relations between the EU and the Republic of Macedonia.....	5
2.	Political criteria.....	5
2.1.	Democracy and the rule of law.....	5
2.2.	Human rights and the protection of minorities.....	12
2.3.	Regional issues and international obligations.....	16
3.	Economic criteria.....	17
3.1.	Introduction.....	17
3.2.	Assessment in terms of the Copenhagen criteria.....	18
3.2.1.	The existence of a functioning market economy.....	18
	3.2.2. The capacity to cope with competitive pressure and market forces within the Union.....	21
4.	Ability to assume the obligations of membership.....	23
4.1.	Chapter 1: Free movement of goods.....	24
4.2.	Chapter 2: Freedom of movement for workers.....	25
4.3.	Chapter 3: Right of establishment and freedom to provide services.....	25
4.4.	Chapter 4: Free movement of capital.....	26
4.5.	Chapter 5: Public procurement.....	27
4.6.	Chapter 6: Company law.....	27
4.7.	Chapter 7: Intellectual property law.....	28
4.8.	Chapter 8: Competition Policy.....	29
4.9.	Chapter 9: Financial Services.....	31
4.10.	Chapter 10: Information society and media.....	31
4.11.	Chapter 11: Agriculture.....	32
4.12.	Chapter 12: Food safety, veterinary and phytosanitary policy.....	34
4.13.	Chapter 13: Fisheries.....	35
4.14.	Chapter 14: Transport policy.....	35
4.15.	Chapter 15: Energy.....	36

4.16.	Chapter 16: Taxation	37
4.17.	Chapter 17: Economic and Monetary Union.....	38
4.18.	Chapter 18: Statistics	39
4.19.	Chapter 19: Employment and Social Policy	40
4.20.	Chapter 20: Enterprise and Industrial Policy.....	41
4.21.	Chapter 21: Trans European Networks	42
4.22.	Chapter 22: Regional Policy and Coordination of Structural Instruments	43
4.23.	Chapter 23: Judiciary and fundamental rights	44
4.24.	Chapter 24: Justice, Freedom and Security	48
4.25.	Chapter 25: Science & Research.....	50
4.26.	Chapter 26: Education & Culture.....	51
4.27.	Chapter 27: Environment.....	51
4.28.	Chapter 28: Consumer and Health Protection.....	53
4.29.	Chapter 29: Customs Union.....	53
4.30.	Chapter 30: External Relations	54
4.31.	Chapter 31: Foreign, Security and Defence Policy.....	55
4.32.	Chapter 32: Financial control	56
4.33.	Chapter 33: Financial and Budgetary Provisions	57
	STATISTICAL ANNEX	58

COMMISSION STAFF WORKING DOCUMENT The Republic
of Macedonia 2006 Progress Report

1. INTRODUCTION

1.1. Preface

The European Council of 17 December 2005 granted the status of candidate country to the Republic of Macedonia. This is the first report on progress made by this country in preparing for EU membership.

The report:

- briefly describes the relations between the Republic of Macedonia and the Union;
- analyses the situation in the Republic of Macedonia in terms of the political criteria for membership;
- analyses the situation in the Republic of Macedonia on the basis of the economic criteria for membership;
- reviews Republic of Macedonia's capacity to assume the obligations of membership, that is, the *acquis* expressed in the Treaties, the secondary legislation, and the policies of the Union.

The period covered by this report is 1 October 2005 to 30 September 2006. Progress is measured on the basis of decisions taken, legislation adopted and measures implemented. As a rule, legislation or measures which are under preparation or await Parliamentary approval have not been taken into account. This approach ensures equal treatment across all reports and permits an objective assessment.

The report is based on information gathered and analysed by the Commission. In addition, many sources have been used, including contributions from the government of the Republic of Macedonia, the Member States, European Parliament reports and information from various international and non-governmental organisations.

The Commission draws conclusions regarding the Republic of Macedonia in its separation communication on enlargement², based on the technical analysis contained in this report.

¹ The *rapporteur* for the Republic of Macedonia is Mrs Doris Pack.

² Enlargement Strategy and Main Challenges 2006 - 2007.

1.2. Relations between the EU and the Republic of Macedonia

The Republic of Macedonia is participating in the Stabilisation and Association Process.

The Republic of Macedonia has made progress in the implementation of the Stabilisation and Association Agreement (SAA). But is not meeting all of its obligations under the SAA. Notable exceptions include telecom liberalisation and the protection of the intellectual property.

In July, the Commission submitted a proposal to the Council for negotiating directives to negotiate visa facilitation and readmission agreements with the Republic of Macedonia.

The revised European Partnership was adopted in January and the government presented an action plan for its implementation in February. The government adopted a draft National Programme for the Adoption of the *Acquis* in March.

The EU Police mission, "EUPOL Proxima", ended in December. The implementation of the police reform at local level continued to be supported by an EU Police Advisory Team until June, then by a CARDS funded project.

The EC pre-accession financial assistance to the Republic of Macedonia amounts to € 43.6 million for 2006.

2. POLITICAL CRITERIA

This section examines progress made by the Republic of Macedonia towards meeting the Copenhagen political criteria which require stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities. It also monitors, regional cooperation, good neighbourly relations, and the respect for international obligations, such as cooperation with the UN International Criminal Tribunal for the former Yugoslavia.

2.1. Democracy and the rule of law

The *Constitution* was amended in December 2005, mainly to pave the way for the reform of the judiciary as recommended in the European Partnership. Eleven amendments were made to reform the court system, the immunity rules, the administrative sanction system, the selection and training system for judges and prosecutors, the Judicial Council and the Public Prosecutor's Office, and allow administrative bodies to impose sanctions.

Parliament

Parliamentary elections were held on 5 July.

There were significant efforts to improve the electoral system in the period leading up to the elections. Recommendations of OSCE's Office for Democratic Institutions and Human Rights (OSCE-ODIHR) were taken into account in line with the European Partnership. The Democratic Party of Albanians (DPA) returned to Parliament in February, following a 9-month boycott. This was a welcome development which allowed DPA's participation in the

debate on the electoral code and judicial reforms. The opposition was then able to fully assume its role in accordance with democratic standards. A comprehensive reform of the electoral code was enacted in March with a broad consensus, providing for a fully professional State Election Commission. The influence of political parties over electoral administration was significantly curtailed, by ensuring the participation of civil servants in electoral administration. New legal provisions have improved the position of women as regards both inclusion in lists of candidates and participation in the electoral administration. At the same time, the criminal code was changed to strengthen sanctions for election-related crimes. In June, the leaders of the main parties signed a code on fair elections.

The judiciary has acted against the perpetrators of irregularities committed during the local elections in 2005. Sentences were delivered in 14 of the 19 cases prosecuted and prison sentences delivered against 28 perpetrators.

The electoral process was conducted generally in a peaceful and orderly manner and largely in accordance with international standards, as observed by OSCE-ODIHR.

However, there were significant irregularities on the election day. Ballot stuffing, family voting, intimidation and other types of fraud continued to occur, albeit at lower levels than in previous elections. Additionally, the early days of the election campaign were tainted by a number of violent incidents, mainly involving the two principal ethnic Albanian parties.

The first round of voting took place on 5 July and voting was repeated on 19 July in 29 polling stations where it had been cancelled by the Supreme Court due to irregularities. However, there were still shortcomings in a substantial number of polling stations in applying OSCE principles and commitments as well as the commitments set out in the code of conduct signed by political leaders. The Public Prosecutor's Office therefore initiated procedures for 11 criminal acts during the pre-election period and investigations of eight cases of electoral fraud as a result of police reports.

Voter participation was low, at 56%. Citizens' trust of the electoral process should be further strengthened. All irregularities should be investigated and addressed so that they do not occur in the future. Strong political commitment will be needed to ensure higher standards at the next elections due in 2009.

Following the elections, the coalition "For a better Macedonia" won 45 of the 120 seats. This included the Socialist Party and the Liberal Party, led by the *Internal Macedonian Revolutionary Organisation - Democratic Party for Macedonian National Unity* (VMRO-DPMNE). It formed a government coalition with the Democratic Party of Albanians, the New Social-Democratic Party, VMRO-National Party, the Democratic Renewal of Macedonia and the Party of European Future.

The parliamentary seats were distributed as follows: VMRO-DPMNE (37), Social Democratic Union (24), Democratic Union for Integration (14), Democratic Party of Albanians (11), New Social-Democratic party (7), VMRO-National party (6), Liberal Democratic Party (5), Liberal Party (3), Party for Democratic Prosperity (3), Socialist Party (3), Democratic Party of Turks (2), Democratic Renewal of Macedonia (1), Party of European Future (1), Roma Union (1), Democratic Party of Serbs (1). 30% of the Members of Parliament are women.

The new Parliament held its constitutive session on 26 July. The DUI-PDP coalition has boycotted Parliament from its first meeting in protest at not having been invited to be part of

the new government, as the main ethnic Albanian parliamentary group having won 60% of the ethnic Albanian community votes.

Until its recess in June, the Parliament generally functioned satisfactorily. Progress in the Stabilisation and Association Process was regularly discussed in the Committee on EU Affairs based on reports by the Deputy Prime Minister, who is in charge of EU integration. However, a persistent disagreement on the use of the Albanian language by the chairperson of the committee prevented the social affairs committee from meeting. The committee for security and intelligence issues could also not meet, after its chairperson was transferred for trial to the International Criminal Tribunal for the former Yugoslavia (ICTY) in 2005.

The increased tension between the majority and the opposition, especially with DUI-PDP, needs to be addressed. It will be essential for the government to seek consensus on a number of critical reforms, due to the specificities of the country's political model, and in the interest of political stability. The opposition will need to assume its role fully and constructively. This will be particularly important in areas linked to the reforms undertaken to implement the Ohrid Framework Agreement, where decisions require a double majority: a majority of MPs and a majority of the MPs belonging to non-majority communities. The necessary channels of communication have to be established without further delay.

Overall, there was some progress in strengthening the electoral process, despite irregularities and incidents which will have to be fully addressed. A constructive dialogue between all parties will be essential to adopting and implementing important political reforms and related legislation. The implementation of the Ohrid Framework Agreement remains essential to foster a positive environment for further reforms.

Government

Prime Minister Gruevski presented a new government which was approved by Parliament on 26 August. It includes representatives from the Democratic Party of Albanians, the New Social-Democratic Party, the Socialist Party, the Liberal Party and the Democratic Party of Turks. The government presented its priorities for 2006-2010 which were: improving the living standards of the citizens, increasing employment, strengthening the fight against corruption, developing democracy, improving interethnic relations, political stability and integration into the EU and NATO.

Public Administration

The 2000 Law on Civil Servants has been further implemented and the first performance appraisal of the civil servants completed in 2005. An Action Plan was adopted in January to set up a functional human resources management system. A new system of salaries for civil servants was introduced in April. Rules for defining disciplinary offences and conducting disciplinary procedures have been established. 31 disciplinary procedures have been initiated against civil servants in 2006.

Steps have been undertaken to increase transparency in public administration. A new Law on Free Access to Public Information, enacted in January, entered into force in September. An independent commission was set up in June to oversee its implementation. The government also promoted several web-portals to facilitate access to administrative bodies.

The number of complaints to the Ombudsman increased by 56% in 2005, mostly due to better public awareness. All ten deputy Ombudsmen have taken office, which should further improve the operation of the Ombudsman institution. Since January, all ministries have to report on a three-monthly basis to the General Secretariat of the government on the implementation of recommendations or requests made by the Ombudsman.

The government's rules of procedures were amended in April to further improve the planning and decision-making system. A new coordinating body for inspectorates has been set up to strengthen their role.

The Secretariat for European Affairs has assumed a central role in coordinating progress on EU integration objectives. An audit of the structures put in place to work on the European integration process has been launched in order to assess future needs. An Action Plan has been prepared to fulfil European Partnership priorities. In March, the government adopted a draft National Programme for the Adoption of the *Acquis* which was submitted for comments to the Commission. The new government announced in September its intention to revise the draft on the basis of its work programme and the Commission's comments and assessment of the progress achieved. Its successful implementation will also depend on the readiness of the new government to allocate sufficient financial and human resources for its implementation.

The situation regarding the training of civil servants has continued to improve. The Civil Servants Agency adopted a National System for the Coordination of Training of Civil Servants in October 2005 and organised a number of seminars and training courses on EU- and civil service-related issues.

The transfer of competences to municipalities has moved ahead. In March, the government adopted a five-year training strategy aimed at developing a professional and reliable local self-government public service. Close cooperation between the Ministry of Local Self-Government and the municipalities has helped to alleviate some problems. Public services have begun to improve in most municipalities, particularly as regards urban planning. The Association of Municipalities has continued to play a crucial role in addressing all issues arising from the relations between the government and the municipalities.

The Law on Defence was amended in May, to allow for establishing a professional army, as part of the reforms needed to prepare for NATO membership. The entire process of transformation is due to be completed by the end of 2007. In September, the new government adopted a national programme for NATO membership.

The general level of security has steadily improved. This has been achieved both by the increased operational capacity of the police and the increasing trust of all communities towards the police.

However, the mechanisms to increase professionalism and accountability and guarantee independence and political neutrality need to be fully implemented. The single decision taken in September to replace officials in the ministries and public bodies on a massive scale illustrated that political changes still have a deep impact. Such decisions affect administration staff at top and middle management levels and challenge the promotion of a merit based career system. Implementation of the code of ethics for civil servants should be further strengthened. The Civil Servants Agency should be further strengthened to be able to play its full role in assessing performance of civil servants and in disciplinary procedures.

A process for citizens' consultation and participation in the initial stage of developing legislation is included in the 2000 Law on Organisation and Operation of State Administrative Bodies. However, it is little used. Training measures are needed to ensure the correct and consistent implementation of the 2005 Law on General Administrative Procedures across the public administration and to further strengthen citizen's rights.

There is still room to improve co-operation with the ombudsman, especially for the Ministry of Interior.

Ministries need to be more realistic in their planning and increase their capacity for strategy and policy development, given the lack of appropriate administrative structures for implementation. Additionally, the uneven quality of legislation leads to difficulties in its implementation. The practice of prior impact assessment should be extended.

There are still serious challenges to be addressed before passing to the next steps in the decentralisation process. The problem of debts remains an issue, and substantial debts could threaten the functioning of several municipalities. Smaller municipalities have had difficulties in delivering basic services. Possible under-financing of the educational sector is a matter of concern. Municipal tax collection remained a challenge in many municipalities. Further progress in fiscal decentralisation will require the development of financial and internal control mechanisms to allow appropriate planning and to minimise the risk of fraud and corruption. The municipalities' capacity to manage state-owned property should be developed, particularly considering the scarce resources available to foster local economic development.

The Ministry of Interior and the police have been restructured, though not altogether in line with the 2003 Police Reform Strategy. The adoption of a new Police Law met a key priority of the European Partnership. The late adoption of this framework law has impeded the decentralisation of the police and the creation of a new appointment system for police chiefs, delaying the implementation of the reform. Constructive cooperation between the government and the opposition to ensure the smooth implementation of the law is needed (*see also Chapter 24 - Justice, freedom and security*).

Overall, reforms in the organisation of the public administration are taking place progressively and aim to improve management and increase transparency. However, implementing reforms in the administration and the reform of the police remain serious challenges.

Judicial system

The amendments made to the Constitution in December allowed a breakthrough in the judiciary reform. The legal framework for strengthening the independence and the efficiency of the judiciary is largely in place. They were supported by a broad political consensus.

New laws on Courts and Administrative Disputes were enacted in May. These will substantially reform the structure of the judiciary as from 2007, once in force. Changes include the creation of a fourth court of appeal and special court departments in five basic courts to deal with cases of organised crime. A new administrative court will be established as the first instance for judicial review of administrative decisions so as to remove the burden of hearing administrative disputes from the Supreme Court. The composition and role of the Judicial Council was changed, to strengthen its independence and allow it to play a decisive role in appointing and dismissing judges. Out of its 15 members, 8 will be judges elected by

the judges, 3 will be elected by the Parliament, 2 by the Parliament upon a proposal by the President of the Republic. The President of the Supreme Court and the Minister of Justice are ex-officio members. The principle of equitable representation should be respected in the election of its members.

The Parliament's role in selection and disciplinary procedures of the judges has been abolished. Changes were also introduced to promote a merit based career system for judges and prosecutor. A new Academy for the training of judges and prosecutors was set up. This should pave the way for the professional and non-political selection of judges.

