**International Monetary Fund**

Former Yugoslav Republic of Macedonia and the IMF

**Press Release**:
IMF Executive Board Completes Third Review Under the Stand-By Arrangement with the Former Yugoslav Republic of Macedonia
February 27, 2008

Country's Policy Intentions Documents



# **Former Yugoslav Republic of Macedonia:** Letter of Intent and Technical Memorandum of Understanding

February 6, 2008

The following item is a Letter of Intent of the government of former Yugoslav Republic of Macedonia, which describes the policies that Macedonia intends to implement in the context of its request for financial support from the IMF. The document, which is the property of former Yugoslav Republic of Macedonia, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Skopje, Macedonia

February 6, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Strauss-Kahn,

1. **After one and a half years in office, our ambitious economic reforms have created a better and more prosperous Macedonia.** The tax cuts we introduced have been designed to stimulate new investment and to boost employment. Our commercial banking law is attracting major foreign banks and will strengthen banking supervision. Our policies of market liberalization, most notably in telecommunications, transportation and other service sectors, are improving growth and competitiveness. In recognition of our achievements, the World Bank recently ranked us at the fourth place among economic reformers. These reforms will promote Macedonia's integration in the global economy, and create an environment that fosters internationally competitive enterprises.

2. **Looking ahead, we aim to maintain macroeconomic stability and further improve the business environment, so as to raise economic growth, attract foreign direct investment, and reduce unemployment**. Prudent fiscal policies will continue to underpin macroeconomic stability. Taxes and social security contributions will be further streamlined and reduced, including by cutting personal and corporate income tax rates (to 10 percent as of January 2008) and reducing payroll taxes. Government spending will be redirected to more productive uses, and spending on education and on infrastructure will be increased. Greater fiscal transparency, fiscal decentralization, and improved capital budget execution will further improve the quality of fiscal policy. The business environment will be further improved by completing the 'regulatory guillotine' process and the real estate cadastre, and by reforms in the central registry, and in bankruptcy procedures. We are also taking key steps to ensure stable energy supply and improve the electricity sector's finances. These reforms are expected to result in higher economic growth and a better standard of living.

**Recent Economic Developments**

3. **Economic performance continues to improve:**

- **In the first three quarters of 2007, real GDP increased by 5 percent compared to the previous year**. Industrial production (in particular of iron and steel, processed food and construction materials), trade, transportation and telecommunications made significant contributions to growth. Private consumption was stimulated by higher private sector wages, employment growth and increased access to consumer credit. Investment also picked up benefiting from lower taxes and more friendly investment climate.

- **Average inflation has fallen** from 3.2 percent in 2006 to 2.3 percent in 2007, but year-on-year the rate increased to 6.1 percent, mainly due to increases in food prices.

- **The current account balance during the first three quarters of 2007 has been stronger than expected**, reflecting a lower trade deficit and higher private transfers. Increases in exports of metals, together with high iron and nickel prices, have boosted export receipts. Imports have also risen, both consumption goods (reflecting strong economic activity and improved prospects), but particularly intermediate and investment goods, which will boost the economy's productive potential. Despite making more than €200 million in repayments to international creditors, at around €1.5 billion (or 4 months of imports of goods and services), international reserves remain ample. We have repaid all of our outstanding obligations to the Fund. As a result of the early repayments, external debt declined to 35 percent of GDP.

4. **In the first three quarters of the year, we met all of the program's fiscal and monetary program targets (Table 1)**. The fiscal balance has been much stronger than expected, with more rapid growth and improvements in tax administration boosting tax and social contribution revenues. Central bank interest rates have gradually declined to around 5 percent, while the spread between lending and deposit rates in commercial banks has continued to decline and is now around 5 percentage points.

5. **We have also successfully implemented a number of structural reforms,** in the areas of tax policy and administration, fiscal transparency, key economic sectors (including health, energy, finance, and telecommunication), and the overall business climate (Table 2). This Letter of Intent highlights key achievements in these areas in our first year in office, and lays out a reform agenda that builds on these.

**Economic policies for 2008 and the medium term**

6. **Economic growth is set to increase, while inflation will remain low.** In light of the strong results in 2007, we have raised the growth assumptions underlying our Fund-supported program to 5 percent in both 2007 and 2008, well above historical performance. Despite the increased risks in the international economy, we believe that these assumptions are prudent: as our reforms take hold, we believe that the actual growth outturn may be considerably higher: as much as 6 percent in 2007, 6½ percent over the medium-term. Over the medium-term inflation is expected to remain at around 2 percent, in line with partner

countries. As growth picks up, the current account deficit is expected to increase to around 6 percent of GDP. We will keep gross international reserves at around 4 months of imports.

7. **With growth picking up, unemployment has started to fall**. Registered unemployment remains high, although this partly reflects registration of informal workers as unemployed, to claim health benefits. Our policies aimed at increased growth and foreign direct investment should significantly increase employment. But we are also taking direct measures to reduce unemployment, in particular by reducing the tax wedge for part-time and low-wage workers. Starting from April 2008, we will encourage part-time work, by no longer requiring part-time workers to pay full-time health contributions. We will also reduce social contributions for low paid workers, by gradually reducing minimum social contributions. Together with our policies aimed at improving education, our reforms will stimulate job creation and gradually reduce the unemployment rate.

**Fiscal policy and public sector reforms**

8. **In 2007, the central government ran a small budget surplus, outperforming the program's 1 percent of GDP deficit target.** In light of this strong revenue overperformance and likely expenditure savings, in 2007 we passed two supplementary budgets with increased spending (of around 2 percent of GDP) on education, infrastructure to attract foreign direct investment, civil service employment needed for EU accession, wage increases, and energy (additional allocations to allow budgetary organizations to clear their arrears with EVN-ESM). Starting in October 2007, VAT rates for computer hardware and software, public transport, thermal solar systems and medicines were reduced from 18 to 5 percent.

9. **For 2008 we will keep to our prudent fiscal policy, while continuing to reduce tax rates and to redirect government spending to more productive uses**. To maintain macroeconomic stability, we will keep the deficit target to 1½ percent of GDP. Starting in January, we lowered personal and corporate income tax rates from 12 to 10 percent. We also introduced a small business tax that replaces the profit tax for enterprises with turnover below MKD 3 million, and introduced a flat-rate tax based on turnover. Our budget also includes adequate funding for decentralization to allow an effective transition to formula-driven allocations to municipalities, as well as for the introduction of compulsory secondary education and implementation of the new Law on Higher Education.

10. **We are taking steps to improve the quality of government spending.** In the **health** sector, we will emphasize cost-effective preventive and primary health care services, and reduce spending on relatively expensive inpatient and specialized interventions. We are also developing a plan for improving the efficiency of hospitals, and we are providing hospitals with incentives to reduce expenditures and improve the quality of services. The use of co-payments will be increased, to provide an effective incentive for cost-conscious choices by patients. In **education**, we will increase instructional time in schools, with teachers spending more time on teaching. Starting from the school year 2007/08, secondary education becomes

compulsory. Computers and information technology will be integrated into education under the "computer for every child" project, and additional resources will be made available for school furniture and furnishings. We have introduced mandatory instruction in two foreign languages in primary education, and classes on entrepreneurship and business administration in secondary education. We will increase spending on **infrastructure**, maintaining and investing in new roads, and improving transport links to our neighbouring countries, including by developing railway infrastructure along Corridor 10.

