



Brussels, 6.2.2023
SWD(2023) 42 final

COMMISSION STAFF WORKING DOCUMENT

ex-ante evaluation statement

Accompanying the document

**Proposal for a DECISION OF THE EUROPEAN PARLIAMENT AND OF THE
COUNCIL**

on providing macro-financial assistance to the Republic of North Macedonia

{COM(2023) 74 final}

Ex-ante evaluation statement

EU Macro-Financial Assistance to the Republic of North Macedonia

TABLE OF CONTENTS

1. PROBLEM ANALYSIS AND NEEDS ASSESSMENT.....	2
1.1 Introduction	2
1.2 The macroeconomic situation in North Macedonia	3
1.3. IMF and other donor support	6
1.4. External financing needs.....	6
1.5. Structural reforms.....	8
2. OBJECTIVES AND RELATED INDICATORS OF THE MACRO-FINANCIAL ASSISTANCE.....	9
2.1. Objectives.....	9
2.2 Monitoring indicators	9
3. DELIVERY MECHANISMS AND RISK ASSESSMENT	10
3.1 Delivery mechanisms	10
3.2 Risk assessment	10
4. ADDED VALUE OF EU INVOLVEMENT	11
5. CHARACTERISTICS OF MACRO-FINANCIAL ASSISTANCE	11
5.1 Exceptional Character and Limited Time-frame	11
5.2 Political preconditions and EU-North Macedonia relations	11
5.3 Complementarity	12
5.4 Conditionality.....	13
5.5 Financial Discipline.....	13
6. EVALUATION AND COST-EFFECTIVENESS.....	13
6.1 Evaluation	13
6.2 Achieving cost-effectiveness.....	14

1. PROBLEM ANALYSIS AND NEEDS ASSESSMENT

1.1 Introduction

Given the strong dependence of North Macedonia on imported energy, soaring gas and electricity prices led to a significant deterioration of the external balances in 2022. Underpinned by sound economic and monetary policy and committed reform implementation, the economy was on track to recover from the COVID-19 induced setback. However, the steep rise in global food and energy prices began to take its toll on domestic demand and the country's external balance. A significant widening of the country's trade and current account deficit has emerged since the beginning of 2022 despite strong inflows of remittances from abroad. Foreign reserves declined in the early months of 2022, mainly in response to rising import prices and external debt repayments, but have stabilised since the summer. Year-on-year GDP growth still averaged 2.6% in the first half of 2022 but slowed to 2% in the third quarter. High uncertainty over the economic fallout from Russia's war of aggression against Ukraine, rising inflation and tighter financing conditions are set to curtail domestic demand further. Exports are impacted by weaker external demand and by ongoing supply chain disruptions, particularly those affecting the production of automotive components, one of the country's main export sectors.

Against the backdrop of tighter global financial conditions, higher energy prices and higher-than-expected losses by the domestic, state-owned electricity producer, the government of North Macedonia renewed its request for macro-financial assistance (MFA) on 18 October 2022. The Commission had put the government's initial request for MFA, submitted on 19 April 2022, on hold, mainly because the economy was still relatively resilient and because there were some other options to meet external financing needs in 2022. In April, the government had already secured Staff Approval from the International Monetary Fund (IMF) for a 24-month precautionary and liquidity line (PLL) of up to EUR 530 million, which was officially approved by the IMF Executive Board on 22 November 2022. Given the country's high gross external financing needs in 2023 and significant uncertainties regarding the availability and costs of external market financing, the Commission is now submitting a proposal to the European Parliament and the Council to provide an MFA loan of up to EUR 100 million to North Macedonia. The proposed legal basis will be Article 212 of the Treaty on the Functioning of the European Union.

The proposed MFA would help North Macedonia to cover part of the country's residual external financing needs in 2023, which are estimated at EUR 800 million under the IMF's baseline scenario. The operation would reduce the economy's short-term balance-of-payments and fiscal vulnerabilities and demonstrate the EU's support for the country when addressing this challenging situation. Its design and implementation would take account of the policy guidance agreed in the Joint Conclusions of the Economic and Financial Dialogue between the EU and the

Western Balkans and Türkiye of 24 May 2022¹, as well as the programme North Macedonia has agreed with the IMF².

The disbursement would take place in two instalments. The release of each instalment would be conditional on progress being made with the implementation of a number of policy measures to be agreed between the Commission and the authorities and listed in a Memorandum of Understanding (MoU) as well as on a satisfactory track record implementing the IMF programme. The MoU is likely to focus on policy reforms addressing fiscal governance, tax policy, the management of public investment, public-private partnerships, business environment, transparency in state aid, energy efficiency, judiciary reform, and the fight against corruption. The policy measures will aim to address some of the most important weaknesses of the economy of North Macedonia and its economic governance system.

