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Former Yugoslav Republic of Macedonia: Recent Economic Developments

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FORMER YUGOSLAV REPUBLIC OF MACEDONIA

Recent Economic Developments

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Approved by the European I Department

April 25, 2000

Contents | Page

I. Introduction 5

II. Real Sector Developments 7
- A. Demand and Supply 7
- B. Prices 10
- C. Labor Market 10
- D. Wages 12

III. Monetary Developments 14
- A. Recent Developments 14
- B. Instruments of Monetary Policy 15

IV. Banking System Soundness and Recent Lessons 18
- A. Introduction 18
- B Market Structure 18
- C. Banking System Operations and Recent Developments 20
- D. Banking System Soundness and Vulnerability 26
- E. Macroeconomic Effects of Banking System Fragility 36
- F. Banking Supervision and the Legal Environment 39
- G. Dealing with Unsound Banks 41
- Attachment I: Banking Definitions 44
- Attachment II: Measuring the Systemic Risk of Interbank Exposures 47

V. Enterprise Sector Transformation and Financial Performance 48
- A. Transformation of Socially Owned and State Enterprises 48
- B. Financial Performance of the Enterprise Sector 49
- C. The Macedonian Stock Exchange (MSE) 52

VI. Fiscal Policy and Developments 54
- A. Overview 54
- B. Fiscal Policy Developments in 1998 54

C. The 1999 Budget and Developments 56
D. The 2000 Budget 57
E. The Structure of Public Expenditure and Revenues 58
F. The Extrabudgetary Funds 59
G. Structural Fiscal Issues 61
H. Special Revenue Accounts 63
I. Total Government Debt 64

VII. External Sector Developments 65
A. Current and Capital Accounts Developments 65
B. External Debt and Reserve Adequacy 73
C. Exchange and Trade Regime 74

Annex I: Unemployment in FYR Macedonia 77
Annex II: Pricing of Oil Derivatives 84
Annex III: Did Privatization Increase Profitability in FYRM? 87
Annex IV: Tax Summary as of April 1, 2000 98

Text Boxes

1. Frozen Foreign Currency Deposits 21
2. Deposit Insurance Fund 22
3. Development Bank 26
4. Assessment of Interbank Exposures 35
5. External Competitiveness 67
6. Real Effective Exchange Rate Indices 68

Figures

1. Economic Activity Indicators and Inflation 8
2. Employment and Wages 13
3. Commercial Bank Liquidity and Foreign Exchange Composition of Foreign Exchange Reserves 32
4. Interest Rates 37
5. Foreign Exchange Market 40
6. Illiquid Enterprises 51
7. General Government Operations, 1996–2000 55
8. Balance of Payments Developments, 1998–99 66
9. External Trade Developments, 1995–99 69

Text Tables

1. Basic Economic Indicators, 1996–99 4
2. Selected Real Sector Indicators, 1992–99 11
3. Summary Balance Sheet of Banks 19
4. Banking System Liabilities 23
5. Banking System Assets 25
6. Banking System Income Statement and Profitability 27
7. Credit Exposure 28

8. Banking System Soundness....29
9. Credit and Off-Balance-Sheet Activity....34
10. External Assistance Pledged at the May 1999 Consultative Group Meeting....72
11. Debt and Reserve Indicators....74
12. Selected Labor Force Indicators, 1996–99....79
13. Structure of Unemployment, 1996–99....83
14. Pricing of Oil Derivatives, 1999–2000....86
15. Levels Estimator and Selection Bias....91
16. Net Profits by Sector, 1995–97....93
17. Difference Estimator....95

Statistical Appendix

18. Gross Domestic Product at Current and Constant Prices by Economic Activity, 1995–99....104
19. Gross Domestic Product by Aggregate Demand Components, at Current and Constant Market Prices, 1995–99....105
20. Price Indices, 1995–99....106
21. Employment, According to Administrative Sources and the Labor Force Survey, 1996–98....107
22. Nominal and Real Net Average Wages by Sector, 1995–99....108
23. Monetary Survey, 1995–99....109
24. National Bank Accounts, 1995–99....110
25. Deposit Money Bank Accounts, 1995–99....111
26. Interest Rates, 1995–99....112
27. Privatization by Model of Transformation, 1995–99....113
28. Main Indicators of Enterprise Sector Activity by Type of Ownership, 1996–98 114
29. Summary of Central Government Operations, 1996–2000....115
30. Summary of General Government Operations, 1996–2000....116
31. Summary of Special Fund Operations, 1996–2000....117
32. Special Revenue Accounts and Expenditure Financed from Special Revenue Accounts, 1998–99....118
33. Expenditure Financed from Special Revenue Accounts by Agency and Economic Category, 1998–99....119
34. Outstanding Domestic Debt of the Central Government by Type of Debtor, 1996–99....120
35. Balance of Payments, 1995–99....121
36. Commodity Composition of Exports and Imports, 1995–Nov. 99....122
37. Destination of Merchandise Exports, 1995–Nov. 99....123
38. Origin of Merchandise Imports, 1995–Nov. 99....124
39. Exports and Imports by Final Use, 1995–Nov. 99....125
40. Services Account, 1995–99....126
41. External Debt Disbursements, 1995–99....127
42. External Debt-Service Obligations, 1995–99....128
43. External Debt Stock, 1995–99....129
44. Official Gold and Convertible Foreign Exchange, 1995–99....130
45. Exchange Rate Developments, 1995–99....131

Table 1. FYRM: Basic Economic Indicators, 1996–99

	1996	1997	1998	1999 Prel.
Real economy	(Percent change)			
Real GDP	1.2	1.4	2.9	2.7
Consumer prices, period average	2.3	2.6	-0.1	-0.7
Real wages, period average	0.5	0.2	3.8	3.6
Unemployment rate (average) 1/	31.9	36.0	34.5	32.4
Government finances 2/	(In percent of GDP)			
General government balance (accrual)	-0.5	-0.4	-1.8	0.0
Central government balance (accrual)	-0.7	-1.2	-0.9	0.9
Government debt 3/	41.5	48.1	45.7	53.2
Money and credit	(Percent change, end of period)			
Broad money M3 4/	0.3	15.8	14.9	29.7
Total credit to private sector	19.0	18.9	10.4	9.4
Short-term lending rate	23.2	21.6	20.5	20.0
Credit auction rate 5/	11.0	15.2	18.5	14.7
Balance of payments				
Trade balance (percent of GDP)	-7.2	-10.4	-12.0	-11.9
Current account balance (percent of GDP)	-6.5	-7.4	-8.8	-4.0
Official gross reserves (US$ million; end of period)	267	280	334	458
Reserve cover (in months of c.i.f. imports)	2.0	1.9	2.1	3.1
External debt-service ratio 6/	11.1	8.7	10.1	13.0
External debt-to-GDP ratio (in percent) 7/	25.4	31.5	41.1	43.3
Exchange rates 8/	(Percent change, period average)			
Nominal effective exchange rate	12.4	24.2	-3.6	5.7
Real effective exchange rate (CPI-based)	-2.6	-13.1	-11.0	-1.2
Geographic, demographic, and social indicators				
Land area (in km2)	25,430	25,430	25,430	25,430
Population (in thousands)	1,983	1,997	2,009	2,022
Per capita GDP (in $; at market rates)	2,225	1,852	1,740	1,698
Population density (people per sq km)	78.0	78.5	79.0	79.5
Population growth (in percent)	0.9	0.7	0.6	0.6
Life expectancy at birth (years)				
Male	68.6			
Female	72.9			
Crude birth rate		15.9		
Infant mortality rate (per 1,000 live births)		17.2		
Crude death rate (per 1,000 people)		7.9		
Health care				
Physicians (per thousand persons)	2.3			
Hospital beds (per thousand persons)	5.2			
Net enrollment ratios				
Primary	95.3			
Secondary	51.4			

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

1/ Persons seeking employment as percent of total labor force, based on official Labor Force Survey.
2/ Excludes revenue and expenditure of the special revenue and expenditure accounts of line ministries.
3/ Total debt of central government and external debt of general government; includes liabilities assumed by the government upon the sale or closure of loss-making enterprises and associated with the cleaning up of Stopanska Banka's balance sheet prior to its sale.
4/ Includes foreign currency deposits.
5/ Data for 1999 is for October.
6/ Debt service due, including IMF, as a percentage of exports of goods and services.
7/ Including IMF.
8/ Partner countries exclude FR Yugoslavia. The effective exchange rate calculations are based on the chain index method, where the partner country weights are not fixed.

I. Introduction

1. After a generally favorable performance in 1998, the FYRM economy suffered a setback in the first half of 1999, mainly owing to the Kosovo crisis. The impact of the crisis, however, was less severe than initially feared. With the ending of the conflict in early June, economic activity picked up markedly and the balance of payments improved beyond expectations. The stance of financial policies was generally prudent in 1999, and inflation remained low. Structural reform initiatives resumed in the second half of 1999, but the follow-through was weak because of the uncertain political climate.

2. A broad-based pickup in economic activity in the wake of the Kosovo crisis was key to an estimated GDP growth of 2.7 percent in 1999. Unlike the experience of the previous years, an improvement in net foreign demand was a major driving force behind the growth performance. Domestic demand was sluggish, mainly owing to erosion of investor confidence. Consumer prices declined in the course of the first seven months of the year, largely because of lower food prices. Thereafter, inflation turned positive with the firming of food prices and higher oil prices. Unemployment fell slightly, but the rate remained high at 32½ percent.

3. The balance of payments position improved in 1999, and indicators of external vulnerability remained satisfactory. The current account deficit (excluding grants) narrowed sharply to 6 percent of GDP (from 9½ percent in 1998), as both exports and imports declined for the year as a whole. After a severe trade disruption during the Kosovo crisis, exports and imports picked up strongly with the ending of the conflict. Service receipts also surged in the second half of the year, with FYRM serving as a key transit route for travel and delivery of goods to Kosovo. The capital account surplus contracted as the foreign direct investment inflows experienced in 1998 were not sustained. With a sizable amount of unrecorded inward transactions, many of them Kosovo-related, gross official reserves increased by about US$125 million, to the equivalent of 2.7 months of next year's imports at end-1999.

4. The National Bank of Macedonia (NBM) faced contrasting challenges in the conduct of monetary policy during and immediately after the Kosovo crisis. With the onset of the crisis, the NBM provided liquidity support to banks experiencing difficulties on account of deposit withdrawals and delays in debt-service payments by enterprises. The liquidity position of banks improved dramatically in the post-crisis period, as residents began reconstituting their earlier deposit withdrawals and the NBM intervened in the foreign exchange market to neutralize appreciation pressures. A large part of this liquidity influx was sterilized. Official and money market interest rates peaked in May and fell sharply, to below pre-crisis levels, as liquidity in the banking system improved. However, notwithstanding the large swings in liquidity, the lending and deposit rates of banks remained virtually unchanged during the year.

5. The fiscal situation improved in 1999 despite the Kosovo crisis, but there were lapses in expenditure management and control. The central government accounts swung to a surplus

of about 1 percent of GDP, compared with a deficit of 0.2 percent of GDP envisaged in the pre-crisis budget, and the general government accounts were in approximate balance. Tax revenues were extremely buoyant, mainly on account of efforts to improve tax administration. There were slippages in outlays on wages, goods and services, and some social programs, but these were largely offset by saving in other areas. The breach of wage discipline was more serious than indicated by budgetary data, as several line ministries made additional wage payments (totaling nearly 1½ percent of GDP) from their off-budget self-generated special revenues.

6. The pace of structural reforms picked up from end-1999. A value-added tax (VAT) was introduced on April 1, 2000, after the slow progress in administrative preparations forced the authorities to postpone its introduction in January. In the enterprise sector, 8 out of the 12 loss-making enterprises targeted for closure or sale under the recently expired Fund-supported program had been dealt with by end-March 2000. In the banking sector, a majority share in Stopanska Banka, the largest commercial bank, was sold to a consortium of foreign investors in early April 2000.

II. REAL SECTOR DEVELOPMENTS[1]

A. Demand and Supply

1. Following a long recession in the first half of the 1990s, real economic growth turned positive in 1996 and accelerated to 2.9 percent in 1998, the highest growth achieved since independence (Table 2). In 1999, despite the Kosovo crisis, growth is estimated to have slowed down only slightly. However, the pattern of sectoral growth dramatically changed in 1999: on the demand side, net foreign demand became a major driving force, while on the supply side, industry relinquished its growth-leading role to construction, communications, and trade sectors.

2. Following two years of rapid growth, domestic demand was sluggish in 1999, reflecting a significantly lower inventory accumulation and continued weak fixed capital formation (Table 19 and Figure 1). The investment environment deteriorated with the onset of the Kosovo crisis in the first half of 1999. Trade disruptions adversely affected the import-intensive investment in equipment and machinery. This was partially offset, however, by a surge in investment in construction, which accounts for about one half of the fixed investment.

3. While the deteriorating situation in Federal Republic of Yugoslavia (FRY) adversely affected the investment behavior in the country, the low investment growth in the past decade reflects a number of structural factors. These are (i) weak domestic savings and limited access to foreign resources; (ii) lack of a developed domestic capital market that limited the availability of longer-term financing for investment; (iii) high level of real interest rates; (iv) inefficiencies in the banking system, which continues to channel scarce financing to unviable enterprises through connected lending or at the behest of the government; and (v) the slow pace of structural reforms, as private sector firms in Macedonia have tended to substantially outspend the state-owned enterprises in investment[2].

4. Consumption growth accelerated in 1999, reflecting mainly the jump in the growth rate of government consumption (from about 4 percent in 1998 to an estimated 10 percent in 1999) due to increased expenditures on refugees. This more than offset the slowdown in private consumption, as uncertainties in the region encouraged precautionary savings.

5. The downward trend in net foreign demand was abruptly reversed in 1999, as Kosovo-related disruptions in trade resulted in a severe compression of imports. As a result,

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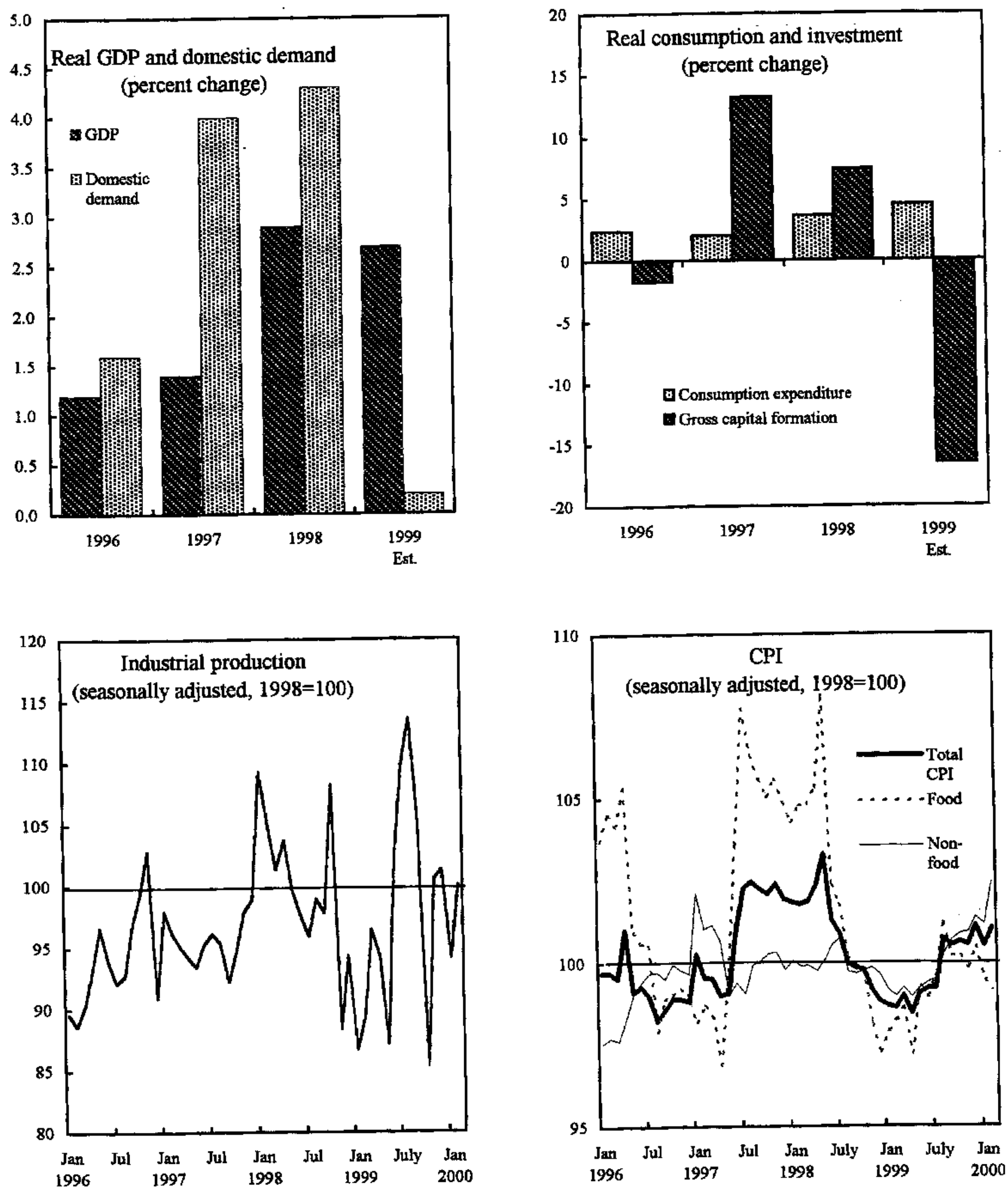
[1] Prepared by Aliona Cebotari.