11. **Public wages will be increased by 10 percent in each of the next three years, starting in October 2007**. This will allow the public sector to attract quality staff. The increase in wages will also result in an increase in pensions. To keep pensions in line with improving living standards, we have changed the pension indexation formula to 50 percent wages and 50 percent consumer price inflation. However, after the budget was passed, in January 2008 we increased pensions by an average of 15 percent, a one-off measure to make up for low increases in previous years. We project that higher contribution collections will finance this. Further pension increases will follow the new 50 percent wages and 50 percent price inflation indexation formula. In making the public wage and pension increase, we remain committed to meeting the 1½ percent of GDP deficit target.

12. **Reforms in the Public Revenue Office (PRO) and the social funds, supported by IMF technical assistance, have boosted revenue collection**:

- The **PRO** has intensified arrears collection by applying the new Tax Administration Law, and improved services by accelerating refunds and making more information available to taxpayers. The PRO has also set itself performance targets to be achieved by end-2007 (May structural benchmark). The special tax office for administering large taxpayers, created in July 2006, has strengthened compliance and improved service to the country's largest businesses. The PRO has also designed a strategy for improving the administration of small- and medium-sized taxpayers (June structural benchmark). Amendments to the Law on the Public Revenue Office to allow the PRO more flexibility in paying salaries and rewarding performance through a professional performance management system were recently submitted to parliament.

- The **Pension and Disability Fund** (PDF)'s new IT system, introduced in 2006, has bolstered revenue collection. From April 2008 the PDF will start collecting all social insurance contributions (structural performance criterion). We have established an inter-fund working group to design and implement this initiative. As part of this process, in March 2007 Parliament passed legislation harmonizing the minimum bases for social contributions. This legislation was implemented in July 2007, starting with salaries paid in June (structural performance criterion). Legislation to harmonize the base for health care contributions (currently calculated on the basis of earned salary) with pension and employment contributions (which are based on contracted salary) is under preparation; this will be implemented by July 2008 (new structural performance criterion). In July 2007 we submitted draft legislation that gives the PDF legal authority for collecting health and employment contributions to Parliament (structural benchmark). Following this, the Ministry of Health and the Ministry of Labor have signed an inter-agency agreement setting out the terms and conditions under which the Pension Fund will collect health and employment contributions on behalf of the Health and Employment Funds. Our aim remains for the PRO to collect all taxes and contributions by end-2009.

13. **We have designed and announced a strategy to fully harmonize PIT and social contributions** (structural benchmark), central to our strategy of cutting labour taxes, fighting the informal economy, enhancing the business environment and reducing unemployment. Harmonization will also greatly simplify the tax burden for businesses, again stimulating employment. This year we will start the phased implementation of this strategy. From April 2008 onwards, health care contributions for part-time workers will be calculated on a per-hour basis (structural performance criterion), harmonizing them with personal income tax and other contribution collections. This will reduce the labour tax wedge. From 2009, we will phase out minimum social contributions over a period of two to three years. We also aim to shift from net to gross wages in calculating personal income tax and social contributions as soon as is practicable.

14. **Our customs administration reforms have also helped boost revenues and improve the business climate**. New simplified procedures for import clearance and the elimination of most customs fees and administrative taxes have improved compliance. Going forward, we will introduce a new customs information system to facilitate enforcement and the exchange of information with our international partners. Amendments to the Customs Law, to align the law with the EU acquis, were adopted by parliament in January 2008.

15. **Health sector finances are much better.** We have now placed economic directors in all Health Care Institutions (HCIs), and have reduced the stock of HCI arrears from 1.8 billion denar (0.6 percent of GDP) at end-2006 to 1.2 billion denar (0.4 percent of GDP) by end-June 2007. The new international tender for drug procurement (structural benchmark for end-June 2007) was delayed because in the first phase of the tender, 16 out of 29 bidders had to be excluded (in accordance with public procurement procedures). However, after re-tendering, 27 bidders were authorized to participate in the second phase; we expect that this will result in lower prices. The tender is expected to be completed shortly (reset structural benchmark for end-April). We will also take steps to limit the unnecessary use of drugs and encourage rational drug prescription.

16. **We will exercise caution in the exploration of possibilities for using Public-Private Partnerships (PPPs) for infrastructure investment which will be aimed at achieving value-for-money.** We will carefully identify and select opportunities for PPPs after establishing a framework for managing the associated fiscal risks, including through

appropriate legislation, sound institutions, and establishing a system for reflecting PPPs in fiscal reporting and debt sustainability analysis.

17. **We have launched the second phase of fiscal decentralization**:

- **To date, 51 out of 84 municipalities have qualified for participation in the second phase of decentralization**. Municipalities qualify for participation in the second phase of decentralization if they (i) have met the conditions for the first phase of decentralization, (ii) possess adequate staff capacity for financial management, (iii) show 'good financial results' for at least 24 months and (iv) have no arrears to suppliers or creditors exceeding ordinary terms of payment. Those that have moved to the second phase have started to receive block grants from the central government for primary and secondary education, child care, social care for the elderly, and culture. We have adopted by-laws specifying the methodology for the allocation of the block grants, increasing the flexibility of municipalities to allocate non-salary revenues more efficiently and encourage savings. A student-based formula for the calculation of the block grant for primary and secondary education will be introduced for 2008. We have established working groups to monitor spending of the grants and report to the government every six months.

- **We have also taken several other actions to increase local government revenues**: (i) business premises are now included in the base of the property tax; (ii) charges for street lighting have been doubled; (iii) the central government tax on lease agreements and the sale of urban land will now be shared with local governments (40 percent for the central government and 60 percent for local governments); and (iv) the tax on the exploration of natural resources is shared on the same basis. While decentralization should improve the targeting of spending, by carefully devolving revenues with responsibilities, it will not have any impact on the government deficit.

18. **We will strengthen the monitoring and control of public enterprise finances.** In 2006, Parliament adopted legislation requiring public enterprises to submit quarterly reports on their financial position to the government. Enterprises have now amended their statutes to comply with this new legislation. The first reports, covering the second quarter of 2007, were submitted by October 2007 (structural benchmark). We have selected a consultant to prepare for the privatization of the State Company for Management of Resident and Business Premises. By end-April 2008, the consultant will prepare a report that assesses the value of the company's assets and advises on the modalities of the privatization. In July 2007 we split Macedonian Railways in two: rail infrastructure and rail transport. A World Bank funded consultant will submit a strategy paper that advises on, inter alia, possibilities for cost reduction and track access charges by end-March 2008. Regarding privatization, the consultant will advise by June 2008, at which time the government will decide on the best option for strengthening rail services and efficiency, and for addressing outstanding debt of the rail companies. We are preparing legislation to introduce competition in freight

transportation by rail. Consultants are also providing advice on the privatization or concessioning of Macedonia's two airports. We aim to select an investor in these airports by May 2008.

19. **We will continue developing the domestic public debt market**. Our revised debt management strategy, to be presented to Parliament in February 2008, will aim to reduce the cost of government borrowing and develop the public debt market. In October 2007, we removed the cap on interest rates in the three month treasury bill auctions to facilitate market development. To promote competition in the treasury bill market we will reject outlier bids and limit the size of individual participation in each auction. We have established monthly meetings between the government and the NBRM to discuss economic developments. The NBRM will continue to sterilize excess liquidity using various monetary policy instruments, including longer-term central bank bills.