Further legislative parts of the Judiciary Reform Strategy have been implemented to improve the functioning of the judiciary. The Laws on Misdemeanours and on Administrative Disputes were enacted in May. They should alleviate the burden on the courts and reduce the backlog of pending cases. Other steps taken conferring the administrative bodies the power to impose sanctions and introducing the concept of alternative dispute resolution for civil and commercial cases will also decrease the burden on the courts.

The entry into force of the Laws on Enforcement of Civil Judgements and on Litigation Procedure which changed court procedures and its implementation should improve the enforcement of civil law cases.

The budgetary resources allocated in 2006 to the judiciary have slightly increased compared to 2005. Overall, judicial reform has remained high on the agenda of the new government just as for the previous government.

However, the judicial system shows the same serious shortcomings as in previous years affecting both its independence and its efficiency. The financial situation of the courts remains a matter of concern. Delays occurred in setting up the new Academy for judges and prosecutors as well as in nominating the members of the Judicial Council. The law on the conditions for appointment and dismissal of public prosecutors and their deputies remains to be adopted. The real effects of judicial reform will only become apparent once the new laws take effect and new, fully operational structures are in place.

The effective implementation of the reforms and the improved operation of the judiciary will have to be demonstrated by a sustained track record. It will be important for the new government and Parliament to maintain the momentum of reform and provide appropriate budgetary allocations. Broad political consensus will be required to proceed with reform and its implementation. It will be even more important for those parts of the reforms where decisions have to be taken by a double majority. The sustained and full support of the members of the judiciary will also be needed, especially at senior level.

Overall, the constitutional and legal framework for an independent and efficient judiciary is now largely in place. However, most of the reforms in the judiciary have not yet entered into force. There are important challenges in this field, which require a sustained programme of reforms. (*See also chapter 23 - Judiciary and fundamental rights*)

Anti-corruption policy

Since the November 2005 opinion, the legal and institutional framework to address corruption has been further strengthened. Changes in the electoral code included the obligation for each party to account for its campaign expenses. Recommendations from the Council of Europe

Group of States Against Corruption (GRECO) are steadily being implemented. There has been progress in the cooperation and coordination in the fight against corruption. An inter-ministerial body was set up in April to co-ordinate the activities of those involved. Relations between the State Anti-Corruption Commission and the Public Prosecutor are more constructive. Co-operation with the Public Prosecutor's Office has progressed at the operational level, especially in the Specialised Unit for Fight Against organised Crime,

According to the State Anti-Corruption Commission, almost all officials have submitted asset declarations. The Commission has brought charges against those who have not submitted these.

Steps were taken to improve transparency in public decisions and in the management of state assets. In particular the Law on Free Access to Public Information was adopted in February and entered into force in September. The discretionary powers of ministers and other officials in the administration have been reviewed.

However, the results of legal and institutional measures remain far from satisfactory and have had a limited impact. Corruption remains widespread, holding back economic development and weakening social cohesion. The UN Convention against corruption still has to be ratified. The OECD Convention on combating bribery of foreign public officials in international business transactions has yet to be signed. Little progress was achieved in identifying the extent of corruption, which hampered preventive and detection measures.

Whereas there have been a few high profiles cases concluded, such as the case of the Director of Health sentenced to four years in prison, prosecutions of corruption cases remain at a low level. Several investigations are in procedure against judges and prosecutors for abuse of their functions. There have been two sentences against police officers for bribe or abuse of position, and one criminal procedure against a customs officer.

The implementation of the existing anti-corruption regulations requires additional capacity and political will. While, according to the State Anti-Corruption Commission, almost all officials have submitted asset declarations, sentences delivered to officials failing to fulfil this obligation have been lenient. A fully effective checking of the property declarations would require strengthening the bodies involved. The implementation of the regulations on political parties' finances and election campaign financing are serious challenges, including for the State Audit Office capacity to determine irregularities.

Tangible progress in reducing the discretionary rights of ministers and other officials has yet to be achieved. Incompatibility rules still lack clarity, and control and enforcement mechanisms are weak. Conflict of interest remains to be regulated and monitored. For instance, there is no clear policy as regards the employment of former members of the government.

More initiatives should be undertaken by the Public Prosecutor Office. More remains to be done to demonstrate a zero tolerance policy. The irregularities identified by the State Audit Office in its reports should be followed up. The potential of the Ombudsman Office should also be used more fully.

The new government has put a particular focus on the fight against corruption in its work programme. It remains to be seen if the political intention demonstrated will be strong enough to ensure effective progress in this area.

Overall, there was some progress in strengthening the legal and institutional framework for fighting corruption. However, corruption remains widespread. Many allegations of corruption have yet to be investigated. Strong political will is required to step up efforts to combat corruption effectively. *(See also Chapter 23 - Judiciary and Fundamental Rights)*

2.2. Human rights and the protection of minorities

Observance of international human rights law

There are currently 638 applications pending against the Republic of Macedonia before a decision making body of the European Court of Human Rights. The Court received 251 applications in 2006, compared with 248 in 2005. Out of five judgements in 2006, four established there was a violation. All violations were related to the length of judiciary proceedings. An inter-ministerial committee was set up in May to follow up the obligations deriving from the European Social Charter. Protocol 1 has still not been ratified.

Civil and political rights

In April, the government decided to set up an inter-ministerial body for human rights led by the Ministry of Justice. This body will strengthen and coordinate co-operation among state institutions dealing with human rights issues. It will present yearly reports.

As regards **prevention of torture and ill-treatment**, the Law on Criminal Procedure was amended to abolish mandatory pre-trial detention. Positive developments have taken place in the Ministry of Interior's sector for internal control and professional standards. These have contributed towards strengthening its ability to investigate charges of police abuse and corruption.

However, mechanisms for investigating degrading treatment need to be strengthened, including through the co-operation between the Ombudsman and the Ministry of Interior. Incidents of ill-treatment continue to occur, particularly during arrest and detention.

In absence of a new law on the police, there had until now been no legal basis for ensuring the adoption of a code of police ethics and of transparent and accountable appointments, promotion and disciplinary procedures. The use of "informative talks" by the Police remains unclear. Continuous efforts in training and raising awareness on human rights issues and police ethics are needed.

There has been limited progress in the situation in prisons. There are concerns about the number of deaths, including suicides, in **prisons**. The Council of Europe's Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment carried out inspections in May. Its recommendations should be fully implemented.

The European Parliament's Temporary Committee on the alleged use of European countries by the CIA for the transport and illegal detention of prisoners visited Skopje in April to investigate the case of Mr Khaled El Masri, a German citizen of Lebanese origin. The authorities are encouraged to conduct effective and rigorous investigations to ascertain the truth and to cooperate fully with the European Parliament's Temporary Committee on this issue.

Telecommunication tapping still takes place in absence of a proper legal framework. The Law on Interception of Communications has not yet been enacted. This must be addressed without further delay.

There were limited and local cases of violations of freedom of religion. However, in the village of Sekirnik, the communities involved reached an agreement on the construction of a church. In Lazec, a dialogue has been initiated on the construction of a mosque. The revision of the Law on Religion and Religious Groups is still under consideration. The draft revisions should provide more liberal procedures for the registration of religious institutions. These should also remove all remaining impediments to free practice of religious belief.

Legal guarantees for freedom of expression were further strengthened with the abolition of imprisonment as a possible punishment for defamation. The new Broadcasting Law, which was enacted in November, provided for greater independence of the regulatory body - the Broadcasting Council. The law allows for public funding of satellite broadcasting services in the languages of the non-majority communities through the *Macedonian Radio Television*. However, the issue of strengthening the mechanisms necessary to ensure the economic and financial independence of the media remains to be addressed. Rigorous implementation of the new legislative framework is needed, especially to secure the funding of the regulatory body and the public service broadcaster (*see also chapter 10, information society and media*). Access to information will have to be effectively ensured, as foreseen by the new Law on Public Access to Information of Public Character.

Freedom of association and assembly have been guaranteed. The 2005 labour relations law entered into force, allowing legal entities to set up associations to exercise economic and social rights. Two trade unions and two employers' associations were registered.

The active involvement of civil society organisations in public policy-making and reforms has developed further, for instance, through making proposals for new legislation. The government adopted a strategy for co-operation with civil society in June. A new law on sponsorship and donations was enacted in April, providing tax incentives for donations and sponsorship by a local or foreign legal or physical entity. However, the strengthening of civil society requires further coordination between non governmental organisations (NGO) and the public authorities. The development of the NGOs' activities is still hampered by a lack of resources. Changes in the criteria for allocating grants from the state budget to NGOs are still needed, so as to better define objectives and avoid non-transparent selection procedures.

Overall, there has been no major violation of the civil and political rights. However, more needs to be done to improve the legal framework and enhance effective implementation of these rights.

Economic and Social Rights

In the field of women's rights, a Law on Equal Opportunities for men and women was enacted in May. Implementation of the UN Convention on Elimination of Discrimination against Women has generally been assessed positively by the UN in a number of areas. These include education, health care, political participation and the non-government sector. Additional activities are to be undertaken in the spheres of employment, the situation of women in rural areas and violence (*see also chapter 19 - Employment and social policy*). There was no particular progress in the definition of rape or in measures against domestic violence and sexual harassment, which remain at a high level and are rarely prosecuted. A

strategy for combating illegal immigration and trafficking in human beings was adopted in March. This aims to better protect victims and witnesses and improve the investigation and the prosecution process of perpetrators. However, further action is needed to curb forced prostitution and trafficking in women and girls (*see also Chapter 24 - Justice, freedom and security*).

In February, the government adopted an action plan for the protection of **children's rights** and set up a national coordination body. This plan was complemented by a development programme to apply these.

A national strategy for the development of **education** in the period 2005-2015 was adopted in April. Progress has been made in relation to minority education (*see below*). However, challenges to the reform of the education system remain. The education budget is limited. The impact of the decentralisation process remains to be assessed.

There is limited progress in the implementation of the National Strategy for the Rights of **Persons with Disabilities**. The situation in institutions caring for persons with mental disabilities is still not satisfactory. The government needs to further develop social care policies, including community-based options as alternatives to institutions. Some of the existing community mental health centres operate well, but conditions in psychiatric hospitals vary greatly.

Regarding **labour rights and trade union rights**, there are no significant developments to report in the area of social dialogue, which requires strengthening.

The process of **restitution of property** that was confiscated during the Yugoslav regime has progressed slowly. According to the Ministry of Finance, decisions have been taken on 8,549 of 21,986 applications filed between 2000 and 2005. There has been no improvement in the restitution issue of the properties of the Orthodox church and the Muslim community.

Minority rights, protection of minorities and cultural rights

In general, inter-ethnic relations have continued to improve. The commitment of the government to make progress in the implementation of the Ohrid Framework Agreement remained essential for the country's stability. Inter-ethnic issues were not conflicting issues during the electoral campaign.

The Ombudsman's annual report indicates that four complaints relating to minority rights were received in 2005. This constitutes a substantial decrease compared with the eleven complaints made in 2004.

Some progress has been achieved in participation of non majority communities in the public administration and public enterprises. The general level of participation grew from 20.5 % in July 2005 to 21.7 % in August (Albanians 16.5%; Serbs 1.6%; Turks 1.4%; Roma 0.6%; Vlachs 0.5%; Bosniaks 0.3%; other communities 0.9%). In the judiciary, the principle of equitable representation in the selection of judges and prosecutors as well as in the composition of the Judicial Council has been enshrined in the new laws.

As regards education, progress has continued. The total level of enrolment of students from non-majority groups in the three State Universities is progressively increasing, and reached 24% in 2005/2006 compared to 20,6% in 2004/2005. Additional quotas have been decided in

accordance with the 2005-2015 education action plan. In the South East Europe University, 72% of the 4800 students are from minorities.

Provisions on the use of non-majority languages in official documents have been implemented (ID cards, passports, excerpts from the central registry, driving licences and registration certificates). Progress has continued regarding their use as an official language.

However, dialogue and trust-building between communities should be further developed to achieve sustainable progress. Localised incidents have attracted the attention of the media. Non majority communities remain significantly under-represented in the public administration. Furthermore, progress has been uneven across the various communities. Ethnic Albanians have made significant gains, although they are still under-represented in public life. Other groups have seen little or no gains.

Significant discrepancies continue to exist among individual ministries. In the police sector, progress has come to a standstill. In the absence of a common strategy to ensure equitable representation, solutions have so far been specific to individual institutions or sectors. There is a need for additional efforts to ensure that equitable representation policies and mechanisms fully reflect the ethnic diversity of the population.

As regards the use of minority languages, smooth implementation of the legal provisions will require sustained commitment and further investment, for example to implement the provisions on traffic signs.

There are still insufficient opportunities for interaction between the different communities, particularly in the sphere of education. While some initiatives in this area exist, they are mainly led by civil society. There appears to be no comprehensive policy to bridge the gap between the different communities through the education system.

All political parties must continue to work on building consensus on ethnic-related issues, in full compliance with the letter and spirit of the Ohrid Framework Agreement.

The situation of the Roma community continues to cause concern. There has been some progress in the implementation of the four action plans under the 2005-2015 Decade of Roma Inclusion. These were set up for the development of education, housing, employment and health care, but still have limited impact. Special funds have been established in the relevant ministries to support the implementation of the action plans. The Ministry of Labour and Social policy has also been working on Roma employment by supporting the establishment of family businesses for young Roma. However, tangible progress in the conditions of the Roma will require sustained commitment to the implementation of the objectives of the National Strategy for Roma. Discrimination against Romani people continues. They are still disproportionately the subject of ill-treatment by the police. Others are denied citizenship. Romani children are frequently denied the right to education and comprise the majority of the country's street children.

The number of internally displaced persons (IDPs) decreased from 1420 to about 720.

There are 2,096 refugees in the country, the vast majority Roma, Ashkalia and Egyptians from Kosovo. Since the Law on Asylum entered into force, only 28 refugees have received recognised refugee status. Most applicants have been granted "humanitarian protection", which is a status with a duration of up to 12 months. There are still concerns over the

transparency and independence of the government commission competent to deal with appeals against first instance decisions on refugee status.

Overall, there were no major problems in the area of fundamental rights. The level of minority rights' protection has remained high. However, there are still a number of areas where implementation of the fundamental rights should be fostered. The implementation of the Ohrid Framework Agreement is essential to foster a positive environment for further reforms.

2.3. Regional issues and international obligations

The Republic of Macedonia has maintained full cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY).

The trial of the only case ("Ljuboten") for which the ICTY indicted citizens of the Republic of Macedonia has not yet started in The Hague. The four cases for which the Tribunal decided not to pursue its investigations due to its "exit strategy" (UNSCR 1534/04), have not yet been referred back to the national authorities for possible further investigation. The government has agreed with the ICTY to start the process of return of cases progressively, starting at the beginning of 2007. A number of judicial reforms are required before these cases can be dealt with. The handling of the returned cases will be a major test of the maturity of the institutions and the capacity of the judicial system.

As regards the International Criminal Court, the government stated that the scope of the non-surrender agreement concluded with the USA does not include citizens of the Republic of Macedonia. However, it still does not comply with "the EU Guiding Principles Concerning Arrangements between a State Party to the Rome Statute of the International Criminal Court and the United States Regarding the Conditions for Surrender of Persons to the Court" adopted by the Council in September 2002. In particular it does not contain practical provisions ensuring investigation and prosecution by national jurisdictions.

Regional cooperation and good neighbourly relations form an essential part of the process of moving towards the European Union.

The Republic of Macedonia has continued its active participation in regional initiatives, such as the Stability Pact, the South-East European Cooperation Process (SEECP), the Central European Initiative and the Adriatic Ionian Initiative. The Republic of Macedonia is committed to the establishment of the Regional Cooperation Council. It is party to the Energy Community Treaty that entered into force in July 2006 and a signatory of the agreement on the European Common Aviation Area of June 2006.

The Republic of Macedonia ratified the agreement on CEFTA membership in May. It is participating in the negotiations for establishing a single regional Free Trade Agreement, based on an enlarged and amended CEFTA. A Free Trade Agreement with Kosovo (UNHCR 1244) entered into force in February. The Republic of Macedonia has concluded bilateral free trade agreements with all South East European countries.

Bilateral relations with *Albania* have been developing. Reciprocal high level visits have been accompanied by signing of cooperation agreements concerning police cooperation, transport, energy, defence, tourism, culture, information, science, and the opening of an additional border crossing point. The Republic of Macedonia offered assistance during

the electricity crisis in Albania in 2005. A joint committee for the Lake Ohrid basin was created.

Relations with *Serbia* have remained good. However, the religious dispute between the *Macedonian Orthodox Church* and the *Serbian Orthodox Church* continues to require caution from the governments of both countries.