[2] For example, investment of public enterprises declined by 1.5 percent in 1998, whereas private sector investment grew by 13.3 percent and its share in total investment increased from 49.5 percent in 1996 to 57.1 percent in 1998. (These figures are based on enterprise-level data and are not fully consistent with the national accounts concepts).

Figure 1. FYRM: Economic Activity Indicators and Consumer Prices



Sources: FYRM authorities; and IMF staff estimates.

unlike in the previous years, net foreign demand was the driving force behind the overall growth in 1999.

6. On the supply side, growth during 1996-98 was spurred by a strong pickup in industry and a gradual recovery in transport and communications (Table 18). Following a sustained decline (averaging over 12 percent a year during the period 1991-95), industrial output recovered in 1996 and grew at an average rate of 4 percent over the period 1996-98. Industrial growth was helped by a number of favorable developments, including (i) the reactivation of idle capacities, especially in the iron and steel and metal processing industries, following their divestiture to foreign strategic investors in 1998; and (ii) increased access to foreign markets, particularly after the trade cooperation agreement was signed with the European Union in November 1997.

7. There were signs already in 1998, however, that structural weaknesses in the enterprise sector, as well as developments in the neighboring FRY, an important export market for industrial output in Macedonia[3], stood in the way of sustained economic growth in the industrial sector. The outbreak of the crisis in Kosovo in mid-1999 delivered a major blow to industrial production in 1999, which is estimated to have declined by 2.5 percent for the year as a whole (Figure 1). The decline occurred despite the pickup in the production of a number of industrial products (construction materials, food, beverages and tobacco) following the surge in Kosovo-related demand.

8. Several sectors benefited in the aftermath of the Kosovo crisis, and they took up the growth-leading role played in the previous years by industry. These were trade, transport and communications[4], and construction, which together contributed 2.2 percentage points to GDP growth in 1999, with the remainder distributed relatively evenly across the remaining sectors (excluding industry).

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[3] The sectors that traditionally export to the region have suffered most in 1998. For example, production of construction materials in 1998 fell by 12.1 percent, beverages by 7.8 percent and electrical equipment by 9 percent.

[4] In the transport and communication sector, the buoyant telecommunications activity (due to the fast expansion of the mobile telephone network) was partially offset by the fall in transport activities during and following the military conflict, as roads, bridges and river routes through the neighboring FRY were destroyed during the conflict and took time to restore.

B. Prices

9. After hovering around 2 percent during 1996-97, average annual consumer price inflation turned slightly negative, falling by an average of 0.1 percent in 1998 and further by 0.7 percent in 1999 (Tables 2 and 20). Prices began to decline in September 1997, notwithstanding the 16 percent devaluation of the denar in July that year. There are a number of reasons why the devaluation did not lead, as expected, to upward pressure on prices. These include: (i) a six-month wage freeze following the devaluation; (ii) the anemic economic growth in early-1997 that prevented producers from passing higher costs to consumers and induced them instead to absorb these costs in lower profit margins; and (iii) the fall in the prices of food and raw materials in the domestic and international markets. Food prices, which account for about 40 percent of the consumer price index, fell sharply in 1998, reflecting the good agricultural crop in that year and increased domestic supply due to difficulties in exporting to the FRY and the EU's imposition of a ban on lamb exports to European countries. The declining trend in consumer prices was further reinforced in early 1999 by a weakening of the price of clothing and footwear and by the reduction of the domestic retail price of oil derivatives in the first half of 1999 (see Annex II).

10. The deflationary trend bottomed out in May 1999 (on a seasonally-adjusted basis). The prices of food, tobacco and beverages picked up due to a surge in demand for these products from Kosovo, and as the increases in oil prices in international markets were passed through to domestic prices. During the period May-December 1999 prices increased by 3 percent on a seasonally-adjusted basis, bringing end-period inflation in 1999 to 2.4 percent.

C. Labor Market

11. The decline in employment that accompanied the recession in the first half of the 1990s bottomed out by end-1997.[5] Employment increased by 5.4 percent in 1998 and a further 1 percent in 1999,[6,7] reflecting, albeit with a one-year delay, the pickup in overall

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[5] According to the results of the labor force survey (LFS). There are three sources of employment data in Macedonia: (i) the business surveys conducted by the Statistical Office on a monthly and semiannual basis. These do not cover the Ministries of Interior and Defense, nor agriculture, and cover poorly the predominantly private sectors; (ii) financial statements of enterprises submitted, annually and semiannually, to the Payments Bureau. These underestimate true employment because of massive underreporting of employees by firms, which tend not to register hired workers to avoid payroll taxes; (iii) the Labor Force Survey (LFS), conducted annually since 1996. This is considered to be the most reliable source of employment data in the country, as it captures unregistered employment, employment in the private sectors, as well as in the Ministries of Interior and Defense; however, it cannot be used to infer employment dynamics within the year.

[6] Administrative sources, i.e. data collected by the Statistical Office through a monthly and semiannual surveys, show a continued decline in employment throughout 1998 and 1999 (Table 21).

Table 2. FYR Macedonia: Selected Real Sector Indicators, 1992–99

(Annual percentage change)

	1992	1993	1994	1995	1996	1997	1998	1999 Prel.
Real GDP	-8.2	-1.2	-1.8	-1.1	1.2	1.4	2.9	2.7
Domestic demand	-12.1	5.1	5.0	3.8	1.6	4.0	4.3	0.2
Industrial output	-15.8	-14.4	-7.0	-8.9	5.0	2.9	4.5	-2.5
Consumer price index								
Average	1,500	362.5	128.4	15.7	2.3	2.6	-0.1	-0.7
End-of-period	...	254.3	55.4	8.6	-0.9	3.2	-3.1	2.4
Employment (LFS), total 1/	-4.8	-5.6	-6.0	-9.9	-2.1	-4.7	5.4	1.0
Economic sector	-5.4	-6.8	-7.7	-12.5	-3.1	-6.1	6.2	1.2
of which: industry	-6.5	-5.1	-5.9	-13.4	-4.0	-9.7	8.3	-0.7
Noneconomic sector	-2.0	-0.6	0.6	-0.1	0.9	1.4	1.2	0.0
of which: state administration	-8.1	-0.6	2.0	-1.0	0.6	0.6	8.3	6.0
Unemployment rate 2/	...	...	...	...	31.9	36.0	34.5	32.4
Nominal net average wage, total	...	495.6	105.0	10.7	2.8	2.8	3.7	2.9
Economic sector	...	478.9	110.3	12.3	3.2	3.7	4.5	3.6
of which: industry	...	454.0	105.8	11.1	3.6	2.3	3.1	1.5
Noneconomic sector	...	535.3	85.6	4.0	0.8	0.3	1.6	1.4
of which: state administration	...	520.2	87.1	3.0	1.4	2.3	1.3	2.8
Real net average wage, total	...	28.7	-10.2	-4.4	0.4	0.2	3.8	3.6

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

1/ For 1992-95 based on administrative surveys, adjusted for poor coverage of the private sector; for 1996-99 Based on labor force survey.
2/ Based on the labor force survey, conducted since 1996.
3/ Based on net average wages in industry.

economic activity in 1996 and the growth experienced by the country in 1998 (Tables 2 and 21). Despite some recent decline, the unemployment rate remained very high, at 32.4 percent in 1999 (see Annex I).

[7] Keeping in mind that the LFS was conducted in April, at the height of the Kosovo crisis, and that many sectors recovered significantly in the post-crisis period, it is possible that employment growth in 1999 has been underestimated by the LFS.

12. Employment growth in the economic sector[8] (6.2 percent in 1998 and 1.2 percent in 1999) was more buoyant than in the noneconomic sector, as it benefited from relatively higher rates of growth during this period. Unlike in the past, small private firms (i.e. firms founded with private capital) were the main source of the increase in employment, with their share in total employment increasing from 43 percent in 1996 to 49 percent in 1999. Employment in the noneconomic sector has increased gradually and steadily since 1996, spurred by an expansion in public administration (of 8.3 percent in 1998 and a further 6 percent in 1999). This increase occurred despite the hiring restriction implicit in the freeze on the budgeted wage bill in both 1998 and 1999, and it more than offset the shedding of labor in education and health sectors.

D. Wages

13. Nominal net wages[9] continued to grow during 1998-99, averaging over 3 percent a year (Table 2). As a result, real wages grew by close to 7 percent during the two-year period ending 1999. Wage growth in the economic sector substantially outpaced that in the noneconomic sector, owing mostly to the restrained wage stance followed by the authorities in the latter over the past several years.[10] As a result, the wage differential between the two sectors was virtually eliminated by end-1999 (Figure 2). Within the economic sector, financial services, catering and tourism, and trade led the wage growth, averaging over 7 percent in 1999, twice the growth rates registered in other economic sectors (Table 22). Wage growth in the noneconomic sector remained about half that of the economic sector, with wages in public administration leading growth, averaging an estimated 2 percent a year during 1998-99.[11]

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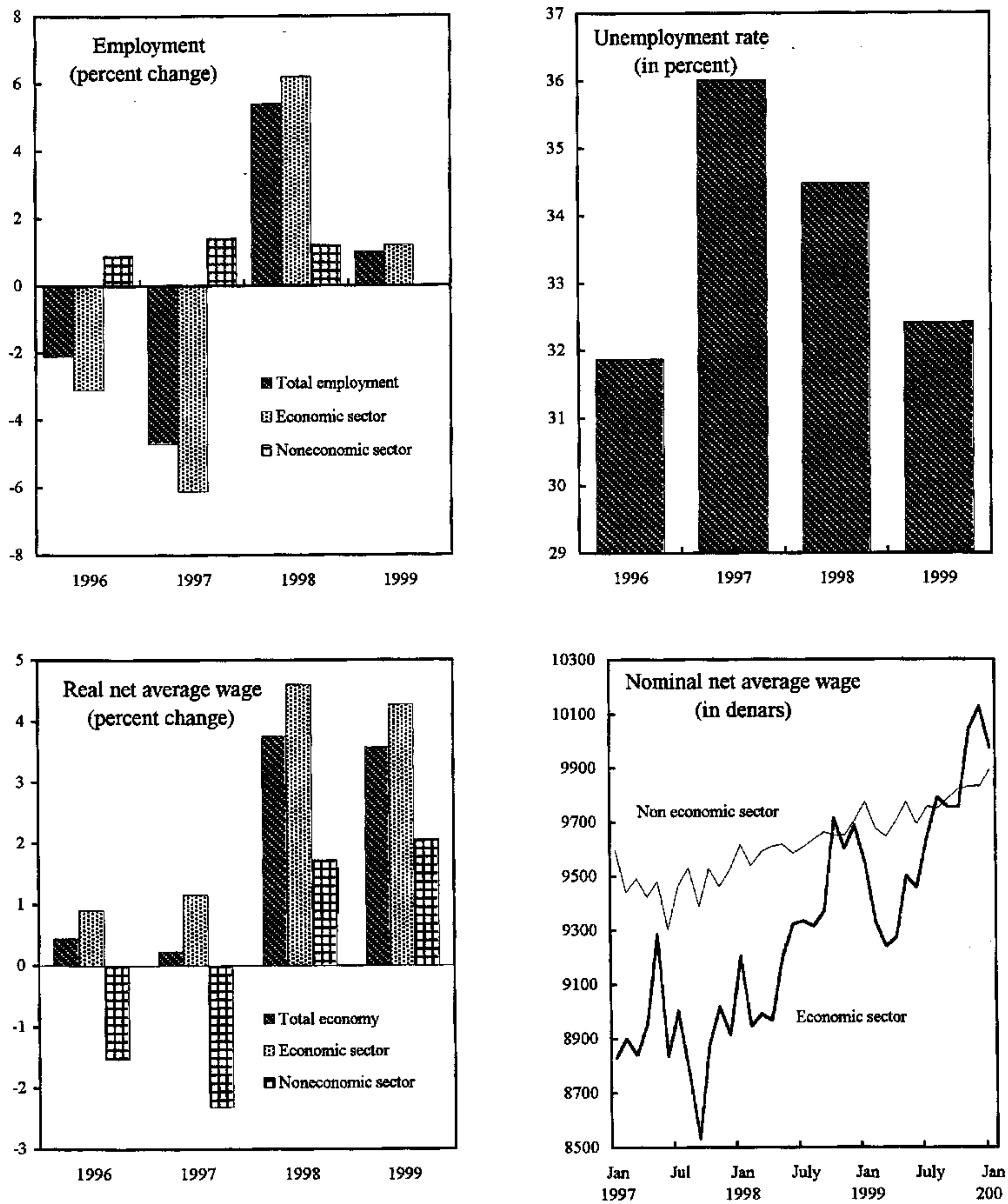
[8] All sectors excluding public administration, education and health, which make up the noneconomic (budgetary) sector.

[9] Macedonian wage statistics reports mainly net, rather than gross, wages. These are wages paid by employers net of payroll taxes and non wage benefits.

[10] Wages in the noneconomic sector used to be substantially higher than in the rest of the economy. As a result, the wage legislation adopted in 1994, which aimed to restrain wage growth in the public sector (i.e. institutions and firms that were less than 70 percent private) by indexing nominal wages to expected consumer price inflation, provided for a lower indexing coefficient in the three noneconomic sectors to allow wages in the rest of the economy to catch up. Also, during 1998-99 the government faced a limit on its budgeted wage bill.

[11] The actual growth in public administration may be substantially higher. This is because (i) official statistics do not cover the Ministries of Defense and Interior, and, in the case of the latter, large wage increases were given to employees at the time of the Kosovo crisis in 1999; and (ii) it is likely that the official statistics do not capture wage payments made by government ministries from their own special revenue accounts.

Figure 2. FYRM: Employment and Wages 1/



Source: FYRM authorities.

1/ Employment and unemployment data are based on labor force surveys.

III. Monetary Developments[1]

A. Recent Developments

1. FYRM has been pursuing an exchange-rate-based monetary policy since 1996. This has proved successful in reducing inflation to industrial country levels. However, structural weaknesses in the financial system have prevented a more vigorous economic recovery. Imbalances in the enterprise and banking sectors—largely reflecting delays in restructuring—have contributed to the low degree of financial intermediation and to high interest rates. In early 1999, the Kosovo crisis exposed major weaknesses in the banking sector and in the transmission mechanism of monetary policy. The rapid economic recovery in the aftermath of the crisis, as well as prospects of reforms has helped restore confidence in the banking system (Chapter IV).

2. For most of 1998 there were no significant pressures on the exchange rate, but a tightening of monetary conditions in November was needed to counter short-lived speculative pressures in the foreign exchange market. By end-year, the external reserve accumulation reached 2.1 months of imports. Money and credit growth were consistent with targets for the year, and by December, 12-month growth of denar M2 reached 11 percent, with denar private credit growth of 10 percent. NBM deposit auction rates increased to 18 percent by the end of the year, compared with a low of around 11 percent in mid-1998 (Tables 23–26).

3. With the onset of the Kosovo crisis in late-March 1999, there were withdrawal of deposits from commercial banks and delays in debt-service payment by enterprises, causing some banks to experience severe liquidity shortages. Denar deposits contracted by 4 percent in the first quarter while foreign currency deposits declined by about 20 percent. In the event, the National Bank responded by injecting liquidity while allowing the deposit auction rate to increase to 25 percent by May 1999. Also, the National Bank intervened in the foreign exchange market in April and May with net sales to counter the increasing pressure on the denar.

4. With the ending of the conflict, demand for currency in circulation normalized with impressive speed and both denar and foreign currency deposits were quickly reconstructed. The NBM intervened in the foreign exchange market to neutralize appreciation procedures. The monetary effects of these large foreign exchange purchases were partly sterilized through the unwinding of previously auctioned NBM credits along with an increased issue of NBM bills. Money increased rapidly in the second half of the year. As the liquidity position of banks improved, the money market interest rate declined to 11 percent, compared with a peak of 22 percent in May.[2]

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[1]Prepared by Paulo Drummond.

[2]The NBM ceased auctioning deposits in November.

5. Despite the large swings in liquidity position of commercial banks, deposit and lending interest rates of commercial banks were broadly inflexible. Deposit rates hovered around 9 percent, while lending rates remained within a broad range of 19–27 percent.

B. Instruments of Monetary Policy

6. As part of measures to create a more market-oriented and efficient financial system, the NBM is in the process of revamping its set of instruments for the conduct of monetary policy to secure a smooth transition to indirect monetary policy instruments from April 1, 2000. The NBM received technical assistance missions from the Fund's MAE in December 1998 and December 1999. In this section, the current instruments are reviewed and a broad description of the direction of change is provided.