**Monetary and financial sector reform policies**

20. **The NBRM will aim at low inflation by maintaining a de facto pegged exchange rate regime backed by adequate international reserves.** The NBRM's monetary program for 2008 is consistent with average growth of broad money of about 30 percent, in line with a gradual increase in money demand. We expect capital inflows to remain strong, reflecting confidence in our macroeconomic policies. Increased monetization, supplemented with a moderate increase in banks' external financing and a drawdown of their funds abroad, will finance increased private sector credit and financial intermediation. The Ministry of Finance and the NBRM will stand ready to prevent the strong balance of payments from leading to excessive liquidity in the financial system.

21. **We remain committed to strengthening the financial soundness of the Central Bank and safeguarding its independence**. As part of our strategy to implement EU-consistent legislation, we have prepared a new draft Central Bank Law, with the help of IMF technical assistance. In October 2007, we submitted our draft for review to the European Commission and to the ECB, and we aim to submit our draft to parliament by end-March 2008 (new structural performance criterion). The primary objective of the NBRM will remain to achieve and maintain domestic price stability, and the NBRM will retain full autonomy in reaching that goal. The draft law strengthens the NBRM's governance and accountability, including by providing a clearer division of responsibilities between the Governor and the NBRM Council. Under the draft law, all three vice governors of the NBRM will be members of the Council (which will continue to have nine members). The draft also proposes that the exchange rate regime shall be jointly agreed between the government and the NBRM, without prejudice to the NBRM's primary objective.

22. **We are continuing to reform the financial sector.** In May 2007, we passed a new banking law which, among other things, strengthens banks' governance, tightens provisions on connected lending, and establishes a framework for consolidated supervision, more

closely in line with best international practice. The law eases restrictions on foreign bank branching, and contains provisions to protect the governor's decisions in the areas of bank licensing, administration and bankruptcy from reversal by the courts. Credit is growing at more than 30 percent annually, the presence of foreign banks is increasing, and spreads between lending and deposit rates have continued to narrow.

23. **The NBRM is implementing a more risk-based, anticipatory approach to banking supervision, through its supervisory development plan.** A framework for assessing risk profiles has been developed and tested successfully on three banks (September structural benchmark). In December 2007, the NBRM finalized a detailed guidance manual which will be used for conducting on-site supervision (structural benchmark). We will publish documents on the supervisory framework and the risk assessment process by end-March 2008 (structural benchmark). The NBRM has also issued accounting guidelines, a new chart of accounts and formats for banks' financial statements in line with IFRS (September structural benchmark). The new Banking Law will allow the NBRM to set additional accounting guidelines and request further information and disclosures from financial institutions that are needed for prudential purposes. The NBRM's efforts to create a completely new credit registry are expected to be completed by August 2008 (reset structural benchmark), slightly later than earlier envisaged, owing delays in technical assistance. In the interim, the NBRM will approve the credit registry's detailed content specifications and protocols for submitting and retrieving data by end-March 2008 (structural benchmark).

**Attracting foreign investment and improving the business climate**

24. **We are simplifying business regulations.** In June we published a list of all licenses administered by line ministries and government agencies, together with their justification (June structural benchmark). We have subsequently reviewed these (about 2,000 laws and by-laws), in consultation with the business community and international experts. On the basis of this, the government adopted a set of measures in July and August, including reductions in fees (including at the State Cadastre, Central Registry, and Customs Authority), selected use of the "silence is consent" rule, and a reduction in documentation requirements. By end-February 2008, changes in by-laws will be completed, and required amendments in laws will be submitted to Parliament. Regulations that remain will be entered into a national electronic registry, easily accessible to all. When developing new laws and regulations, we will also introduce a regulatory impact assessment (RIA) system. Recent amendments to the Company Law and the Law establishing the "one-stop shop" reduced the time required to register a business from five days to four hours, and eliminated the requirement to deposit paid–in capital before registering a limited liability company. With the "one-stop shop system" in place, business registrations have increased dramatically, from about 7,000 in 2005 to 11,000 in 2006, and about 10,800 in the first 10 months of 2007.

25. **We are making good progress in strengthening property rights**. About 70 percent of Macedonian territory will be covered by the Real Estate Cadastre by end-2007, 75 percent

by end-June 2008 (structural benchmark), 84 percent by end-2008, and the Cadastre will be completed by end-2009. We submitted a new Law on the Real Estate Cadastre to parliament in early 2008. This law, which has been prepared in close consultation with the World Bank, should help improve the quality of services provided by the Cadastre office. These reforms should facilitate the use of land as loan collateral, which will help lower borrowing costs and expand credit.

26. **Foreign direct investment is increasing.** We have created new Technological Industrial Development Zones near Skopje (Skopje-2), Stip and Tetovo, bringing the total of these to four. The first zone, Skopje-1, is evolving into a cluster of automotive industrial activity. The 2007 supplementary budget included increased infrastructure spending to support these zones. We have also amended the law on Technological Industrial Development Zones to bring it closer to the EU *acquis*. To limit erosion of the tax base, the government will continue to use an 80 percent export requirement as one of the guiding principles for participation in these zones.

27. **We are implementing a number of key steps to ensure stable energy supply and improve the finances of the electricity sector, in close collaboration with the World Bank. These key steps are:**

- **Development of a new strategy**. With the cooperation of the World Bank, we have developed a strategy that will identify priority investments in the energy sector and lay out a plan for obtaining the necessary financial resources.

- **Increased private sector participation**. We are in the process of securing private participation in the development of more than 60 small and medium-sized hydro-electric facilities. The tender to privatize the Negotino thermal power plant, the second largest in the country, was cancelled, with a view to safeguarding Macedonia's security of electricity supply. However, tenders for the construction of a number of new hydro-power plants are proceeding well, and we have recently authorized the construction of the first combined heat and power plant.

- **Improved payment discipline**. We will continue to support EVN-ESM, the electricity distribution company, in its efforts to ensure that all users make timely payments for their current electricity use. We will ensure that budgetary organizations clear their arrears with EVN-ESM. To limit network losses, we will eliminate legal barriers related to meter ownership, access and connection. The transfer of meter ownership to EVN-ESM should help reduce electricity theft and meter manipulation.

- **Reform of the electricity market model**. In March 2007 we amended the energy law to reduce the quantity of electricity supplied to large users at subsidised prices. From May 2007, subsidised electricity was reduced to 45 percent of historical usage. This reduced fiscal losses in the electricity sector by around €50 million. Starting from

January 2008, large users are required to purchase 100 percent of their electricity at market prices, which should remove the need for a budgetary transfer to MEPSO in 2008. In addition to this, we envisage a phased transition from the present single-buyer model to a competitive model based on bilateral contracts. ELEM, the power generation company, will be provided with a license to supply power directly to EVN-ESM under regulated contracts, to be used to satisfy the electricity needs of medium-sized and small users; any power generated by ELEM that exceeds the needs of these users may be sold at the open market. A gradual liberalization of the electricity market for medium sized and small users (including households) is envisaged to be completed by 2015.

- **Transparent budget support for the sector**. The 2007 budget included a transparent subsidy to compensate MEPSO for its operating losses (largely due to the difference between import and domestic prices), estimated at €20 million. Under the new market model, MEPSO will transmit power for a transmission fee, and will no longer engage in wholesale trade of electricity.

- We will support **reform of electricity tariffs and tariff methodology** to facilitate the introduction of the new market model, aiming to gradually phase out cross-subsidies between consumer groups, and establish prices at full cost recovery levels. We will develop a new tariff scheme with a block structure, and gradually increase tariffs for all users. We will continue to support the independence of the energy regulatory commission, and strengthen its capacity.