The position of the Republic of Macedonia towards the Kosovo issue continued to be constructive throughout the initial phase of the status talks. High level visits have contributed to foster cooperation. The border demarcation remains to be resolved in the context of the talks. This issue, of a technical nature, should continue to be approached in a constructive manner. Co-operation with UNMIK and the Kosovo authorities also resulted in the reopening of a regular passenger rail service between Skopje and Pristina, which had been interrupted since 1999.

The Republic of Macedonia recognised *Montenegro's* independence in June. A consulate was opened in Podgorica in January.

Relations with *Bosnia and Herzegovina* have remained good. A number of bilateral agreements have been signed, including on mutual legal assistance, property rights issues and mutual execution of court rulings in criminal matters.

Relations with *Croatia* have continued to develop. Co-operation is particularly strong as regards the EU integration processes, with a regular exchange of information both at a technical and political level

Relations with *Bulgaria* have been developing. Meetings at senior political level have been accompanied by intensified technical co-operation and cross-border activities. In June, an agreement on transnational police cooperation was signed.

Relations with *Greece* have been developing. In December 2005 the two countries opened an Office for Consular, Economic and Trade Relations in Bitola and a Consulate in Thessaloniki respectively. Cooperation has developed in many areas, including transport, health, security, culture and customs. However, there has been no progress on the name issue which remains an open problem. Renewed efforts are needed, with a constructive approach, to find a negotiated and mutually acceptable solution on the name issue with Greece, under the auspices of the UN, within the framework of UN Security Council Resolutions 817/93 and 845/93, thereby contributing to regional cooperation and good neighbourly relations.

3. ECONOMIC CRITERIA

3.1. Introduction

In examining the economic developments in the Republic of Macedonia, the Commission's approach was guided by the conclusions of the European Council in Copenhagen in June 1993, which stated that membership of the Union requires the existence of a functioning market economy, and the capacity to cope with competitive pressure and market forces within the Union.

3.2. Assessment in terms of the Copenhagen criteria

3.2.1. *The existence of a functioning market economy*

Economic policy essentials

All relevant political parties agree on establishing a market based economy. The government adopted the 2006 Macroeconomic Policy Document in December 2005, emphasising the objective of maintaining economic stability and promoting growth and employment. Since 2006, the country has participated in the EU's Pre-accession Fiscal Surveillance procedure. In April, the authorities submitted the first fiscal notification. They are currently preparing the first Pre-accession Economic Programme (PEP), which is due by December. Programme cooperation with the International Monetary Fund (IMF) and World Bank is on track, with positive assessments on the country's progress by both institutions concerning its programme commitments. A broad political consensus on the fundamentals of economic policy has been maintained.

Macroeconomic stability

In the second half of 2005, real GDP grew by around 4% year-on-year, driven by exports and investment. In the first half of 2006, output growth slowed to 2.6% due to weak industrial production and decelerating construction. Industrial production only increased by 2.8% year-on-year during the first eight months of 2006, compared to 8.2% during the same period in 2005. Average per-capita GDP in purchasing power standards was 26% of the EU-25 average, compared to 25% the year before. Overall, economic performance has stayed on track, although below potential.

In 2005, the current account deficit declined to 1.4% of GDP, compared to 7.7% in 2004. About half of the decline was due to higher exports. These increased from 31% of GDP in 2004 to 36% of GDP in 2005. Net private transfers increased from 13.3% of GDP in 2004 to 17.6%, which also contributed to the improvement in the current account. Foreign direct investment (FDI) declined slightly, from 2.8% of GDP in 2004 to 1.7% in 2005, but rose sharply during the first half of 2006 and reached some 6% of the GDP, projected for 2006. Exports were slightly below the pre-year level (-0.5%), whereas imports rose by 4%. Overall, external deficits have markedly narrowed, with an annualised current account deficit of around 3% of the GDP during the first half of 2006.

At the end of August 2006, official reserve assets of the country's central bank (NBRM) stood at € 1.3 billion, equivalent to more than 4 months of imports of goods and services. The main reasons for the rapid increase in reserves were the inflow of proceeds from the privatisation of the electricity distributor ESM, which amounted to about 5% GDP, and other foreign exchange inflows through the cash exchange offices. In August 2006 gross external debt stood at some 39 % of GDP, after the sale of a € 150 million 10-year government Eurobond had led to a temporary increase in the debt ratio. The revenues of the bond sale were used to finance the repayment of the London Club debt, which helped to lower the costs of the debt service.

The unemployment rate declined to 36.1% in the second quarter of 2006, whereas the employment rate increased to 35%. Besides seasonal effects, the impact of the recent liberalisation of labour legislation has contributed to this favourable development. Unemployment among the young is very high and the duration of unemployment in this age

group is long. The existence of a substantial informal sector most may lead to a significant over-estimation of real unemployment. (*See also Chapter 19 - Social Policy and Employment.*) Overall, unemployment has started to decline, although from a very high level.

The recent strengthening of foreign currency reserves and the improved confidence in the stability of the financial system has allowed a marked reduction in policy interest rates. For example, Central Bank bill rates dropped to 5.5% in August 2006, compared to 10.0% a year before. In October 2005, the NBRM switched from auctioning fixed-rate Central Bank bills to flexible-rate auctions, which resulted in a marked decrease of these rates. Short-term lending rates of commercial banks have declined from 12.1% at the end of 2005 to 11.1% in August 2006. In March 2006, the NBRM started to replace its main instrument for monetary policy (28-day Central Bank bills) with 3-month treasury bills. Credit growth to the private sector continued to be high, at some 24.5% during the first half of 2006. However, the credit provision to the private sector is relatively low, around 25% of GDP. The volume of broad money (M4) rose by 15% year-on-year during the first half of 2006. Overall, monetary policy has remained sound, responding to the improved confidence in the stability of the financial system.

Consumer price inflation has increased to 3.3% during the first nine months of 2006, compared to 0.4% during the same period in 2005. The main factors were supply driven elements, such as increases in excise taxes and higher energy costs. The country's statistical office is currently preparing an indicator of core inflation. Overall, inflation has remained under control.

The NBRM has managed to maintain the exchange rate of the Denar against the euro on a level of 61.3 Denar/euro and intends to continue this de-facto peg. In order to improve the efficiency of the foreign exchange market, the NBRM has established an electronic system of exchange rate monitoring and introduced a system of market-makers. Overall, the exchange rate has remained stable towards the euro.

Fiscal balances turned out better than expected in 2005, with a general government surplus of 0.3% of GDP (cash basis), compared to a targeted deficit of 0.8% of GDP³. As in previous years, revenue collection was better than expected, whereas expenditures remained lower than planned. A new Law on Tax Procedure entered into force in April 2006, which assists tax collection, simplifies procedures and improves the equal treatment of tax payers. In addition, the strengthening of the public debt management institutions and the adoption of the 2006-2008 Public Debt Management Strategy should result in an improved debt structure and lower expenditures for debt servicing. Fiscal decentralisation appears to be on track. The introduction of a second-pillar pension system by January 2006 puts the pension system on a sounder footing, although the decrease of social security contribution will increase fiscal pressures in the short-term. Due to a financing transaction, public debt temporarily increased from 36.6% of GDP at the end of 2004, to 40.1% of GDP at the end of 2005. However, by mid-2006 it had declined again to below 35% of GDP. Overall, public sector accounts have remained close to balance and public administration has been strengthened.

Economic stability was maintained, with balanced public finances, low inflation and improving external accounts. The improved reserve position has strengthened confidence in the stability of the foreign exchange regime and has allowed for a lowering of interest rates.

³ The data still is based on GFS and not yet fully in line with the European accounting standard ESA 95.

Overall, the macroeconomic policy mix has succeeded in maintaining economy stability, although key challenges such as high unemployment and low investment persist.

Free interplay of market forces

Privatisation of the last state enterprises continued. In October 2005, most of the remaining state property was transferred to four institutions for further liquidation: the Pension Fund, the Ministry of Economy, the Ministry of Finance and a public real estate agency. Most of the companies transferred to the Ministry of Economy are subject to bankruptcy procedures. The book value of minority shares owned by the pension fund was 2.8% of GDP at the end of 2005. By June 2006, the pension fund had sold minority shares in 14 local companies, amounting to some 24% of the fund's total privatisation portfolio and accruing revenues of G 16 million (0.3% of GDP). The state maintained ownership of around 30 enterprises, with an estimated value of 16% of GDP and minority shares in privatised companies. The state electricity company was divided into three sections - for generation, transmission and distribution. The distribution company was sold in March 2006 to a strategic foreign investor for the equivalent of 5% of GDP. In June 2006, the state offered most of its shares in the landline telecom company for sale on the stock exchange. This meant 45.1% of the company's shares, leaving only 2% in state hands. So far, a 9.9% stake in the company has been sold for G 60.3 million (1.4% of GDP).

Free market entry and exit

The government significantly reduced entry barriers and accelerated exit procedures. For example, a one-stop-shop system for company registration has been established. This resulted in a marked simplification of procedures and reduced the average time for registration to seven days. The one-stop-shop system started to operate in January 2006 and handled about 18,600 applications during the first nine months⁴. Around 8% of the new companies were owned by foreign investors, who invested some € 3 million (0.1% of GDP) in the country. Furthermore, the competence of the Credit Guarantee Fund was extended to cover long-term loans for SME investments. Bankruptcy legislation was amended in March 2006 to accelerate market exit procedures. This should lead to a shortening of procedures and reduce costs. However, the necessary implementing legislation is not yet fully in place. Overall, barriers to market entry and exit have been reduced.

Adequate legal system

The necessary legal system is largely in place. However, slow legal procedures are an important impediment to the functioning of the system, for example, delaying the clarification of ownership disputes. The time required to register a real estate transaction was -reduced; for example from several weeks to one day in the case of an accelerated procedure. However, the real estate cadastre covers only about 47% of the country so far. The authorities plan to finalise the full registration by 2009. Several measures to simplify and accelerate legal procedures have been adopted, such as the law on international trade arbitration in March 2006 and the Law on Mediation in May 2006, which introduced alternative dispute settlement procedures. Progress has been made in accelerating market entry and in clarifying property rights. However, the judiciary has continued to be a bottleneck.

⁴ Out of this number about 7600 applications were new registrations.

Sufficiently developed financial sector

In 2005, credits to the private sector increased from 21.5% of GDP (end 2004) to 24.4% of GDP (end 2005). The recent decline in interest rates, the establishment of a guarantee fund and the acceleration of registration of property rights contribute to increasing financial intermediation. The operational efficiency of local banks has still been relatively low. The banking sector has remained comparatively small, with banking assets amounting to about 49% of GDP, although the number of banks is still relatively high. A recent merger of two smaller banks reduced the number of banks to 19. There are also 15 savings houses. Overall, financial intermediation has deepened.

The five largest banks account for 76% of total assets and 75% of total credits. Spreads between lending and deposit rates shrank from about 7.2% in early 2005 to around 6.7% in July 2006. The high spreads partly reflect an unfavourable asset structure. The share of assets deposited abroad declined from 35% in 2004 to 25% in 2005, indicating a marked improvement of confidence in the financial system. All banks are controlled by private owners, with the exception of the small 100% state-owned development bank. Foreign banks are majority owners of two of the three largest banks. The state has continued to withdraw from the banking sector, by selling a number of minority shares. However, concentration in the banking sector has remained high.

Banking sector capitalisation has remained high, with a capital adequacy ratio of some 20% in mid-2006 compared to 23% in 2004. Small banks have a high capital adequacy ratio of some 27% on average, while large banks register a ratio of some 13%. The share of non-performing loans declined from 13% in 2004, to 11% of total loans in 2005. The share of worst performing credits has declined from 7.6% to 4.6%. The profitability of the sector rose in 2005. Returns on assets and equity reached 1.3% and 8.1%, respectively. Overall, the stability of the financial sector has strengthened further.

Market capitalisation of the 57 companies listed on the *Macedonian Stock Exchange* rose from 16% of GDP in 2004 to 18% in 2005. By mid-2006, the stock market capitalisation had reached some 20% of GDP. Securities trading rose by 7% in 2005. Foreign-owned brokerage houses have entered the market. However, so far no foreign investment fund has been established. (See also *Chapter 9 - Financial Services*.) Overall, the size of the non-banking financial sector has increased, but the level still remains very low.

3.2.2. The capacity to cope with competitive pressure and market forces within the Union Existence of a functioning market economy

The Republic of Macedonia has achieved a sufficient degree of macroeconomic stability. It has made important progress in reducing barriers to market entry and exit, in strengthening the legal and institutional framework and in improving the transparency and accountability of public procedures. However, the full functioning of the market economy is still impeded by weaknesses in the judiciary, administrative bottlenecks, a low degree of legal certainty, a high number of unsettled property disputes, and considerable labour market imbalances. Preparations for the general elections slowed down the finalisation of important structural reforms, such as the implementing regulations of the bankruptcy law, delays in implementing a supervisory development plan, amendments to the law on banking supervision and the central bank law.

Sufficient human and physical capital

The authorities adopted a series of reform measures in 2005 to modernise curricula, to improve the training of teaching staff, to promote vocational education and training and to support life long learning. However, as a result of decades of underspending on education the infrastructure is inadequate and outdated. High unemployment rates among school leavers are an indication of the deficits in this area. Furthermore, in certain rural areas access to education remains limited. The education system does not sufficiently reflect the country's needs (*See also Chapter 26 - Education and Culture and Chapter 19 - Social Policy and Employment.*) Overall, some measures have been taken to improve education and human capital.

Labour contracts have become more flexible. This is the result of the new labour code, which allows part-time employment and simplifies procedures in the case of redundancies, overtime, shift work etc.. Active labour market measures have also been strengthened. These developments have helped to reduce unemployment and increase employment. The existence of a substantial informal sector probably leads to an overestimation of the true dimension of unemployment. Overall, labour markets have become more flexible, but the supply and demand mismatch is still high.

Gross fixed capital formation rose marginally from 17% of GDP in 2004 to about 18% in 2005. This low ratio can be seen as an indication for a weak business environment. Public investment was particularly low at 3.6% of GDP in 2005. The share of investment in GDP has remained relatively low, given the country's need to catch up with international standards.

Foreign direct investment increased sharply in the first half of 2006 to around 6% of projected GDP. The main factors were payments related to the privatisation of the electricity distributor, amounting to about 5% of GDP. Apart from these privatisation-related cases, greenfield FDI inflows remained limited. Unclear property rights and fragmented responsibilities between the central and local governments have contributed to delays in FDI projects. The agency for Investment Promotion became operative in 2005, but suffers from resource constraints. Overall, FDI inflows have continued to increase; however, they were mainly driven by privatisations.

Adequate sectoral and enterprise structure

The last two decades of insufficient investment have eroded the quality of transport networks. An upgrading of the overall system of infrastructure has started for projects related to the European transport corridor X. The railway company has been separated into two operative companies, so as to privatise them. In the telecommunications sector, the state has embarked upon offering its remaining shares (except a 2% "golden share") on the Stock Exchange. Public research and development expenditures were raised to 0.7% of GDP in 2005. (*See also Chapter 14 - Transport Policy, Chapter 21 - Trans-European Networks, and Chapter 25 - Science and Research.*) Overall, infrastructure has continued to require repair and modernisation.

Only minor changes have been recorded in the production structure of the economy. There has been a significant increase in the value added of wholesale and retail trade, whose share in total value added rose from 12.9% of GDP in 2004 to 13.4% in 2005. The value added of industry has remained around 29% of GDP. This pattern is confirmed by labour market data, which indicates broadly unchanged employment figures for industry at around 22% of the labour force. Overall, changes to the structure of the economy have remained limited.

The number of enterprises has increased significantly during the last year. However, the number of employed in these enterprises has only risen by 2.6%, indicating that the main increase has occurred in small enterprises. There are many 'single employee enterprises' due to the absence of the legal category "self-employed". The authorities have tried to ease the financing constraint for SMEs by improving the functioning of the Guarantee Funds. However, the low degree of real estate registration hampers the provision of collateral for credit provision. (*See Chapter 20 - Enterprise and Industrial Policy.*) Overall, the number of small firms has increased considerably, but their share in total employment remains relatively low.

State influence on competitiveness

The authorities have shown an increasing reluctance to intervene in market processes, for example by moving towards rule based decisions for public tenders. No precise data on the actual volume of direct state aid are available at present. However, there are indications that indirect state aid leads to significant distortions in the competitive position of enterprises in the market. These are in the form of accumulated payment arrears of taxes and social security contributions. Providing electricity below cost price or allowing the accumulation of payment arrears are examples of these indirect state interventions. (*See Chapter 8 - Competition Policy.*) Overall, direct state intervention has continued to decline, but indirect state aid still leads to distortions in relative prices.

