

FORMER YUGOSLAV REPUBLIC OF MACEDONIA (FYROM) INTERIM COUNTRY STRATEGY PAPER

1. SUMMARY

1.1 Both regional and domestic factors have inhibited FYROM's progress to a pluralist democracy and well-regulated market economy. The reform programme of the new government elected in November 1998 was subsequently impeded by the economic and political fallout of the Kosovo crisis. Events are now moving in a more positive direction with the end of hostilities in Kosovo. The substantial assistance likely from the European Union (EU) and International Financial Institutions (IFIs), combined with the proposed Stabilisation and Association Agreement (SAA) with the EU and the greater focus on the region provided by the Stability Pact, present an ideal opportunity for reform in Macedonia. This is the challenge that the Government must now meet.

1.2 The **Goal** of this strategy is to support the development of a pluralistic democracy and well regulated market economy in FYROM, in such a way that benefits are sustainable and spread through all levels of society. The **Purpose** is to increase the capacity of government at all levels, civil society and the private sector to achieve transition.

1.3 Major programmes supporting reform in FYROM are provided by the EU, World Bank and European Bank for Reconstruction and Development (EBRD). We shall seek to work with these agencies to influence the development of appropriate policies and well designed programmes and effective delivery of them. We shall work for benefits to flow to FYROM from the Stability Pact for South Eastern Europe and from the work of the Stabilisation and Association Agreement being negotiated with the EU.

1.4 The intended **Outputs** of this strategy are:

- sustainable micro, small and medium enterprise support structures in place.
- enhanced capacity to conduct international trade.
- effective financial and policy planning in government, to deliver an inclusive reform programme.
- strengthened capacity of government and civil society actors to engage in the design and delivery of equitable social policies.

1.5 To achieve these Outputs we will:

- support a range of bilateral projects and programmes (current activities and future plans are set out below);
- work with Macedonian partners and the European Commission to promote the effectiveness of the various sources of EU support to Macedonia, seeking to complement these through our bilateral programme;

- work with the World Bank and EBRD in areas of common interest.

1.6 In June 1999 the UK Prime Minister pledged £5 million for a bilateral programme to support FYROM's reforms.

1.7 Further work is needed to identify and agree the areas of bilateral support, and refine outputs taking account of the activities and plans of other multilateral and bilateral donors and of the evolving reform process. We plan to develop a full country strategy paper by mid-2000, agreed with Macedonian partners.

1.8 The strategy is summarised in the logframe attached.

2. THE CHALLENGE

Political and Governance

2.1 FYROM was the only republic of the former Yugoslavia not to experience violent conflict on achieving independence in 1991. Its development since then has been severely impaired by the instability of the Western Balkan region and problems with international recognition.

2.2 The current coalition was elected in late 1998 on a pro-reform agenda. The government programme has, in part, been blown off course by events in Kosovo. It faces some fundamental issues:

- weak trade and economic links within South Eastern Europe;
- vulnerability to social unrest due to the varying political and economic status of different ethnic groups;
- weak formal institutions and a high level of centralised decision making;
- underdeveloped civil society actors and weak organisational structures;
- weak social policies and high levels of relative poverty among the majority, and absolute poverty among the Roma;
- threats to social and political stability posed by the rapid growth in municipalities, and the accompanying decentralisation of functions to embryonic and ill-equipped local governments.

2.3 Key to reform is tackling the weakness of formal state institutions, most notably a lack of central budget management through the Ministry of Finance. A much-needed overhaul of public administration is currently underway which will look at fundamental questions about the role of government and its policy processes. The Government recognises that it must do this if it is to achieve its economic and social development

goals, including staffing reductions. Over the last year it has approved a public administration reform strategy which aims to establish a professional, efficient and modern central public administration. A local government reform programme has also been agreed. A series of public administration laws are under preparation and are expected to be enacted during early 2000.

2.4 The issues that the Government needs to address are complex and politically sensitive. For example, downsizing will be difficult when unemployment levels are already high, social services are stretched, and private sector employment opportunities are limited. The EU is providing project support to the administrative reform programme but, with the exception of legislative drafting work, progress has so far been slow. The Kosovo crisis and its aftermath have contributed to some of these delays. There is a serious lack of technical and managerial capacity within government to take the reform process forward. And the Government urgently needs to establish a team of staff and a work unit dedicated to administrative reform policy and implementation issues.

2.5 The FYROM Government has created the Ministry of Local Self Government, in the expectation that this will improve allocative efficiency and improve decision making. Decentralisation will clearly have some potential benefits, in terms of increasing the influence of communities over decisions which affect them, reducing bureaucratic obstacles to change, and bringing local provision more closely in line with local needs and local priorities. However, in FYROM there are many practical obstacles to decentralisation - most notably the limited availability of financial and human resources, and the responsiveness of local decision-making processes in practice - particularly in ethnically mixed municipalities and in municipalities where the majority are from ethnic minority groups.