- We are developing a **social protection mechanism** to target electricity subsidies to the most needy consumers. The new program is expected to provide subsidies to around 70,000 households.

- We are also working on an energy efficiency program, aiming to reduce the use of electricity for heating purposes.

28. **We continue to make significant progress in reducing telecommunications costs and expanding Internet access**.

Progress in Telecom Liberalization

| | 2005q1 | 2005q2 | 2005q3 | 2005q4 | 2006q1 | 2006q2 | 2006q3 | 2006q4 | 2007q1 | 2007q2 | 2007q3 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Number of VOIP providers 1/ | ... | ... | ... | 20 | ... | ... | ... | 46 | 65 | 84 | 118 |
| Number of internet providers 1/ | ... | ... | ... | 12 | ... | ... | ... | 87 | 87 | 97 | 97 |
| Fixed telephone providers | ... | ... | ... | 1 | ... | ... | ... | 1 | 2 | 5 | 5 |
| Internet penetration 2/ | ... | ... | ... | ... | ... | ... | ... | 27 | 27 | 28.5 | 29 |
| Interconnection fees (local call origination) 3/ | ... | ... | ... | ... | ... | 1.43 | ... | ... | 0.54 | 0.54 | 0.54 |
| Fixed telephone tariff to US 4/ | 18.0 | ... | ... | ... | ... | 12.90 | ... | ... | 9.9 | 9.9 | 9.9 |
| Fixed telephone tariff to Germany 4/ | 27.0 | ... | ... | ... | ... | 16.90 | ... | ... | 9.9 | 9.9 | 9.9 |

1/ Number of notified providers at the end of the year.
2/ Number of internet users as a fraction of the total population.
3/ Denars per minute (Maktel).
4/ Denars per minute (Maktel).

- **A third mobile operator started providing services in September.**

- **We recently launched a tender for the allocation of one frequency for 3G cell phone services**.

- **We have had to delay the introduction of telephone number portability** until June 2008 to allow more time to select a commercial provider to organize and maintain the central database of ported numbers.

- **We are in the process of harmonizing the concession agreements** with Maktel, T-mobile and Cosmofon with the Electronic Communications Law, in cooperation with the European Commission.

- **As a result of these efforts we have strengthened liberalization and competition**: the number of providers has increased, including fixed line and mobile providers, and prices for consumers have fallen (meeting the June structural benchmark).

- **The program will continue to monitor quantitative measures of liberalization** in this sector every six months (structural benchmark).

29. **On the basis of our strong policy implementation and economic track record, we request completion of the Third Review, and a rephasing of access under the Arrangement.** We believe that the policies described in this letter (with program conditionality for 2008 summarized in Tables 3 and 4) will achieve the goals of our economic program: macroeconomic stability; sustained, high economic growth; increased employment, and better integration into the world economy. Nevertheless, we stand ready to take any further measures to keep our program on track. In light of the delayed completion of the review, we would like to rephase purchases under the Arrangement, such that there will be four reviews rather than five reviews. The fourth review will be completed on or after May 15, 2008 (Table 5). Data for end-December quantitative performance criteria will be

available before the Board discussion, and we expect that all of these will be observed. We will remain in close consultation with the Fund, in accordance with the Fund's policies, and provide the Fund with such information as it requests on policy implementation and achievement of program objectives. We reaffirm our intention not to make this and future purchases under the SBA that will become available upon observance of performance criteria and completion of reviews.

Sincerely,

/s/

Nikola Gruevski

Prime Minister

/s/

Zoran Stavreski

Deputy Prime Minister

/s/

Trajko Slaveski

Minister of Finance

/s/

Petar Gošev

Governor

National Bank of the Republic of Macedonia

Table 1. FYR Macedonia: Quantitative Performance Criteria and Indicative Targets for 2007
(Targets and Actual Outcomes)

| | Mar-07 | Jun-07 | Sep-07 | Dec-07 |
|---|---|---|---|---|
| | (In million euro) | | | |
| | End of Period Stocks for Program Evaluation | | | |
| **Floor for net international reserves of the NBRM** | 1,130 | 1,186 | 1,247 | 1,259 |
| Adjustor | -43 | -127 | -135 | ... |
| Revised target | 1,087 | 1,059 | 1,112 | ... |
| Actual | 1,224 | 1,267 | 1,366 | ... |
| **Ceiling on new nonconcessional medium- and long-term external debt contracted or guaranteed by the general government or the NBRM with original maturities of more than 1 year** | 38 | 64 | 89 | 103 |
| Actual | 0 | 0 | 53 | ... |
| **Ceiling on new non-concessional medium and long-term external debt contracted** | 25 | 33 | 52 | 60 |
| **by the public enterprises with original maturities of more than 1 year (indicative)** | 0 | 0 | 0 | ... |
| Actual | | | | |
| **Ceiling on short-term external debt of the central government or the NBRM with maturities of up to 1 year (stock); including guarantees for such debt** | 0 | 0 | 0 | 0 |
| Actual | 0 | 0 | 0 | ... |
| **Accumulation of external payments arrears** | 0 | 0 | 0 | 0 |
| Actual | 0 | 0 | 0 | ... |
| | (In billion denars) | | | |
| | Quarterly Stocks for Program Evaluation | | | |
| **Ceiling on net domestic assets of the NBRM** | -47.2 | -48.9 | -51.8 | -50.1 |
| Adjustor | 2.6 | 7.8 | 8.3 | ... |
| Revised target | -44.6 | -41.1 | -43.5 | ... |
| Actual | -53.3 | -54.0 | -59.5 | ... |
| **Ceiling on net domestic assets of the banking system (indicative)** | 35.5 | 42.4 | 45.9 | 55.6 |
| Adjustor | 2.6 | 7.8 | 8.3 | ... |
| Revised target | 38.1 | 50.2 | 54.2 | ... |
| Actual | 35.8 | 50.2 | 52.3 | ... |
| **Ceiling on net domestic credit to the central government from the NBRM** | -24.7 | -23.6 | -24.6 | -19.7 |
| Adjustor | 2.6 | 7.8 | 8.3 | ... |
| Revised target | -22.1 | -15.8 | -16.3 | ... |
| Actual | -23.5 | -17.3 | -22.2 | ... |
| **Ceiling on central government domestic arrears excluding suppliers (indicative)** | 0 | 0 | 0 | 0 |
| Actual | 0 | 0 | 0 | ... |
| **Ceilings on central government domestic arrears to suppliers (indicative)** | 0.6 | 0.6 | 0.6 | 0.6 |
| o/w non HIF domestic central government arrears | 0.4 | 0.4 | 0.4 | 0.4 |
| Actual | 0.3 | 0.4 | 0.3 | ... |
| o/w non HIF domestic central government arrears | 0.3 | 0.4 | 0.3 | ... |
| **Ceiling on arrears of the Health Insurance Fund (indicative)** | 0.2 | 0.2 | 0.2 | 0.2 |
| Actual | 0 | 0 | 0 | ... |
| | Cumulative Flows within the Year for Program Evaluation | | | |
| **Ceiling on central government wages (indicative)** | ... | ... | ... | 26.0 |
| Actual | ... | ... | ... | ... |
| **Floor for central government fiscal balance** | 0.3 | 0.5 | 0.8 | -3.4 |
| Adjustor | 0 | 0 | 0.4 | ... |
| Revised target | 0.3 | 0.5 | 1.2 | ... |
| Actual | 2.0 | 5.3 | 11.7 | ... |
| *Memo item: Program exchange rate* | 61.3 | 61.3 | 61.3 | 61.3 |

Sources: Data provided by the authorities; and IMF staff estimates.