Credit ceilings

7. The NBM has maintained the practice of setting bank-by-bank credit ceilings since January 1994, to control the expansion of domestic credit as well as for prudential reasons. Aggregate monthly credit ceilings are allocated to banks and savings houses in proportion to their level of capital less foreign exchange position. Banks are penalized for exceeding their credit ceilings by being disallowed from granting any new credits for 30 days following the violation.

8. However, credit ceilings have become increasingly distortionary, as individual banks' shares in total credit tend to be perpetuated without regard to their individual performance, profitability, or ability to mobilize resources. Although this distortion can be minimized by the opportunity to trade unused credit ceiling allotments, in practice the trading of credit margins by banks has been very limited. In addition, credit ceilings have become increasingly ineffective as banks' measured credit may fall well below actual credit owing to misclassification of certain credit items as other assets.[3]

9. One of the measures aimed at creating a more efficient financial system is the NBM's preparation to transform credit ceilings into selective prudential limits and to replace the current ceilings for credit control with indirect instruments of monetary policy. In line with previous MAE mission recommendations, the National Bank intends to ensure that, prior to phasing out credit ceilings, central bank bill rates will fluctuate. The NBM has started preparing a plan to develop, at an early stage, other instruments of indirect control, including repurchase operations.

Reserve requirements

10. Denar reserve requirements for commercial banks have remained unchanged since 1993, at 8 percent for sight deposits (for savings houses the equivalent rate is 4 percent)

[3]Including receivables from payments made on behalf of banks' clients arising from guarantees and letters of credits.

and 3.5 percent for longer-term deposits (for savings houses the equivalent rate is 1.5 percent). The remuneration paid on reserve requirements is unified. In June 1998, to help reduce the costs of intermediation and in line with MAE's advice, the remuneration paid on reserve requirements was increased from 3.6 percent to 6.2 percent, a level closer to market rates. The higher remuneration had only a marginal impact of 0.2 percentage point on the intermediation spread. Excess reserves remain unremunerated.

11. Since June 1998, reserve requirements on foreign exchange deposits held by individuals have been lowered from a 100 percent uniform reserve requirement into six different categories: reserve requirement for sight deposits have been lowered to 70 percent; for one-month deposits, 60 percent; for three-month deposits, 50 percent; for six-month deposits, 40 percent; for deposits up to a year, 30 percent, and for deposits of more than one year, 20 percent. Foreign exchange deposits of enterprises remain subject to a 100 percent uniform reserve requirement.

12. Average reserve requirements have not been used as an active monetary policy instrument, though in the past, marginal reserve requirements have been implemented to limit the liquidity of specific banks. Because the current system is unified not on deposits—neither across currencies nor across maturities—but on remuneration only, it has a built-in impact on banks' demand for reserve money. Changes in the composition of deposits give rise to an automatic modification in the overall level of reserve requirements. The current system also adds a wedge between long- and short-term deposit rates, implying a role for the National Bank that should be left to banks. The lowering of the reserve requirement on foreign currency deposits has helped increase the share of foreign currency credit into total credit from 21 percent (at the time of its introduction) to 23 percent as of December 1999.[4]

NBM credit auctions

13. Credit auctions have played an important role as a key instrument for liquidity management. The NBM has used the auctions primarily to inject liquidity according to the monetary program and also to support large distressed banks with structural liquidity needs. With the improvement in the liquidity positions of banks, the NBM has gradually moved to, de facto, phase out credit operations. At end-December 1999, the outstanding stock of deposits sold on auction declined to denar 500 million, compared with denar 2.1 billion in March 1999. Credit auctions have become a one-sided instrument and the NBM's ability to reduce liquidity by withdrawing deposits sold at auction has been greatly diminished.

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[4]Although banks are not allowed to lend in foreign currency, they can lend to their customers in domestic currency with a foreign currency clause. See Chapter on Banking System Soundness for a discussions of the impact of this measure on banks' risk and lending operations.

National Bank bills

14. The National Bank has managed to increase its supply of securities as banks have allocated part of their improved liquidity to central bank bills during 1999. The stock of outstanding central bank bills remained under denar 1 billion until December 1998 and increased rapidly to denar 2 billion by end-1999 (equivalent to 24 percent of reserve money, twice the share a year earlier).

15. Under the current setup, the NBM auctions bills across a range of maturities daily, announcing a maximum interest rate for each maturity and unlimited volumes. The NBM has not encountered difficulties placing bills at the current interest rates offered on various maturities (7 days, 6 percent; 14 days, 7.5 percent; 28 days, 9.5 percent; 42 days, 10 percent; 56 days, 10.5 percent; 91 days, 11 percent). However, 38 percent of all outstanding bills are held by the second largest bank, and the NBM has benefited from captive markets: the Deposit Insurance Fund holds about 14 percent of the outstanding stock of NBM bills.

16. The NBM envisages that open market operations will become the NBM's principal monetary instrument of liquidity management in 2000. To that end, the NBM has taken a decision to allow market forces to determine the interest rate on its bills. To encourage the development of a secondary market, the NBM has decided that all bills will have unified maturity, with no possibility of repurchase before maturity, and limited amounts of bills will be offered in weekly auctions (as opposed to daily). Intra-week liquidity needs would be satisfied through repurchase agreements. Bills bought in the primary market could be used as collateral for Lombard credits.

Lombard credit facility

17. The NBM operates a Lombard credit facility to provide lender-of-last-resort funds to banks. Banks must provide collateral equivalent to twice the amount of credit desired, in the form of NBM bills. In November 1998, the NBM increased the Lombard rate to 18.5 percent from 14.4 percent. Despite the increase, the new rate was at times below the interest rate on credit auctions and the interbank market rates for long periods. The collateral required under the Lombard facility is 133 percent of the loan to be received for the use of bonds.

IV. Banking System Soundness[1]

A. Introduction

1. Weaknesses in the banking and enterprise sectors remain a major cause of low growth. A large share of nonperforming assets in the portfolio of large banks, stemming from losses in the enterprise sector, has been a key impediment to development in the financial sector. The banking system has been crippled by the low level of intermediation, high cost of capital, severe lack of financial discipline, and poor allocation of credit. Reforms aimed at strengthening lending practices, encouraging foreign bank participation, improving bank supervision and, above all, a consolidation process that breaks away from the past will be key to help pave the path to economic recovery.

2. This chapter provides an overview of the soundness of the banking system in FYRM. The chapter is organized as follows: Section B presents background information on the structure and composition of the banking system. Section C reviews banking system operations, and outstanding portfolio and recent developments. Section D provides an overview of banking system soundness and vulnerability. Section E reviews the macroeconomic effects of banking system fragility. Section F provides an overview of bank supervision and the legal environment. Section G reviews and draws lessons from the recent Macedonian experience in dealing with unsound banks. Attachment I provides a summary of key definitions used for the purpose of this note.[2]

B. Market Structure

3. The number of banks in FYRM is large. As of September, 1999, there were 22 commercial banks, 2 branches of foreign banks and 15 savings houses. Of the total number of banks, 13 were operating under an NBM license allowing both domestic and foreign operations, while the remaining licensed banks had licenses only for domestic operations. Since end-April 1999, a minimum capital of DM 5 million is required for a domestic operation license and DM 15 million for foreign operations. The minimum capital for foreign operations is scheduled to increase to DM 18 million at end-April 2000 and DM 21 million at end-April 2001.[3]

4. The banking system is heavily concentrated. At end-September 1999, Stopanska Banka, the largest bank, accounted for 31 percent of the system's total assets and 41 percent of total deposits (Table 3). Jointly with Komercijalna Banka, the two banks accounted for

[1] Prepared by Paulo Drummond.

[2] According to the Banks and Savings Houses Act and NBM Regulations. Some terminology may differ from standard usage.

[3] The minimum capital requirements for domestic operations are, respectively, DM 6 million by end-April 2000 and DM 7 million by end-April 2001.

Table 3. FYRM: Summary Balance Sheet of Banks

	Dec.97	Dec.98	Sep.99			
	All banks	All banks	All banks	Stopanska Banka	Komercijalna Banka	Other banks
			(In millions of denars)			
Assets						
Cash and bonds	19,934	21,688	28,219	8,117	8,303	11,798
Credit to nonbanks	31,402	32,183	33,751	14,469	6,313	12,969
Credit to banks	1,067	581	1,477	488	75	914
Capital investments and fixed assets	4,262	4,605	4,936	1,577	578	2,781
Accrued interest and other assets	3,658	7,339	9,595	4,275	551	4,769
Provisions 1/	9,410	7,302	13,394	8,707	770	3,917
Total assets 2/	50,912	59,093	64,584	20,219	15,051	29,314
Liabilities						
Deposits	25,390	32,219	40,556	16,506	10,967	13,084
Borrowing	9,249	9,394	8,663	3,478	714	4,472
Other liabilities	4,166	2,674	4,330	2,087	698	1,545
Owned funds 3/	12,108	14,807	11,035	-1,851	2,672	10,214
Total Liabilities 2/	50,912	59,093	64,584	20,219	15,051	29,314
Off-balance sheet items	12,520	14,736	14,228	7,861	2,896	3,471
			(In percent of GDP)			
Assets						
Cash and bonds	10.8	11.4	14.5	4.2	4.3	6.0
Credit to nonbanks	17.0	16.9	17.3	7.4	3.2	6.6
Credit to banks	0.6	0.3	0.8	0.3	0.0	0.5
Capital investments and fixed assets	2.3	2.4	2.5	0.8	0.3	1.4
Accrued interest and other assets	2.0	3.8	4.9	2.2	0.3	2.4
Provisions 1/	5.1	3.8	6.9	4.5	0.4	2.0
Total assets 2/	27.5	31.0	33.1	10.4	7.7	15.0
Liabilities						
Deposits	13.7	16.9	20.8	8.5	5.6	6.7
Borrowings	5.0	4.9	4.4	1.8	0.4	2.3
Other liabilities	2.3	1.4	2.2	1.1	0.4	0.8
Owned funds 3/	6.5	7.8	5.7	-0.9	1.4	5.2
Total liabilities 2/	27.5	31.0	33.1	10.4	7.7	15.0
Off-balance-sheet items	6.8	7.7	7.3	4.0	1.5	1.8

Sources: National Bank of Macedonia (NBM), Banking Supervision Department; and IMF staff estimates.

1/ Includes unallocated specific provisions.
2/ Net of provisions.
3/ As per banks' balance sheet.

55 percent of total assets and two-thirds of all deposits in the banking system. The rest of the banking system was dispersed across 20 nonsystemic smaller banks, with a reduced deposit base.[4]

5. The banking system is dominated by banks controlled by formerly socially owned enterprises, most of them now private. Some of the shareholding companies have become shareholders during bank reorganizations in the early years. This pattern of ownership, jointly with underdeveloped capital markets, has resulted in less than active shareholding participation in banks. It has also led to the pervasive connected lending and large exposure to single debtors that permeate the system.[5]

6. The ownership structure has little foreign participation. The share of foreign capital in the total founders' capital of commercial banks was about 15 percent at end-1998. Foreign capital holds a majority stake in only four banks, including one foreign branch from Turkey, two banks from Russia (one of which is undergoing bankruptcy procedures), and one bank from Bulgaria. Western banks have, so far, abstained from participation in the Macedonian banking system. This changed rapidly in 1999, with one small equity acquisition by a Greek bank, in addition to the large Greek investment in Stopanska Banka.

7. The banking environment generally allows banks to operate independently but some banks have been subject to a considerable degree of government intervention. The Development Bank created in 1998 to help channel credit lines from abroad has targeted individual commercial banks to carry out its operations. The government has also provided idle budget funds in support of commissioned loans—a substantial share of income for a number of banks. In addition, the government has exercised its ability to shift large deposits of state-owned enterprises across banks, affecting individual banks' liquidity position and profitability. There is also anedoctal evidence of outright moral suasion.

C. Banking System Operations and Recent Developments

8. The level of banking system financial intermediation remains quite low, reflecting low confidence in the banking system, a precautionary preference for holding cash in foreign currency and an attempt to avoid the control—and obligations—imposed by the Bureau of Payments Operations (ZPP). Total banking system deposits—denar and foreign currency[6]—amounted to only 21 percent of GDP by September 1999, despite a steady increase in the last two years (Table 3). The low confidence in the banking system has deep roots associated, inter alia, with events that go back to the time of FYRM independence, particularly the

[4] The third largest bank accounted for 5 percent of total banking system assets.

[5] At end-September 1999, six banks had exposure to a single shareholder in excess the prudential limit.

[6] Held by residents and non-residents.

freezing of foreign currency deposits that took place at the time of dissolution of the former Socialist Federal Republic of Yugoslavia (Box 1).

9. During the past two years, the recovery of deposit-taking activities and a gradual and slow process of reintermediation of financial activities by banks has taken hold. Banking system activities—measured in terms of total assets—have been growing faster than the GDP growth. As of September 1999, total assets of the banking system[7] stood at 47 percent of GDP, compared with 43 percent in 1998 and 40 percent in 1997 (Table 3). Total banking system assets was split between on-balance assets—gross of provisions—equivalent to 40 percent of GDP, and off-balance assets equivalent to 7 percent of GDP.[8]

Box 1. Frozen Foreign Currency Deposits

At the time of the dissolution of the former Socialist Republic of Yugoslavia (SFRY), commercial banks in FYRM had significant claims on the SFRY National Bank, both from foreign exchange actually redeposited with the SFRY National Bank and for exchange rate losses against which the SFRY National Bank had guaranteed the commercial banks. As of December 1999, outstanding foreign exchange deposits were DM1.1 billion, equivalent to about 17½ percent of GDP, reduced by payment transactions from the original stock of approximately DM 1.7 billion as of April 1992.

After the dissolution of SFRY, the FYRM passed a Law on the "guarantee of the Republic of Macedonia of foreign exchange deposits of citizens." This Law effectively froze the foreign currency deposits of Macedonian citizens, as these deposits can be used only for the limited payments specified in the Law. The Law provides that the FYRM guarantees the foreign exchange deposits of its citizens with the National Bank of the SFRY. The Law also determines that, as guarantor, the FYRM provides banks with foreign or local currency for the purpose of repaying citizens' foreign exchange deposits. Under the Law, the deposits accrue interest and commercial banks are currently permitted to pay local currency to depositors, up to specified amounts, for some very limited purposes specified in the law; commercial banks may also provide foreign exchange to depositors for certain kinds of limited payments abroad. However, no other payments or transfers are permitted to be made with the foreign currency deposits guaranteed by the FYRM.

The government is currently preparing a new draft Law to address the issue of servicing frozen foreign deposits within a fiscally sustainable framework (see Chapter VI).

[7]On- and off-balance sheet items, excluding provisions for loan losses, and without risk-weighting.

[8]The increase in banks' assets could be overstated, owing to possible inaccuracies and misclassification of accrued interest.

10. During the last two years, deposits of nonbanks have fluctuated in response to macroeconomic and regional developments around a rising trend (Table 4). Deposits of enterprises, mostly short-term, were particularly strong in the second half of 1999, in the wake of large foreign inflows from abroad. Household deposits have increased gradually, helped, inter alia, by the establishment of the Deposit Insurance Fund set up in January 1997 (Box 2). Households have also gradually reallocated deposits from longer maturities to shorter ones, possibly reflecting a precautionary motive to become more liquid in the period.

Box 2. Deposit Insurance Fund

The Savings Deposit Insurance Fund (DIF) was established in January 1997 as a joint stock company owned by all banks and savings houses allowed to take personal deposits. The government has no capital in the fund. The DIF has been managed by a Managing Board with representatives of five banks, one savings house, and one member appointed by the National Bank.

Deposits are insured in the amount of 75 percent, with an aggregate ceiling of DM 10 thousand. This limit applies to the total of all deposits by individual depositors per bank or savings house. Coverage includes principal and interest combined and is provided for denar and foreign currency deposits. Compensation, however, is to be made in denars. Since its establishment, the Fund has not been called upon to make a pay-out.

The fund is financed through the collection of premiums from the members, up to 2.5 percent of an institution's deposit base, and income from the investment of assets. Until December 1999, banking and savings houses had been paying an actual premium of 1.5 percent, as defined by the DIF managing board. The fund's assets are targeted to be not less than 5 percent of the total savings deposits in the system by September 2000. At end–1999, the total funds available at the fund were about 4 percent of the total amount of deposits of individuals in the banking system, fully held as NBM bills.

The DIF has no role in the supervisory process nor in the management of the assets of failed institutions. The NBM is the sole institution in charge of supervising operations of banks and savings houses. In case funding is needed, the National Bank is allowed to issue loans to the DIF. In case of bankruptcy of a bank or savings house, liabilities to the National Bank are settled first, followed by settlement of any liabilities to the fund.