2.6 The World Bank is becoming increasingly involved in public administration reform working closely with the EU. A Public Expenditure and Institutional Review (PEIR) is underway. This will include an analysis of public administration reform issues in view of the read across to the economic reform agenda and the need for more effective control and management of resources. A Financial Sector Adjustment Loan (FESAL) is envisaged which would be tied to progress with administrative reforms. We have provided consultancy support to the PEIR which, in its scope and significance as a focus for coordination of donor assistance will be key in guiding the future of the UK bilateral programme.

2.7 Public confidence in the workings of central government is low. The entire ethic of Government needs to be radically overhauled to ensure that the new Government can fulfil its election pledges and allow FYROM to continue on the path of reform. An effective public administration is needed for sound policy development and service delivery. More work needs to be done to ensure that citizens are informed as to their rights under FYROM law. Many Macedonians still feel unable to approach local or central Government with their problems.

Economic

2.8 The Government have had to work hard to come to terms with a stagnant and frail economy left to them by their predecessors and bedevilled by the impact of Kosovo and other regional problems on private investment prospects, both foreign and domestic. However the degree of macro-economic stability achieved over the last four years has been remarkable. The economy is now growing, albeit at a slow rate. FYROM's two key problems are the low rate of domestic savings (due to lack of reforms in the banking sector), and the continued existence of loss making state enterprises.

2.9 The Kosovo crisis has further worsened FYROM's vulnerable position, although an early end to the conflict and rapid refugee return have helped to reduce the costs, and the international reconstruction effort has provided a welcome boost to the economy. The most significant impact of the conflict has been to disrupt trade to and through the Federal Republic of Yugoslavia ((FRY). The direct budgetary costs of hosting 250,000 refugees were also high, despite strong international relief efforts. International donors, particularly the World Bank, IMF and European Commission, have pledged extensive financial support of \$176 million to meet FYROM's financing needs, including significant help on grant terms to meet gaps in the budget.

2.10 However, it has not proved possible to conclude a Poverty Reduction and Growth Facility (PRGF) - (newly titled ESAF) with the IMF, which would provide significant concessional resources to finance an ambitious programme of reforms. Negotiations continue, and must remain a priority for the Government, since the IMF is a significant source of finance and technical advice.

2.11 The Government has identified the Small and Medium Enterprise (SME) sector as a crucial area requiring continued support. Development of the sector will provide benefits to the majority. It is an essential complement to economic restructuring and industrial reform.

Social

2.12 The effect of the break-up of the Former Yugoslavia on the social fabric of FYROM society has been less than that in other Former Yugoslav Republics. But the same problems that existed in the Former Yugoslavia still exist in FYROM. Civil society is fragmented and isolated from democratising principles. A law on NGOs and Citizens Associations was passed in 1998 allowing for the first time for the development of NGOs in a proper legal framework. Most Macedonians, from all of the different ethnic groups, are becoming aware of the need to respond to emerging social problems, but lack the know how or the direction required to reach and respond to the needs of Macedonian society.

2.13 The key social issue, as elsewhere in the region is to enhance access to social welfare services for vulnerable groups and to do so in a manner that will reduce poverty and social exclusion, and enhance social cohesion. The problem that exists within the social services in FYROM is a lack of fiscal awareness, planning and transparency.

2.14 The functioning of government in FYROM revolves around two themes: the division of ministerial posts on the basis of ethnically-based parties within a coalition of

political parties; and a confusion of responsibilities between different functional ministries which reduces efficiency and increases centralisation tendencies. New challenges are likely to arise as the government pursues decentralisation to the municipal level, which will lead to some ethnically-mixed local governments and municipalities where the majority is from one ethnic minority group. The programme of decentralisation must also address the issue of providing sufficient human and financial resources to municipalities to ensure that the new structures operate effectively.

2.15 New municipal structures will be required to develop new ways of working with civil society actors. FYROM's current, centralised, system of government has impeded the development of civil society but the twin forces of decentralisation and strong donor support are likely to contribute to an expansion in the role of local NGOs, which will be increasingly involved in delivering services. The danger may be that local governments cannot keep up with an NGO sector that is actually stronger in terms of skills and resources.

2.16 Technical skills in the design and implementation of social policies in FYROM are weak, and the existing expertise and approaches in social sector organisations are often ill-suited to meet the demands of change under the conditions of transition. The difficult external environment has weakened economic ties within south east Europe and has compounded FYROM's traditional position as one of the less developed parts of former Yugoslavia. Coupled with the loss of jobs that usually accompanies the restructuring of industry, unemployment may be much greater than the official figure of 32% of the active labour force. The result has been an increase in people living below the national poverty line from 4% of the population in 1991 to 20% in 1996.