Table 2. FYR Macedonia: Performance of Structural Conditionality in 2007

| Measure | Type 1/ | Status |
|---|---|---|
| **Tax policy and administration** | | |
| Public Revenue Office to identify performance measures for (i) registering additional taxpayers; (ii) improving taxpayer services; (iii) recovering tax arrears and delinquent tax returns; and (iv) auditing taxpayers; and set target levels of performance to be achieved by end-2007. (May 2007) | BM | Met. |
| Public Revenue Office to design a strategy for improving the administration of small- and medium-sized enterprises (June 2007). | BM | Met. |
| Implement the March 2007 legislation harmonizing social security bases (abolishing complexity factors and sectoral minimum wages in calculation of health fund premia) (July 2007). | PC | Met. |
| Prepare a strategy for the harmonization of the base of the personal income tax and social security contributions (September 2007). | BM | Met with delay, in January 2008 . |
| Submit legislation to parliament that vests the Pension and Disability Fund with the legal authority for collecting health and employment contributions (September 2007). | BM | Met. |
| Initiate phased implementation of the strategy for the harmonization of the base of the personal income tax and social security contributions (details to be specified at Third Review). | PC to be set at Third Review | Implementation will start in April 2008, with contributions for part-time workers based on actual earnings (PC), and in July 2008 with use of actual rather than contracted wages (PC). |
| **Fiscal transparency** | | |
| Implement legislation requiring state enterprises to submit quarterly reports on their financial position to the government, starting with data for second quarter of 2007 (October 2007). | BM | Met. |
| **Health sector** | | |
| Conclude international tendering for drug procurement (June 2007). | BM | Not met. Reset for April 2008. |
| **Financial sector** | | |
| Prepare a comprehensive framework for assessing banks' risk profile and test the performance of the prepared procedures on at least two banks (September 2007). | BM | Met. |
| Issue accounting guidelines, a new chart of accounts, and formats for bank's financial statements in line with IFRS (September 2007). | BM | Met. |
| Finalize detailed guidance manual for conducting on-site supervision (December 2007). | BM | Met. |
| Create a new credit registry and make it fully operational (December 2007). | BM | Reset to August 2008 in light of TA delays. |
| **Business climate** | | |
| Publish a list of all licenses administered by line ministries and social agencies, together with their justification (June 2007). | BM | Met. |
| Abolish licenses that are no longer needed (September 2007). | BM | Delayed. Changes in by-laws are expected to be completed by end-February 2008, and amendments in laws will be submitted to Parliament by end-February 2008. |
| **Energy sector** | | |
| Develop an action plan, working with the World Bank, to improve energy sector finances (May 2007). | BM | Partially met with delay, in January 2008. The plan improves government finances, but at the expense of large users and the privatized distribution company. |
| **Telecoms liberalization** | | |
| Liberalize the telecommunications sector (to be measured, inter alia, by the number of new service providers, new fixed line competition, and additional mobile telephone licenses) (June and December 2007). | BM | Met. |

1/ PC=structural performance criterion; BM=structural benchmark.

Table 3. FYR Macedonia: Quantitative Performance Criteria and Indicative Targets for 2008

| | Mar-08 | Jun-08 | Sep-08 Proj. | Dec-08 Proj. |
|---|---|---|---|---|
| | (In million euro) | | | |
| | End of Period Stocks for Program Evaluation | | | |
| **Floor for net international reserves of the NBRM** | 1,359 | 1,439 | 1,527 | 1,567 |
| Adjustor | ... | ... | ... | ... |
| Revised target | ... | ... | ... | ... |
| Actual | ... | ... | ... | ... |
| | Cumulative Changes for Program Evaluation | | | |
| **Ceiling on new nonconcessional medium- and long-term external debt contracted or guaranteed by the general government or the NBRM with original maturities of more than 1 year** | 108 | 168 | 214 | 290 |
| Actual | ... | ... | ... | ... |
| **Ceiling on new non-concessional medium and long-term external debt contracted by the public enterprises with original maturities of more than 1 year (indicative)** | 0 | 15 | 15 | 53 |
| Actual | ... | ... | ... | ... |
| **Ceiling on short-term external debt of the central government or the NBRM with maturities of up to 1 year (stock); including guarantees for such debt** | 0 | 0 | 0 | 0 |
| Actual | ... | ... | ... | ... |
| **Accumulation of external payments arrears** | 0 | 0 | 0 | 0 |
| Actual | ... | ... | ... | ... |
| | (In billion denars) | | | |
| | Quarterly Stocks for Program Evaluation | | | |
| **Ceiling on net domestic assets of the NBRM** | -54.8 | -57.5 | -61.3 | -60.9 |
| Adjustor | ... | ... | ... | ... |
| Revised target | ... | ... | ... | ... |
| Actual | ... | ... | ... | ... |
| **Ceiling on net domestic assets of the banking system (indicative)** | 77.6 | 89.5 | 95.5 | 111.1 |
| Adjustor | ... | ... | ... | ... |
| Revised target | ... | ... | ... | ... |
| Actual | ... | ... | ... | ... |
| **Ceiling on net domestic credit to the central government from the NBRM** | -10.9 | -9.0 | -10.2 | -6.8 |
| Adjustor | ... | ... | ... | ... |
| Revised target | ... | ... | ... | ... |
| Actual | ... | ... | ... | ... |
| **Ceiling on central government domestic arrears excluding suppliers (indicative)** | 0 | 0 | 0 | 0 |
| Actual | ... | ... | ... | ... |
| **Ceilings on central government domestic arrears to suppliers (indicative)** | 0.6 | 0.6 | 0.6 | 0.6 |
| o/w non HIF domestic central government arrears | 0.4 | 0.4 | 0.4 | 0.4 |
| Actual | ... | ... | ... | ... |
| o/w non HIF domestic central government arrears | ... | ... | ... | ... |
| **Ceiling on arrears of the Health Insurance Fund (indicative)** | 0.2 | 0.2 | 0.2 | 0.2 |
| Actual | ... | ... | ... | ... |
| | Cumulative Flows within the Year for Program Evaluation | | | |
| **Ceiling on central government wages (indicative)** | ... | 15.8 | ... | 31.6 |
| Actual | ... | ... | ... | ... |
| **Floor for central government fiscal balance** | -0.7 | -1.4 | -2.8 | -5.5 |
| Adjustor | ... | ... | ... | ... |
| Revised target | ... | ... | ... | ... |
| Actual | ... | ... | ... | ... |
| *Memo item: Program exchange rate* | 61.3 | 61.3 | 61.3 | 61.3 |

Sources: Data provided by the authorities; and IMF staff estimates.