Trade integration with the EU

The country is a small open economy with total trade of goods and services accounting for around 100% of GDP in 2005. During the first eight months of 2006, about 55% of all exports went to the EU-25, while about 45% of imports came from the EU-5. In 2006, the country joined CEFTA and concluded a number of free trade agreements, including with neighbouring Kosovo. Trade integration with the Western Balkan region increased, reaching 33% of the country's exports and 10% of its imports. The EU remain by far the country's main trading partner. In the region, Serbia is also an important trade partner. The export structure is still highly concentrated on a few items, with textile and clothing products amounting to about 24% of total exports, and manufactured iron and zinc products to some 26%. (*See Chapter 30 - External Relations.*) Overall, trade integration is well advanced, but the commodity composition is concentrated on a few price-sensitive products.

International price competitiveness improved slightly during the last year, benefiting from low inflation and a nominally stable exchange rate. The real effective exchange rate depreciated by 3% in 2005, whilst labour productivity increased by 2.7%. At the same time, real wage increases remained in line with productivity growth and unit labour costs decreased by 4% in 2005. Overall, price competitiveness and labour productivity has improved.

4. ABILITY TO ASSUME THE OBLIGATIONS OF MEMBERSHIP

This section examines the Republic of Macedonia's ability to assume the obligations of membership - that is, the *acquis* as expressed in the Treaties, the secondary legislation, and the policies of the Union. It also analyses the Republic of Macedonia's administrative capacity to implement the *acquis*. The analysis is structured in accordance with the list of the 33 *acquis* chapters.

4.1. Chapter 1: Free movement of goods

Some progress has been made as regards the general principles, with the introduction of the principle of mutual recognition in the Law on Product Safety, which came into force in March 2006. The Republic of Macedonia still needs to make sure that its legislation, including distinctly as well as indistinctly applicable measures, is compatible with Articles 28 - 30 of the EC Treaty and related jurisprudence of the European Court of Justice.

As regards horizontal measures, the new Law on Product Safety replaced the 2002 Law on Prescribing Technical Requirements for Products and Conformity Assessment as well as some articles of the Law on Consumer Protection. It covers the whole area of technical harmonisation and establishes the basis for transposition of the principles of the "new approach" and the "old approach".

In the area of *standardisation*, 855 harmonised European standards (ENs), mainly related to the directives on low voltage equipment, safety of machinery and construction products, were adopted as national standards.

Progress has also been made on the strengthening of administrative capacity in some key institutions. A Sector for Internal Market has been established within the Ministry of Economy, dealing with free movement of goods, harmonisation of technical regulations, and consumer protection. The *Institute for Standardisation of the Republic of Macedonia* has established 15 new technical committees. Its administrative capacity has been strengthened by new staff and information technology equipment. The *Institute for Accreditation of the Republic of Macedonia* performs *accreditation* functions and is financed from the state budget. It has been provided with sufficient office space to perform its duties, but lacks staff. The institute became a full member of the European Co-operation for Accreditation when the country was granted candidate status.

A Council for *Metrology*, consisting of domestic experts, was established within the Bureau of Metrology. Existing capacity is insufficient to perform laboratory testing and calibration tasks.

The Government established a co-ordination body for co-operation in the area of *market surveillance*. The Ministry of Economy has been designated as responsible for market surveillance relating to the implementation of the technical norms under the Law on Product Safety.

Some progress can be noted on New and Global Approach directives for the construction sector. The Law on Construction Products came into force in April 2006, regulating essential requirements and attestation of conformity of construction products. In addition, rulebooks on construction products and on machines have been adopted.

In areas covered by the Old Approach directives, rulebooks on the quantitative analysis of textile fibres, on the composition and names of textiles, and on labelling of materials used in the main components of footwear have been adopted.

No progress can be reported in the area of procedural measures.

Conclusion

There has been some progress in this chapter, but it remains uneven. Some progress in alignment can be reported in the area of horizontal measures but most of the sectoral *acquis* on free movement of goods remains to be transposed and implemented. Alignment with the *acquis* in this area has been initiated but is still at an early stage.

4.2. Chapter 2: Freedom of movement for workers

There are no developments on access to the labour market. The employment service agency and its network of employment offices still lack the technical and human capacities required for participation in the European Employment Services (EURES). Preparations in this area are moderately advanced.

There has been some progress in the area of co-ordination of social security systems. The Republic of Macedonia has signed further bilateral social security agreements with Romania, the Czech Republic and the Netherlands. Administrative capacity to implement Community rules on the co-ordination of social security systems remains insufficient. Further steps have to be taken in this respect. Preparations in this area are moderately advanced.

Conclusion

Limited progress has been achieved in this chapter. Alignment with Community rules is at early stage. Administrative capacity needs to be strengthened.

4.3. Chapter 3: Right of establishment and freedom to provide services

No progress has been made towards removing barriers to the right of establishment for EU natural and legal persons. The provision of certain services to foreigners may not be allowed or allowed only under conditions of reciprocity. The regulatory framework needs to be adapted so as to remove remaining legal barriers for EU natural and legal persons.

Concerning the freedom to provide cross border services no progress has been made towards removing barriers to the provision of cross-border services by EU natural and legal persons. The legislation does not make a distinction between foreign operators providing services on a temporary basis and those providing services through a permanent establishment. Such an establishment requirement is incompatible with the *acquis*. National legislation does not distinguish between permanent and temporary provision of services. In order to ensure compatibility with the *acquis*, the licensing/authorisation system needs to be assessed in detail as regards its aims, scope and practical application. All incompatible measures will have to be amended or repealed.

As regards the mutual recognition of professional qualifications, the legislation and approach followed by the Republic of Macedonia (also concerning administrative structures for recognition of foreign qualifications) are currently based on academic recognition. Full implementation of EU law on professional recognition is foreseen for 2008.

No further approximation of the country's legislation to the *acquis* on postal services has taken place. The restructuring of the Public Enterprise for Postal Traffic *Macedonian Post-office* into a shareholding company in state ownership is underway. The statute of the new company was adopted and the Government appointed the members of the supervisory board.

An independent national postal services regulatory authority has yet to be established and a policy based on the postal directives needs to be adopted.

Conclusion

There has been no progress in this chapter. Further efforts to align the legislation with the *acquis* and to effectively implement and enforce it are needed.

4.4. Chapter 4: Free movement of capital

In the field of capital movements and payments, progress is on schedule. The country fulfils all the commitments undertaken under stage I of the SAA and has undertaken to gradually liberalise its capital account. Nonetheless, alignment remains limited and will require considerable further efforts. Significant restrictions exist in particular on the acquisition of real estate by EU persons and companies as well as on short-term capital movements. Portfolio investment remains only partially liberalised.

With regard to payment systems, some progress can be reported. A new Bankruptcy Law was passed in March which transposes the basic principles of the EC directive on settlement finality. In order to improve the rules for cross-border payment operations, three decisions of the central bank have been amended. Additional six are being revised to achieve harmonisation with EU legislation in this area. Nonetheless, a strategic document for the development of payment systems still has to be prepared. The national legislation is not yet fully in line with the *acquis*. Overall, in the area of capital movements and payment systems, preparations for alignment with the *acquis* are underway.

As concerns the fight against money laundering, limited progress has been made in the implementation of the National Strategy against Money Laundering and Funding Terrorism. Four memoranda of understanding were signed, three thereof with the financial intelligence departments of the USA, Luxembourg and Moldova and one with the national bank. However, the legislation does not yet fully comply with EU standards. The directorate for money laundering prevention is at the core of a nascent system for combating money laundering and financing of terrorism. It is not yet capable of ensuring adequate volume and quality of reports submitted to the investigating and prosecuting authorities. The directorate is not adequately staffed in terms of both quantity and quality. Improved quality would help improve co-operation with other bodies involved in prevention of money laundering. The division of labour with respect to financial crimes between the investigative authorities of the Ministry of Finance and the Ministry of the Interior remains unclear. Amendments to the Law on Financial Police remain to be enacted. Preparations in this area are moderately advanced, but further legislative alignment is necessary and the enforcement capacity needs to be strengthened, in particular by raising awareness among reporting institutions and by further establishing a credible enforcement record on the part of the relevant institutions.

Conclusion

Some progress has been made in the area of free movement of capital, in particular as regards payment systems. As regards money-laundering, the legislative and institutional framework still needs to be reinforced. Overall, further efforts are needed to align the legislation with the *acquis* and to effectively implement and enforce it.

4.5. Chapter 5: Public procurement

Substantial progress has taken place regarding alignment in the area of public procurement. As regards general principles, the Law on Public Procurement was amended in December, providing for an online system accessible to the public via the internet. An implementing regulation for electronic public procurement was adopted by the Ministry of Finance in May.

Progress can be reported regarding the award of public contracts. The Public Procurement Bureau has made substantial efforts to increase the public sector's awareness, including a web site which gives access to public procurement legislation, announcements of public procurement tenders, procedures and registers and findings of the second-instance Public Procurement Commission, a daily update of the register of public procurement and seminars on public procurement rules.

The Public Procurement Bureau cooperates actively with the Commission for Protection of Competition, the State Commission for the Fight against Corruption, and the State Audit Office. However, effective remedies still have to be put in place.

Conclusion

Significant progress can be reported in alignment with the *acquis* in the area of public procurement and in strengthening implementation capacity. The basis for developing an effective public procurement system has been established. However, effective remedies still have to be put in place. Considerable efforts are still needed to effectively implement and enforce the legislation.

4.6. Chapter 6: Company law

Significant progress in the area of *company registration* can be reported. Procedures have been simplified and time needed for company registration reduced significantly. The Law on the One-Stop Shop System and the Keeping of the Company Register and the Register of Other Legal Entities entered into force in October 2005. To facilitate its implementation, the Company Law was amended, along with 16 other laws. Manuals on the registration forms for entries in the company register and the register of other legal entities, and on the opening and closing of an account for the participants in payment transactions have been adopted to ensure the effective functioning of the one-stop shop (*see also Economic criteria*). In addition, the central registry tariff was amended. The possibility of electronic registration and data management of other registries still has to be addressed.

As regards *administrative capacity*, the administrative structure for the new system of company registration was set up and started to operate in January. The Central Registry was reinforced by seven regional company registration offices. The responsibilities of the courts (i.e. company registration and registration of other legal entities) and the State Statistical Office (i.e. issuing of registration numbers to the companies and other legal entities) were transferred to the Central Registry, which communicates electronically with the Internal Revenue Service and commercial banks.

Additional staff were recruited at the Central Registry for the purposes of the one-stop shop system. As a result of the new arrangements, registering a firm now takes an average of 6 days instead of 48 days. In less than six months of operation, the number of companies registered was equal to the total number registered in 2005.

In December, the Ministry of Finance amended the rulebooks on accounting standards for financial reporting, and those on the use of international accounting standards. However, it should be clarified whether the presentation of the accounts is required to be in line with the "Full International Financial Reporting Standards (IFRS)" and whether the standards are systematically updated following updates of IFRS. In addition, it is important to indicate that an extension of IFRS to all limited liability companies should not be used as a substitute for transposition of the *acquis* (4th and 7th company law directives). Furthermore, applying IFRS to SMEs could create undue complications, since those standards are not designed for small companies.

A strategy and action plan to enhance the quality of corporate financial reporting was published in April. It includes plans for a review of the Trade Company Law and related secondary legislation to achieve compliance with the Directives on Annual Accounts and on Consolidated Accounts and IAS regulation.

As regards auditing, international standards of audit were updated and published. A code of ethics determined by the International Federation of Accountants (IF AC) was adopted by the Ministry of Finance in October.

The Institute of Certified Auditors was established in May as a professional association. Its charter, establishing the rules, scope and independence of the audit profession, has yet to be approved. The Accounting Standards Committee was set up in May as a body of the Institute. It is not yet operational.

Efforts have been made to improve the supervision of audit. The Ministry of Finance established a Council for Promotion and Supervision of the Audit of the Professional Association of Auditors in December.

Conclusion

There has been notable progress in this area, in particular the introduction of the one-stop-shop system for company registration, as requested in the European Partnership. Standards for accounting and auditing have been amended. Further efforts will be needed to ensure the effective implementation and enforcement of these rules.

4.7. Chapter 7: Intellectual property law

Some progress has taken place concerning copyright and related rights. In accordance with the provisions of the new law, enacted in December, the Ministry of Culture has approved implementing legislation on the issuing of licences for new collecting associations. As regards administrative capacity, a sector for copyright and related rights was formed within the Ministry of Culture and is operational. The Government also appointed a president and members of the commission dealing with copyright and related rights. Following a public competition, two licences were issued for the new collecting associations which, in addition to the existing one - ZAMP, will assist the implementation of the law.

In the field of industrial property rights some progress has been recorded. The agreement on co-operation in the field of patents with the European Patent Organisation (EPO) has been extended and will be valid until accession to EPO. Further amendments to the Industrial Property Law were enacted in March. The State Market Inspectorate may now temporarily close a business; seize products, equipment, funds and documents used in violating industrial

property rights and launch a misdemeanour procedure. These changes were introduced after the Constitution was amended in December to empower administrative organs to impose sanctions.

In an effort to enhance administrative capacity, a coordinating body for industrial property was formed. It brings together the institutions involved in protection of industrial property, with the aim of enhancing enforcement of industrial property law, strengthening the system for protection of industrial property rights, co-ordinating the activities of the various institutions, and raising public awareness of industrial property rights. Additional, although limited, recruitment has taken place in the State Office for Industrial Property, bringing the total to 25 employees, and in the sector for inspection supervision and control of the Ministry of Culture. The inspectors and prosecutors still lack the necessary equipment and expertise to detect and prosecute infringements.

Little progress has been made concerning enforcement and there are still no reliable statistics. An operation led by the state market inspectorate between February and June led to almost 400 charges being brought under the Laws on Copyright and Related Rights and on Trade, and eleven criminal charges under the Law on Copyright and Related Rights. The State Market Inspectorate has urged the public to report any illegal sale or renting of pirated materials and has provided a toll-free number for this purpose. There are no developments concerning the seizure and destruction of equipment used to make pirated goods. Enforcement is lagging behind the legal framework. Enforcement of intellectual property should be enhanced by the extension of the competence of 13 basic courts (*see also Chapter 23 - Judiciary and Fundamental Rights*). The necessary measures to guarantee no later than June 2006 a level of protection of intellectual, industrial and commercial property rights similar to that existing in the Community, including effective means of enforcing such rights, have not yet been taken. Therefore, the Republic of Macedonia does not comply with the Stabilisation and Association Agreement.

Conclusion

There has been some progress regarding the alignment of the legislation with the *acquis* in this chapter, in particular in the area of industrial property rights. However, the Republic of Macedonia must step up its efforts as regards enforcement, administrative structures and political will to crack down on piracy and counterfeiting, in order to comply with the Stabilisation and Association Agreement in this area. Preparations to align with the *acquis* are at an early stage.

4.8. Chapter 8: Competition Policy

Some progress can be reported in the area of antitrust. A new Law on Protection of Competition is in force since January. It is in line with the *acquis* and covers all sectors. Implementing legislation taking over the Community's regulations on block exemptions, *de minimis* and mergers as well as other implementing legislation related to professional secrecy has been adopted. Previous problems related to the period for the prosecution of cartels have been resolved by extending the relevant time period from two to five years. Following the changes made to the Constitution, the Commission for Protection of Competition (CPC) could now be empowered to impose fines or other sanctions directly, without having to pass through the courts. However, this requires the adoption of specific legislation.

However, further amendments to the adopted legislation are still needed. The merger notification conditions need further alignment. Furthermore, the definition of professional secrecy should be revised, in order to avoid any problems related to its definition. Furthermore, there is an overlapping of competences between the public prosecution service and the CPC in cases of violations of competition rules. According to the new Law on Misdemeanours, a criminal procedure conducted for an infringement of competition rules leads to the suspension of the infringement procedure before the CPC. This leads to the de facto non-application of competition rules and should be clearly avoided.

As regards *administrative capacity*, the CPC's lack of administrative staff and appropriate premises limits its capacity to properly fulfil its tasks and should be addressed. Out of the five members of the CPC, only two are full-time working members. Only six experts are employed at the commission.

The institutional capacity of the CPC needs to be urgently reinforced through support for education and training, as well as through the development of procedures and mechanisms for institutional communication between the CPC, sectoral regulators, government entities and consumer associations. In addition, investigation procedures need to be strengthened, clear guidelines and interpretations of competition law developed, and transparency and accountability promoted through information dissemination, public awareness campaigns and publication of cases solved and decisions made.

The *enforcement record* of the CPC is still unsatisfactory.