1.2 The macroeconomic situation in North Macedonia

Following a partial recovery from the pandemic-induced recession, North Macedonia has been severely hit by the fallout from Russia's war of aggression against Ukraine. GDP dropped by 4.7% in 2020 but rebounded by 3.9% in 2021, driven by domestic demand. Remittances from abroad returned to pre-crisis levels and bolstered household's disposable income. COVID-19 containment measures were gradually lifted. Growth slowed towards the end of 2021 as external demand weakened, disruptions in global supply chains grew and global food and energy prices started to rise rapidly (fuelled further by the fallout from Russia's war of aggression against Ukraine in 2022). North Macedonia has limited direct exposure to Russia or Ukraine, but its economy is vulnerable to rising commodity prices. Government efforts to mitigate the impact on households and small business have caused fiscal spending to increase well above the initial budget. Sharply rising food and energy prices have pushed inflation to almost 20% in the autumn of 2022. GDP grew by 2.6% in the first half of 2022, thanks in part to a rise in investment, but this rise was largely due to increases in companies' stocks. Annual growth slowed to 2% in the third quarter of 2022.

The external position started to deteriorate in late 2021 as import prices rose sharply. The current account deficit stood at 3.5% of GDP in 2021 (the same as in 2020). This was above the 2017-2019 average of 1.5%. However, the goods trade balance has deteriorated steadily since the last quarter of 2021, largely on account of rising energy prices and reflecting the country's high dependence on energy imports. The economy imports over 30% of its domestic energy needs and fully relies on imports for gas and oil. Driven by the sharply deteriorating energy balance, the four-quarter moving average current account deficit rose to 7.3% of GDP in the third quarter of 2022, compared to 1% in the third quarter of 2021. This was despite a marked increase in private transfers (remittances) and the services surplus, which was helped by a rebound in tourism. The external debt ratio had decreased each year between 2016 and 2019 but jumped by 7.3 percentage points

¹ <https://www.consilium.europa.eu/media/56385/st09459-en22.pdf>

² <https://www.imf.org/en/Publications/CR/Issues/2022/11/29/Republic-of-North-Macedonia-Request-for-an-Arrangement-under-the-Precautionary-and-525935>

(pps.) in 2020 to 80.3% of GDP and rose further to 81.4% in 2021, mainly as a result of continued foreign financing for crisis-induced needs.

Foreign reserves dropped heavily in the first half of 2022, mainly due to higher energy imports and external debt repayments. Foreign exchange reserves declined by over 14% in the first half of 2022 due to the increased conversion of domestic denar-denominated savings into euro; a surge in energy imports; external debt payments; and decreasing valuations of securities holdings. In early 2022, during a period of high energy imports, the central bank intervened in the foreign exchange market to support the de facto exchange rate peg to the euro. Forex markets stabilised somewhat over the summer due to seasonally high inflows of foreign currency that exceeded central bank expectations and supported by a EUR 250 million private placement of government securities in Germany in September. Foreign exchange reserves increased each month between July and December to reach 100% of the IMF's reserve adequacy metric and now correspond to 3.9 months of imports. However, reserves are expected to decline again as the heating season progresses and energy imports increase further.

The central bank has been tightening monetary policy to counter rising inflation expectations and protect the de facto exchange rate peg. Headline inflation rose to 19.8% in October 2022, reflecting the high pass-through of the global energy and food price shock, but abated somewhat in November and December. Since April 2022, the policy rate has been raised by 350 basis points in eight consecutive hikes to 4.75%, thereby increasing the spread to the European Central Bank (ECB). The central bank also adjusted reserve requirement rates in June and September to disincentivise the shift into euro deposits that was a significant factor behind the fall in reserves in early 2022. These actions have reduced inflation expectations and pressures on the exchange rate.

The authorities have responded to the external shocks with significant fiscal support. In addition to ongoing expenditures to support the energy sector and maintain subsidised electricity prices for households, the authorities of North Macedonia adopted a EUR 400 million package of measures in March 2022, and another one in October, worth EUR 350 million, to protect households from rising food and energy prices, and to help firms maintain liquidity. Largely on account of under-implementation of the capital expenditure budget, the fiscal deficit for the full year of 2022, at 4.3% of government-projected GDP, remained below the revised target (5.3%) and in line with the government's initial target. The government intends to continue supporting the loss-making domestic electricity producer and end customers also in 2023, yet in a more targeted fashion. The level of general government debt and public debt (including the debt of state-owned enterprises) remained moderate but rose markedly in 2020 and 2021, reflecting high fiscal deficits and, in 2020, the fall in GDP. Public debt decreased somewhat in 2022, to some 57% of government-projected full-year GDP at end-September 2022.