Table 4. FYR Macedonia: 2008 Structural Conditionality

| Measure | Type 1/ | Date |
| --- | --- | --- |
| **Tax policy and administration** | | |
| Integration of Social Fund Collections. Pension and Disability Fund and its network of field offices will execute collection programs for all social insurance contributions and their contributors. | PC | April 2008 |
| Health Fund contributions for part-time workers to be paid on actual hours worked, rather than assuming a full-time work week. | PC | April 2008 |
| Pension and Disability Fund and Employment Fund contributions calculated on the basis of actual, rather than contracted, wages. | PC | July 2008 |
| **Health sector** | | |
| Conclude international tendering for drug procurement. | BM | April 2008 |
| **Financial sector** | | |
| Submit to parliament a new Central Bank law, as described in paragraph 21 of the Letter of Intent. | PC | March 2008 |
| NBRM to publish documents on the supervisory framework and the risk assessment process under risk-based banking supervision. | BM | March 2008 |
| NBRM to approve the new credit registry's detailed content specifications and protocols for submitting and retrieving data. | BM | March 2008 |
| **Business climate** | | |
| Extend the coverage of the Real Estate cadastre to 75 percent of Macedonian territory | BM | June 2008 |

1/ PC=structural performance criterion; BM=structural benchmark.

Table 5. FYR Macedonia: Proposed Schedule of Performance Criteria and Purchases, 2007–08 1/

| | Schedule set at 2nd Review | | | | Proposed Schedule | | | |
|---|---|---|---|---|---|---|---|---|
| | Performance Criteria | Purchase (SDR millions) | In percent of quota | Scheduled Purchase 2/ | Performance Criteria | Purchase (SDR millions) | In percent of quota | Scheduled Purchase 2/ |
| Approved purchases | … | 17.36250 | 25.20 | … | … | 27.65625 | 40.14 | … |
| Actual | … | 10.50000 | 15.24 | … | … | 10.50000 | 15.24 | … |
| Treated as precautionary 3/ | … | 6.86250 | 9.96 | … | … | 17.15625 | 24.90 | … |
| Reviews | | | | | | | | |
| 2nd Review | December 31, 2006 | 10.29375 | 14.94 | Approval of 2nd Review | … | … | … | … |
| 3rd Review | June 30, 2007 | 4.80375 | 6.97 | August 15, 2007 | September 30, 2007 | 9.60750 3/ | 13.94 | Approval of 3rd Review |
| --- | September 30, 2007 | 4.80375 | 6.97 | November 15, 2007 | | | | |
| 4th Review | December 31, 2007 | 4.80375 | 6.97 | February 15, 2008 | March 31, 2008 | 7.20563 4/ | 10.46 | May 15, 2008 |
| --- | March 31, 2008 | 4.80375 | 6.97 | May 15, 2008 | June 30, 2008 | 7.20563 4/ | 10.46 | August 15, 2008 |
| 5th Review | June 30, 2008 | 4.80375 | 6.97 | August 15, 2008 | … | … | … | … |
| Total purchases | … | 51.67500 | 75.00 | … | … | 51.67500 | 75.00 | … |

1/ The authorities have made one purchase under this arrangement totaling 15.24 percent of quota, and are treating remaining available purchases in a precautionary manner.
2/ Earliest possible date at which a purchase could be made available.
3/ Including purchases originally scheduled to be made available in August (end-June test date) and November (end-September test date) 2007.
4/ Includes rephased amounts that were originally scheduled to be made available in February 2008 (based on end-December 2007 test date and completion of the 4th Review).

## TECHNICAL MEMORANDUM OF UNDERSTANDING

This Technical Memorandum of Understanding (TMU) defines the variables subject to quantitative targets (performance criteria and indicative targets) established in the Memorandum of Economic and Financial Policies (MEFP), and describes the methods to be used in assessing program performance with respect to these targets.

### DEFINITIONS

1. For the purpose of this TMU, the term "central government" covers: central government as defined in the Annual Budget Document, including Special Revenue Accounts, Employment Fund, Health Insurance Fund, Pension Insurance Fund, Road Fund, and agencies and institutions that are currently treated by the Ministry of Finance as part of government, and which correspond to the classification followed by the National Bank of the Republic of Macedonia (NBRM) in its monthly submissions to the Fund of balance sheets of the central bank and the consolidated accounts of the commercial banks. The authorities will inform the Fund staff of any new funds, or other special budgetary and extra-budgetary programs that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's *Manual on Government Finance Statistics 2001*, and will ensure that these will be incorporated within the definition of central government.

2. The term "general government" covers the central government as defined above and the municipalities which are classified as part of general government according to the budget documents and which are included by the NBRM in its monthly submissions to the Fund of balance sheets of the central bank and the consolidated accounts of the commercial banks.

3. The term "public enterprises" refers to institutional units that are established and controlled by the Government and the Parliament of the Republic of Macedonia and that perform market activities.

### NET INTERNATIONAL RESERVES OF THE NBRM

| | Floor on level of NIR (in million euros) |
|---|---|
| March 31, 2008 (performance criterion) | 1359 |
| June 30, 2008 (performance criterion) | 1439 |

4. **Net international reserves** (NIR) of the NBRM are defined as the difference between the NBRM's reserve assets and its reserve liabilities.

5. **Reserve assets** are defined as liquid and usable foreign convertible currency claims on nonresidents plus monetary gold. Reserve assets of the NBRM thus include monetary gold, SDRs, foreign currency cash, securities (including accrued interest), deposits abroad, and the reserve position at the Fund. Excluded from reserve assets are any assets that are

frozen, pledged, used as collateral, or otherwise encumbered, claims in foreign exchange arising from transactions in derivative assets (futures, forwards, swaps, and options), and precious metals other than gold. On September 30, 2007, reserve assets thus defined amounted to 1,489 million euro.

6. **Reserve liabilities** are defined as all foreign exchange liabilities of the NBRM to nonresidents and residents, including all credit outstanding from the Fund, arrears on principal or interest payments to commercial banks, suppliers, or official export credit agencies, and future and contingent commitments to sell foreign exchange arising from transactions in derivative assets (futures, forwards, swaps, and options). Central government's foreign exchange deposits at the NBRM are excluded from reserve liabilities. On September 30, 2007, reserve liabilities thus defined amounted to 119 million euro.

**Adjustors**

7. The NIR floors of the NBRM will be adjusted:

- upward for any privatization proceeds in foreign currency;
- downward for any prepayment of external debt.

**NET DOMESTIC ASSETS OF THE NBRM**

| | Ceiling on level of NDA (in billion denars) |
|---|---|
| March 31, 2008 (performance criterion) | -54.8 |
| June 30, 2008 (performance criterion) | -57.5 |

8. **Net domestic assets** (NDA) of the NBRM are defined as reserve money minus the net foreign assets (NFA) of the NBRM. On September 30, 2007, NDA of the NBRM was minus 59.7 billion denars.

9. **Reserve money** is defined as currency in circulation (outside banks), vault cash of banks, and required and excess reserve deposits of banks in denars and in foreign currency held at the NBRM or at the NBRM accounts abroad. On September 30, 2007, reserve money was 32.5 billion denars.

10. **Net foreign assets** (NFA) of the NBRM are defined as reserve assets plus those foreign assets of the NBRM that are excluded from reserve assets defined in this TMU, minus foreign exchange liabilities of the NBRM to nonresidents. On September 30, 2007, NFA of the NBRM was 92.3 billion denars.

**Adjustors**

11. The NDA ceilings will be adjusted:

- downward for any privatization proceeds in foreign currency;
- upward by the amount of any prepayment of external debt.

### NET DOMESTIC ASSETS OF THE BANKING SYSTEM

| | Ceiling on level of NDA (in billion denars) |
|---|---|
| March 31, 2008 (indicative target) | 77.6 |
| June 30, 2008 (indicative target) | 89.5 |

12. **Net domestic assets** (NDA) of the banking system, which includes the NBRM and the deposit money banks, are defined as broad money (M3) minus the net foreign assets (NFA) of the banking system. On September 30, 2007, NDA of the banking system was 52.1 billion denars.