2.17 The number of unemployed is difficult to determine because a significant number do not register due to their ineligibility for cash benefits and because many people who claim to be unemployed actually work on an undeclared basis, which reduces employers' overheads on social security contributions to the Government. Nevertheless, it is widely recognised that the number of unemployed is exceptionally high and has a profound effect on levels of social exclusion, and that both unemployment and exclusion will increase with plans for the privatisation and/or bankruptcy of 12 large companies, which employ 6,500 people.

2.18 If FYROM is to implement the necessary reforms to revive the enterprise sector and reduce the budget deficit, there are likely to be significant social costs. The Ministry of Labour and Social Policy (MOLSP), is responsible, through 39 district Centres for Social Work (CSW) and Labour Offices, for employment and social welfare policy. Social protection systems have played an important role in mitigating the impact of economic restructuring. Social transfers - in the form of cash benefits - should play an important role in preventing a significant number of people from falling into absolute poverty. However growing needs, declining resources and fragmented welfare delivery systems have made existing social policies inadequate and placed frontline social protection services under great pressure.

2.19 The problems associated with the effectiveness of cash-benefit transfers are compounded by the weak organisational structures in employment services and social

care delivery. Agencies which fall under the remit of the MoLSP pursue passive measures towards the unemployed and in the delivery of social welfare services. The notion of active measures, which could involve enabling - through a diverse range of community development initiatives and local non-government organisations - the development of partnerships with Centres for Social Work and Labour Offices is largely unknown.

2.20 The World Bank and the EU under the Phare programme are stepping up their direct involvement in social policy reforms. The World Bank has focused on mitigating the effects of redundancy among the labour force of the 12 companies identified for privatisation and/or bankruptcy. This intervention is funded under the auspices of a Specific Investment Loan (SIL) of US\$10 million for a Social Support Project. The US Department of Labour (under the auspices of USAID) has also recently established an office in FYROM to assist with employment policy.

2.21 Phare is developing a 2 million euro programme aimed at improving social care and welfare policy formulation within the MOLSP and in six pilot district CSWs. Recommendations of the consultants within the Phare programme are the placement of a Technical Adviser in the MOLSP to revise institutional capacity; the development of social care and welfare policy in the MoLSP's department of Social Care; revision and harmonisation of legislation; revision of budgetary procedures; the development of community care and diversification of service provision by strengthening NGOs. In addition, the World Bank's PEIR makes recommendations for efficiency measures in social sectors.

2.22 The MOLSP has identified the need for further donor inputs into strengthening the operations of the Ministry and those of the district Labour offices and CSWs. Priority issues are strengthening social policy development, equipping staff to engage with local community development planning and mobilisation, and fostering partnerships between CSWs, community based organisations and local NGOs. It is not clear to what extent the various donor initiatives are complementary rather than duplicatory. Phare have two consultants in the MoF to advise on budgetary and administrative reform; the WB under the PEIR is also planning to insert advisers on these issues; UNDP is planning to establish a budgetary support unit; the WB is planning to make significant interventions through SIL and FESAL loans which cut across the PEIR process; and Phare is also planning to place an adviser in the MOLSP. A coordinated programme of donor support needs to be developed. This will help clarify gaps for UK bilateral technical assistance which should add distinctive value to the programmes of multilateral donors.

Donor Programmes

2.23 Donor led reforms have traditionally concentrated on three main areas: trade development; enterprise restructuring; public sector finances; and social policy and welfare reform. More recently, and in addition to these areas, attention has expanded to include public administration reform, strengthening civil society and creating conditions for social cohesion between different ethnic groups, World Bank and EU involvement in these areas is discussed above. Donors have also provided short-term

budgetary support; EU (60 million euros), the USA (\$60 million) France (95 million FFr) and Switzerland (4 million SFr) are the largest contributors to untied budgetary support for 1999/2000.

2.24 The EU Phare programme of assistance to FYROM began in March 1996, following a four year period of support under the Phare Critical Aid Programme. Total funding under the Phare and Cross-Border Programme (with Greece) since 1996 has been 210 million euros. In addition, 25 million euros in budgetary support has been provided through the Obnova programme, for refugee-related costs in the health, education and social sectors. A proposal by the European Commission for a further 80 million euros in budgetary support for local government development is under consideration.

2.25 The Phare 1999 Operational Country Programme focuses on 5 areas. Support to enterprise development and the financial sector; public investment and infrastructure; agriculture and national resources; social sector and human resources; and reform sustainability.

2.26 USAID and UNDP are active in support to the development of social policy and civil society. CIDA, SIDA and GTZ are also planning support to civil society development.