The 2023 budget, adopted by the Parliament in December, raises the fiscal deficit target (compared with original plans outlined in the May 2022 medium-term fiscal strategy) from 4.2% to 4.6% of GDP. At the same time, the government lowered the real GDP growth projection for 2023, to 2.9%. The 2023 budget provides for a small consolidation effect from the withdrawal of some fiscal stimulus measures as well as a reduction in subsidies to the state-owned electricity company. It contains a number of fiscal consolidation measures, such as streamlining preferential treatments and exemptions in VAT and in direct taxation on the revenue side and reducing government consumption on the expenditure side. In line with the policy guidance of the May

2022 Joint Conclusions, crisis-related fiscal support is projected to become better targeted to vulnerable groups.

The Commission's autumn forecast projects moderating growth and lower fiscal and external deficits after 2022, while risks are clearly to the downside. GDP growth in 2022 and 2023 is set to slow to 2.3% and 2.5% respectively as high inflation weighs on domestic demand. The Commission forecast expected the external deficit to widen considerably in 2022, mostly reflecting higher energy prices, and to improve in 2023 and 2024. The fiscal deficit is expected to fall in 2023 as a result of revenue-enhancing reforms and some consolidation. However, it is set to remain high due to the continuing need to support the economy during the energy crisis. The new organic budget law, adopted by the Parliament in July 2022, puts a cap on the fiscal deficit (3% of GDP in non-crisis times) and on general government debt (60% of GDP), and will, once applied, anchor fiscal policy in the medium term. The growth outlook could be challenged if geopolitical challenges lead to further energy and food price shocks, possibly in combination with a further tightening of global financial conditions and more difficult access to capital for emerging market economies. Also, a prolonged disruption of supply chains would halt the improvement of external deficits. On the other hand, the EU accession process could bolster reforms, fiscal and external sustainability, including through the further strengthening of foreign direct investment inflows.

Table 1: North Macedonia – Selected macroeconomic indicators 2013-2021

	2013-18 average	2019	2020	2021
North Macedonia - Key economic figures				
GDP per capita (% of EU-27 in PPS) ¹⁾	37	38	37	42
Real GDP growth	2.9	3.2	-6.1	4.0
Economic activity rate of the population aged 15-64 (%) , total ¹⁾	65.1	66.3	65.5	65.5
<i>female</i>	52.0	54.8	54.0	53.4
<i>male</i>	77.8	77.3	76.7	77.1
Unemployment rate of the population aged 15-64 (%) , total ¹⁾	25.2	17.4	16.6	15.8
<i>female</i>	24.7	18.6	16.1	14.7
<i>male</i>	25.5	16.6	16.9	16.6
Employment of the population aged 15-64 (annual growth %)	2.5	5.4	-0.5	0.2
Nominal wages (annual growth %)	2.5	5.1	8.3	5.7
Consumer price index (annual growth %)	0.8	0.8	1.2	3.2
Exchange rate against EUR	61.58	61.51	61.67	61.63
Current account balance (% of GDP)	-1.3	-3.3	-3.4	-3.5
Net foreign direct investment, FDI (% of GDP)	3.0	3.2	1.5	3.7
General government balance (% of GDP)	-3.1	-2.0	-8.2	-5.4
General government debt (% of GDP)	38.3	40.5	51.9	51.8

Notes :

1) Eurostat

Source: national sources

1.3. IMF and other donor support

Following the authorities' request and staff level agreement, the IMF's Executive Board adopted, on 22 November, a 24-month arrangement under the Precautionary and Liquidity Line (PLL) of up to EUR 530 million. The PLL is an instrument in the IMF's toolbox which is only available to countries with sound economic fundamentals and a strong record of policy implementation, but with some remaining vulnerabilities. Its use therefore signals that the economic policies of North Macedonia are deemed generally sound, and the arrangement explicitly aims to help boost international reserves and facilitate other external financing.

Other potential sources of financing which are not included in the IMF scenario have not yet materialised. The EBRD has approved a EUR 100 million liquidity line to the state-owned energy company, which is currently blocked by the Parliament due to disagreements over energy-related conditions attached to it (closure of lignite-fired plants). The World Bank is considering to provide budget support of around EUR 80-100 million. There is a possibility that the government will receive an additional loan from the IMF's new Resilience and Sustainability Trust (RST) of around EUR 75-100 million. The government's request for an RST loan is expected to be taken to the board by end-May 2023. An RST loan would be tied to conditions in the energy sector. Would any of these potential official financing sources materialise, which at this stage remains uncertain, this would correspondingly reduce the amounts to be raised from the market.