13. **Broad money** (M3) includes currency in circulation, demand deposits, quasi-deposits, and non-monetary deposits (time deposits over 12 months and restricted deposits) of the non-central government denominated in denars and in foreign currency. On September 30, 2007, broad money was 161.8 billion denars.

14. **NFA of the banking system** are defined as the banking system's foreign assets minus foreign liabilities. On September 30, 2007, NFA of the banking system was 109.7 billion denars.

**Adjustors**

15. The ceilings on the NDA of the banking system will be subject to the same adjustors as the ceilings on the NDA of the NBRM.

### NET CREDIT TO THE CENTRAL GOVERNMENT FROM THE NBRM

| | Ceiling on level of net credit to central government from NBRM (in billion denars) |
|---|---|
| March 31, 2008 (performance criterion) | -10.9 |
| June 30, 2008 (performance criterion) | -9.0 |

16. **Net credit to the central government** from the NBRM is defined as claims in denars and foreign currency on the central government from the NBRM minus total central government deposits in denars and foreign currency with the NBRM. For the purpose of this program, accounts of the central government include all accounts recorded as central government accounts in the monetary statistics reported by the NBRM in accordance with the above definition of central government. Excluded from this definition are any T-bills issued for monetary policy purposes and corresponding government deposits at the NBRM. On September 30, 2007, net credit to central government from the NBRM was 22.2 billion denars.

**Adjustors**

17. The ceilings on net credit to the central government from the NBRM will be subject to the same adjustors as the ceilings for the NDA of the NBRM.

**GOVERNMENT FISCAL BALANCES**

| | Floors on cumulative changes in central government fiscal balances (in billion denars) |
|---|---|
| March 31, 2008 (performance criterion) | -0.7 |
| June 30, 2008 (performance criterion) | -1.4 |

18. Quarterly floors for the cumulative changes in central government fiscal balances will be determined and monitored from the financing side relative to end-December 2007. The financing flows will be measured as the sum of domestic financing, foreign financing, and privatization proceeds.

19. **Domestic financing** for the central government includes net credit to the central government from the NBRM as defined above, change of the central government accounts in the commercial banks, change in stock of domestic securities issued by the central government, and net variation in domestic arrears (as defined below).

20. **Foreign financing** for the central government includes disbursements of external loans received by the central government, including disbursements received for foreign financed projects of budget users and extra-budgetary funds, and restitution of foreign assets of the former SFRY as a result of succession proceedings minus amortization due or pre-paid, and rescheduled debt service payments programmed to be paid out.

21. **Privatization proceeds** for the central government include privatization proceeds and lump sum proceeds from concession fees in denars and foreign currency.

**Adjustors**

22. The floor on the central government fiscal balances will be adjusted upwards by any dividend receipts in 2008 from the Makedonski Telekomunikacii exceeding 2.6 billion denars.

### CENTRAL GOVERNMENT WAGE BILL

23. The ceiling on the **central government wage bill** includes central government wages and salaries, including allowances, as well as transfers to local governments to cover wages in education, child care, and elderly care.

24. A semi annual ceiling of 15.8 billion denars (indicative target) has been established for the wage bill to be measured at end-June 2008.[1]

### MEDIUM- AND LONG-TERM DEBT

| | Ceiling on new non-concessional medium- and long-term external debt contracted or guaranteed by the general government or the NBRM (in million euros, cumulative from end-2007) |
|---|---|
| March 31, 2008 (performance criterion) | 108 |
| June 30, 2008 (performance criterion) | 168 |

25. The limit on **medium and long-term debt** applies to the contracting or guaranteeing by any branch of the general government and the NBRM of new non-concessional external debt with an original maturity of more than one year. The performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 by the Executive Board of the IMF,[2] but also to commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are changes in indebtedness resulting from refinancing credits and rescheduling operations (including the deferral of interest on commercial debt), credits extended by the IMF and the BIS, and credits on concessional terms, defined as those with a grant element of 35 percent or more calculated using the OECD Commercial Interest Reference Rates (CIRRs) applicable for the program period.

[1] Under the program, the authorities are committed to holding the yearly ratio of the central government wage bill to tax revenues (excluding social security contributions) at the level of the 2005 supplementary budget.

[2] *Decision No. 6230-(79/140) August 3, 1979, as amended by Decision Nos. 11096-(95/100), October 25, 1995, and 12274-(00/85), August 24, 2000.* Under the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 by the Executive Board of the IMF the definition of "debt" has been broadened with respect to the conventional definition to include, among other things, such instruments as financial leases.

26. Specifically, the discount rates for debts with maturities less than 15 years will be based on the average CIRR of the previous 6 months, and for debts with maturities of 15 years and more the average CIRR of the previous 10 years. Debt falling within the limit shall be valued in euro at the exchange rate prevailing at the time the contract or guarantee becomes effective.

| | Ceiling on new non-concessional medium- and long-term external debt contracted by the public enterprises (in million euros, cumulative from end-2007) |
|---|---|
| March 31, 2008 (indicative target) | 0 |
| June 30, 2008 (indicative target) | 15 |

27. A separate limit is established on contracting by the public enterprises of new non-concessional external debt with an original maturity of more than one year. Thirty three public enterprises will be covered under this performance criterion, including: PE Sluzben Vesnik (official gazette), PE Makedonski Zheleznici (railways), Mlekara DOO (trading in dairy products), 11 Octomvri-Eurocompozit AD (production of electrical insulation and materials), PE Agro-Berza (agricultural commodity exchange), Soncogledi (production, trade and services), PE za Stopanisuvanje so Stanben i Deloven Prostor (public housing activities), Veles DOOEL (production of rail vehicles), Remont na Prugi i Niskogradba DOOEL (maintenance of rail tracks and civil engineering), PE Makedonska Radiodifusija (broadcasting), Makedonska Banka za Podrska na Razvojot (Macedonian Bank for Support of Development), PE za Stopanisuvanje so Pasista (pastures management), PE za Stopanisuvanje za Objekti za Sport (management of sport facilities), PE Zletovica (water supply activities), PE Studencica (water supply), PE Lisice (water supply activities), Makedonska Informativna Agencija (information agency), PE Dojransko Ezero (water management), PE Gevgelisko Valandovsko Pole (water supply), PE Jasen (management of pastures), Makedonska Posta (postal services), MEPSO (electricity transmission), PE Makedonski Sumi (forestry), PE Srezevo (irrigation), ELEM (electricity generation), TEC Negotino (electricity generation), Boris Trajkovski DOOEL (construction, management, and leasing of a concert/athletic hall), GA-MA (transportation and distribution of natural gas), Toplik 2001 DOOEL (multi-purpose hall), Arest DOOEL (production, trade and services), PE Makedonija Pat (road maintenance), Drzaven Studentski Centar Skopje (student housing), PE Makedonska Radio-Televizija (radio and television broadcasting). When there is a change of control of any of the listed enterprises due to privatization, the stock of debt contracted or guaranteed by such enterprises as defined under this performance criterion will be limited to the level reached on the day the control is transferred.

### SHORT-TERM EXTERNAL DEBT

28. The limit on **short-term external debt** applies to the outstanding stock of short-term debt contracted or guaranteed by central government and the NBRM with an original maturity of up to and including one year. The term “debt” has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 by the Executive Board of the IMF. Excluded from this performance criterion are changes in indebtedness resulting from rescheduling operations (including the deferral of interest on commercial debt), and normal import-related credits. Debt falling within the limit shall be valued in euro at the program exchange rates. Under the program, non-accumulation of short-term debt as defined above is a continuous performance criterion. On September 30, 2007, short-term external debt as defined above was zero euros.