As regards state aid, the amendment of the Law on State Aid, by which competence for the monitoring and control of State aid was transferred from the State Aid Commission to the Commission for Protection of Competition, has been an important step forward to ensure an operationally independent state aid authority. In future, rules for horizontal aid measures will have to be adopted. Substantial work will have to be undertaken to ensure that the country's industrial policies are made compatible with the State aid rules.

As regards *administrative capacity*, additional employees were recruited. Considerable efforts will be needed to strengthen the institutional capacity of the new state aid authority. Its staff need training. Transparent procedures for communication between the state aid authority, the industrial policy unit of the Ministry of Economy and other relevant government entities need to be established, procedures for handling cases and carrying out investigations need to be improved, a system to monitor and evaluate the current structure of state aid needs to be developed, and awareness-raising campaigns need to be organised and implemented.

There is still little awareness among government institutions and the general public, including the business sector, of the notification process and of the functioning of the state aid control system in general. It is necessary to foster state aid culture at all levels of government. The widespread and systematic non-payment of social security contributions and taxes by many industrial companies leads to unfair competition and impinges on the establishment of a level playing field for companies. Furthermore, the state aid authority will have to concentrate on the building up of a credible enforcement record. Preparation is lagging behind.

Conclusion

There was some progress in this area, mostly limited to the legal framework. However, further legislative alignment is needed. The Republic of Macedonia needs to make

considerable efforts to implement existing legislation much more effectively, in particular as regards the functioning of the Commission for Protection of Competition and its recently established competences on State aid.

4.9. Chapter 9: Financial Services

Concerning the banking sector and financial conglomerates, some progress has been made. The National Bank adopted a Supervisory Development Plan in January. This plan aims to enhance prudential supervision and to move gradually towards risk-oriented supervision. However, the country has made less effort to align its legislation with the *acquis* than in the previous year. It is necessary to continue to develop and strengthen banking supervision practice, including in the light of Basel II implementation and further amendment of the banking law in line with the *acquis*, especially with the Capital Requirements Directive. Preparations in the banking sector are advanced.

There has also been some progress as regards the insurance sector. The country continued its efforts to align its national legislation with the *acquis*. The Law on Compulsory Insurance in Traffic was adopted in October 2005. The implementing legislation regarding a new motor third party liability premium tariff structure was adopted in May. As far as *pension insurance* is concerned, the amendments to the Law on Mandatory Fully Funded Pension Insurance were enacted in December, by which certain areas related to the Agency for Supervision of Fully Funded Pension Insurance and the functions of the National Bank as a custodian of the pension funds were regulated in more detail. However, further amendments will be needed to meet the requirements of the 4th Motor Insurance Directive.

The insurance sector remains little-developed and is mostly focused on non-life insurance. Supervision of the insurance sector continues to be weak, and an independent body has not been set up. Nonetheless, the country has made an effort as regards the insurance sector and is well on track.

Some progress can be reported as regards the securities market and investment services. A new Law on Securities, which aims at transposing several EU directives in this area, came into force in November. The Law regulates investor compensation schemes, admissions of securities to an official stock exchange listing, information to be published on those securities, the prospectus and on markets in financial instruments. The administrative capacity of the Securities and Exchange Commission has also been strengthened. In order to promote inter-institutional cooperation a bilateral Memorandum has been signed between the Securities and Exchange Commission and the Agency for Supervision of Fully Funded Pension Insurance in January 2006. Preparations in this area are well on track.

Conclusion

There has been progress in the area of financial services, as the country has continued its efforts to align its national legislation with EU standards in the various sectors. Nonetheless, some deficiencies remain, in particular as regards the standard of supervision in the banking and the insurance sectors.

4.10. Chapter 10: Information society and media

Some progress has been made in parts of the area of electronic communications and information technologies. A substantial amount of secondary legislation was adopted to

implement the Law on Electronic Communications. It enabled the regulatory authority to approve the first reference interconnection offer in January, and the reference unbundling offer in April, of the significant market power operator in the fixed voice telephone networks and services market. This has proved insufficient to ensure a level playing field to alternative operators and competition has remained symbolic up to now

The Republic of Macedonia is still in breach of its obligations under the Stabilisation and Association Agreement in this field. Several important issues remain to be addressed to fulfil the starting conditions for market liberalisation, such as retail tariff regulation, cost accounting and accounting separation, number portability and regulation of leased lines provision. The Government is also running late in negotiating the revision of the concession agreements, in particular with the incumbent operator, and with the two mobile operators. The regulatory authority still needs to improve its organisation and capacity, including the allocation of adequate human resources, in order to be able to properly undertake its regulatory functions. Preparations in this area are lagging behind.

In the field of **information** society services, considerable efforts have been made to implement the national strategy for information society development by strengthening the administrative capacity of a number of bodies and by improving provision of public services to citizens and businesses through information and communication technologies. Significant progress was made in the field of e-government. However, legislation concerning electronic commerce and conditional access services remains to be adopted. Preparations are moderately advanced in this area.

The main piece of legislation in the audiovisual sector is the new Law on Broadcasting which entered into force in November 2005. The Law is largely in line with European standards on the media and the audiovisual *acquis*, including the Television Without Frontiers Directive. Other positive developments include the adoption of the law on public access to information of public character and the elimination of custodial sentencing for defamation. Rigorous implementation of the new Law on Broadcasting is needed to secure the funding of the regulatory body (Council of Electronic Media) and of the public service broadcaster, to depoliticise the procedure for selecting the members of the regulatory body, to establish the legal procedure that will ensure the political independence of the public broadcasting system and to introduce a more competitive licensing system which will diminish any political. The regulatory body adopted a code of ethics in June. However, a national broadcasting strategy remains to be adopted. Preparations in this area are at a reasonable level.

Conclusion

There has been notable, but uneven progress with respect to information society and media. Several important outstanding issues remain to be addressed in order to end the breach of the Stabilisation and Association Agreement, and to secure harmonisation of concession agreements with the provisions of the primary law. Preparations to align with the *acquis* are moderately advanced in this area. In the audiovisual sector, considerable efforts are needed to ensure the independence (especially financial) of the public broadcaster as well as to strengthen the media regulatory body.

4.11. Chapter 11: Agriculture

Regarding **horizontal** issues, pending the foreseen adoption of a General Law on Agriculture and Rural Development, there is still no general act covering the agriculture sector. No major

progress has been made with respect to *the paying agency*, the *Integrated Administration and Control System (IACS)* and the *Land Parcel Identification System (LPIS)*. The registration of agricultural land in the real estate cadastre is still being discussed by the Ministry of Agriculture and the State Geodetic Authority, including the creation of a database that can be used for the agriculture information system and the integrated administration and control system.

The Law on the Agricultural Census, which includes provisions on the preparation, organisation and performance of an agricultural census, was enacted by the Parliament in March 2006. The budget for the census has been prepared, and funds have been made available. However, the census will not be conducted in October 2006 as planned, but in 2007.

As to the common market organisations (CMOs), developments have occurred regarding wine and tobacco. There have been no changes in measures relating to other products.

Two rulebooks, on the method of wine production and on the analysis of the chemical content of wines, were adopted by the Ministry of Agriculture in February 2006. Also, some progress has been made on the pilot project for establishment of a vineyard register in the Tikveš region as regards the development of the necessary software and hardware and with digitalisation.

The Law on Tobacco and Tobacco Products was enacted in February 2006. It regulates the funding, production, processing, quality control, packaging, trading, and purchase of tobacco and tobacco products. It also defines the level of subsidies for primary tobacco production.

The Ministry of Agriculture has been designated as the managing institution for rural development and is therefore the main responsible body for this issue. The Government has adopted an 'Information for Rural Development' document which will be used as the basis for developing a strategy for agriculture and rural development. In the 2006 state budget, the Government has allocated €734,000 for the rural development programme, mainly for investments in agricultural equipment. Both legal entities and individual farmers are eligible to apply for these funds, which will be managed by the Ministry of Agriculture.

The 2006 programme for the revitalisation of villages has been adopted. It will cover construction and reconstruction of water-supply systems, construction of sewage systems and preparation of technical documentation for water management. A scheme which enables socially vulnerable people to farm state-owned agricultural land has been introduced. However, this measure aims more at granting social support rather than developing the agricultural sector.

After some delays, the preparation for the Rural Development component of IPA has started. The Ministry of Agriculture has been designated as the managing authority of the IPARD programme and made responsible for setting up the IPARD paying agency. Twenty-three additional employees have been recruited to prepare IPARD and have started the necessary training. Premises, equipment and an IT system have been provided for the future paying agency. The country should continue the preparations for IPARD in order not to risk any delay.

No particular progress can be reported as regards quality policy.

Concerning organic farming, manuals on organic plant products, on organic farm products and on processing of organic products were adopted in May 2006.

Concerning bilateral trade relations, the Government approved the protocol for changes to the SAA regarding tariff quotas for sugar exports from the Republic of Macedonia to the European Union, which entered into force in January. The protocol sets a new limit of 7,000 tons (net weight) per annum of duty-free exports of sugar.

Conclusion

There has been uneven progress in the area of agriculture and rural development. There is not yet a coherent strategy in this area. The adoption of a general act covering the agriculture sector is needed. Alignment with the *acquis* has been initiated but is still at an early stage.

4.12. Chapter 12: Food safety, veterinary and phytosanitary policy

Some progress has been made on general issues. The Ministry of Health, in cooperation with the Ministry of Environment and Urban Planning, drew up a programme for basic knowledge of food hygiene procedures and environmental protection. In March, the Government adopted a programme to support exporting companies. The Ministry of Economy will manage funds totalling € 280,000 in 2006, part of which will be used to compensate companies for expenses incurred in connection with Hazard Analysis and Critical Control Point (HACCP) certification and product certification. In this sector, preparation is still at an early stage.

In the veterinary sector, two rulebooks have been drafted, on border inspection posts (BIPs), and on diseases for which reporting is compulsory. At two pilot BIPs, the veterinary inspectorate has been trained in contingency planning and disease awareness and equipped with personal computers, equipment for sample collection, storage facilities, materials for the examination and transport of animal samples, and equipment for examining live animals.

The identification and registration of movements of cattle is proceeding, and a strategy for identification and registration of sheep and goats has been approved by the Ministry of Agriculture.

The administrative capacity of the veterinary directorate, including its branch offices, has been strengthened by additional staffing. The training of veterinary inspectors on-site for supervision, control and prevention of contagious diseases and training of laboratory staff in good laboratory practice and provision of quality is ongoing.

Avian influenza testing equipment has been supplied, and assistance has been provided to improve incineration of carcasses. The Government has established a national committee, headed by the Prime Minister, for coordination of measures to prevent and monitor the spread of avian influenza in the country. In this sector preparations are on track.

As regards the placing on the market of food and feed, no particular progress can be reported. Agro-food establishments need to continue their investments in order to align with EU hygiene standards.

Some progress has been made in the area of specific rules for food. Various manuals concerning food safety have been adopted by the Ministry of Health. They include guidelines for food labelling; the composition and safety of baby milk; assessing basic knowledge of food hygiene procedures and environmental protection; general requirements for food safety,

food labelling, food additives, food pollutants, residuals of pesticides and of veterinary medicines; additives which can be used in food production; handling of frozen food; safety of natural mineral water; safety of baby food; safety of fruit juices; safety of cocoa and chocolate products; safety of sugar and sanitary conditions for food production. No particular progress can be reported on specific rules for feed.

Some progress was made in the phytosanitary sector. The Law on Seeds and Seedlings was enacted in March. It covers production, trade, labelling, import and export of seeds and seedlings. Manuals on marketing of seed for cereal crops and for fodder crops, and on keeping a register of suppliers of seed of agricultural plants were prepared. The 2006 programme for seeds and seedlings has been adopted.

The administrative capacity of the state phytosanitary laboratory has been strengthened with additional staffing and new equipment (computers and equipment for collecting, storing and examining plant samples). The phytosanitary inspectorate at the border inspection posts has been provided with computers, and equipment for collecting, storing, examining and transporting plant samples. The staff of the plant protection directorate (charged with the duties of the plant health authority) have been trained. The programme on the protection of plants against diseases and pests was adopted in February.

The Ministry of Agriculture has published a manual on phytosanitary standards for wood materials used for packaging purposes in international trade which is in line with the relevant FAO phytosanitary standards. Preparation in this sector is still at an early stage.

Conclusion

There has been progress in parts of the area of food safety, veterinary and phytosanitary policy. However, the enactment and implementation of legislation is lagging behind, requiring considerable and sustained efforts. Alignment with the *acquis* is at an early stage.

4.13. Chapter 13: Fisheries

There has been limited progress in this area. No steps have been taken towards establishing an administration responsible for structural and market policies, and no change has been made to the state aid rules.

Conclusion

Most of the relevant *acquis* does not apply to the Republic of Macedonia. Preparations to align with the *acquis*, where relevant, are at an early stage.

4.14. Chapter 14: Transport policy

There has been limited progress in the area of road transport. A significant amount of new legislation is still needed in order to align with the *acquis* in this field. Preparations in this area are at an early stage.

Good progress can be reported with respect to rail transport. Implementing rules for the construction and maintenance of railways and of electromotive units need to be adopted. *Macedonian railways* cut its staff by 680 in 2005. The Government approved the plan to transform *Macedonian Railways* into two state-owned companies: *Public Enterprise Macedonian Railways Infrastructure*, which will manage the rail infrastructure, and a joint

stock company, *Macedonian Railway Transport*, which will provide transport services. The restructuring is part of the action plan endorsed by the Government, which includes a debt-relief programme, employee lay-offs, sale of non-core assets and preparation of a five-year business plan. Furthermore, the Government endorsed the investment programme for the railway sector for 2006, which allocates € 2.5 million to railway reconstruction and maintenance. However, the financial position of the railway company remains poor, and the level of arrears remains high. Public service obligations are still not compensated. There has been no progress on the rules for the transport of dangerous goods. Preparations in this sector are on track.

The new Law on Aviation, which entered into force in February 2006, represents substantial progress in the field of **air transport**. It provides for the establishment of two independent institutions, enabling separation between the regulatory and the operational functions. The Agency for Civil Aviation will take on the regulatory functions, while a joint-stock company with a single shareholder - the State - will provide air traffic services. The Law also envisages the formation of an independent body for investigation of accidents and serious incidents, and an independent co-ordinator for slot allocation. By signing the European Common Aviation Area Agreement (ECAA), the Republic of Macedonia has undertaken to integrate into the EU internal aviation market and to apply EU aviation standards. This will require the application of the ECAA agreement in practice and the fast implementation of the first transitional phase of the relevant aviation *acquis*, including market access conditions, safety, security, airport policy, environmental and social issues and air traffic control, in line with the European Partnership short term priority.

There are no significant developments to report in the areas of **combined transport, inland waterways and state aid**.

Conclusion

The Republic of Macedonia has made good progress in some areas of the transport policy. However, considerable efforts to align the legislation with the *acquis* and strengthening the administrative capacity in all transport sectors are needed.

4.15. Chapter 15: Energy

There has been some progress with respect to **security of supply**. The Republic of Macedonia currently possesses oil stocks equivalent to 56 days of average consumption. The new Law on Energy enacted in May requires a strategy for the long-term development of the energy sector to be elaborated. Preparations in this area are well advanced.

Good progress can be reported as regards the **internal energy market**. The country ratified the Energy Community Treaty in May. The new Law on Energy regulates, amongst others, energy policy, the regulatory authority, construction of new facilities, the electricity market, the natural gas market, the oil and oil derivatives market, the thermal and geothermal energy market, licensing, energy efficiency and renewable energy sources, and includes provisions on supervision and penalties. Appropriate implementing legislation needs to be developed. Administrative capacity should be significantly strengthened in the energy sector, and particular attention paid to the independence of the Energy Regulatory Commission.

The state-owned electricity company was restructured and divided into three companies. In March, the privatisation of the distribution company was completed. The privatisation of the other two companies has been decided. Preparations in this area are well on track.

No significant developments can be reported as regards state aid.

Some progress can be reported in the field of energy efficiency and renewable energy for which the new Energy Law requires the adoption of a 10-year strategy. Implementing legislation on energy efficiency and renewable energy remains to be adopted. A programme for sustainable energy was adopted in March, aimed at promoting investment in energy efficiency and renewable energy, in particular the removal of financial and administrative barriers. Further significant efforts are needed to increase the share of renewable energy sources, as required by the Renewable Energy Directives on transport and electricity. Preparations in this area are at an early stage.