1.4. External financing needs

For 2023, the IMF projects economy-wide external gross financing needs of EUR 1.5 billion, consisting of the current account deficit (EUR 622 million) and large debt amortisation needs (EUR 878 million).³ When calculating remaining financing needs in 2023, the IMF considers the second tranche disbursement under the PLL⁴ (EUR 155 million) as well as the EUR 80 million EU budget support under the new EUR 1 billion EU Energy Support Package for the Western Balkans. Given the high external gross financing needs of the country in 2023, and the limited amount of financial assistance secured so far from donors, remaining external financing needs as calculated by the IMF are elevated, at EUR 800 million in 2023 and EUR 300 million in 2024 (see Table 2). Remaining needs are assumed to be met by external market financing, including through a new Eurobond.

The IMF programme also sketches out a downside scenario under which global growth slows more than expected and financial conditions tighten more, the budget deficit would increase, as would the current account deficit, and there would be lower foreign direct investment inflows. Gross financing needs would hence be higher compared to the baseline scenario. Eurobond issuances could become even more challenging in such a scenario, resulting in higher interest rates and lower volumes. The IMF assumes that due to negative shocks, the government would be able to secure external financing in the amount of EUR 500 million only in 2023, instead of EUR 800 million, and with higher spreads. This additional shortfall would be met by drawing from the PLL

³ IMF repayment calculations include public and private external debt and hence result in a higher amount than official repayments on foreign debt.

⁴ The tranche under the PLL amounting to EUR 110 million was disbursed in 2022.

(i.e. transforming the third and fourth precautionary tranches into disbursing ones) also in the second year of the arrangement, in November 2023 and May 2024.

There is considerable risk that the expected amount of external market-based financing cannot be fully realised. The assumed external market financing of EUR 800 million under the IMF baseline scenario (which is technically a residual between estimated needs and assured official financing)⁵ is elevated and may prove challenging (and not only in a worst-case scenario). Government bond yields have increased markedly and market conditions remain volatile, which might make it challenging for North Macedonia to fully meet remaining financing needs⁶. There may thus be larger residual financing needs than indicated in the IMF estimates. The proposed MFA can be considered as a significant contribution towards meeting the remaining external financing needs in a difficult financial market environment.

Table 2: The external financing gap and potential financing sources of North Macedonia

(Millions of euros, unless specified otherwise)						
	2022	2023	2024	2025	2026	2027
Gross financing needs	1.347	1.500	1.033	1.478	1.764	1.108
Current account deficit	996	622	584	597	638	686
MLT debt amortization 1/	350	878	449	881	1.126	422
Financing sources	970	1.775	1.587	2.051	2.091	1.469
FDI (net)	493	553	596	634	675	717
MLT debt disbursements	419	507	638	683	712	729
Government external financing	300	800	300	700	700	0
Other 2/	-242	-84	53	34	4	23
Net change in reserves (-: increase)	266	-510	-554	-574	-327	-361
Financing gap	110	235	0	0	0	0
Precautionary and Liquidity Line (PLL)	110	155	0	0	0	0
European Union (Grant)	0	80	0	0	0	0
Remaining financing gap	0	0	0	0	0	0
<i>Memorandum items</i>						
Gross International Reserves (GIR)	3.377	3.887	4.442	5.015	5.342	5.703
as % of ARA Metric	93	100	106	110	113	113

Sources: National Bank of North Macedonia; and IMF staff estimates

1/ Excluding the amortization of MLT intercompany loans, which is included in FDI (net).

2/ Including the capital account balance, trade credits and advances, currency and deposits, private portfolio investments, short-term loans, and net errors and omissions

⁵ Staff can only present a programme to the board that is fully financed; hence the external financing acts as a residual and that might de facto, at least partly, represent a financing gap.

⁶ Given increased uncertainties and higher government bond yields, plans to issue Eurobonds have been put on hold across the Western Balkans.

1.5. Structural reforms

North Macedonia has a good track record of structural reform implementation, but key challenges remain. The proposed MFA would be expected to leverage important macro-relevant reforms through its specific conditionality. The current energy crisis has put in focus the challenges that make the country's economy vulnerable to external shocks. These should be addressed in order to strengthen macro-fiscal and external sustainability. These include the need to rebuild fiscal space in the medium term, also by strengthening the tax base; to improve fiscal governance; and to carry out growth-enhancing reforms targeting the management of public capital spending and weaknesses in the business environment in areas such as the rule of law, the fight against corruption and the state aid regime. The country's high energy intensity and energy imports underscore the urgent need to accelerate the clean energy transition as a way to reduce vulnerability to external shocks and increase energy security. In the following paragraphs, these challenges are presented more in detail.

Downside risks to the economic recovery call for a cautious phasing out of fiscal support while rebuilding fiscal space in the medium term. Due to high uncertainty about the continuing impact of Russia's war against Ukraine, standing ready to provide crisis mitigation if needed seems appropriate. At the same time, once the recovery is on solid grounds, the country needs to return to more prudent fiscal positions and to stabilise debt levels in the medium term. This should be supported by strengthening fiscal governance. Following its recent parliamentary adoption, the provisions of the new Organic Budget Law (OBL) should be swiftly implemented, and an independent fiscal council be set up.