11. The currency composition of deposits changed very little between December 1997 and June 1999. Boosted in particular by foreign currency deposits of nonresidents and residents alike, the share of foreign currency deposits in total deposits peaked at 44 percent as of September 1999, compared to 36–40 percent in the earlier period. The share of denar

Table 4. FYRM: Banking System Liabilities

	1997	1998				1999		
	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.
	(In percent of total liabilities)							
Deposits of nonbanks	46.4	46.3	45.8	45.8	49.8	46.1	48.0	57.4
Sight and short-term deposits	40.4	40.3	39.7	39.8	44.3	40.1	42.2	51.5
o.w. in foreign exchange	18.3	16.9	16.5	15.7	21.2	17.6	18.0	24.3
by economic classification:								
enterprises	26.5	25.3	24.5	23.8	28.7	25.4	27.2	35.1
households	8.6	9.1	9.2	10.3	10.1	9.3	8.9	9.4
other	5.3	5.9	6.0	5.8	5.5	5.4	6.0	6.9
Long-term deposits	6.0	6.0	6.0	6.0	5.6	6.0	5.8	6.0
o.w. in foreign exchange	0.4	0.5	0.6	0.6	0.6	0.7	0.6	0.7
by economic classification:								
enterprises	0.9	0.8	0.9	0.9	0.7	0.8	0.9	1.1
households	4.3	4.2	4.2	4.2	3.9	3.9	3.7	3.6
other	0.9	0.9	1.0	1.0	1.0	1.3	1.3	1.3
Borrowings	18.2	17.5	18.1	17.0	15.9	17.5	16.6	13.4
Short-term borrowings	12.0	11.3	11.5	8.9	7.2	8.2	7.8	5.3
o.w. in foreign exchange	7.6	8.0	7.9	5.7	3.6	3.5	3.9	3.3
		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-term borrowings	6.1	6.2	6.6	8.1	8.6	9.3	8.8	8.1
o.w. in foreign exchange	4.9	4.7	5.7	7.1	7.9	8.6	8.0	7.4
Owned funds 1/	23.8	23.6	25.3	24.7	25.1	25.7	25.8	17.1
Other	11.6	12.6	10.8	12.4	9.2	10.7	9.6	12.1
Memorandum items:								
Total banking system liabilities (in millions of denars)	50,912	50,881	50,723	52,143	59,093	57,531	61,503	64,584
Foreign exchange deposits (in millions of U.S. dollars)	172	156	155	165	249	186	196	281

Sources: National Bank of Macedonia (NBM), Banking Supervision Department; and IMF staff estimates.

1/ As per banks' balance sheet.

deposits has been sustained at a relatively high cost. The interest rate spread between denar and foreign currency deposits [9] has fluctuated around 6–7 percentage points.

12. Fueled by increasing banking system deposits, banks have allocated an increasing share of assets to credit to nonbanks (Table 5). In addition to regular credit, banks have extended credit mostly through off-balance-sheet activity that has come on-balance, classified in the form of receivables and other assets (Table 5).[10] Such assets include denar and foreign currency advances for letter of credit transactions made on behalf of bank's clients in previous periods, as well as receivables from payments made on behalf of banks' clients arising from banks' guarantees. About 90 percent of total bank credit to nonbanks was corporate credit while interbank credit and credit to households remained marginal for banks' business. The latter, in particular, suffered from the weak environment and legal framework for creditors' rights, which has remained a key obstacle to lending by banks (see Section F).

13. The share of foreign currency denominated loans in total credit increased from 18 percent in December 1997 to 21 percent in 1998 and 25 percent in September 1999, owing to three main factors. First, the cost of foreign currency loans was significantly cheaper—the denar-foreign currency spread on lending rates hovered around 8 percent. Second, there was greater availability of credit lines channeled through commercial banks. About 60 percent of the foreign currency credit flow in 1999 (about US$28 million) was associated with credit lines from abroad (mostly IBRD and EBRD) and loans disbursed by the Development Bank, out of its own funds (Box 3).[11] Third the reduction in the reserve requirement on foreign currency deposits from 100 percent to 61 percent in June 1998 allowed banks discretion to channel resources, previously deposited in accounts abroad, to foreign currency credit.

[9] Paid on three-month deposits.

[10] In December 1998, Stopanska Banka reprogrammed denar 6 billion, equivalent to 7 percent of banking system assets, reclassifying "other assets" into "credit to enterprises."

[11] At end-September 1999, foreign currency credit was equivalent to 13 percent of the banking system assets.

Table 5. FYRM: Banking System Assets

	1997	1998				1999		
	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.
	(In percent of total assets, unless otherwise indicated)							
Cash and securities	39.2	35.6	33.8	32.3	36.7	31.7	34.2	43.7
Bank credit to nonbank	61.7	54.9	55.0	51.7	54.5	56.7	54.2	52.3
enterprises	43.5	35.9	36.6	36.9	42.9 /1	44.5	40.1	37.1
households	3.8	3.6	3.4	3.9	3.6	3.5	3.8	3.6
others	1.7	2.3	2.7	3.5	2.1	2.3	2.5	1.9
Overdue and nonperforming loans	12.7	13.1	12.3	7.4	5.8	6.4	7.8	9.7
Credit to banks	2.1	2.4	2.0	1.4	1.0	2.6	2.3	2.3
Provisions	18.5	19.3	17.8	12.6	12.4	14.1	13.8	20.7
Other assets	15.6	26.4	26.9	27.2	20.2	23.1	23.1	22.5
Accrued interest	4.7	5.4	5.6	5.8	4.1	5.1	4.6	4.7
Other assets 2/	2.5	12.5	13.1	13.3	8.3 /1	9.9	10.6	10.2
Capital investments and fixed assets	8.4	8.5	8.2	8.1	7.8	8.1	7.9	7.6
Memorandum items:								
Total off-balance-sheet items	24.6	27.0	29.6	29.1	24.9	26.7	22.9	22.0
Uncovered letters of credit and guarantees	16.3	17.7	17.9	18.1	16.6	18.1	14.6	14.2
Covered letters of credit and guarantees	3.2	3.1	4.7	4.1	3.0	2.3	2.6	2.7
Other off-balance-sheet items	5.1	6.2	7.0	7.0	5.3	6.4	5.6	5.2
Total risk-weighted assets	81.2	86.4	87.7	91.2	86.9	92.1	84.7	78.1
Risk-weighted on-balance	65.5	69.6	70.6	73.8	71.8	75.3	72.8	71.9
Risk-weighted off-balance	17.7	18.8	19.3	19.5	17.7	19.4	15.8	15.3
Unallocated provisions and other items 3/	1.9	2.1	2.2	2.1	2.6	2.6	3.8	9.0
Total banking system assets (in millions of denars)	50,912	50,881	50,723	52,143	59,093	57,531	61,503	64,584
Foreign currency credit (in millions of U.S. dollars) 4/	94	100	112	120	123	128	142	151
Foreign currency credit (in percent of total banking system assets)	10.2	10.9	12.2	12.8	11.5	12.3	12.8	13.0

Sources: National Bank of Macedonia (NBM), Banking Supervision Department; and IMF staff estimates.

1/ Includes reprogramming of assets by Stopanska banka (6,271 millions of denars).
2/ Includes other receivables, fees and claims classified in temporary accounts.
3/ Uncovered losses and capital investments as per the Banks' Act.
4/ Excludes exchange rate valuation adjustments.

Box 3. Development Bank

The government, in consultation with the German Bank Kreditanstalt für Wiederaufbau (KfW) founded a hybrid export/development bank in 1998. The bank's founding capital of DM30 million was intended to provide export financing in the form of short-term loans secured against identifiable export receipts and export guarantees.

The bank is not a deposit-taking institution and uses its development arm to pass on to commercial banks official lines of credit received from abroad. The bank is not allowed to extend credits or guarantees to the central government or other public institutions. The Bank started its lending activities in March 1999 and has targeted investment projects in small and medium-sized enterprises and export promotion through six commercial banks. As of December 1999, the bank's credit portfolio consisted of US$10 million loans for 30 identified projects. About two-thirds of the credit amount disbursed targeted enterprises under a "consumer goods export promotion program" and about one-third was in support of small and medium-sized enterprises.

14. Banks' operations have been shaped by off-balance-sheet activities equivalent to about 22 percent of total banking system assets (Table 5). About 90 percent of off-balance-sheet assets entails credit risk [12] and more than half of all balance-sheet activity is carried by Stopanska Banka. A separate discussion of the recent impact of off-balance sheet activity on banking system credit is included in Section E.

15. Banks' modus operandi has changed little over the last two years and banking system efficiency and profitability have deteriorated (Table 6). Interest income remains the main source of income—about 50 percent—while fees and foreign exchange income account for about 30 percent. Despite high lending rates, the effective interest margin [13] remains extremely low and has been declining. As a result, the banking system has been making losses in the last two years, masked by small accounting profits, which do not reflect the true position of banks but arise in the context of widespread underprovisioning. Given the impact of accrued losses on the balance sheet of Stopanska Banka, the banking system net accounting income, for the first time, became negative, for the first time in September 1999.

D. Banking System Soundness and Vulnerability

Banking system soundness

16. The quality of loan portfolios is extremely poor and has deteriorated in recent months (Tables 7 and 8). As of September 1999, classified exposures stood at 45 percent of total

[12] The ratio could be larger if security held as cover for letters of credit and guarantees entails risk.

[13] Interest income minus interest expenses, as per banks' balance sheets.

Table 6. FYRM: Banking System Income Statement and Profitability

	1997 Dec.	1998 Sep. 1/	1998 Dec.	1999 Sep. 1/
	(In percent of total banking system assets)			
Total income	16.8	8.9	16.6	9.6
Interest income	7.9	5.6	9.2	5.4
Fees	3.2	3.3	3.3	2.1
Foreign exchange income	3.1	0.0	0.9	0.9
Other income	2.6	0.0	3.3	1.2
Total expenses	13.9	7.6	14.4	8.4
Interest expense	3.9	2.4	3.6	2.6
Provisions	3.7	1.0	4.8	1.4
Wages	2.7	1.8	2.5	1.9
Other expenses	3.6	2.4	3.5	2.5
Gross income	2.9	1.3	2.2	1.2
Unallocated provisions for potential loan losses	0.6	0.5	1.4	7.6
Net income	2.3	0.8	0.8	-6.4

Sources: National Bank of Macedonia (NBM), Banking Supervision Department; and IMF staff estimates.

1/ January— September.

Table 7. FYRM: Credit Exposure

	1997	1998				1999		
	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.
	(In percent of credit exposure, unless otherwise indicated)							
By credit classification								
Regular loans	47.2	45.7	46.6	50.5	60.2	59.1	53.1	59.4
Nonperforming loans	12.7	11.6	10.7	5.7	5.2	5.0	13.4	8.5
Accrued interest	5.2	5.6	5.9	6.4	4.2	5.0	4.4	4.7
Other claims	15.3	16.0	15.4	15.3	9.0	9.2	10.3	9.5
Off-balance-sheet assets	19.6	21.0	21.4	22.1	21.4	21.7	18.8	17.9
By risk classification								
Pass	38.7	38.5	39.5	41.4	40.8	40.0	38.9	35.1
Watch	25.6	27.2	28.7	29.6	26.4	26.1	19.3	20.1
Substandard	11.6	11.3	11.5	14.0	15.6	16.5	22.3	19.4
Doubtful	12.9	12.7	13.1	12.9	14.2	14.3	15.9	13.4
Loss	11.1	10.4	7.2	2.2	3.1	3.0	3.6	12.0
Allocated provisions	23.0	22.0	19.7	15.2	16.3	15.9	18.0	17.8
Memo items:								
Credit exposure (in millions of denars)	45,251	48,353	47,841	46,831	49,944	52,270	52,018	53,008
Credit exposure (in percent of total banking system assets)	88.9	95.0	94.3	89.8	84.5	90.9	84.6	82.1
Guaranty capital (in millions of denars)	11,273	11,446	12,402	12,473	13,304	14,068	13,612	10,174
Allocated provisions (in millions of denars)	10,429	10,661	9,438	7,113	8,119	8,322	9,377	9,444

Sources: National Bank of Macedonia (NBM), Banking Supervision Department; and IMF staff estimates.

Table 8. FYRM: Banking System Soundness 1/

	1997	1998				1999		
	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.
	(In percent, unless otherwise indicated)							
Asset Quality								
Classified exposure/ Total credit exposure 2/	35.6	34.4	31.8	29.1	32.9	33.8	41.9	44.8 /3
Provisions/ Classified exposure	64.7	64.2	62.0	52.3	49.5	47.0	43.1	39.7
Provisions shortfall/ Classified exposure	2.0	2.9	1.8	2.5	5.1 /4	4.6	6.7	20.6 /5
Accrued interest/ Net loans 6/	10.5	14.3	14.2	14.1	9.5	11.2	12.1	11.7
Capitalization								
Guaranty capital/ Risk-weighted assets (C.A.R)	27.3	26.0	27.9	26.2	25.9	26.5	26.1	20.2 /7
Capital/ Total assets 8/	23.5	23.5	25.3	24.7	23.6	25.5	23.3	16.9 /9
Paid-in capital (millions of DM) 10/	386	394	421	424	476	501	464	473
Banks compliant with 1999 Min.Cap.Req.(DM 15 mil.) 11	6	6	6	6	9	11	13	13
Banks compliant with 2001 Min.Cap.Req.(DM 21 mil.) 11	4	4	5	5	6	7	7	7
Liquidity								
Short-term debt/ Total liabilities	12.0	11.3	11.5	8.9	7.2	8.2	7.8	5.3
NBM debt/ Total liabilities	4.6	3.2	3.7	3.4	3.9	4.3	3.3	1.6
Liquid assets/ Short-term liabilities	70.1	64.4	62.1	61.3	65.4	61.2	62.9	70.4
Profitability								
Net interest margin/ Total assets	4.1	1.3	2.5	3.8	5.5	1.5	1.8	2.7
Net income/ Total assets 12/	2.3	0.6	0.6	1.0	1.9	0.0	0.4	-6.4
Memorandum items:								
Classified exposure/ Total credit exposure (adjusted)	35.6	34.4	33.0	33.2	36.5	37.3	45.1	48.0
Provisions/Classified exposure (adjusted)	64.7	64.2	64.0	60.6	57.0	54.4	50.2	47.0
Provisions shortfall/ Classified exposure (adjusted)	2.0	2.9	1.7	2.0	4.3	3.9	5.9	18.1

Sources: National Bank of Macedonia (NBM), Banking Supervision Department; and IMF staff estimates.

1/ Definitions are described in Attachment I.
2/ Since June 1998, the ratio has been affected by write-offs of loans classified in the loss category. The adjusted ratio is shown as a memo item.
3/ Reclassification of assets by Stopanska Banka accounts for 2.6 percentage points.
4/ Shortfall in provisions by Almako Banka accounts for 3.6 percentage points.
5/ Shortfall in provisions by Stopanska Banka accounts for 15.0 percentage points.
6/ Net of provisions. Net loans exclude interbank loans.
7/ After reduction in guaranty capital of Stopanska Banka, equivalent to 7.1 percentage points of overall CAR.
8/ As per NBM's Banking Supervision Department.
9/ After increase in unallocated provisions for Stopanska Banka, equivalent to 5.5 percentage points of total banking system assets.
10/ Paid-in capital is used as the benchmark for compliance with the minimum capital requirement.
11/ Number of banks compliant. Since April 1999, capital has been adjusted for unallocated provisions,uncovered losses and requests for capital increases not yet approved by NBM.
12/ Assets and income adjusted for unallocated provisions.

credit exposure. About 11 percent of total credit exposure became classified in 1999, mainly in the context of the Kosovo crisis, when enterprises responded to the shock by stoping servicing their debts. The ratio of classified exposure stabilized in the third quarter of 1999 reflecting a partial reversal of nonperforming loans into regular loans as some enterpirses resumed servicing their debts. The quality of exposure is worse than average for some banks at end-September 1999, seven of 22 banks had more than 50 percent of their credit exposure classified.

17. Total specific loan loss provisions amounted to 40 percent of total classified exposures at end-September 1999, compared with 50 percent in December 1998 and 65 percent in 1997, largely reflecting underprovisioning by some banks, including the large Stopanska Banka and the smaller Almako Banka which became technically insolvent in the period (Section G). Allocated provisions are likely to be inadequate since they are also based on the value of collateral, the market value of which is likely to be lower than the book value.[14] On the basis of anecdoctal evidence, and as illustrated by the cases of Stopanska Banka and Almako Banka (see Section F), there is considerable risk that bad assets and losses are understated owing to possible misclassification of loans, and banking sector statistics may severely underestimate the degree of system fragility.[15] Underprovisioning also arises because of provisioning based on loan classifications done several months earlier, which may entail a substantial provision shortfall compared with provisions required under current loan classification.

18. At end-September 1999, seven banks accounting for 50 percent of banking system assets had CAMEL ratings of 4 or 5.[16] Of this total, two banks are being dealt with either by recapitalization and sale to a foreign strategic investor (Stopanska Banka, which accounts for 35 percent of banking system assets) or by closure (Almako Banka, holding 4 percent of banking system assets).

19. Measured capital asset ratios (CAR) of banks overestimate the true capitalization condition of the banking system. The high capitalization reflects unallocated provisions that have hidden in the system owing to misclassification of credit exposure. In September 1999, one-off adjustments to the guaranty capital of Stopanska Banka to account for unallocated provisions implied a decline in the overall banking system capitalization ratio of about 7 percentage points, to 20 percent.[17] In general, the high capitalization arises more because of accounting effects rather then economic solvency. For some banks, the high capitalization is

[14] Verification of collateral is part of the regular on-site inspectios by the Bank Supervision Department of the National Bank.

[15] Since September 1998, the Banking Supervision Department has started disclosing the amount of unnalocated provisions, by banks.