There was some progress in the field of nuclear energy. The Republic of Macedonia has no nuclear installations for energy production or research, no nuclear fuel cycle facilities and no intention of developing any nuclear capacity. Following ratification, the international Convention on Nuclear Safety entered into force in the country in June 2006. Limited progress can be reported in the area of nuclear safety and radiation protection. A national register on ionising radiation sources was established within the Radiation Safety Directorate. The Directorate issued 18 licences. The country became a member of the Incident Emergency Centre of the IAEA and of the European Radioactivity Data Exchange Platform (EURDEP). However, the country still needs to align with the *acquis* on radiation protection, and will need to ensure compliance with Euratom Treaty requirements and procedures, in particular regarding environmental monitoring and radiation protection in connection with medical and industrial applications. Preparations in this area are at an early stage. The country will also need to accede to the Joint Convention on the Safety of Spent Fuel Management and on the Safety of Radioactive Waste Management, to which Euratom became a contracting party in January 2006.

Conclusion

The Republic of Macedonia has made notable progress in parts of the energy sector, in particular as regards internal energy market related legislation. However, adoption of implementing legislation is a matter of priority, in particular in view of commitments under the Energy Community Treaty.

4.16. Chapter 16: Taxation

In the area of indirect taxation, good progress can be reported. Several laws have been amended with the aim of improving the administration and collection of tax revenues. The possibility to defer the payment of VAT at import by 15 days upon request of the taxpayer has been introduced. The exemptions from VAT at import have been aligned with the provisions of the Customs Code. However, a reduced VAT rate on agricultural machinery has been introduced, which deviates from the *acquis*. The Law on Tax Procedures was enacted and the Law on Public Revenue Office have been amended to further define the institutional role and organisation of the Public Revenue Office. Legislation was adopted according to which the fiscal discrimination against imported tobacco products will be ended from 1st January 2007.

In the field of direct taxation and mutual assistance, amendments to the Laws on Profit Tax and on Income Tax have introduced a withholding tax on revenues by foreign legal persons (dividends, royalties, immovable property, certain types of intellectual services, etc.). These are not in line with the *acquis*.

Further legislative adaptations are necessary to bring the legal framework in line with the *acquis*. Overall, the Republic of Macedonia has achieved a reasonable level of alignment at this stage.

There are no developments to report as regards administrative cooperation.

There was some progress as regards administrative capacity. The Public Revenue Office has launched an ambitious reform to restructure its organisation and to strengthen its capacity. A directorate for large taxpayers, which will cover around 130 of the largest taxpayers of the country, has been established. Additional staff are being recruited. Despite the reorganisation, the number of tax inspectors remains clearly insufficient.

However, the effectiveness of tax collection is still a cause for concern, especially with regard to direct taxation. Personal income tax revenues remain far below the EU average, showing the weakness of the administration in the field of tax collection.

Regarding ethics and anti-corruption measures, the number of disciplinary measures against staff members was insignificant. However, the anti-corruption hotline received 3461 calls which led to 2178 inspection activities. A system of electronic tax services has been set up in the Large Taxpayers Office to allow the Office to provide tax records electronically. The Public Revenue Office has established a central registry to provide a unique tax number to newly registered companies through a one-stop-shop system. The administration needs to be further strengthened in terms of both staff and equipment. It needs to develop a comprehensive IT strategy, including interconnection with the Community computerised systems.

Conclusion

There has been progress in legislative alignment in the area of taxation. Significant efforts will be needed to further align legislation, ensure effective implementation of the legislation, as well as to strengthen the administrative capacity in the area of tax collection.

4.17. Chapter 17: Economic and Monetary Union

As regards monetary policy no progress can be reported. The Republic of Macedonia will need to continue to implement the necessary changes to its institutional and legal framework. In particular, the national central bank (NBRM) has to adopt a secondary objective that allows for general economic objectives of the European Community to take precedence over domestic objectives. In addition, it has to adopt the relevant rules and structures related to the integration of the NBRM into the European System of Central Banks by the time of EU accession. Specific legislation must be adopted to establish the full institutional and financial independence of the NBRM and the personal independence of its senior management. There are still some legal provisions that do not preclude monetary financing of the public sector or that give rise to privileged access of public authorities to financial institutions. However, overall preparations in the area of monetary policy are well on track.

On the provisions related to economic policy the country has made some progress. The new strategy for public debt management contributes to enhancing administrative capacity and improving coordination of fiscal policy. However, further efforts are needed to strengthen administrative capacity, in particular as regards the fiscal administration. Overall, in the area of economic policy, preparations are well under way.

Conclusion

There has been little progress in the area of economic and monetary policy. However, overall, preparations to align with the *acquis* are well advanced.

4.18. Chapter 18: Statistics

There has been some progress as regards statistical infrastructure. The Law on State Statistics still has to be amended to address shortcomings as regards, for instance, the definition of official statistics, the scope of the statistical council and the appointment of the top management of the State Statistical Office. The Administrative Business Register has been transferred from the statistical office to the central registers and opened up for the establishment of a Statistical Business Register. Despite of improved cooperation among and between data providers and statistics producers, the progress in this area has been unsatisfactory. Moreover, the various statistical institutions need considerable development of their administrative capacity in terms of infrastructure, as well as human and financial resources, in order to be able to follow up the activities started and to deliver timely, reliable and accurate statistics in accordance with EU standards. In addition, very frequent changes of the top management during recent years, including after the recent change of Government, are slowing down the implementation of the *acquis* on statistics, as these changes create instability and changes of priorities. Overall, in the area of statistical infrastructure, the country has advanced moderately.

Good progress has been made with regard to classifications and standards. Compliance with EU standards is improving with NACE Rev 1.1 and PRODCOM 2005 being adopted. The Republic of Macedonia has submitted a proposal for statistical regions to Eurostat. An agreement has not yet been reached. The production of regional statistics has not yet started. Preparations in this area are on track (*see also Chapter 22: Regional policy and co-ordination of structural instruments*).

As regards sector statistics, progress can be reported in the following areas:

For *demographic and social statistics*, the production of the labour force statistics and the household budget survey has been improved and its scope has been extended. Furthermore, the results of the first EU-harmonised time use survey was published.

Regarding *macro-economic statistics*, work on the production of government finance statistics according to the international standard GFS 2001 at the Ministry of Finance has started, which represents progress towards implementing the EU standard in this area. The State Statistical Office has improved the production system and the data sources for the national accounts. For instance, the framework to calculate the non-observed economy has been further developed and the quarterly gross domestic product (GDP) in current prices has been calculated. Some of the improvements have produced visible results, such as the publishing of GDP for the reference year 2000 using supply and use tables and the publishing of harmonised environmental accounts for the reference years 1998-2004.

For *agriculture and fishery statistics*, the main progress has been the adoption of the Law on Agricultural Census which had been postponed several times. The Law includes provisions on the preparation, organisation and performance of the agricultural census for 2006 (*see also Chapter 11: Agriculture and rural development*). The State Statistical Office has started publishing price indices on a monthly basis.

Conclusion

There has been some progress in the area of statistics. However further alignment with the *acquis* is needed and administrative capacity needs be substantially strengthened. Preparations to align with the *acquis* are on track.

4.19. Chapter 19: Employment and Social Policy

No further progress can be reported in the field of **labour law**. A study was carried out as follow-up to the implementation of the 2005 Labour Relations Law, in order to provide a general overview on the harmonisation with the EU directives. In particular, a report prepared in the framework of a CARDS project concluded that while the new Labour Relations law covers some of the basic *acquis* principles, it still does not fully comply with EU legislation. The report indicates that seven EU directives have not yet been transposed and twelve others are only partially transposed.

There has been limited progress in the area of **health and safety at work**. Legislation was adopted in December to transpose the *acquis* on work involving display screen equipment. However, much of the *acquis* still needs to be transposed. Further efforts are needed to ensure the practical implementation and enforcement of the legal provisions. Preparations in this area are moderately advanced.

There are no significant developments to report in the area of **social inclusion**.

In the area of **social dialogue**, progress has been limited. The operational activity of the Economic and Social Council has diminished in 2006 compared to 2005, during which regular monthly meetings took place. The deadline for bringing the collective agreements into line with the new labour law was February 2006 (6 months from when the law entered into force), but this was only partly met. The general collective agreement for the private sector was signed only in June 2006, and the public sector collective agreement remains unsigned.

Progress has been reasonable in the area of **employment policy**. An employment strategy has been developed which defines objectives for 2010 in line with the European Employment Strategy and Guidelines according to the revised Lisbon Strategy. A second National Plan for Employment 2006-2008 has been prepared. Several initiatives have been undertaken to reform the unemployment benefit system, encourage temporary employment and employment of older redundant workers. However, unemployment remains extremely high. Considering the enormous challenges in this field, further significant efforts are necessary.

Preparations for the **European Social Fund** have started in the framework of the pre-accession instrument.

Some progress can be reported in the area of **social protection**. Implementation of the pension system reform started in January. The establishment of a new sector for inspection of social protection within the responsible ministry strengthened administrative capacity by.

Further efforts have been made to decentralise the system. New legislation is necessary to align with the *acquis*, but the necessary preparations in this area are well under way.

There are no particular developments in the **anti-discrimination** field

Substantial progress has been made in the field of **equal opportunities**. The Law on Equal Opportunities for Women and Men was adopted in May. It aims to incorporate EU definitions of indirect discrimination and harassment as a form of discrimination, as well as provisions on the burden of proof, into national legislation. The new Law improves the institutional mechanisms for equal opportunities by establishing a sector for equal opportunities at the Ministry of Labour and Social Policy and by obliging local self-governments to set up equal opportunity committees and designate equal opportunity co-ordinators. Progress has been achieved in a number of areas, including education, health care, political participation and the non-governmental sector, but there is need for considerable additional action on employment, the situation of rural women, the situation of women from ethnic minorities, violence and trafficking in women. Preparations in this area are well advanced.

Conclusion

There has been notable progress in the area of social policy and employment, mainly as regards the legislation on labour and equal opportunities. However, much of the *acquis* remains to be transposed, notably in the area of health and safety at work. Considerable efforts in the employment policy are needed to address the difficult labour market situation.

4.20. Chapter 20: Enterprise and Industrial Policy

Some progress can be reported in the area of **enterprise and industrial policy principles**. The privatisation of state-owned companies has been largely completed. The privatisation agency was closed down in October 2005, and the majority of its remaining assets were transferred to the pension fund. The introduction of the one-stop shop company registration system has had a positive impact on the business environment (*see also Chapter 6 - Company law*). Further progress has been made in dismantling some of the obstacles faced by SMEs. A credit guarantee scheme became operational in late 2005. The fund has begun operating with a € 4.5 million budget from state and donor resources. A voucher system for training and advisory services has been introduced. The country has started to invest effort in promoting the competitiveness of SMEs and has launched a new initiative, "Sun of the Year", in which companies compete for the best domestic product. There has also been progress on innovation and technology transfer. There are currently three technology transfer centres and a technology park. The country is implementing the European Charter for Small Enterprises, although it has incurred delays in some of the areas.

The establishment of a sector for economic reforms within the general secretariat of the Government strengthened the country's administrative capacity for enterprise and industrial policy. It will provide institutional support for the Government's co-ordinating body for economic reforms, develop a methodology for regulatory impact assessment and strengthen communication with the private sector, specifically the business sector. A new unit for industrial policy in the Ministry of Economy is preparing a study on competitiveness indicators. This set of indicators will be used to develop the industrial strategy.

The country has adopted in June 2006 the new Law on Vocational Education and Science which introduced entrepreneurship learning as an integral part of secondary education.

Some progress has been made with the promotion of on-line access for entrepreneurs. An e-taxes system was launched in July 2006. It allows on-line filing of tax forms, but is currently only used for larger tax payers.

In 2006 the first Innovation Relay Centre has begun operating in the country.

However, the Republic of Macedonia still lacks an industrial strategy, as well as a national technology and innovation strategy. Regulatory impact assessments will have to be introduced. It is necessary to make better use of ICT technologies to facilitate communication with the business sector, to strengthen the national SME Agency and to enhance transparency and the influence of the SME community in the context of the dialogue within the National Entrepreneurship and Competitiveness Council. Preparations in this area are moderately advanced.

No particular developments can be reported in the areas of enterprise and industrial policy instruments and sector policies. Preparations in this area are at an early stage.

Conclusion

There has been progress in the field of enterprise and industrial policy, mainly limited to the implementation of enterprise and industrial policy principles. However, further efforts are needed, to develop instruments and sector policies. The Republic of Macedonia still lacks industrial, technology and innovation strategies. The country is partially meeting the EU requirements in this area.

4.21. Chapter 21: Trans European Networks

There has been reasonable progress in the area of transport networks. The Republic of Macedonia is actively participating in the development of the Core Regional Transport Network and in the South East Europe Transport Observatory (SEETO), in particular by approving the first Rolling Five Year Multi-Annual Plan 2006-2010 (MAP). Continued cooperation in the framework of SEETO is required in the context of the annual revisions of the plans in order to make further progress on the definition of regional priorities and the coordination of investments.

As regards the railway network, Bosnia and Herzegovina, Serbia and Montenegro, Croatia, Turkey, Ukraine, Moldova and the Republic of Macedonia signed a memorandum on the establishment of a high performance network in South-East Europe. The target is to have a railway network operating at a maximum speed of 160 Km/h by the year 2020. Preparations in this area are moderately advanced.

Fair progress can be reported in the area of energy networks. In May, the Republic of Macedonia ratified the Energy Community Treaty. An action plan for the implementation of the treaty still needs to be adopted. A new interconnection with Bulgaria is under construction, as well as an additional interconnection with Greece. With the capacity of the domestic transmission network also being upgraded, preparations in this area are well advanced.

Conclusion

There has been some progress in the area of Trans-European networks. The Republic of Macedonia participates in the regional initiatives and is well on track in this area.

However, the crucial bottleneck remains the substantial financial input required to upgrade the infrastructure.

4.22. Chapter 22: Regional Policy and Coordination of Structural Instruments

Following the reorganisation of local government there has been some progress with respect to territorial organisation. The nomenclature of territorial units for statistics (NTES) has been revised in accordance with Eurostat's NUTS classification. The State Statistics Office has submitted its official proposal for the revised NTES to Eurostat. However, one of the proposed NTES level 3 regions (Eurostat's NUTS 3) does not comply with the size criterion and the territorial levels NTES level 4 and 5 (Eurostat's LAU 1 and LAU 2) comprise rather large units. Further efforts are needed to supply relevant and reliable statistics on the NUTS 3 level (*see also Chapter 18 - Statistics*). Preparations in this area are moderately advanced.

There has been some progress on the legislative framework. The new Law on Budgets includes mechanisms for multi-annual budget programming with three-year budget projections. A Law on Regional Development to align with the EU Structural and Cohesion Funds regulations is needed. Preparations in this area are at an early stage.

Progress on the institutional framework has been limited. The government established an inter-ministerial body in November to coordinate the drawing up of the strategy for regional development, led by the Minister for local self-government. In May, the government established an inter-ministerial body to coordinate the preparation of the national development plan for the period 2007-2013, led by the minister of finance. The role of local administrations in the future management of the structural and cohesion funds has yet to be defined. The regional level of government does not exist, as the regions on NUTS 3 level are only statistical regions. The Law on Local Self-Government provides for municipalities to cooperate in common development projects. However, structures for co-ordination between national and local levels are still not in place. Preparations in this area are at an early stage.

No significant developments can be reported in the areas of administrative capacity, programming, monitoring and evaluation. An implementing agency for the regional and social components, which will be the precursor of the authority for implementing structural and cohesion funds, still needs to be established. Proper systems and mechanisms for monitoring and evaluation of the quality and impact of development programmes have yet to be devised. Preparations in these areas are at an early stage.

Limited progress can be reported in the area of financial management and control systems. The institution responsible for managing EU funds is the Ministry of Finance, which has established a unit for managing EU funds (the National Fund) and a central financing and contracting unit. Preparations in this area are moderately advanced.

Conclusion

There has been limited progress in the area of regional policy and co-ordination of structural instruments. Alignment with the *acquis* in this area is at an early stage. Considerable efforts will be needed to align the legislation with the *acquis* and strengthen the institutional framework and administrative capacity.

4.23. Chapter 23: Judiciary and fundamental rights

There has been progress in the area of the judiciary, mainly at legislative level following the changes made to the Constitution in December.

The rules for the appointment of judges have been changed by the adoption of the Laws on the Academy for Training of Judges and Prosecutors, on Courts and on the Judicial Council. These are to strengthen the independence of the judiciary. Parliament will no longer play a role in the selection of judges. Judges and presidents of courts will be elected by the Judicial Council with two thirds of the votes of its 15 members.