The implementation of budgeted capital expenditure remains weak largely because of shortcomings in the management of public investment. It is important to address these shortcomings to ensure a rigorous and transparent project selection and efficient preparation and implementation, given the government's plans to significantly raise capital investment. Measures should be based on the approved action plan. Adopting the new legal framework for public-private partnerships could provide additional financing sources for public infrastructure projects. The country's revenue-to-GDP ratio is, by comparison, very low. Revenue collection suffers from substantial - primarily structural - weaknesses, including a comparatively narrow tax base, and shortcomings in technical and human capacities. These need to be addressed, so as to facilitate the move towards a reduction in the primary deficit.

Competitiveness of domestic companies, investment and global value chain integration is undermined by a challenging business environment. This includes a large informal economy, a lack of skills, innovation and technology adoption, low productivity and the need to modernise and digitalise public administration. COVID-19 had significant negative effects on the economy of North Macedonia and exacerbated these structural challenges, causing companies to reduce their investment in development of human and physical capital. At the same time, the crisis has revealed vulnerabilities in global value chains, which also affected the companies of North Macedonia. Improving the competitiveness of local companies and benefiting from the post-COVID-19 restructuring of global value chains will require improvements in human and physical capital and the business environment, including better enforcement of business regulation and corporate governance, a more focused investment attraction strategy, less complex state-aid rules, as well as better services including trade and transport logistics. North Macedonia also needs to continue to tackle corruption, improve the rule of law and strengthen institutions in order to promote

competitiveness. Addressing these fundamental concerns is a prerequisite for successfully transforming the economy.

The Russian war of aggression against Ukraine clearly demonstrates the urgent need to accelerate the clean energy transition. This would help reduce vulnerability to external shocks and increase energy security. At this stage, the economy of North Macedonia is characterised by high energy intensity, inefficiencies in the ageing energy production system, persistently high dependency on highly polluting lignite coal, and inefficient energy consumption. A sustainable post-COVID recovery will have to address the longer-term transition to green growth, particularly in the context of geo-political shocks and bearing in mind the upcoming carbon border adjustment mechanism. Energy supply is unreliable and efforts on energy diversification need to be improved. The government has annual targets on raising the share of renewables in energy consumption, but, at this stage, renewable energy still only accounts for a relatively small share of power generation and hydropower is the most exploited renewable source of energy. Energy efficiency has the potential to significantly reduce the impact of energy costs on the competitiveness of the economy by reducing the need for energy overall, but measures to improve energy efficiency are hardly progressing. While energy transition and the sustainability of the energy system are considered priorities in the government's strategic documents, implementation will be a challenge and needs to be accompanied by enhanced institutional capacity.

2. OBJECTIVES AND RELATED INDICATORS OF THE MACRO-FINANCIAL ASSISTANCE

2.1. Objectives

The objectives of the proposed MFA operation are to:

- i) Contribute to covering the external financing needs of North Macedonia in the context of a significant deterioration in the external position due to the impact of high energy prices, and upcoming repayments of foreign debt.
- ii) Support the fiscal consolidation efforts and external stabilisation expected in the IMF programme.
- iii) Support macro-relevant structural reform efforts aimed at reducing the economy's vulnerability to energy price shocks and accelerating the transition to clean energy; improving the implementation of public investment; promoting the competitiveness of domestic companies by improving the business environment, in line with policy commitments jointly agreed with the EU in the context of the country's Economic Reform Programme.

2.2 Monitoring indicators

The fulfilment of the objectives of the assistance will be assessed by the Commission, including in the context of the ex-post evaluation (see below), on the basis of the following indicators:

- i) Progress with fiscal consolidation and external stabilisation, in line with the requirements of the IMF-supported programme.
- ii) Progress with the implementation of structural reforms, notably the specific policy actions to be identified as conditions for disbursement of the assistance, which will be included in a

Memorandum of Understanding to be negotiated between the Commission and the authorities of North Macedonia.

3. DELIVERY MECHANISMS AND RISK ASSESSMENT

3.1 Delivery mechanisms

The MFA operation under consideration is expected to cover part of the residual financing needs for the 2023-2024 period and would amount to a maximum of EUR 100 million. The Commission proposes to provide the assistance in the form of a medium-term loan. Given the proposed size of the operation, the Commission is considering releasing the assistance in two instalments, evenly disbursed over the programme period, between 2023 and early 2024.

It is important to ensure the MFA's value added, notably by providing the EU with sufficient leverage to promote reforms. To that end, policy conditions will be attached to the MFA's disbursements, with each tranche, including the first one, being subject to good progress with the IMF programme and the specific actions agreed with the EU in the Memorandum of Understanding as well as the fulfilment of the political preconditions (see below).