[16]Including Stopanska Banka. Includes off-balance sheet items.

[17]The CAR should be restored with the recapitalization of Stopanska Banka (see Section G).

also a structural feature associated with their low deposit base. Banks with small deposits tend to maintain higher-than-average CARs.

20. Until mid-1999 the banking system was subject to structural liquidity shortages requiring long-term liquidity support by the National Bank (Figure 3). Largely reflecting broader macroeconomic and regional developments the liquidity position of banks worsened considerably in the period October 1998 through April 1999 as foreign capital outflows created a liquidity squeeze that fed into downward movements in credit quality. Banks came under increased pressure largely because of rapidly deteriorating loan portfolios, raising the prospects of a systemic problem. Beginning in May, the overall liquidity position of banks improved relatively fast as economic activity picked up and unexpected foreign inflows. Banks foreign exchange reserves were boosted by rapid growth in foreign exchange deposits of residents and non-residents alike (Figure 3). Banks used their improved liquidity position partly to withdraw from the deposit auction, which carried relatively higher funding costs, and partly to allocate funds into central bank bills. By November, banks had reduced the outstanding credit from the NBM to almost zero.

21. The overall improved liquidity position masks large variations across banks. Many banks are net suppliers of funds to the interbank market and their claims are subject to credit risks, while few banks have consistently relied on interbank borrowing, indicating a liquidity shortage. During 1998 and 1999, about 11 banks (excluding Stopanska Banka) have consistently borrowed in the interbank market about 80 to 90 percent of all interbank funds, an amount equivalent to 6 percent of borrowing banks' own funds.[18]

22. Profitability remains weak and in the last two years, the banking system has made losses, largely owing to weak credit portfolio. Until June 1999, profitability indicators show small positive accounting margins, overestimating the true banking system condition. It is difficult to assess the extent of hidden losses but they reflect underprovisioning that stems from misclassification of credit exposure, neglect of the nonaccrual rule by some banks, and episodes of interest capitalization to avoid the suspension of interest payments.

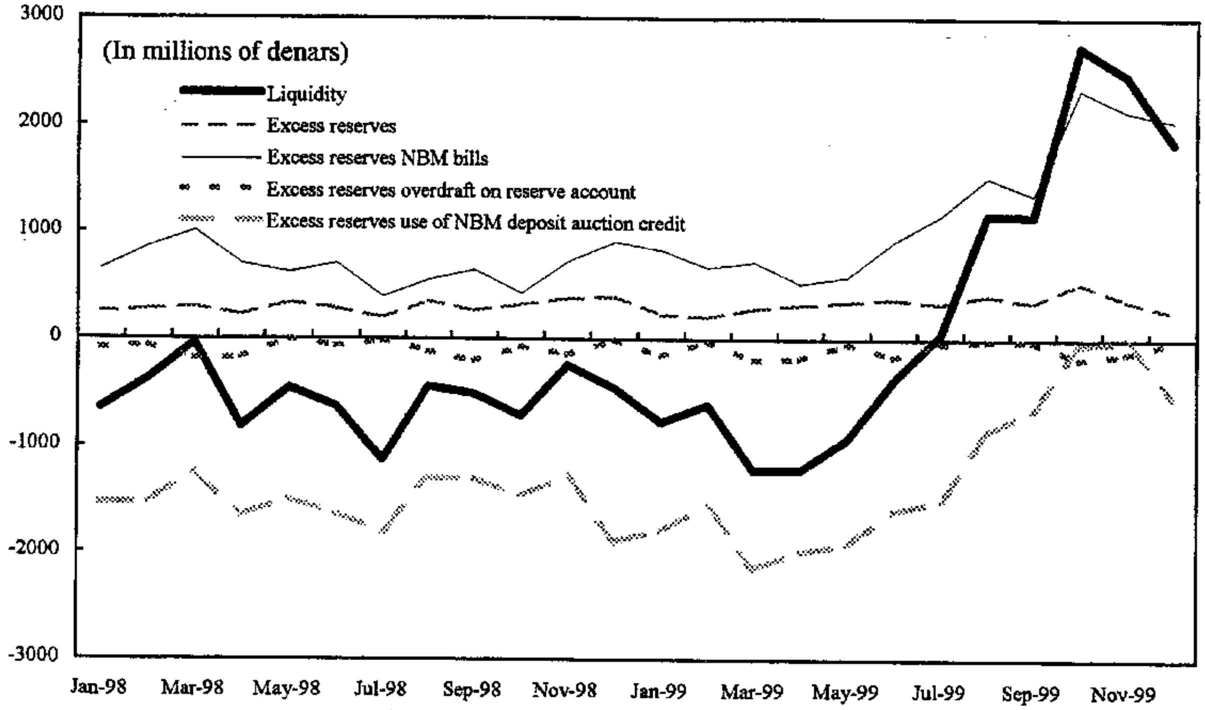
Banking system vulnerability

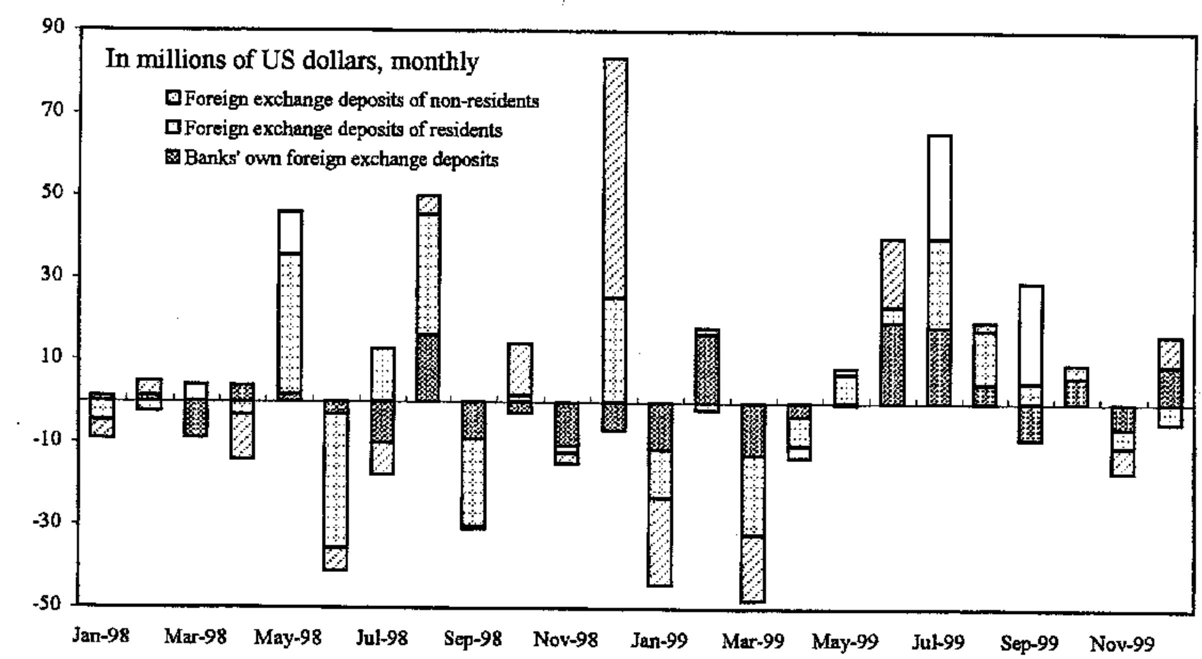
23. Assessing the banking system's vulnerability is particularly important in FYRM in light of the repeated macroeconomic shocks with economy-wide implications from the recent past. Although more general systemic risks will be significantly reduced upon completion of the sale and recapitalization of Stopanska Banka, the banking system remains vulnerable and subject to large risks associated with its bad loan portfolio, large off-balance-sheet exposures, maturity gaps, and interest rate and foreign currency risks.

24. The banking system is highly vulnerable to credit risk, because of the high share of unclassified exposure and possible under provisioning. If one-third of total credit exposure

[18]Equivalent to less than 2 percent of total banking system assets.

Figure 3. FYRM: Commercial Bank Liquidity and Composition of Foreign Exchange Reserves





Source: FYRM authorities.

(net of specific provisions) were to become nonrecoverable, then, about 60 percent of the banking system's own funds would be wiped out.[19]

25. Although banks do not have short open foreign exchange positions, they bear a substantial risk to foreign currency exposure. Over the last two years, banks have transferred an increasing part of their foreign currency risk into credit risk, of domestic borrowers, to the extent that the borrowers themselves have open positions. As of end-September 1999, all banks had net long foreign exchange positions, but one-fourth of total credit was denominated in foreign currency. Four banks (excluding Stopanska) carried foreign currency loans in their portfolios in the range of one-fourth to one-third of each bank's total credit exposure. In FYRM's small open economy, particularly vulnerable to trade shocks, banks' vulnerability to foreign currency risks is greatly associated with vulnerability of borrowers' net foreign currency earnings.

26. The improved overall liquidity position has reduced the maturity gap and the vulnerability of banks to higher interest rates. During 1999, banks have managed to reduce their short-term borrowing and debt to the NBM (mostly short-term deposit auctions). As a result, the coverage of short-term liabilities by liquid assets increased to 70 percent in September 1999, compared with 60–65 percent over the last two years. However, a group of banks with maturity gaps of less than one month has remained dependent on interbank funds for over a year, rendering them vulnerable to liquidity from other banks, eventual NBM support, and/or sustained rising costs of funds.

27. The banking system's vulnerability to off-balance sheet risks remains very high, given the magnitude of outstanding off-balance sheet claims, the risk of underprovisioning and the low compliance ratios by borrowers. The average default ratio of all uncovered off-balance-sheet items, including letters of credit and guarantees for the whole banking system, was 25 percent during the last six months of 1999 (Table 9).[20] The default ratio was slightly higher for Stopanska Banka (28 percent), which accounts for half of all off-balance-sheet exposure.

28. An assessment of the implications of interbank exposures for a group of identified troubled banks (excluding Stopanska Banka) shows that, on the basis of interbank market

[19] Excluding Stopanska Banka and Almako Bank.

[20] The NBM Supervision Department began monitoring off-balance-sheet activity in May 1999.

Table 9. FYRM: Credit and Off-Balance-Sheet Activity 1/

	1999							
	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
	(In percent)							
Credit developments								
Credit due to off-balance-sheet activity/(in percent of total new credit) 2/					31.8	37.2	23.0	13.8
Of which: Stopanska Banka					18.0	34.8	25.8	24.1
Default rates 3/								
All banks								
Off-balance sheet items 4/			22.3	34.9	35.7	12.2	20.5	17.0
Letters of credit			19.7	33.4	31.8	30.8	31.1	18.3
Guarantees			23.9	35.9	38.8	7.0	15.1	16.4
Stopanska Banka								
Off-balance-sheet items 4/	41.8	39.4	21.1	33.4	45.2	32.6	18.6	15.9
Letters of credit	37.0	23.2	8.0	34.3	26.1	61.8	22.6	10.0
Guarantees	45.5	51.5	27.7	33.0	66.1	22.8	17.7	17.6
Memorandum items:								
	(In millions of denars)							
All banks								
Off-balance-sheet items 4/								
Current due	1,712	1,466	1,496	1,776	1,213	4,010	1,752	2,074
Paid (by bank)			334	620	433	488	359	352
Letters of Credit (L/Cs)								
Current due	975	731	562	728	539	875	589	666
Paid (by bank)			111	243	172	269	183	122
Collection of overdue L/Cs 5/			186	130	201	243	217	185
Of which: Collection of overdue L/Cs (current month)			24	55	43	58	125	67
Guarantees								
Current due	737	735	934	1,048	674	3,135	1,163	1,407
Paid (by bank)			223	377	262	218	175	230
Collection of overdue guarantees 5/			238	137	129	143	142	319
Of which: Collection of overdue guarantees (current month)			57	68	38	15	18	88
Credit flow due to off-balance-sheet activity			-90	353	103	102	0	-152
Stopanska Banka								
Off-balance-sheet items 4/								
Current due	920	758	816	733	519	973	763	882
Paid (by bank)	385	299	172	245	234	317	142	140
Letters of credit								
Current due	403	325	274	214	271	244	141	192
Paid (by bank)	149	76	22	73	71	151	32	19
Collection of overdue L/Cs 5/	184	98	50	40	48	79	24	63
Of which: Collection of overdue L/Cs (current month)			5	27	2	20	11	14
Guarantees								
Current due	518	433	542	519	248	729	623	690
Paid (by bank)	236	223	150	172	164	166	110	121
Collection of overdue guarantees 5/	74	132	142	99	65	7	30	51
Of which: Collection of overdue guarantees (current month)			14	55	25	6	0	2
Credit flow due to off-balance-sheet activity	126	69	-20	106	121	231	88	26

Sources: National Bank of Macedonia (NBM), Banking Supervision Department; and IMF staff estimates.

1/ Off-site monitoring of off-balance-sheet activity started in April 1999.
2/ Credit measured by NBM (adjusted for exchange rate valuations) may not reflect all credit expansion due to off-balance-sheet activity.
Cumulative since July.
3/ In percent of current due.
4/ Uncovered Letters of credit and guarantees.
5/ Data on overdue Letters of credit and guarantees (current month) are available from July on.

transactions, the current levels of interbank exposure makes a small group of banks, vulnerable to illiquidity or insolvency (Box 4). A group of 11 banks that has consistently (for

Box 4. Assessment of Interbank Exposures

The banking system in FYR of Macedonia presents a somewhat unique situation in that, other than the large Stopanska Banka which is being restructured and sold to a foreign investor, a number of troubled small banks remain. While it is straightforward to verify that each individual troubled bank does not pose systemic risks due to their size, it is less clear whether as a group, the current small troubled banks may eventually come to pose a systemic risk. Assessing the possibility of simultaneous illiquidity or insolvency of several small banks is important in practice in light of the repeated macroeconomic shocks with far reaching and economy-wide implications that have stormed the Macedonian economy. In addition, to the extent that interbank market relations deepens, the assessment of interbank exposures will become increasingly important.

An assessment of the systemic risk posed by interbank exposures was made using indexes that capture the systemic importance of troubled banks in the interbank market (IE indexes; see Attachment II). A set of troubled banks (TB) in FYRM was defined to include all banks (excluding Stopanska Banka) that have received CAMEL ratings of 4 or 5 by the Supervision Department and banks with CAMEL ratings of 3 that have borrowed more than 10 percent of their own funds (equity capital and reserves) in the interbank market. The systemic importance of troubled banks on the interbank market was measured by the share of all sound banks' loans to each one of the troubled banks in their own portfolios. If lending to any one of—or the set of—the troubled banks represent a large share of sound banks assets, then illiquidity or insolvency of troubled banks can be expected to cause difficulties to lending banks.

The assessment of systemic risks of interbank exposures using IE indexes for FYRM was made for December 1998 and December 1999. The set of troubled banks consists of 11 small banks in both periods: 8 banks (excluding Stopanska Banka) with CAMEL ratings 4 or 5 and 3 banks with CAMEL ratings 3 and funds borrowed in the interbank market equivalent to more than 10 percent of their own funds (capital and reserves). As of December 1998, the set of troubled banks as defined above had borrowed denar 277 million in the interbank market, equivalent to 82 percent of total interbank funds. As of December 1999, the amount of funds borrowed was denar 217 million, equivalent to 90 percent of total interbank funds. In both periods, the funds borrowed represented about 6 percent of troubled banks' own funds (capital and reserves). The index of interbank exposures was 0.04 in 1998 and 0.05 in 1999 indicating the group of identified troubled banks posed limited direct systemic risk.

This result, however, must be interpreted with caution. Interbank market transactions do not record all interbank exposures. Interbank market transactions account for about one third of overall interbank exposures and therefore provide an underestimate of the overall potential impact. In addition, given weaknesses in statistics, accounting standards and difficulties in assessing individual bank positions, care needs to be taken to interpret the assessment of systemic potential of interbank exposures according to this methodology. More importantly, to the extent that behavior of depositors of sound banks is affected by the illiquidity or insolvency of troubled institutions, small troubled banks could have a systemic impact above and beyond their relative size in the banking system.

borrowing. The possible illiquidity or insolvency of a group of identified small banks, however, would seem to pose limited systemic risk.

E. Macroeconomic Effects of Banking System Fragility

29. The fragility and structural problems of the banking system have affected the transmission channels of monetary policy, making it less efficient. In particular, unsound banking practices that continue to lead to misallocation of resources have implied that additional credit has not been channeled in a way that maximizes benefits to the real economy. In addition, the high cost of intermediation and a harmful bias in the cost of credit toward bad debtors have effectively, led to an interest rate wedge that taxes viable enterprises and reduces the availability of bankable projects at current rates.