As regards public prosecutors, the Constitution has been amended so that only the State Public Prosecutor is appointed by the Parliament. The role of the government in electing the State Public Prosecutor was also reduced. The government will need the prior consent of the Public Prosecutors Council before proposing to the Parliament a candidate. Appointment is for a period of six years and is renewable. Deputy public prosecutors are appointed for an unlimited period by the Public Prosecutors' Council, which is also responsible for their dismissal. The conditions for appointment or dismissal of public prosecutors and their deputies will be regulated by a law still to be adopted. However, implementation of the Law on Judicial Council has been upheld in the absence of a consensus on the nomination of the Council members.

Steps have been taken to strengthen the *disciplinary procedures*. Twenty seven judges were dismissed for incompetence or negligence. Disciplinary rules have been modified. The Judicial Council will decide on termination of judicial office and the dismissal of judges in cases of severe disciplinary infringements, unprofessional or negligent exercise of their judicial office. Judges and court presidents have a right to appeal before an independent panel of judges. Immunity rules were also modified with a constitutional amendment which abolished the immunity for prosecutors.

With respect to impartiality, several court cases have been filed against judges and public prosecutors for corruption.

As regards professionalism and competence, professional requirements to be a judge in the Court of Appeal and in the Supreme Court have been increased. An academy for the training of judges and prosecutors was set up by law in January, funded by the state budget. Candidates for a basic court will have to complete a training course at the new academy. Admission will be based on an anonymous examination. However, the academy is not yet operational and delays have occurred in selecting its Director and executive Director.

Steps have been taken to improve the efficiency of the judiciary. The 2006 *budget* for the courts has increased by 3% compared to 2005, with about € 21.1 million. This remains insufficient to cover the running costs of the judiciary and the debt of the courts (€1.4 million, due mostly to the post office for summoning services). The budget for the Public Prosecutor's Office has increased by 12%, with € 3.7 million.

Computerisation of courts to enhance capacity for case management is ongoing. However *infrastructure and equipment* for the judiciary remain serious problems. The number of judges and prosecutors have slightly decreased (624 and 187 respectively, compared to 635 and 193 in 2005).

The number of employees in the judicial administration has declined. The 2005 report of the Skopje Court of Appeal pointed out the lack of judges and experts, and the lack of sufficient budgetary resources whereas the number of cases per judge has doubled in comparison with 2000.

The total number of pending cases in the basic courts was 937 756. There were 534 548 cases registered in 2006. The large number of misdemeanour and enforcement cases remains a major reason for the inefficiency of the judiciary. The Supreme Court remained overburdened, notably with administrative cases which constituted 80% of the new cases received.

A Law on Mediation was enacted in May to introduce the concept of alternative dispute resolution for some civil cases as well as for commercial cases and alleviate the burden on courts. Sixty mediators have been appointed. The law will enter into force in November 2006. The Laws on Litigation Procedure and on Enforcement of Civil Judgements adopted in 2005 in order to improve the enforcement of judgements entered into force in January and May respectively. Since June, the new enforcement agents received 2926 requests for enforcement, out of which 1201 were completed.

In line with the **Judicial Reform** Strategy, the Constitution was changed in December which allowed for the adoption in May of new Laws on Courts, Judicial Council, Misdemeanours and Administrative Disputes. However, apart from the Law on the Judicial Council which entered into force in September 2006, the other laws will only enter into force in 2007. In practice, the judiciary suffers from the same serious deficiencies outlined in the Opinion.

Overall, the Republic of Macedonia has made progress in the constitutional and legal framework of the judiciary reform. However, the reform is at an early stage and improving the independence and the efficiency of the judiciary remains a major challenge.

There has been some progress in the area of **anti-corruption policy and** measures. Corruption remains widespread and is perceived as among the main problems for the country.

The legal and institutional framework to address corruption has been strengthened. The immunity rules have been changed, in line with the recommendations of the Council of Europe Group of States Against Corruption (GRECO), through changes to the Constitution and to the relevant laws. Only the Prime Minister will be given immunity, which may be lifted by Parliament. The reform in the judiciary, in particular the changes in the selection of judges and prosecutors, was also a step recommended by GRECO to better prevent corruption. Changes in the electoral code before the July parliamentary elections included the obligation for each party to account for its campaign expenses.

There was some progress in increasing the transparency of public activities, notably with the adoption in February of the Law on Free Access to Public Information and the measures taken in the public procurement area (*see also Chapter 5 - Public procurement*). The new government presented a set of additional measures aimed at enhancing the fight against corruption.

The State Anti Corruption Commission has continued to monitor the implementation of the Programme for Prevention and Repression of Corruption. Misdemeanours procedures have been initiated against 30 Members of Parliament for not having submitted their declaration of assets in the delay foreseen by the Law on Prevention of Corruption. Relations between the

State Anti-Corruption Commission and the Public Prosecutor have improved and are more constructive. An inter-ministerial body was set up in April to co-ordinate the activities of all organs involved in the fight against corruption. At the operational level there is ongoing cooperation between the Public Prosecutor's Office, and the relevant services in the ministry of interior, especially the Specialised Unit for Fight Against organised Crime, has progressed.

However, tangible results in the fight against corruption remain dependant on further strengthening of the institutions, more transparency in public decisions and to the full implementation of adopted legislation. The OECD Convention on combating bribery of foreign public officials in international business transactions has yet to be signed. The UN Convention against corruption remains to be ratified. Further progress is needed in the implementation of the rules regarding anti-money laundering. Overlapping competences and the insufficient exchange of information between the law enforcement bodies involved in combating corruption need to be fully addressed. One police officer has been sentenced for receiving bribe and one criminal procedure has been opened against a custom officer. Further capacity to investigate and prosecute corruption is needed.

Overall, corruption remains widespread in the Republic of Macedonia and affects various aspects of society. The lack of good governance, of transparency and accountability in public administration, as well as of well defined rules on conflict of interest facilitate corruption. Considering the challenges the country has to meet, very strong political commitment is required.

As regards **fundamental rights**, there have been few new developments.

The *Ombudsman* is playing an increasing role to defend individual rights. In 2005 it has received 3,935 complaints, which is an increase of 56% compared with 2004. Out of a total of 2,729 complaints processed, 504 violations were identified and 1,206 investigations are ongoing. 887 complaints were received by the deputy Ombudsmen in the regional offices. The largest number of violations was in the field of property rights (29%), followed by police interventions (17%), labour relations (11%), and judiciary activities (10%). Since January, ministries and other administrative bodies have to report to government on a quarterly basis on the implementation of recommendations or requests made by the Ombudsman. There is still room to improve co-operation, in particular from the Ministry of Interior.

As regards *prohibition of torture, inhuman and degrading treatment and punishment*, positive developments occurred in the Ministry of Interior's sector for internal control and professional standards, which worked towards strengthening its ability to investigate charges of police abuse and corruption. Incidents of ill-treatment, particularly during arrest and detention, continue to occur. Investigation mechanisms need to be strengthened, including through the co-operation between the Ombudsman and the Ministry of Interior. There were concerns about a rise in the number of deaths, including suicides, in prisons. Recommendations by the Council of Europe's Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment, which carried out inspections in May, should be fully implemented.

As regards the *respect of private and family life and communications*, telecommunication tapping still takes place in absence of a proper legal framework. This must be addressed without further delay.

Legislation on *personal data protection* was adopted in December, with a two year transition period. The supervisory authority (the Directorate for personal data protection) is operational.

The law on civil servants has been amended to enable the employees in the directorate for data protection to have the status of civil servants. However, the Republic of Macedonia has not yet signed the additional protocol to the Council of Europe Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data regarding supervisory authorities and trans-border data flow. The Directorate for personal data protection still needs greater capacity.

In the field of *freedom of thought, conscience and religion*, the revision of the Law on Religion and Religious Groups is still under consideration. The draft revisions should provide more liberal procedures for registration of religious institutions and also remove all remaining impediments to free practice of religious belief.

Legal guarantees for *freedom of expression and information* were further strengthened with the abolition of imprisonment as a possible punishment for defamation. The economic and financial independence of the media should be further strengthened.

In the field of *gender equality*, a Law on Equal Opportunities for men and women was enacted in May. Implementation of the UN Convention on Elimination of Discrimination against Women has generally been assessed positively by the UN in a number of areas. However, there was no particular progress in the definition of rape and in measures against domestic violence and sexual harassment, which remain at a high level with rare prosecutions.

Right to property is ensured. However the process of restitution of property that was confiscated during the Yugoslav regime progressed very slowly. According to the Ministry of Finance, decisions have been taken on 8,549 of 21,986 applications filed between 2000 and 2005. The issue of the restitution of the properties of the Orthodox church and the Muslim community has seen no improvement.

In terms of *non discrimination*, there is no specific criminal provision related to acts of xenophobia.

Basic principles remain guaranteed as regards *the right to an effective remedy and to a fair trial*. Preparatory steps have been taken to further develop the legal framework for witness protection in such a way as to ensure that the safety of vulnerable witnesses is appropriately balanced with the accused's right of defence.

The Law on Criminal Procedure was amended to abolish mandatory *pre-trial detention*, in line with the case law of the European Court of Human Rights. However, the use of "informative talks" by the Police remains unclear. Continuous efforts in training and awareness-raising on human rights issues are needed.

In February, the government adopted an action plan for the protection of *children's rights*. This plan was complemented by a development programme for the practical exercising of children's rights.

The legal framework on minority rights ensures a high level of protection. Complaints relating to *minority rights* received by the Ombudsman have decreased (eleven complaints in 2004, four in 2005). As regards the use of minority languages, smooth implementation of the existing provisions will require sustained commitment and further investments. Dialogue and trust-building between communities should be further enhanced to achieve sustainable progress.

No particular development can be reported concerning EU citizens' rights.

Conclusion

Overall, there has been some progress in the area of the judiciary and fundamental rights. The Constitution and the legal framework were amended to allow for the implementation of the judiciary reform. Some progress has been made in the legal and institutional framework to fight corruption. However, the judiciary reform is at an early stage and improving the independence and the efficiency of the judiciary remains a major challenge. Corruption remains widespread. Very strong political will is needed. There is further scope for improvement in fundamental rights (*see also Political criteria - Democracy and the rule of law*). The situation as regards protection of personal data remains a matter of concern.

4.24. Chapter 24: Justice, Freedom and Security

Significant progress can be reported in the area of migration. A new Law on Aliens was adopted and will enter into force in March 2007. It regulates entry and admission, stay and residence, expulsion and voluntary return, irregular migration, trafficking in human beings, migration statistics and data protection. The Government adopted a strategy in March, together with a national action plan, for combating illegal immigration and trafficking in human beings. The agreement on the status and activities of the Migration, Asylum and Refugees Regional Initiative was ratified. New readmission agreements were signed with Belgium, the Netherlands, Luxembourg, Spain, Poland and Austria. The Republic of Macedonia has now ratified twelve readmission agreements. The country has expressed its readiness to conclude a readmission agreement with the Community. Further alignment with the EU negative list is necessary. The border police has detected 1303 illegal migrants at border crossings and prevented 749 illegal attempts to cross the green border. The new legislation is largely in line with the *acquis*, but enforcement capacity needs to be strengthened.

There have been no significant developments in the field of asylum. The implementing legislation for the Law on Asylum and Temporary Protection is still missing. The Law still lacks provisions for subsidiary protection. Further legislative alignment and administrative strengthening are necessary. In this area, the Republic of Macedonia is moderately advanced.

Progress has been considerable with respect to visa policy. Alignment with the EU positive list has continued with the abolition of visa requirements for all remaining new Member States. With the recently adopted Law on Aliens, the legislation is largely in line with the *acquis*. Further efforts are needed to strengthen administrative capacity, notably by establishing a national visa IT management system and a visa centre, and by ensuring that the department for consular affairs is properly resourced and staffed. Preparations in this area are close to completion. In terms of document security, significant preparations have been undertaken to start issuing new identification documents including biometric data.

Some progress can be reported in the area of external borders and Schengen. An integrated border management action plan was adopted in October 2005. The Law on Control of the State Border was adopted in May. It covers border checks at border crossing points and border surveillance, constitutes the legal framework for the implementation of the integrated border management strategy, and regulates relations between the competent authorities. The border crossing points data communication network is partially operational. A national border

management co-ordination centre has been established, but is not yet operational. The infrastructure at the border crossing point in Tabanovce (a main crossing point with Serbia) has been upgraded and has been in use since April. The categorisation of border crossing points was decided in June.

Implementation of the integrated border management strategy needs to be closely monitored. Further efforts are needed to change the operational behaviour of the border crossing guards from a military to a civilian approach. No progress has been made on the upgrading of technical equipment for document analysis at border crossing points. In the area of border control, the Republic of Macedonia is well advanced in terms of alignment with the *acquis*. However, the implementation of the reform of the border police has been delayed by the late adoption of the new law on the police.

There has been little progress in the area of **judicial cooperation in civil and criminal matters**. Bilateral agreements were concluded with Bosnia and Herzegovina on mutual legal assistance, property rights affairs, extradition and mutual execution of court rulings in criminal matters. Questions remain as regards the quality of the implementation of the *acquis*, as well as regarding the overall functioning and efficiency of the judicial system. Preparations in this area are moderately advanced.

Limited progress can be reported in the field of **police cooperation and the fight against organised crime**. The police reform strategy is being implemented at central level with regard to both the separation of the political and operational competences within the Ministry of Interior, and the implementation of the national integrated border management strategy. However, the police reform suffered from a major setback with regard to the decentralisation process, because of the delay in adopting the law on the police and implementing legislation (*See also section on the political criteria*). Preparations for closer cooperation with EUROPOL especially concerning input to the European organised crime threat assessment and analysis capacities need to be advanced

The UN Convention on the fight against organised crime and two of its Protocols have been ratified. As regards international cooperation, agreements were concluded with Slovenia, Switzerland and France.

Some progress was achieved regarding *trafficking in human beings*. The government adopted a national strategy and action plan to combat trafficking together with an action plan for the protection of minors. Training of judges, prosecutors, police and social workers was carried out. The Republic of Macedonia still needs to ensure full compliance with minimum standards for the elimination of trafficking.

The Law on Witness Protection was further implemented by the adoption in March of rules on keeping the records of protected people and keeping the original documents of a protected person. The witness protection programme needs further development to reach EU standards. The Law on Weapons has been adopted and will enter into force in January 2007. Implementing legislation remains to be adopted. Significant shortcomings remain in the mechanism for issuing international arrest warrants in some parts of the country.

Improvements have been made in equipment and infrastructure. Equipment has been delivered to the police special task unit. Technical assistance and equipment for the police radio and digital system was designed on the basis of the national police reform strategy to serve the needs of the regional headquarters. The central forensic laboratory is being

renovated, and police capacity for evidence management and forensic analysis has been enhanced by the supply of equipment to the regional headquarters. The delivery of IT equipment enabled the sector for criminal intelligence analysis to upgrade its capacity.

Inter-agency cooperation does not meet international standards. Moreover, intelligence-led policing and international operational cooperation remain underdeveloped. An integrated intelligence model for inter-agency use in the fight against organised and financial crime still needs to be created. Preparations in this area are moderately advanced.

Legislation in the field of customs co-operation in criminal matters needs adaptation to be ready to join the Convention on Mutual Assistance and Co-operation between the Member States (Naples II) and the Convention on the use of Information Technology for customs purposes (CIS Convention). The required number of customs officers and of IT equipment will need to be assessed, in particular for the prevention and the fight against crime.

Reasonable progress can be reported as regards the fight against terrorism. The Republic of Macedonia has ratified most of the relevant conventions and agreements in this area. The Council of Europe Convention on the prevention of terrorism still needs to be ratified. There are gaps in the Criminal Code as regards the definition of a terrorist offence and in the Criminal Procedure Code as regards special investigative means. Inter-agency coordination and judicial control over intelligence bodies need to be strengthened. Overall, the counter-terrorism legislative framework is largely aligned with the *acquis*.

There has been little progress with respect to the fight against drugs. Six centres for prevention and treatment of drug abuse have opened. The supply side of the fight against drug trafficking suffers from the small number of operational law-enforcement actions. The recently signed strategic agreement with EUROPOL has yet to be followed by an operational one. Significant further efforts will be necessary to adopt a national strategy in line with the EU Drug Strategy 2005-2012 and the EU Drugs Action Plan 2005-2008 to effectively fight trafficking in drugs. Preparations in this area are moderately advanced.

Conclusion

There has been progress in parts of the area of justice, freedom and security, notably as regards migration and visa policy, and border management. Progress has been more limited in the areas of judicial cooperation, police cooperation, the fight against organised crime and the fight against drugs. Considerable efforts are needed to align the legislation with the *acquis* in this area and ensure its effective implementation and enforcement.