3.2 Risk assessment

On the basis of a thorough assessment of potential risks, the Commission services consider that there are sufficient grounds and guarantees to proceed with the proposed MFA to North Macedonia.

Credit risk: A reliable track record of repaying external obligations on time; good credit rankings; sound macrofiscal policies and moderate debt levels (as well as improvements in the structure of debt towards longer maturities) underline the country's capacity to service its debts, even against the background of increasing public debt levels and rising interest payments. Overall, North Macedonia has a track record of steady sovereign access to international capital markets at favorable terms. The country's debt is ranked BB-/B by Standard and Poor's (August 2022), with a stable outlook. Following its first Eurobond issuance in 2005, North Macedonia has accessed international capital markets regularly, with three Eurobond issuances totaling EUR 1.9 billion over the last five years. To support the economic recovery from the pandemic, the authorities issued a six-year EUR 700 million Eurobond in May 2020 and a seven-year EUR 700 million Eurobond in March 2021 at competitive rates. In September 2022, the government managed to issue a 3-year registered marketable bond with an international bank worth EUR 250 million, at a 370 basis points spread over the 6-month Euribor rate.

Fiduciary risk: Past progress in developing institutional capacities in public financial management and in the fight against corruption make it unlikely that the MFA, which is not dedicated to specific expenses (contrary to project financing, for example), could be used in a fraudulent way. Management systems in the central bank and the Ministry of Finance, administrative procedures, control and oversight functions, the security of IT systems and the appropriateness of internal and external audit capabilities are at a considerably advanced stage in North Macedonia. MFA assistance will be liable to verification, control and auditing procedures under the responsibility of the Commission, including the European Anti-Fraud Office (OLAF), and the European Court of Auditors.

External risks: There are moderate external risks, stemming from a possible weakening of the European and global economic environment and from a significantly drawn-out war of aggression against Ukraine, impacting further on international energy prices (taking into account the dependence on energy imports of North Macedonia, including full reliance on Russia for gas imports, and the country's close trade links with the EU market). Such developments would lead to further weakening of the fiscal and balance-of-payments situation of North Macedonia.

4. ADDED VALUE OF EU INVOLVEMENT

The Union's financial support to North Macedonia reflects the country's strategic importance to the EU as an EU candidate country with which accession negotiations process was launched in July 2022. The MFA instrument is a policy-based instrument directed to alleviate short- and medium-term external financial needs. As a part of the overall EU package of assistance, it would contribute to supporting the European Union's objectives of economic stability and economic development in North Macedonia. By supporting the authorities' measures to improve fiscal governance and consolidation, and to accelerate the clean energy transition, hereby reducing the economy's energy import dependence and its vulnerability to energy price shocks, the proposed assistance would help improve the effectiveness of other EU financial assistance to the country, including budgetary support operations.

5. CHARACTERISTICS OF MACRO-FINANCIAL ASSISTANCE

5.1 Exceptional Character and Limited Time-frame

The MFA operation would be exceptional, aiming to support a sustainable external finance situation for North Macedonia. It would run in parallel to the IMF PLL arrangement, as adopted by the Executive Board on 22 November 2022. The proposed MFA would only be implemented if the IMF programme remains on track. Against this background and given the expected time of approval of the programme, the assistance is expected to be implemented in 2023-2024. The disbursement of the first tranche could take place in the third quarter of 2023, the second tranche could be disbursed in the first half of 2024. All disbursements are conditional on the IMF programme remaining on track and on a number of policy measures, agreed with the EU and listed in the Memorandum of Understanding attached to the proposed MFA operation.

5.2 Political preconditions and EU-North Macedonia relations

A pre-condition for granting MFA is that the eligible country respects effective democratic mechanisms, including a multi-party parliamentary system and the rule of law, and guarantees respect for human rights.

As noted in the 2022 Commission Communication on EU Enlargement Policy⁷ (hereinafter: Commission Communication), the launch of the EU accession negotiations process with North Macedonia last year was a major breakthrough and marked the beginning of a new phase in the EU-North Macedonia relations. The first political intergovernmental conference with North Macedonia took place on 19 July, following the approval by the Council of the negotiating framework. This was a clear recognition of the progress achieved by North Macedonia to advance

⁷ COM(2022) 528 final

the EU reform agenda and to deliver tangible and sustained results, including under the fundamentals cluster.

As indicated in the Commission Communication⁸, North Macedonia continued its efforts to strengthen democracy and the rule of law, despite some challenges. The country has shown its commitment to continuing to deliver results in key areas of the fundamentals.