30. An immediate and direct outcome of banks' poor lending practices has been the biased and poor allocation of credit. Banks have continued to lend without regard to borrowers' capacity to service debt or their creditworthiness. In addition, banks have continued to finance risky borrowers because the cost of rolling over debt and possibly extending new credit to bad debtors, despite weak collection rates, is preferred to the alternative of not doing so and charging losses against capital. The share of total credit flow to the largest 16 debtors with classified exposure was as high as 83 percent in the first three quarters of 1999.[21]

31. The bad loan portfolio of the banking system has resulted in prohibitive costs of intermediation (Figure 4). Banks have shifted the credit risk burden into higher interest rates, effectively penalizing new and good borrowers and distorting the allocation of credit. The spread between nominal lending and deposit rates has remained high at about 8–10 percent annually, which is associated with a wedge between nominal and effective lending rates (rates effectively collected by banks) in the range of 16–18 percent annually. Despite such high rates, given the implicit interest rate subsidy to outstanding nonperforming borrowers, the effective net interest margin of banks (net interest income) has remained low, hovering around 1–5 percent (Table 8).[22]

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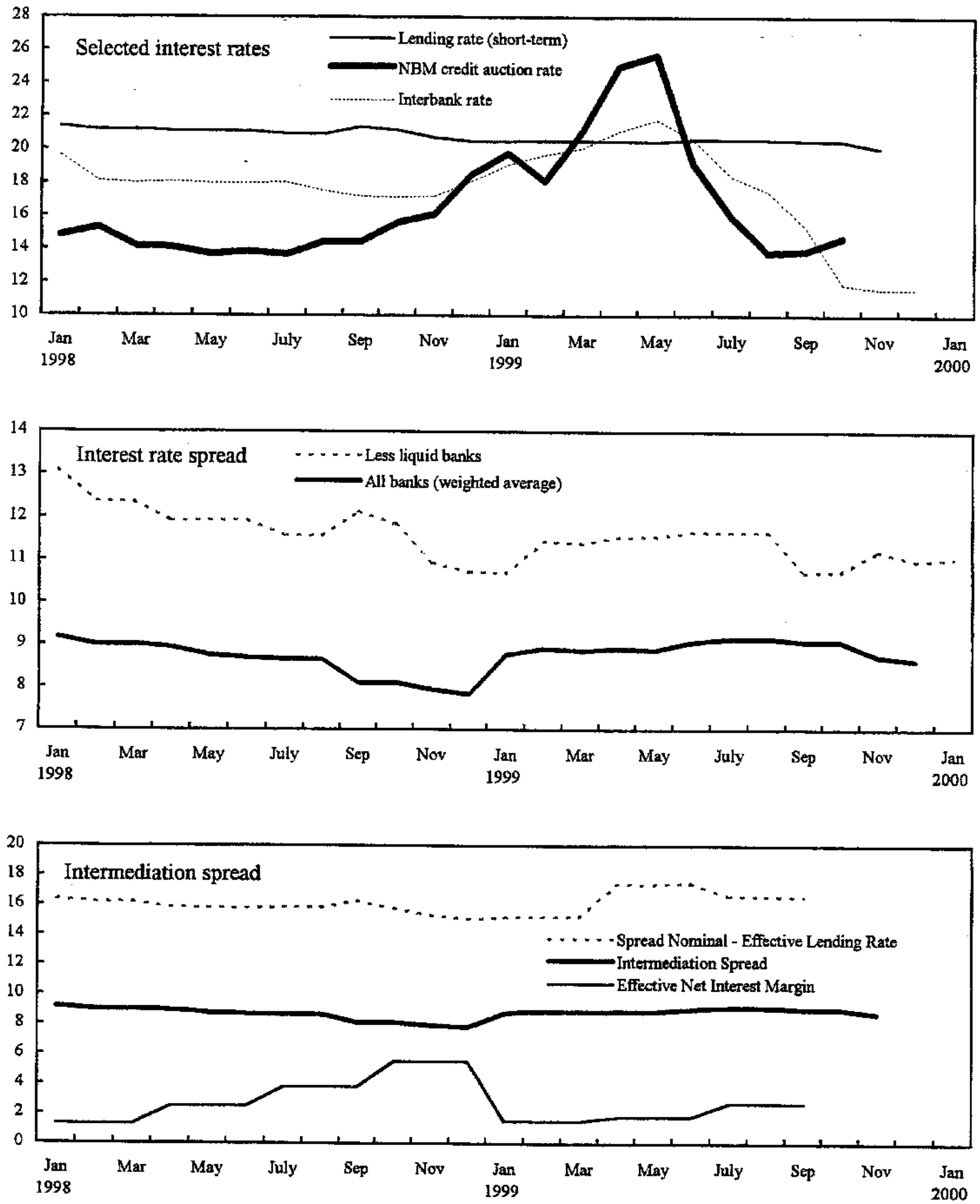
[21]This ratio may overestimate the share of credit to the 16 largest debtors with classified exposure to the extent that credit arising from denar and foreign currency advances for letter of credit transactions made on behalf of banks' clients in previous periods, as well as receivables from payments made on behalf of banks' clients arising from guarantees (an off-balance-sheet item fee that has come on balance) may have been improperly classified as "other assets" in banks' balance sheets. The ratio, adjusted for potential misclassification, would still be very high (53 percent).

[22]Low remuneration of reserve requirements is also partly responsible for the high spread between lending and deposit rates. In June 1998, the National Bank increased the remuneration or reserve requirements by 2.8 percentage points to 6.2 percent, a level that remains below market rates. The higher remuneration, however, has a marginal impact on the intermediation spread, estimated to be only 0.2 percentage point.

Figure 4. FYRM: Interest Rates
(In percent)



Sources: FYRM authorities and IMF staff estimates.

32. The NBM's monetary policy stance of accommodating the liquidity needs of banks with structural needs has reduced the incentive for banks to change their own interest rates, causing commercial banks' interest rates to remain inflexible and largely insensitive to changes in banks' liquidity position's (Figure 4). As a result, in tandem with increased volatility of NBM's rates, commercial banks' interest rates have remained largely unchanged without affecting interest-sensitive activity in the economy. At the same time, the permanent illiquid position of a number of banks has implied as even higher cost of capital and intermediation spreads for part of the banking system (Figure 4).

33. The large share of risky off-balance-sheet exposure has created an endogenous component to credit expansion in the very short term. The amount of receivables from payments made on behalf of banks' clients arising from guarantees and letters of credit that have come on balance peaked at one-third of banks' measured credit to the enterprise sector in the third quarter of 1999 (Table 9).[23] The poor payment and collection ratios of off-balance-sheet exposure have implied a high endogeneity of credit expansion in the very short run, which has limited the ability of the NBM to tighten credit conditions when needed. It has also highlighted the need for an increasing role for the Supervision Department in terms of credit control and monitoring.

34. Weaknesses in the banking system have also demonstrated the reduced room for maneuver by the NBM. Because troubled banks that posed systemic risks needed support during the Kosovo crisis, the monetary authorities had to tighten, the liquidity position of the remainder of the banking system to maintain a given level of market liquidity. By providing liquidity support and accommodating banks' liquidity needs of weak banks, the NBM effectively redistributed reserves across banks into weak banks, thereby sanctioning a transfer of the adjustment burden to sound banks within the banking system, with a long-lasting adverse impact on compliance and financial discipline.

35. The fragility of the banking system has added volatility to the foreign exchange market as illiquid banks have dumped foreign exchange inflows into the market to maintain their denar liquidity. Movements in commercial banks' foreign reserves have been closely associated with developments in the foreign exchange market (Figures 3 and 8). Between January 1998 and October 1998 the commercial banks' foreign exchange reserve position remained, on average, broadly balanced, and the spread of the interfirm rate remained under 2 percent over the NBM middle exchange rate with a high daily market turnover (above DM 1.5 million). Between October 1998 and June 1999 commercial banks lost about US$30 million in foreign exchange reserves as pressures on the foreign exchange market exacerbated largely in anticipation of, and as a result of, political and regional developments. The exchange rate spread peaked above 4 percent in early November 1998 and in April 1999, immediately after the start of the Kosovo conflict. In April, the foreign exchange market became very thin and illiquid with small transactions moving the market. From June to

[23]Credit measured by the NBM may not reflect all credit expansion that is due to off-balance-sheet activity, owing to possible misclassification of credit by banks as other assets and temporary accounts.

December 1999, commercial banks accumulated as much as US$156 million in foreign exchange, and the exchange rate spread shrank to less than 1 percent in the interfirm market as substantial foreign inflows dampened market pressure (Figure 5).

F. Banking Supervision and the Legal Environment

36. The weak and fragile conditions of the banking system have developed against a background of incipient banking system supervision and a legal environment that suffers from several shortcomings. In recent years, the NBM has taken gradual steps to reshape and improve its banking supervision capacities. An assessment of compliance with core principles of banking supervision conducted in November 1999 has found favorable compliance with principles related to the regulatory and legal basis of supervision. However, the review found that substantial efforts are required to comply with those principles related to timely and rigorous regulatory enforcement, and off-site monitoring and supervision. In addition, the review found that further work is needed to start preparing to achieve compliance with those principles that postulate the coverage of several types of risks that more mature financial systems face.

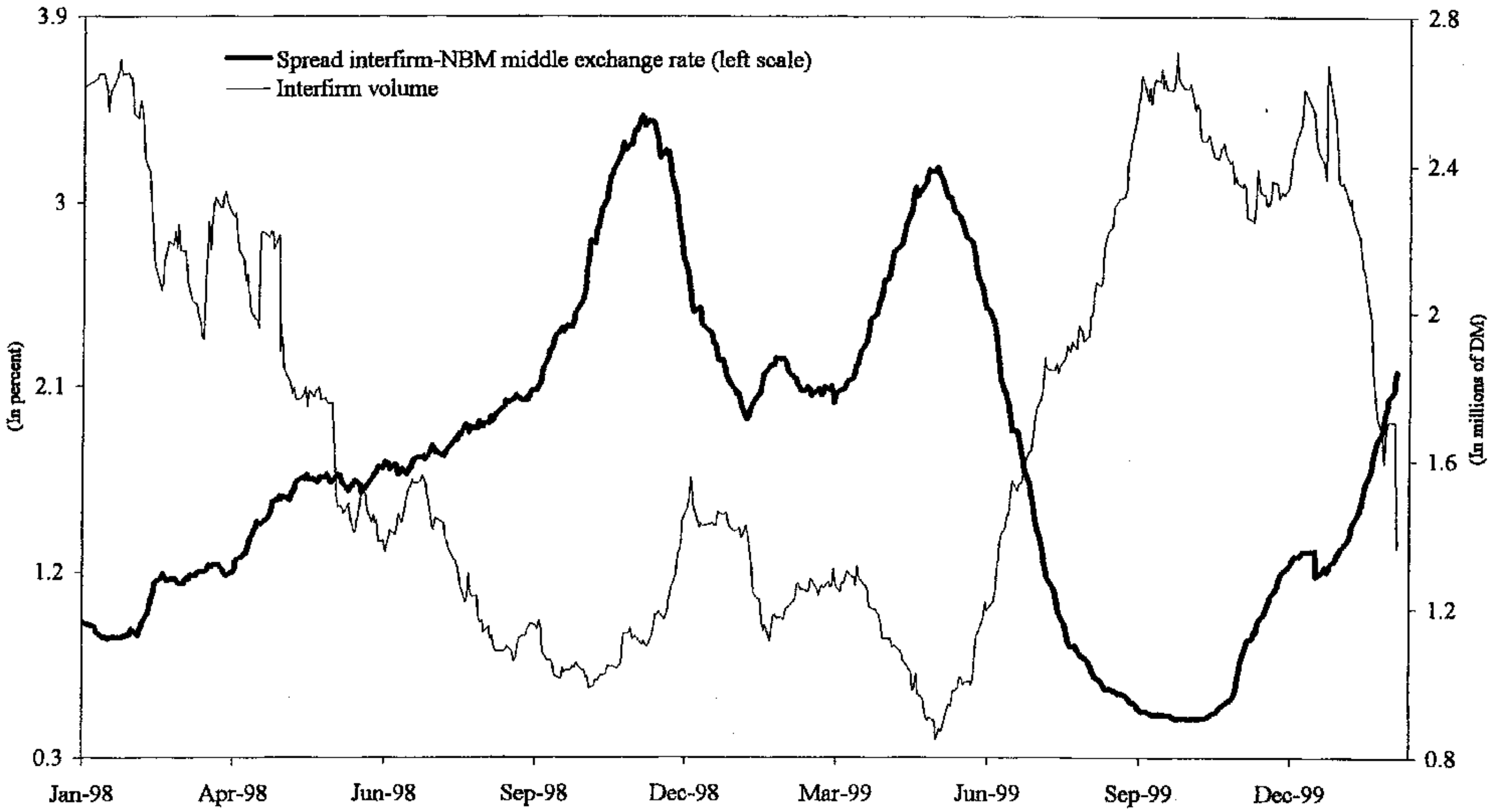
37. The NBM has taken initial steps to strengthen its off-site monitoring ability, including monitoring of off-balance-sheet activity. A separate unit within the Banking Supervision Department has been set up to conduct off-site analysis. The unit has been monitoring off-balance-sheet activity by banks since April 1999, and it is expected to tackle problems on several fronts, including enforcing adequate provisioning, reducing the time lag of monitoring in between on-site inspections, and reviewing adequate and timely banking system data submission and accounts.

38. To improve enforcement of banking supervision, the NBM has created a troubled bank unit within the Supervision Department. The unit aims to closely monitor banks that are chronic violators of prudential standards and to monitor and specify explicit criteria for addressing problem banks that are illiquid or insolvent and are primary candidates for reorganization or liquidation. The unit is currently establishing rules for the provision of NBM emergency liquidity and government solvency support. The unit is expected to strengthen the NBM's supervisory capacity by seeking to enforce the timely implementation of corrective actions and by strictly enforcing prudential rules and regulations, including the minimum capital requirement.

39. The NBM is currently redrafting the Banks' Act regulating the banking system, aiming to enable early intervention and resolution of troubled banks, to increase savings house capital requirements, to mandate standards for accounting and auditing, to improve licensing and exit policies and to further develop prudential regulations to bring the draft law in line with the Basle Core Principles of Bank Supervision and EU standards.

40. Over the last two years, the existing legal framework for creditors' rights has remained broadly unchanged and is a key obstacle to greater banking system intermediation. Poor loan recovery has been associated with long delays in processing claims to take possession of mortgages and other collateral. Under the current Bankruptcy Law, courts can

Figure 5. FYRM: Foreign Exchange Market
(30-day moving average)



Source: FYRM authorities; and IMF staff estimates.

delay the opening of a bankruptcy proceeding, while under the current Law on Executive Procedures, creditors are not allowed to take possession of collateral without the prior approval of the courts. In addition, under the existing Collateral Law, security cannot be given over a changing pool of assets such as inventories and accounts receivables, based on a general description of the assets, making it more difficult for small and medium-sized enterprises to meet collateral requirements. Finally, the current Mortgage Law does not facilitate foreclosure in case of loans secured by real property.

G. Dealing with Unsound Banks

41. The combination of weak credit portfolios, hidden losses, poor lending practices, connected lending, and weak collection has led the largest bank, Stopanska Banka, and a smaller bank, Almako Banka to become insolvent between end-1998 and early 1999. Stopanska Banka first failed to meet the minimum reserve requirement in April 1999. At the same time, Almako was declared insolvent by the NBM and then had its operating licenses revoked by the NBM as an intermediate step prior to initiation of bankruptcy procedures. In what follows, this note provides a review of recent developments in Stopanska Banka and Almako Banka with a view to looking into the latest individual problems within the banking system, the nature and timing of response by the NBM's bank supervision, and to drawing lessons from the recent experience.

Stopanska Banka

42. The bank accounts for almost half total credit exposure and slightly more than half of risky loans in the banking system posing a clearly systemic risk. Stopanska's liquidity position began to deteriorate fast in the second half of 1998, reflecting the behavior of large borrowers/shareholders who defaulted on their payments in anticipation of a failed reverse debt-equity swap made possible by a former prospective foreign investor in the bank.[24] In March 1999, the bank deposit base suffered a relatively large shock after the onset of the Kosovo crisis with a resulting worsening of Stopanska's liquidity position that led it to increase its debt against the National Bank. In April 1999, Stopanska failed to meet the minimum reserve requirement and the Governor of the National Bank adopted a decision banning any new credit activity for one month. In May, Stopanska again failed to meet the minimum reserve requirement and the lending ban was extended for one more month. On that occasion, the NBM adopted a decision to cap new credit extension, including off-balance sheet activity, in an attempt to restore the bank's liquidity position.

43. Beginning in May 1999, the government identified a new strategic investor (the National Bank of Greece, NBG) willing to bid for a majority shareholding stake in the bank with the participation of the EBRD and the IFC. Agreement was reached with the agreed purchase price for 85 percent of the ordinary share capital set at DM 94 million (equivalent to 81 percent of total capital, DM 116 million). Under the investment, the NBG acquires

[24] The share purchase contract was expected to be closed on October 1998 but the deal did not go through.

65 percent of SB's ordinary share capital and the EBRD and the IFC acquire a maximum of 10 percent of SB's ordinary share capital each. The government recapitalized the bank by issuing Euro-denominated bonds to Stopanska Banka in exchange for the four largest borrowers' bad debts amounting to DM 235 million.The bond terms are 15-year maturity, Euribor plus 1 percent coupon and one year grace period. The bad debts have been transferred to the Bank Rehabilitation Agency for collection. However, the active restructuring of the bank's large debtors and the track record on BRA's collection have not yet been established. To help offset the cost of servicing the newly acquired debt the government has agreed to save all of its proceeds from the sale of Stopanska Banka estimated to be about DM60 million (including its equity participation and all the premiums received on the existing shares). The share purchase agreement was signed on December 20 and closing of the contract is expected to take place before March 31, 2000. In addition, the investors undertook to increase capital by about DM50 million before May 31, 2000, largely to help restructure and improve the liquidity position of the bank.