4.25. Chapter 25: Science & Research

Limited progress can be reported in the area of research policy. The Government adopted the programme for scientific research, development of technology and development of a culture of technology for 2006. Activities are aimed at promoting scientific research, innovative projects and a culture of technology. In view of the wide disparity between the needs and the available budget, provision has also been made for co-operation with the private sector. Part of the funding will be allocated to setting up a special fund for development of technology. Apart from the attempt to involve the private sector in scientific activities, the programme contains no substantial change compared with previous years, and the amount allocated remains at the 2005 level of € 4.3 million (less than 1% of GDP). Preparations in this area are moderately advanced.

As regards the 6th and 7th Framework Programmes for Research and Technological Development, there has been reasonable progress in preparing for participation. The Republic of Macedonia participated in the Sixth Research Framework Programme (FP6) as a third country on a project basis. In 2006, it was in a position to increase its participation with small support actions, which finance some capacity building (equipment and human resources). It is expected that these actions will facilitate participation in the Seventh Research Framework Programme (FP7). So far, the country has not decided to become associated to FP7. The country should be encouraged to start designing an integrated research policy as recommended under the Action Plan.

No significant developments can be reported with regard to the European Research Area.

Conclusion

The Republic of Macedonia has started to prepare its objectives in the field of science and research. Preparation to align with the *acquis* has been initiated. Significant changes in the country's scientific institutions and substantial resources over a long period remain necessary.

4.26. Chapter 26: Education & Culture

There has been progress in the field of education, training and youth with the adoption of the national strategy for the development of education for the period 2005-2015 and the new Law on Vocational Education and Training. Its implementation will require strong political will, and appropriate allocation of resources. The Law regulates the establishment, management, and operational aspects of vocational education institutions. In order to complete the reform of the vocational education and training system, curricula and syllabi should be developed in consultation with the business community. It is also necessary to set skill standards, draw up a catalogue of professions and to establish a centre for vocational education and training which will co-ordinate co-operation between schools and social partners.

Accreditation, mostly of private higher education institutions, has continued. New legislation on higher education, however, remains to be adopted.

Considerable efforts are needed to ensure the conditions for adequate participation in the relevant Community programmes.

There are no significant developments to report in the area of culture.

Conclusion

There has been progress in the area of education and training. However, preparations for participation in the Life Long Learning and Youth in Action Community programmes will require considerable efforts.

4.27. Chapter 27: Environment

Fair progress can be reported in the area of horizontal legislation. A new Law on Environment entered into force in September 2005. Since the enactment of the Law, a substantial amount of implementing legislation has been adopted in the areas of waste management, nature protection and horizontal issues. The Government finalised a strategy for

environmental data management, published a report on the status of implementation of the Aarhus Convention and organised communication activities to raise public awareness. A bilateral framework agreement in the environment field was signed in March 2006 with the Republic of Montenegro. As regards climate change, the Ministry of Environment concluded a bilateral memorandum of understanding with its Italian counterpart. A national strategy for implementing the Kyoto protocol needs to be prepared. A large amount of legislation remains to be adopted in order to fully align the legal framework with the horizontal legislation *acquis*, especially as concerns the Environmental Impact Assessment and the Strategic Environmental Assessment.

Some progress has been made in the area of air quality. A decision on warning levels, margins of tolerance and target values has been enacted. A register of pollutants and polluting substances containing data for 2005 has been prepared. Significant further efforts are needed to effectively implement the *acquis* in this area.

Limited legislative progress has been made with the adoption of several pieces of implementing legislation on waste management. No national waste management plan has been adopted. Actual results in the development of infrastructure are limited: over the reporting period, only one waste dump was constructed. The Republic of Macedonia is at an early stage in addressing its major problems with illegal waste dumps.

Regarding water quality, limited progress can be reported. The Law on Water was amended in April regarding payment of water charges. The water quality of the river Bregalnica, and the waste-water treatment around Lake Ohrid have improved. Preparations are moderately advanced in this area.

As concerns nature protection, some progress can be reported. The Government has upgraded the legal protection of the national parks Galičica, Mavrovo and Pelister. The Smolare waterfalls have been declared a natural monument in accordance with the Law on Nature Protection. Preparations in this area are well advanced.

Newly adopted implementing legislation represents a degree of progress in the area of industrial pollution control and risk management. An integrated pollution prevention and control system has yet to be established. The law requires operators of industrial sites to prepare contingency plans, but this requirement has not been implemented in practice. Some provisions on the control of major accident hazards involving dangerous substances have not yet been fully transposed. The capacity of the Ministry and other concerned parties (local governments, businesses) to implement industrial pollution control and risk-management measures needs to be strengthened. Preparations in this area are moderately advanced.

There are no significant developments to report in the areas of chemicals, GMOs, noise or forestry. In these areas, the Republic of Macedonia is not yet sufficiently prepared.

As regards administrative capacity, as well as reinforcement of implementation, training on enforcement of environmental law for inspectors and judges was carried out. Significant further efforts are needed to ensure effective enforcement of the *acquis*. Further legislative action is needed to allow the state environmental inspectorate to impose fines directly. In 2005, only two criminal charges related to environmental issues were brought, and no charges have yet been brought in 2006. With regard to investments in infrastructure, the necessary investments were specified by the Government in its environmental investment plan.

However, no concrete projects have so far been launched. Preparations in this area are moderately advanced.

Conclusion

Some progress has been made towards strengthening the legislative framework in the field of environment, but progress in implementing the legislation remains limited, especially in areas that require large investments. Preparations to align with the *acquis* are at an early stage. Very significant efforts are needed, including substantial investment and strengthened administrative capacity for the implementation and enforcement of legislation.

4.28. Chapter 28: Consumer and Health Protection

In the safety area, some legislative developments can be recorded. The Law on Product Safety, enacted in March, transposed the revised EC Directive on General Product Safety. The Government has formed a co-ordination body for market surveillance, which will facilitate co-operation and the planning of common activities among the various inspectorates. However, their respective competences need further clarification.

In the non-safety area, the new Law on Mediation (*see also Chapter 23 - Judiciary and fundamental rights*) promotes alternative dispute resolution. However, there has been no progress on the directives on consumer credit, distance marketing of consumer financial services and injunctions.

Within the Ministry of Economy, a Sector for the Internal Market has been established (with five staff), with one unit responsible for communication with Consumer Organisations and raising public awareness on product safety.

The Law on Sanitary and Health Inspection was enacted in May. The Law covers the competences of the sanitary and health inspectors in enforcing sanitary and health legislation and protecting public health. A law which came into force in January 2006 prohibits smoking in all public places. The law is broadly respected. In accordance with the amendments to the Health Insurance Law, producers and importers of tobacco products harmful to human health are obliged to pay an additional tax which will be used by the health fund to cover part of the gap in the health sector budget.

Conclusion

There was some legislative progress in the field of consumer and health protection, mainly as regards safety-related measures. Sustained efforts are needed to further align with the *acquis* and establish a functioning system of consumer and health protection throughout the country.

4.29. Chapter 29: Customs Union

Significant progress can be reported with respect to customs legislation. The Republic of Macedonia ratified the International Convention on temporary imports (Istanbul Convention) in March 2006. The new Customs Code and the related implementing legislation entered into force in January 2006. It represents a further alignment of customs procedures with EU standards, especially in the fields of procedures with economic impact and simplified procedures. The newly introduced provisions on bonded warehouses and free zones are in line with the *acquis*. The Law on Control on Export of Goods and Technologies

with Dual Use was adopted on 1 February 2006. Its provisions are in line with the EU legislation.

The Republic of Macedonia abolished the fee of € 100 for each request for tariff quotas in July 2006. The decision to abolish the fee of € 19 for services rendered during customs procedure entered into force in October 2006. However, other fees are not in line with the *acquis*, such as the € 14 fee on binding origin information and the € 65 fee for laboratory testing.

The customs legislation is now well aligned with the *acquis*. However, further harmonisation is required, in particular with regard to transit, tariff quotas and the remaining fees.

As regards the administrative and operational capacity of the customs administration, some progress can be reported. A strategy for risk management was adopted in May. It incorporates new security and safety standards for more efficient customs controls. Additional staff is being recruited. An IT strategy has been adopted, which should facilitate the procurement of new IT equipment and the introduction of software compatible with EU systems. All customs declarations are submitted in electronic and in paper form.

In the field of ethics and anti-corruption measures, the customs administration has adopted the Arusha Declaration on corruption and issued a new Code of Ethics for customs officers, obliging them to declare their property and bank accounts. Over the reporting period, ten customs officers were prosecuted for abuse of position for allowing imports without payment of the required duties.

Co-operation memoranda were signed with some of the largest cigarette importers in the country. In January 2006, a co-operation agreement with the Republic of Moldova for mutual assistance in customs matters was ratified. In May 2006, an agreement with the Republic of Slovakia on cooperation and assistance in customs matters was initialled. In June 2006, an agreement on customs cooperation with Finland was signed.

Conclusion

There has been substantial legislative progress in the area of customs union. Significant further strengthening in terms of staff, IT and other equipment will still be necessary in order to allow the customs administration to manage and enforce the implementation of the legislation. The Republic of Macedonia should adopt a strategy for further developing IT systems to allow interconnection and operation with the centralised and decentralised Community IT systems. Further efforts are necessary, in particular as regards the management of human resources and the fight against corruption

4.30. Chapter 30: External Relations

There has been some progress in the field of the common commercial policy. The Republic of Macedonia continued gradually to reduce customs duties, in line with its WTO commitments and bilateral agreements such as the Stabilisation and Association Agreement with the EU. As from 2006, the average duty on industrial goods has been 7.4 %, and the average duty on agricultural goods (including fishery products) has been 17.3 %.

Some progress can be reported in relation to the WTO. The Agreement on Trade in Civil Aircraft, which is part of the WTO framework, was ratified in November 2005.

The Republic of Macedonia ratified the Interim Free Trade Agreement with Kosovo and the free trade agreement with Serbia and Montenegro, respectively in January and April 2006. The agreement with Kosovo envisages a free trade area to be gradually established by 31 December 2007. Customs duties were to be progressively reduced to 70 % of the basic customs duty from 01.01.2006, 60 % from 01.01.2007 and 0 % from 01.01.2008. The Agreement on Accession to the Central European Free Trade Area (CEFTA) was ratified in May 2006 and entered into force in August 2006. In parallel, the Republic of Macedonia has participated very actively to the ongoing negotiations for the simultaneous enlargement and amendment of CEFTA. The Republic of Macedonia has 26 bilateral investment treaties in force. It has ratified four treaties which have not yet entered into force, and has agreed to the draft texts of five further treaties. A protocol amending the bilateral investment treaty with Bulgaria has been signed at Bulgaria's request to align the treaty with the *acquis*.

The Republic of Macedonia should continue to co-ordinate closely with the Commission in international trade negotiations, in particular so as to ensure that, upon accession to the EU, its commitments under the GATS are as consistent as possible with those of the Community. The administrative capacity in this field requires strengthening.

The government adopted a programme for *support to exporting companies*, with funds totalling € 280,000 for 2006. The funds will mainly be used for export promotion in the form of compensation to companies for expenses incurred for Hazard Analysis and Critical Control Point (HACCP) certification and product certification, and for projects related to branding.

In addition, the Law on the *Macedonian Bank for Development Promotion* was amended in December to allow for the establishment of a guarantee fund. The guarantee fund supports SMEs by providing guarantees for investment loans extended by banks and other financial institutions in the country.

The Law on Control on Export of Goods and Technologies with *dual use* was adopted in February. Its provisions are in line with EU legislation. A list of dual-use goods and technologies, based on the Law, was adopted by the Government. The Ministry of Economy has published the licence and the application form for export of dual-use goods and technologies. A commission for export of dual-use goods and technologies has been established with representatives from various ministries.

No progress can be reported with regard to development policy and humanitarian aid; preparations in this area are at a very early stage.

Conclusion

There was some progress in the area of external relations, especially in the fields of dual use goods and regional integration through the CEFTA initiative. The Republic of Macedonia will have to strengthen its institutional capacity to be able to fully participate in the EU's policies in this chapter of the *acquis*.

4.31. Chapter 31: Foreign, Security and Defence Policy

The regular political dialogue between the European Community and its Member States and the Republic of Macedonia has continued on the basis of the SAA.

The country is showing continued commitment to participation in civilian and military crisis management operations in the framework of the European Security and Defence Policy (ESDP). Parliament adopted a decision in May for the participation of the Republic of Macedonia in the EU military operation ALTHEA.

Concerning the Common Foreign and Security Policy, the country has continued to align itself with a number of EU common positions and statements. There has been some progress in the legal framework. The Law on Foreign Affairs was enacted in March but has not yet entered into force. In addition, the Republic of Macedonia has ratified the Convention for the Suppression of Terrorist Bombings and for the Suppression of the Financing of Terrorism, the Convention on Nuclear Safety, and the Convention for the Suppression of Acts of Nuclear Terrorism. A law prohibiting the development, production, storing and use of chemical weapons was enacted in May, which brings legislation into line with the UN convention.

However, the UN protocol against illegal production and trafficking of small arms and ammunitions has not yet been adopted, and a legal basis for the application of international restrictive measures is still needed. As concerns "the EU Guiding Principles Concerning Arrangements between a State Party to the Rome Statute of the International Criminal Court and the United States Regarding the Conditions for Surrender of Persons to the Court", there has been little progress apart from a statement that the agreement with the USA is not applicable to citizens of the Republic of Macedonia (*see also chapter on political criteria*).

Concerning neighbourly relations, see chapter on Political Criteria.

With regard to administrative capacity, there has been some progress. CFSP structures have been strengthened within the ministry of foreign affairs. A unit for CFSP, responsible for co-ordination, was established in January, under the competence of the sector for the European Union. The unit for arms control, responsible for co-ordinating and monitoring the implementation of the international regimes for arms control, non-proliferation and disarmament, was established at the same time. A centre for crisis management was established in October 2005 and has been operational since July.

Conclusion

There has been progress in parts of the area of foreign, security and defence policy. Further alignment will be needed, notably as regards international restrictive measures.

4.32. Chapter 32: Financial control

Substantial progress can be reported in the area of public internal financial control. In February, the Parliament adopted a strategy paper on public internal financial control. It contains a comprehensive action plan and time frame, according to which activities for the development of the public internal financial control system are envisaged to be completed by the end of 2007. The strategy sets the basis for the strengthening of the legal framework and plans the adoption of a Law on Public Internal Financial Control and of amendments to the Law on Internal Audit in the public sector.

In April, the Government adopted a programme aimed at strengthening the institutional capacity of internal audit units at central and local level. The creation of internal audit units at

local level is delayed. A harmonisation unit for financial management and control at the Ministry of Finance is not yet in place. Preparations in this area are under way.

Progress has also been made as regards external audit. A Law amending the Law on State Audit was enacted in May. The amendments introduce further harmonisation with the *acquis*, some of the principles of the LIMA Declaration and a reformulation and specification of certain provisions to increase the efficiency of state audit. The amendments to the Law on State Audit are intended to ensure transparent operation of the State Audit Office, and to make the State Audit Office more efficient and effective according to international standards. In April, the Government amended its Rules of Procedure introducing an obligation for governmental committees to comment on the measures that the ministries and other state administrative bodies have undertaken to deal with irregularities identified in the institutions' audit reports. However, the State Audit Office has no constitutional anchor and is not yet fully staffed. This, together with the still limited audit scope and the limited follow-up of reports given by Parliament, creates a serious handicap to the effective functioning of the external audit.

No developments can be reported in the area of the protection of EU financial interests. No central contact point for the protection of the Community's financial interests (AFCOS) has yet been established.

No particular development can be reported in the area of protection of the Euro against counterfeiting.

Conclusion

There has been progress in this chapter, notably in the area of financial control. However, considerable and sustained efforts will be needed, in particular to strengthen the public internal financial control, external audit and anti-fraud capacities. Overall, preparations to align with the *acquis* are at an early stage.

4.33. Chapter 33: Financial and Budgetary Provisions

The basic principles and institutions for the underlying policy areas affecting the own resources system are already largely in place. Progress has been limited to activities in related areas, such as statistics, where measures have been undertaken to improve the quality of national account statistics. As regards the ability to correctly apply the rules under this chapter, the country has to continue to build sufficient capacities within the relevant authorities (e.g. in areas such as customs, statistics and financial control).

Conclusion

There has been limited progress in the area of financial and budgetary provisions. However, the Republic of Macedonia should be able to meet the requirements of the financial and budgetary provisions *acquis* provided that further efforts to align with the *acquis* in the relevant linked chapters are made.

STATISTICAL ANNEX