However, the work of Parliament was marred by political polarisation, which delayed the adoption of many pieces of legislation. Following intense debates, Parliament adopted conclusions on the proposal which paved the way for the opening of accession negotiations. Parliament needs to play an active and positive role in the EU accession negotiation process. Joint and prompt efforts by all parties are needed as a matter of priority to strengthen Parliament's role as a forum for constructive political dialogue, particularly on the EU reform agenda.

The judicial system of North Macedonia has achieved some level of preparation / is moderately prepared. Some progress was achieved in the field of the judiciary, through the steady implementation of the judicial reform strategy, thereby addressing the recommendations made by the Venice Commission and the Senior Experts' Group on systemic rule of law issues. The preparation of a new judicial reform strategy has started, in an inclusive manner, building upon the lessons learnt from the previous one. Implementation of the updated action plan on the judicial reform strategy has continued but needs to become more systematic. The judiciary has demonstrated its commitment to protect its integrity and independence.

The legal framework on the protection of fundamental rights is largely in line with European standards, but implementation needs to be improved, such as on hate speech and of the national action plan for the Istanbul Convention's provisions.

The general context in North Macedonia is favourable to media freedom and allows for critical media reporting, although there were some tensions during the 2021 local elections. Action on self-regulation of the media should resume and produce practical results in advancing professional standards of journalism. Greater transparency is needed regarding media advertising by state institutions and political parties.⁹

5.3 Complementarity

The proposed MFA would complement the assistance provided by the IMF and other multilateral donors. The EU's MFA would also complement the budget support grant of EUR 80 million to be disbursed as of early 2023 under the new EU Energy Support package put forward by the Commission for the Western Balkans. By supporting macroeconomic policy and structural reforms of North Macedonia, the MFA would enhance the added value and effectiveness of the EU involvement through other financial instruments and help steer the country towards a sustained reform trajectory to strengthen macroeconomic stability, address governance problems and boost potential growth in the longer run and in a sustainable manner.

⁸ COM (2022) 528 final

⁹ A complete assessment of the satisfaction of the political preconditions for MFA is provided in the Annex.

5.4 Conditionality

Disbursements under the proposed MFA operation would be conditional on successful reviews under the IMF programme. In addition, the Commission and the authorities of North Macedonia would agree on a specific set of structural reform measures, to be defined in a Memorandum of Understanding. These reform measures would support the authorities' reform agenda and complement the programmes agreed with the IMF, the World Bank, and other donors, as well as the policy conditions associated with the EU's budget support operation. They would be consistent with the main economic reform priorities agreed each year between the EU and North Macedonia in the context of the Economic and Financial Dialogue between the EU and the Western Balkans and Türkiye, laid down in the jointly endorsed conclusions of the dialogue.

The Commission will seek a broad consensus with the authorities of North Macedonia to ensure their ownership and fostering a smooth implementation of the agreed conditionality. These policy conditions should address some of the shortcomings of the country's economy and economic governance system. Possible areas of conditionality may include reforms to strengthen fiscal governance, e.g. through a well-functioning fiscal oversight body; revenue-enhancing reforms; measures to improve the efficiency of public investment selection and implementation; public-private partnerships; business environment; transparency in state aid; energy efficiency; judiciary reform; and the fight against corruption.

5.5 Financial Discipline

The proposed MFA operation for North Macedonia of up to EUR 100 million is foreseen to be disbursed in two equal tranches to be released in 2023-2024.

The required provisioning of the loan of EUR 100 million at a rate of 9% of the External Action Guarantee will be programmed under the Instrument for Pre-accession (IPA), for a total amount of EUR 9 million (budget line 15.020203 IPA III – Provisioning of the Common Provisioning Fund (External Action Guarantee – MFA)).

In line with the requirements of the Financial Regulation, the European Commission services have carried out, an Operational Assessment of the financial and administrative circuits of North Macedonia. Developments in this area will continue to be closely monitored also through the regular progress reports on PFM reforms produced by the EU Delegation.

6. EVALUATION AND COST-EFFECTIVENESS

This assistance is of exceptional and macroeconomic nature and its evaluation will be undertaken in line with the standard Commission procedures.

6.1 Evaluation

Ex-post evaluations of MFA operations are foreseen in the Multi-Annual Evaluation Programme of the Commission's Directorate-General for Economic and Financial Affairs. An ex-post evaluation of the proposed MFA to North Macedonia will be launched within a period of two years after the availability period has expired. A provision for the ex-post evaluation is included in the proposed Decision for the assistance, and will also be included in the Memorandum of

Understanding. Budget appropriations from the macro-financial assistance grant budget line will be used for this evaluation.