Almako Bank

44. The bank is relatively small with a reduced deposit base and bank's assets equivalent to slightly less than 5 percent of the banking system's total. The bank's portfolio was originally concentrated in loans to parent mines and metal trading companies (lead and zinc). In light of its long-standing fragile position, the bank's liquidity deteriorated sharply over a period of few months in late 1998 as a result of poor asset collection and some withdrawal of deposits. By end-March 1999, bad and doubtful loans accounted for 59 percent of the bank's overall exposure, up from 15 percent at end-September,1998. The bank managed to delay adjustment by tapping increasingly into the liquidity provided by the National Bank through deposit auctions, almost doubling its borrowing from the NBM in 1998. On April 14, the NBM's governor adopted a decision declaring the bank illiquid. The bank's payment operations ceased, denar and foreign exchange deposits of households and enterprises were frozen, and the bank was required to submit a bank rehabilitation program to the NBM with specific measures to reestablish solvency and restore liquidity. By end-April 1999, the bank's negative net worth was denar 268 million (DM 8.6 million) with total uncovered losses of about denar 629 million (DM 20.2 million). On March 1, 2000, after a long period of failed attempts to recapitalize the bank, the council of the NBM closed the administrative procedure for appeal and adopted a decision to initiate bankruptcy procedures.

Lessons from recent experience

45. First, delaying closure or restructuring of nonviable banks entail large adverse consequences. The NBM's provision of perennial liquidity support propping up Stopanska and other illiquid banks delayed achieving a more permanent solution. The consequences have been considerable. By postponing more definite action and accommodating banks' liquidity needs over long time periods, the NBM allowed enterprises to transfer the burden of recurrent losses into the banking system and into the NBM itself. Also, by lessening financial discipline, a more general long-lasting adverse impact on the banking system was felt because it affected compliance and collection efforts. In addition, the fiscal costs of bank

restructuring and closure have been magnified over time as insolvent banks were allowed to continue to operate and more definite action by the Supervision Department was delayed.

46. Second, the macroeconomic impact of banking system weaknesses, if left unchecked, can be extremely large. The harmful distortions on the availability, cost, and allocation of credit due to the poor conditions of the banking system have had a fairly large negative impact on growth and private sector development. They have also reduced the scope for monetary policy response by the NBM.

47. Third, the absence of independent and strong enforcement capacity of the supervisory function prevents proper follow-up of the legal and regulatory framework and implies that weak financial discipline may remain unchecked within the system. Lack of enforcement capacity breeds a moral hazard with long-lasting implications on the behavior of banks.

48. Fourth, in the absence of clear steps that improve financial discipline, banks may reengage in automatic financing of losses accrued by the enterprise sector. Dealing with the stock problem of a poor credit portfolio in the banking system is a necessary but not sufficient condition for reform. Simultaneous steps must be taken—particularly in the enterprise sector—to prevent a resurgence of the flow problem of bad financing to nonviable enterprises. In the mid 1990s, FYRM has undergone a banking system restructuring that has not prevented the recurrence of banking system problems, largely because of its failure to address the issue of loss-making enterprises.

49. Fifth, the consolidation process in the banking system can be greatly facilitated by, and may require, the entry of foreign banks. The sale of Stopanska Banka to a foreign strategic investor is expected to have far-reaching and economy-wide implications for the banking system as a whole.

Banking Definitions[25]

Accrued interest: interest due but not paid for less than 90 days. Gross of provisions.

Allocated provisions: specific reserves set by banks by applying specific weights to credits according to their risk classification (2 percent for A; 10 percent for B; 25 percent for C; 50 percent for D and 100 percent for E).

Capital (owned funds): common and preferred shares, general banks' reserves, revaluation reserves and undistributed profits. Net of uncovered losses and unallocated specific provisions identified by the NBM's Banking Supervision Department.

Credit to banks: regular and nonperforming loans and other claims to domestic and foreign banks, gross of provisions.

Credit to nonbanks: regular and nonperforming loans to private and public enterprises, households and other customers, gross of provisions. Includes short- and long-term denar and foreign currency loans.

Classified exposure: credit exposure classified under Substandard, Doubtful and Loss Risk category.

Credit risk classification: NBM classifies credit risk into five categories from A to E, which correspond to Pass (A), Watch (B), Substandard (C), Doubtful (D) and Loss (E). Classification is based on objective and subjective criteria including the amount of time loans have been overdue (A,15 days; B,from 16–60 days; C,from 61–150 days; D,from151–365 days and E,more than 365 days or without recovery).

Credit exposure: regular and nonperforming loans, accrued interest, other claims and off-balance-sheet credit exposure that entails credit risk.

Guaranty capital: capital adjusted by current profit (50 percent) and other long-term securities, net of current losses and capital investments.

Liquid assets: cash, claims, and securities rediscounted by the NBM; debt securities and accounts with domestic and foreign banks.

Minimum capital requirement: based on paid-in capital. Since April 1999, the NBM's Banking Supervision Department requires banks to adjust the amount of paid-in capital by

[25] According to the Banks and Savings Houses Act and the NBM's regulations. Some terminology may differ from standard usage elsewhere.

deducting unallocated specific provisions, uncovered losses and requests for capital increases not yet approved by the NBM.

Net loans: regular and nonperforming loans to nonbanks, net of provisions.

Nonaccrual interest: interest overdue more than 90 days.

Nonperforming loans: principal of loans classified as Doubtful and Loss and principal of loans for which interest payment has been overdue more than 90 days.

Off-balance-sheet items: covered and uncovered letters of credit and guarantees, performance guarantees, credit commitments, and other uncovered off-balance-sheet items.

Off-balance-sheet credit exposure: uncovered off-balance-sheet items.

Paid-in capital: common and preferred shares and general banks' reserves paid-in in money form, adjusted by annual reports.

Provisions: allocated provisions on credit to nonbanks and banks; unallocated specific provisions and provisions for nonaccrual interest.

Unallocated provisions: provision shortfall identified by the NBM's Banking Supervision Department.

Regular loans: principal of loans (including overdue) other than nonperforming loans.

Risk-weighted assets: risk-weighted on-and off-balance-sheet assets net of uncovered and current losses, capital investments and unallocated specific provisions.

<u>On-balance-sheet items and their risk-weighting is as follows:</u>
-cash, deposits with NBM and gold (0 percent risk);
-claims on NBM and on Government (0 percent);
-claims secured or guaranteed by NBM and Government (0 percent);
-claims covered with cash (0 percent);
-claims on domestic and foreign banks (20 percent);
-precious metals (20 percent); and
-all other assets (100 percent).

<u>Off-balance-sheet items and their risk-weighting is as follows:</u>
-covered letters of credit and guarantees (0 percent risk);
-performance guarantees to nonbanks (20 percent);
-credit commitments to nonbanks (50 percent); and
-uncovered letters of credit and guarantees and other off-balance-sheet items to nonbanks (100 percent).

Performance guarantees, credit commitments, and uncovered off-balance-sheet items to banks (20 percent of risk-weighting for each asset).

Short-term liabilities: deposits and borrowings up to one year. Includes denar and foreign currency liabilities.

Measuring the Systemic Risk of Interbank Exposures

Define a banking system with n banks, of which, m are troubled banks. Define a matrix A where aij is the logarithmic transformation of Aij, the share of bank i's loans to troubled bank j as a percentage of that bank i's total loan portfolio (if one sound bank lends 10 percent and 15 percent of its bank portfolio to two troubled banks, then Aij is 0.1 and 0.15 respectively). Using data from the interbank market, define a matrix W where wij for i=1 to n and j=1 to m, is the share of sound bank i's loans to troubled bank j as a percentage of total interbank loans to troubled bank j (If 10 sound banks lend to 5 troubled banks and each sound bank i lends 10 percent to each troubled bank, then Wij is 0.1 for each i and j).

Then, define the matrix S = A'W where A' is the transposed matrix A. The matrix S has dimension m*m with indexes sj, j=1 to m, where each index Sj is the weighted share of each sound bank's lending to each troubled bank as a percentage of the sound bank total loan portfolio. Define an index of interbank exposure (IE) as Tr(eSj). The impact of potential banks' failures on banks that lend to troubled banks is greater, the closer IE is to 1. The closer IE is to zero, the lower the impact on lending banks.

V. Enterprise Sector Transformation and Financial Performance[1]

A. Transformation of Socially Owned and State Enterprises

1. As part of its transition toward a market economy, the FYRM undertook in mid-1993[2] to dismantle the social ownership system of enterprises inherited from the former SFRY.[3] Privatization, however, did not gain momentum until late 1994. In early 1995 a special law on the Special Restructuring Program (SRP) mandated the restructuring and privatization of an additional 25 large loss-making enterprises, including the state-owned electric utility and the railways. In April 1996 privatization was expanded to agricultural enterprises and cooperatives. With the privatization process nearing its end, the outcome has been below expectations. Internal ownership by workers and managers has widened, owing to the predominant reliance on insider privatization; the government has been increasingly burdened with the liabilities of large insolvent loss-makers; privatization of the state-owned utilities has not yet been initiated; and, notwithstanding the impact of external factors, the overall financial performance of transformed enterprises failed to improve significantly.[4]

2. Two state-controlled agencies have been instrumental in assisting the privatization and restructuring process: the Privatization Agency (PA), and the Bank Rehabilitation Agency (BRA). The former also holds the unsold shares of privatized enterprises on behalf of the State (i.e. "residual shares").[5] As of end-June 1999 shares with an appraised value of DM 465 million, representing 11.3 percent of the total appraised value of privatized enterprises, had been transferred to the Privatization Agency. The State's portfolio largely

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[1] Prepared by Philippe Marciniak.

[2] See SM/98/130; and SM/95/84. Under the *Law on the Transformation of Enterprises with Social Capital* enacted in June 1993, all publicly owned enterprises except agricultural enterprises and cooperatives, a number of "strategic" enterprises, and state-owned enterprises (e.g., the electric power, telecommunications, and railway companies) were slated for restructuring or privatization.

[3] Early privatization efforts were undertaken in late 1989 with the enactment of the *Law on Social Capital*—i.e., the so-called *"Markovic Law"*—under which employees were allowed to purchase "internal shares," generally at a substantial discount to their market value. This legal framework was suspended upon FYR Macedonia's independence in September 1991.

[4] See Annex III: *"Did Privatization Increase Profitability in FYRM."*

[5] Whenever a purchaser did not wish to acquire more than 51 percent of the shares, the State ended up with up to 34 percent of enterprises' shares, as 15 percent of the social capital of socially owned enterprises is reserved for the Pension Fund. The requirement to sell residual shares within 30 days of their acquisition was virtually never met.

comprises shares of underperforming enterprises. The BRA is an asset management agency that was initially considered as a temporary arrangement for resolving the portfolio of nonperforming denar-denominated loans of Stopanska Banka, the country's largest state-owned bank. Subsequently, however, additional claims (representing nonperforming foreign currency debts of socially and state-owned enterprises to Paris Club, London Club, and multilateral creditors[6]) were also transferred to the BRA. To date, most of these nonperforming loans are still on the BRA's books, as collection of claims by the BRA has been minimal and only a few loans were sold, generally to the original debtors either at a steep discount or using government-issued bonds. The shares associated with the US $121 million debt-to-equity conversion of bank debt effected under the 1995 SRP were transferred from the BRA to the Privatization Agency, following the adoption in April 1999 of the *Law on Privatization of State Capital.*

3. Although up to 12 transformation models of socially owned enterprises were allowed under the Law on the *Transformation of Enterprises with Social Capital*, buyouts have been the predominant method of privatization (Table 27). Buyouts, together with the internal shares granted under the "old law," accounted for about half of the privatizations undertaken as of end-1999. Meanwhile, sales of enterprises to private investors accounted for about 19 percent of total transformations, of which about 10 percentage point went to foreign investors. As of end-1999, a total of 1,488 enterprises with social capital had been privatized, leaving 238 enterprises still awaiting privatization. Payments for the shares have generated minimal amounts of cash, as the bulk of the privatization proceeds was paid in the form of certificates related to frozen foreign currency deposits held by households.[7] Moreover, the sale of shares entailed deep discounts, long payment periods, and widespread delays in the collection of payments. Payments through frozen foreign currency deposit certificates increased markedly in 1999 compared with other types of payments, thus reducing the domestic obligations of the State.

B. Financial Performance of the Enterprise Sector

4. Although the financial performance of the enterprise sector as a whole improved slightly during 1996-98, the performance has been disappointing when viewed against the continued privatization and the SRP. The proportion of enterprises suffering losses declined from about 55 percent to 47 percent during 1996-98, and aggregate losses (as measured in

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[6] Claims transferred over time to the BRA had a book value at end-1997 of about US$559 million, of which US$249 million represents dinar claims connected to Stopanska Banka's rehabilitation and US$310 million, foreign currency claims to Paris Club, London Club, and multilateral creditors.

[7] Cumulative privatization proceeds as of mid-1999 amounted to DM 412 million, of which DM 257 million was paid in frozen foreign currency deposit certificates, DM 97 million in bonds issued to banks and DM 58 million in cash.

terms of the operational balance) of loss-makers fell while aggregate profits of profitable firms increased as a ratios to GDP and sales (Table 28). The decline in the share of loss-makers mainly reflected the superior performance of private firms. The share of loss-making firms increased in the state-owned enterprise sector in 1998. Operational balance as a ratio to sales improved markedly for both loss-makers and profitable firms, mainly reflecting the favorable impact of the July 1997 devaluation. Aggregate losses in relation to sales and GDP were highest among transformed enterprises (nearly 17 percent), which reflects largely higher average wages, and delays in shedding labor, since transformed enterprises remain predominantly controlled by managers and workers inclined to preserve their immediate interests at the expense of profit and investment. Preliminary information for 1999 indicates that the overall financial performance of the enterprise sector remained broadly unchanged despite the Kosovo crisis.

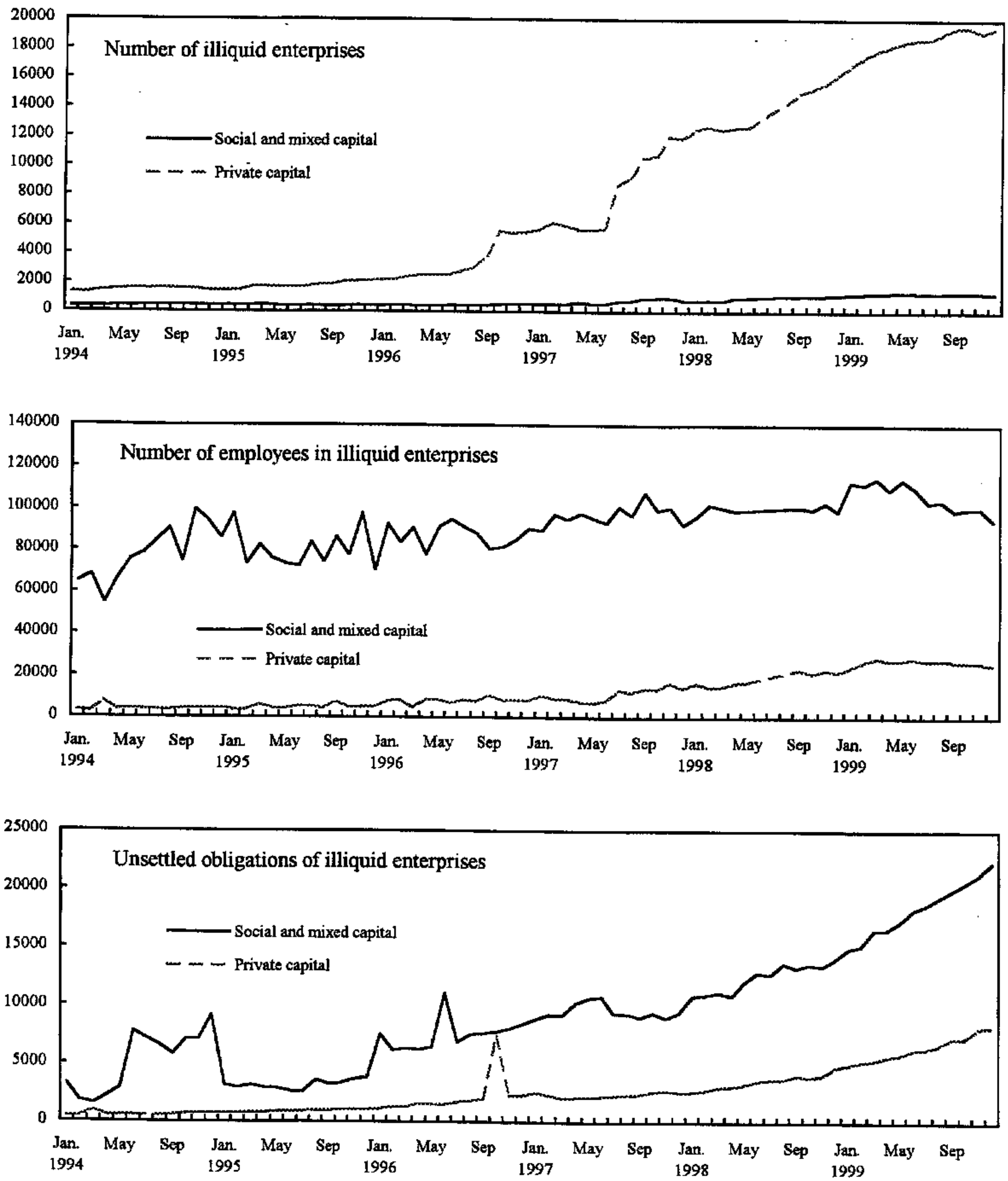
5. There has been a steady rise in the number of illiquid firms[8] in all types of ownership categories (Figure 6), despite a decline in the number of loss-makers. This partly reflects greater willingness of creditors to file for the blocking of enterprises' accounts. About 46 percent of all firms in the formal enterprise sector were faced with liquidity problems as of end-1998, as against 17 percent as of end-1996; and about 42 percent of the enterprises' workforce was in employed in illiquid firms at end-1998, compared with 24 percent at end-1996. The deterioration of enterprise liquidity has accelerated since 1998, particularly in enterprises under social and mixed capital ownership, reflecting inadequate corporate governance standards, moral hazard stemming from earlier relief on overdue obligations to government and the impact of the Kosovo crisis. Unpaid obligations to the State as of end-1999 amounted to the equivalent of 16 percent of GDP, of which about 11 percentage points had been accrued in enterprises under social and mixed capital ownership.