3. CURRENT PORTFOLIO

3.1 The Know How Fund has operated in FYROM since 1995. We have enjoyed an open relationship with the Government.

3.2 The main current project is supporting small and medium enterprise (SME) development. Three support centres have been established in the north and west of FYROM which are promoting the development of the SME sector locally and nationally through the delivery of relevant, high quality and affordable support services. The project has provided a model for other donors becoming engaged in this sector. A recent review of the project noted significant progress after a slow start and opportunity to build on experience in a coordinated effort to develop sustainable institutional structures.

3.3 We have funded an analysis of trade patterns and policies in the Western Balkan region. It examines current access to neighbouring markets and ways in which this might be improved, the possible enhancement of intra-regional trade and options for donor support to trade development. It has been fed into wider discussions between FYROM and the EU on a future Stabilisation and Association agreement and into the work of the Stability Pact.

3.4 We are providing consultancy support via the World Bank to assist with the Public Expenditure and Institutional Review. We shall be looking for progress with the review to guide continuing and future bilateral support to the reform process.

3.5 In response to a request from the Deputy Prime Minister, we are implementing a programme of technical support to the Government's European Integration Office to strengthen their negotiating skills.

4. FUTURE STRATEGY

4.1 The main channel of UK support to FYROM is through the EU programmes managed by the European Commission. We shall give strong emphasis to influencing the effective design and delivery of EU programmes and projects. This will be part of wider plans to redefine EU policy for assistance to South Eastern Europe and to develop effective ways of programme delivery, including the role of the new European Reconstruction Agency.

4.2 We shall work within the Stability Pact for South Eastern Europe, which was established to assist countries of the region to recover from the effects of the Kosovo conflict and to accelerate the process of reform, to obtain positive benefits for FYROM and the countries of the region.

4.3 We shall ensure that our bilateral activities complement and add value to those of the IFI's and that in particular we take into account the World Bank-led PEIR.

4.5 The **Goal** of this strategy is to support the development of a pluralistic democracy and well regulated market economy in FYROM, in such a way that benefits are sustainable and spread through all levels of society.

4.6 The **Purpose** is to increase the capacity of government at all levels, civil society and the private sector to achieve successful transition.

4.7 We will focus our bilateral support on activities that assist FYROM to achieve the following **Outputs**:

(a) **Sustainable Micro, Small and Medium Term Enterprise Support structures in place**

- (i) We shall provide further support to the SME support centres in Tetevo, Ohrid and Gostivar.
- (ii) We shall work with other donors providing support to SME development, particularly the EU, to ensure that there is a coordinated programme of support that focuses on the development of sustainable institutional structures.

(b) **Enhanced capacity to conduct international trade**

- (i) We shall work for the maximum benefits to FYROM from the Stabilisation and Association Agreement (SAA) to be negotiated with the EU. Specifically, we shall explore opportunities to strengthen Government

officials' negotiating skills, working with and through the European Union Integration office, the Ministry of Trade and other key line ministries involved in the SAA process. Our support to the SAA process will also assist the reform programme by developing technical and managerial capacity in key line ministries.

- (ii) We shall consider providing bilateral support for the negotiating process of FYROM's membership of the World Trade Organisation.

(c) Effective financial and policy planning in government, to deliver an inclusive reform programme

- (i) We shall keep in close touch with progress on the World Bank PEIR. We shall consider consultancy inputs as appropriate. We shall determine our bilateral support for improved financial management in the light of the outcome of the PEIR.
- (ii) Similarly, we shall determine the nature of our bilateral support to the administrative reform process when the PEIR is complete and the terms of the FESAL are agreed, including technical assistance requirements. We shall continue to liaise closely with the World Bank and the EU.
- (iii) Possible areas for technical assistance include support with the design and implementation of a series of functional reviews within central government, and support to strengthen the Prime Minister's office and Cabinet operations, focusing on policy and systems issues.

(d) Strengthened capacity of government and civil society actors to engage in the design and delivery of equitable social policies

- (i) We are reviewing the range of donor inputs to social policy reform. We shall then determine where UK bilateral interventions can add value, exploring the scope for working with the EU and World Bank.
- (ii) We shall consider whether there is a distinctive role for us in strengthening civil society, including in relation to other donor activities. Our focus will be on supporting partnerships between civil society actors and government in delivering services.
- (iii) We shall investigate the scope and demand for support to citizen's advice and information services.
- (iv) We shall investigate the scope for strengthening capacity in social policy development and social development skills.

5. IMPLEMENTING THE STRATEGY

5.1 Management arrangements will be determined in the light of progress in developing the strategy.

6. PROGRAMME RESOURCES

6.1 These will be clarified in the light of progress in developing the strategy, guided by the pledges of bilateral support already made.

7. SUMMARY OF CONSULTATION PROCESS

7.1 This strategy will be developed in full consultation with key government and non-government partners and with multilateral and bilateral donors.

Central and South Eastern Europe Department
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