6.2 Achieving cost-effectiveness

The proposed assistance would entail a high degree of cost effectiveness for several reasons:

- i) Since the assistance would be leveraged by that provided by the international financial institutions, with which, as noted, it would be closely coordinated, its ultimate impact could be very significant compared to its cost. Moreover, in negotiating specific policy conditions, the Commission will be able to draw on the expertise of those institutions, including the IMF and the World Bank, and to influence their conditionality as well in ways that will take into account the EU's views.
- ii) Providing coordinated macroeconomic support to North Macedonia on behalf of the EU countries, the MFA would be more cost efficient than the provision of a similar total amount of financial support by EU Member States individually.
- iii) The proposed assistance would be provided in the form of loans, the budgetary impact of which is more limited than that of grants.
- iv) Finally, the Commission will aim at achieving synergies with other EU policies and instruments used to support the implementation by the beneficiary of the relevant measures (notably in the area of public finance management).

Annex:

Assessment of democracy, human rights, rule of law and reforms in North Macedonia

The launch of the **EU accession negotiations process** with North Macedonia in July 2022 was a major breakthrough and marked the beginning of a new phase in the EU-North Macedonia relations. This was a clear recognition of the progress achieved by North Macedonia to advance **the EU reform agenda** and to deliver tangible and sustained results, including under the fundamentals cluster. The Commission started immediately the screening of the EU *acquis*, which is proceeding smoothly. The accession negotiations process is conducted in line with the revised enlargement methodology, which puts a stronger focus on the fundamentals.

Political criteria

In October 2022, the Commission published the enlargement package¹⁰ and assessed that North Macedonia continued its efforts to strengthen **democracy and the rule of law**, despite some challenges. The country has shown its commitment to continuing to deliver results in key areas of the fundamentals.

Overall, the legal framework remains conducive to the organisation of **democratic elections**. Local elections took place in October 2021. The Office for Democratic Institutions and Human Rights of the Organisation for Security and Cooperation in Europe (OSCE/ODIHR) assessed that they were competitive and fundamental freedoms were widely respected. However, efforts should be made to address the outstanding recommendations made by the OSCE/ODIHR and the Venice Commission.

The country has a multi-party parliamentary system. **Parliament** continues to fulfil its functions, despite the challenges and the political polarisation. The Parliament needs to play an active and positive role in the EU accession negotiation process. The **government** continued to work on the **EU reform agenda** and on addressing the consequences of the COVID-19 pandemic and of Russia's invasion of Ukraine. In this regard, North Macedonia confirmed its strong and clear strategic orientation towards the EU by fully aligning with all EU common foreign and security policy decisions and declarations and has since maintained a **100% alignment rate**. By doing so, North Macedonia has shown its determination to advance on its EU path as a reliable partner.

Civil society organisations (CSOs) continue to operate in an enabling environment, including with the adoption of the strategy of cooperation with and development of civil society 2022-2024. Civil society continued to play an important role in decision-making processes and in monitoring the activities of the state. However, efforts are needed to improve transparency in policymaking

¹⁰ COM(2022) 528 final and SWD(2022) 337 final

and the inclusiveness of consultation processes. The legal and financial frameworks still need to be improved and implemented in practice.

Rule of law and human rights

Concerning **judicial reforms**, the Commission reported that some progress was achieved, through the steady implementation of the judicial reform strategy. The preparation of a new judicial reform strategy has started, in an inclusive manner. The judiciary has demonstrated its commitment to protect its integrity and independence. The pace of implementation of the human resources strategies for the judiciary and prosecution services needs to be stepped up. Judicial institutions have implemented consistently the new rules for the appointment, promotion, discipline and dismissal of judges and prosecutors. The Judicial Council and the Council of Public Prosecutors continued implementing the strategic plans. Work was undertaken to upgrade the software system for automatic and random distribution of cases in the courts.

The country continues to consolidate its performance on investigating, prosecuting and trying several **corruption cases**, including at a high level. The cases initiated by the former Special Prosecutor's Office (SPO) continued to move forward, establishing accountability for the illegal wiretaps. A number of cases were subject to first-instance rulings. The State Commission for the Prevention of Corruption (SCPC) has been proactive in providing policy guidance to public institutions on preventing corruption and it opened several cases, including cases against high-level officials. North Macedonia made some progress in the **fight against organised crime**: the internal coordination of activities and the operational cooperation with international partners have improved.

The legal framework on the protection of **fundamental rights** is largely in line with European standards. The Ministry of Labour and Social Policy continues to invest in community services, including support for victims of gender-based violence. Continued improvements can be noted in gender mainstreaming and respect for women's rights. In the area of freedom of expression, the overall situation and climate in which media operates remain generally conducive to media freedom and allow for critical media reporting. Action on self-regulation of the media should resume and produce practical results in advancing professional standards of journalism.

Conclusion

North Macedonia continues to fulfil the general political pre-condition for macro-financial assistance with regard to effective democratic mechanisms, including a multi-party parliamentary system, the rule of law and respect of human rights.