### EXTERNAL PAYMENTS ARREARS

29. **External payments arrears** consist of the total past-due amounts of debt service obligations (interest and principal) on government, government-guaranteed, and NBRM external debt, excluding arrears on external debt service obligations pending the conclusion of debt rescheduling agreements.[3] Under the program, the non accumulation of external payments arrears is a continuous performance criterion. On September 30, 2007, the stock of external payment arrears as defined above was zero euros.

### DOMESTIC PAYMENTS ARREARS

30. **Central government domestic arrears**, excluding those to suppliers, are defined to include all payment delays to: (i) banks for bond payments (including for the repayment of frozen foreign currency deposits); (ii) individuals for Social Assistance Program payments; (iii) central government employees including for wages and salaries, and food and travel allowances; (iv) benefit recipients of the Child Care Program; and (v) local governments. The definition excludes the customary lag in paying wages, social assistance and child allowance payments, and transfers to the Funds (in the following month after they accrue). Under the program, non-accumulation of central government arrears, excluding those to suppliers, as defined above will be an indicative target. On September 30, 2007, central government domestic arrears as defined in this paragraph were zero denars.

31. Central government domestic arrears to suppliers are defined as obligations to suppliers which are due but not paid by more than 60 days and are non-disputed. Under the program, the outstanding stock of domestic arrears, as defined above, will not exceed 0.6 billion denars. On September 30, 2007 the amount of central government domestic arrears to suppliers as defined in this paragraph was 0.3 billion denars.

32. A separate sub-ceiling is set for Health Insurance Fund arrears to suppliers, defined as obligations to suppliers which are due but not paid by more than 60 days and are not

[3] Amounts are only considered past-due after the contractual grace period expires.

disputed. Under the program the aggregate outstanding stock of arrears will not exceed 0.2 billion denars. On September 30, 2007, the Health Insurance Fund arrears as defined in this paragraph were zero denars.

### VALUATION

33. For program purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at program exchange rates, with the exception of the government fiscal balances, which will be measured at current exchange rates. For 2008, the program exchange rates are those that prevailed on December 31, 2004. In particular, EUR1 = 61.3100 denars, US$1= 45.0676 denars; SDR1= 69.9903 denars, and EUR1=1.3604 U.S. dollars. Gold is valued at the price fixed in the London market at end-December 2004 (US$ 438.00 per ounce).

34. The exchange rate effects on the foreign currency denominated assets and liabilities of commercial banks will be estimated on the basis of their currency composition, as provided by the NBRM banking supervision department.

35. For program monitoring, the NBRM estimates the valuation effects on the NIR of the NBRM as follows. On a daily basis all foreign currency denominated balances are converted into Euros using the middle rates from the NBRM official exchange rate list for the same day. These balances are compared to the balances in Euros at the end of the previous day calculated in the same way (i.e., using the middle rates from the NBRM official exchange rate list for that day). The change in the daily Euro denominated balances, so calculated, is compared to the recorded daily transaction flows converted in Euros using the same methodology. Any difference between the two values is attributed to valuation effects. Valuation effects on accrued interest will be calculated as of end-September 2007.

### MONITORING AND REPORTING REQUIREMENTS

36. Performance under the program will be monitored from data supplied to the Fund by the NBRM, the Ministry of Finance, and the SSO as outlined in Table 1. The authorities will transmit promptly to the Fund staff any data revisions. In addition, data on performance at the program test dates will be submitted with a cover letter signed by authorized officials.

## Table 1. FYR Macedonia: Data to be Reported to the IMF

| Item | Periodicity |
|---|---|
| **To be provided by the MOF** | |
| Consolidated central government operations | Monthly, within four weeks of the end of each month |
| Privatization receipts received by the budget (in denars and foreign exchange, and payments in governments bonds) | Monthly, within four weeks of the end of each month |
| Data on workers registered as unemployed with the employment fund. | Monthly, within three weeks of the end of each month |
| Information on new debt and guarantees given on new debt, contracted by the government agencies and public enterprises. | Quarterly, within four weeks of the end of each quarter |
| Data on central government arrears, including to suppliers | Monthly, within four weeks of the end of each month |
| Data on the Health Insurance Fund arrears | Monthly, within four weeks of the end of each month |
| Data on operations of all municipalities | Quarterly, within four weeks of the end of each quarter |
| Data on operations of four largest public enterprises | Quarterly, within eight weeks of the end of each quarter |
| **To be provided by the NBRM** | |
| Balance sheet of the NBRM | Weekly, within one week of the end of each week<br>Monthly, within three weeks of the end of each month |
| Consolidated accounts of the commercial banks | Monthly, within three weeks of the end of each month |
| Monetary survey | Monthly, within three weeks of the end of each month |
| Data on components of the NIR of the NBRM | Weekly, within one week of the end of each week |
| Data on foreign exchange cash flow of the NBRM | Weekly, within one week of the end of each week |
| Foreign exchange market data (exchange rates, volume of trades, and interventions) | Weekly, within one week of the end of each week |
| Current and capita account data | Monthly, within eleven weeks of the end of each month |
| Commercial banks' balance sheets (bank-by-bank) | Monthly, within three weeks of the end of each month |
| Commercial banks' income statements (bank-by bank) | Monthly, within three weeks of the end of each month |
| Data on each bank's liquid position (bank-by bank) including breakdown by currency and maturity | Monthly, within three weeks of the end of each month |

## Table 1. FYR Macedonia: Data to be Reported to the IMF (continued)

| Item | Periodicity |
|---|---|
| Data on lending by domestic money banks (new and rolled-over loans) according to credit rating of borrowers | Monthly, within four weeks of the end of each month |
| Data on off-balance sheet activity of domestic money banks | Monthly, within four weeks of the end of each month |
| Detailed data on each bank's assets and liabilities, including breakdown by currency (domestic, foreign, indexed) and maturity | Monthly, within three weeks of the end of each month |
| Data on commercial banks' deposit and lending rates and underlying stocks | Monthly, within four weeks of the end of each month |
| Financial soundness indicators | Quarterly, within 50 days of the end of the period ending in March and September, within 70 days of the end of the period ending in June and within 100 days for the period ending in December. |
| Commercial banks' balance sheets (bank-by-bank) | Same as above. |
| Commercial banks' income statements (bank-by bank) | Same as above. |
| Data on structure of each bank's loans by sector (corporate vs. households) and by currency (domestic, foreign, indexed) | Same as above. |
| Data on each bank's compliance with prudential regulations | Same as above. |
| **To be provided by the SSO** | |
| Overall consumer price index | Monthly, within two weeks of the end of each month |
| Overall producer price index | Monthly, within two weeks of the end of each month |
| Data on industrial production | Monthly, within two weeks of the end of each month |
| Data on wages | Monthly, within two weeks of the end of each month |
| National accounts by sector of production (nominal and real terms) | Quarterly, within eight weeks of the end of each month |
| **To be provided jointly by the NBRM and MOF** | |
| Data on domestic and foreign borrowing including gross and net debt stock, disbursements, amortization, interest payments by debtors and stock of external payment arrears (including central government, agencies and public enterprises) | Quarterly, within four weeks of the end of each quarter |