6. Continued enterprise sector losses stemmed primarily from insufficient labor adjustment and high labor costs in both privatized and state and socially owned enterprises—about 20–26 percent of total sales. Operating losses were mainly financed by wage arrears, and overdue obligations to suppliers, the government, and banks. Although during 1996-98, wage arrears for the enterprise sector as a whole declined slightly to about 7 percent of GDP in 1998, owing to wage arrears reductions by private and state and socially-owned enterprises, they increased further in the transformed enterprises, to about 4 percent of GDP.

7. Since 1998, the authorities have attempted to address the financial situation of a core group of 12 major loss-makers through sale or liquidation. Although aggregate losses for this group accounted for about one percent of GDP as of end-1998, mounting losses by these enterprises pose a major threat for the country's medium-term development as they crowd out bank credit to viable firms and contribute to misallocation of resources. The implementation of the authorities' enterprise reform program has been considerably delayed, primarily

[8] Including those enterprises whose giro accounts with the Payments Bureau do not contain sufficient funds to cover end-month payment obligations.

Figure 6. FYRM: Illiquid Enterprises



Source: FYRM authorities.

reflecting the authorities' concerns about the social impact of the reform. However, as part of the authorities' efforts to secure financial support from the international community, enterprise reform recently regained momentum. As a result, as of end-March 2000, 6 enterprises had been sold either to private investors or workers, including the Okta oil refinery; two enterprises were liquidated; the outcome for Feni, the nickel mining and processing holding company, is pending finalization of an agreement with the World Bank; and agreements on the sale or liquidation of the remainder remains to be addressed. The direct costs for the budget associated with the enterprise reform identified thus far, is expected to amount to about DM 64 million.[9] In addition, the government implemented debt-equity swaps in 2 enterprises in an amount of DM 13.1 million. The authorities are identifying a list of additional loss-makers for inclusion in the next stage of enterprise reform under preparation.

8. The legal framework supporting enterprise operations still needs further revamping in order to strengthen creditors rights and the efficiency of the court system. To that end, the amendments to the laws on *Bankruptcy*, on *Execution Procedures*, and on *Contractual Mortgages*, are near finalization. The new bankruptcy law is intended to reduce the excessive complexity of the 1997 Law, to ensure efficient bankruptcy administration by district courts and to reduce the considerable delays in proceedings. Under a new *Central Registry Law*, the company register is expected to be transferred from the courts to a new central company register. The legal framework for foreign investment is under review.

C. The Macedonian Stock Exchange (MSE)

9. The MSE is comprised of three market tiers.[10] Trading of equities also takes place outside the MSE, either in the vast informal market among privatized enterprises or in the Privatization Agency and the Bank Rehabilitation Agency, as part of the process of privatization. Stock exchange transactions plunged by about 70 percent compared to 1998 largely owing to the adverse impact of the Kosovo crisis on enterprise performance and political uncertainties related to the Presidential elections in late 1999. In many cases share prices in 1999 dropped well below their purchase price, making shareholders reluctant to incur losses. A major portion of share trading in 1999 stemmed from increased sales of shares by the Privatization Agency and the Pension Fund. The legal framework on securities

[9] Estimated direct costs for the budget include: DM20 million for social costs (i.e. severance payments, unemployment benefits, and costs for re-employment); DM29.6 million for unpaid liabilities to the State; and DM14.8 million for unpaid liabilities to foreign banks.

[10] The first-market tier includes enterprises with market capitalization of DM 15 million or more, at least 200 shareholders, 25 percent of shares held by outsiders, and three years of audited accounts; the second- tier requires at least DM 5 million capitalization, 100 shareholders, 15 percent of shares held by outsiders, and two years of audited accounts; the third tier includes all unlisted companies.

trading was reinforced during 1999, with a view to strengthening corporate governance, increasing liquidity, and expanding trading of government-owned securities. As a result, trading requirement on the stock exchange of all unlisted securities was extended until end-2001; delinquent shares can now be reposed by the Privatization Agency; and government agencies' equity holdings can be combined to attract foreign investors. In late 1999, the government initiated the establishment of a Central Share Registry that will ensure clearing, settlement, and safekeeping of paperless securities.

VI. Fiscal Policy and Developments[1]

A. Overview

1. The general government sector in FYRM consists of the central government, four extrabudgetary funds, and local governments. The funds comprise the Pension and Disability Fund ('Pension Fund'), the Employment Fund, the Health Fund, and the Road Fund. Expenditures by the funds accounted for 55 percent of general government expenditures in 1999, mainly reflecting extensive social transfers.

2. The central government makes transfers to all the funds: transfers to the Pension and Employment Funds to meet statutory obligations for paying entitlements, and capital transfers to the Road Fund for road building. Central government transfers to the funds totaled 4.4 percent of GDP in 1999. There are also significant transfers among the funds themselves. The Pension Fund makes transfers to the Health Fund for the health contributions of pensioners (1.3 percent of GDP in 1999), while the Employment Fund makes transfers to the Pension Fund for the contributions of recipients of unemployment benefits (0.4 percent of GDP) and to the Health Fund for their health insurance premiums (0.7 percent of GDP).

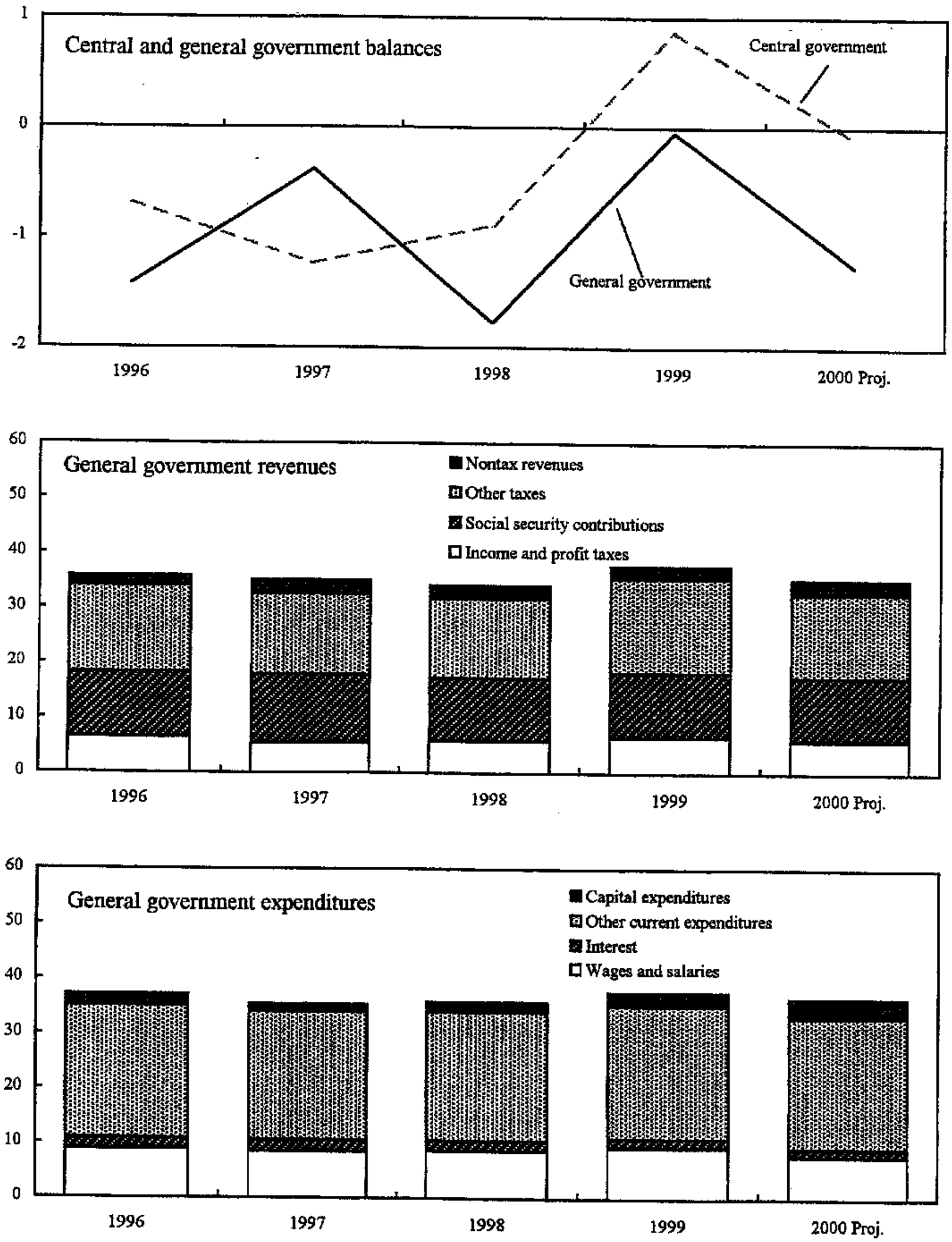
3. Fiscal policy in FYRM over the past few years has been supportive of restrained demand management. Fiscal deficits have been relatively small, and mainly reflected externally-financed (on concessional terms) capital expenditures. However, the overall fiscal position conceals a number of weaknesses. The taxation of labor income is very high, creating disincentives for job creation. With nondiscretionary spending—mainly wages, transfers, and social sector outlays—accounting for nearly four-fifths of total government expenditure, the scope for the budget to contribute to the restructuring of the economy is limited and fiscal management of contingencies is difficult. Many line ministries have recourse to self-generated special revenues that are not subject to the centralized budget allocation process, resulting in possible misallocation of scarce resources.

B. Fiscal Policy Developments in 1998

4. The fiscal situation deteriorated in 1998. The general government deficit widened to 1.8 percent of GDP, mainly reflecting a faster-than-expected implementation of a foreign financed road project and an increase in pension benefits. The central government deficit narrowed to 0.9 percent of GDP, but was higher than budgeted (Tables 29 and 30; and Figure 7). There were shortfalls in revenue, reflecting poor sales tax administration and lower excises from oil derivatives as a result of weak oil prices and the use of ad valorem taxes. There were also election-related slippages in spending: pensions were increased by 10 percent in June; vacation and food allowances were raised in September; and there was unbudgeted spending on textbooks. However, capital spending was squeezed to offset the slippage in

[1] Prepared by Hugh Young.

Figure 7. FYRM: General Government Operations, 1996–2000
(Percent of GDP)



Sources: Data provided by the FYRM authorities; and official projections.

current expenditures. The fiscal deficit was financed mainly through concessional external borrowing from the European Investment Bank (EIB) and privatization receipts.

C. The 1999 Budget and Developments

5. The 1999 budget aimed for a central government deficit of 0.2 percent of GDP. The general government deficit was expected to reach 2.1 percent of GDP, mainly as a result of foreign-financed road construction. The budget called for a reversal of the slippages of 1998; and spending was to be directed somewhat more to capital expenditure items. The wage bill in nominal terms was to be held to its 1998 level, while growth in expenditure on goods and services was to be kept unchanged in real terms. Identified expenditure arrears to suppliers by a selected number of ministries and arrears on child allowances were to be eliminated.

6. Fiscal outturn in 1999 was better than expected, notwithstanding the impact of the Kosovo crisis during April–June. The central government accounts recorded a surplus of about 1 percent of GDP. With the exception of excises, all categories of tax revenue exceeded budget forecasts. Relative to GDP, tax revenues were 2.8 percentage points higher than in the budget. The revenue performance can be attributed to several factors: (i) tax administration efforts were strengthened and the arrears were collected; (ii) customs collections were buoyed by the higher tariffs on imports sourced from countries other than FRY; and (iii) excise tax rates on tobacco and alcoholic beverages, and sales taxes on personal care products, wholesale trade, and raw materials were increased in midyear. However, excises as a whole suffered because of lower collections from oil derivatives as domestic prices were not raised in line with international prices, with the effect that the excise tax rates tended to decline (see Annex II on Pricing of Oil Derivatives).

7. The expenditure outturn was 2.9 percentage points of GDP higher than budgeted. There were refugee-related expenditures of 1.3 percent of GDP, which were largely unanticipated but covered by donor support. Because of delays in the arrival of aid from relief agencies, the government had to provide for the shelter and basic needs of the first wave of refugees. After humanitarian organizations took charge of relief operations, the government continued to incur additional expenditures on utilities for camps, education, health care, special assistance to families hosting refugees, and operations to maintain social peace and border security. In addition, expenditures on the Social Assistance Program were about 10 percent higher than budgeted, which the authorities attribute to dislocations arising from the conflict, and expenditures for the Program for Employment were higher, reflecting an unexpected take-up in the program before its expiration.

8. There was a severe breach of wage discipline in 1999. The wage bill exceeded budgeted appropriations by 1.9 billion denar. This reflected an unbudgeted payment of one-half month's wages in December (930 million denar), unbudgeted wages for employees in the education and interior ministries (500 million denar), and vacation allowances (350 million

denar).[2] Several line ministries also made additional wage payments, totalling nearly 1½ percent of GDP from their off-budget self-generated revenues (see Section H, below).

9. The general government accounts were in balance in 1999. The difference between the balances of the central and general governments reflects externally financed projects of the Road Fund. Net foreign financing provided a source of funds of denar 4.4 billion and there was a corresponding increase in government deposits at the NBM.

D. The 2000 Budget

10. The budget for 2000 maintains support of restrained demand management and includes a broad agenda for reform. Key structural features in the budget are: (1) the oil pricing policy will be flexible so that domestic retail prices change directly with international prices, thereby allowing the excise taxes on oil derivatives to rise to their statutory levels; (2) a VAT is introduced on April 1, 2000; (3) excise tax rates will be maintained after introduction of the VAT; (4) the total wage bill is to be scaled back to its 1998 level; (5) the servicing of frozen foreign currency deposits will be regularized; and (6) funds totaling 1¼ percent of GDP have been allocated to meet the costs of enterprise sector and civil service reforms.

11. The central government budget for 2000 targets a small deficit of denar 213 million or 0.1 percent of GDP (Table 29). Revenues are forecast to decline as a ratio to GDP from 21.4 percent to 20.2 percent. The improved compliance achieved in 1999 is expected to be maintained, but revenue collections will be dampened because: (1) personal and corporate income taxes in 1999 included collection of tax arrears; (2) the transition from the sales tax to the VAT results in a one-time loss in tax collection owing to a longer filing time under the VAT; and (3) free trade agreements with Bulgaria and Turkey are estimated to lower customs duties by about denar 750 million or 0.35 percent of GDP. A part of these losses would be made up by higher excise tax collections. Excises on oil derivatives are forecast to increase by almost 40 percent as the statutory rates are applied from January 2000 under the flexible oil pricing policy. However, little increase is expected in excise collections on other goods (alcoholic beverages, tobacco products, cars, and coffee). Since these goods were not subject to the sales tax but are now subject to the VAT, their consumption is likely to be dampened.

12. Expenditures are expected to decline by 1.2 percentage points of GDP to 22.1 percent in 2000. Current expenditures are projected to decline in absolute terms. This decline mainly reflects the termination of the Program for Employment on January 1, 2000 and the effective

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[2] The Minister of Finance agreed to treat the unbudgeted wage payment in December 1999 as an advance against payments due for January 2000.

end to refugee-related expenditures.[3] Also, child allowances are lower as arrears were paid off in 1999. The wage bill and allowances are capped at 1998 levels and are 10 percent below 1999 levels.

13. The restraint on current spending creates room for an allocation for civil service and enterprise reforms equivalent to 1¼ percent of GDP. Transfers to the Pension Fund are higher on account of a court-ordered increase in pensions of 8 percent that came into effect in September 1999. Capital expenditures, including transfers to the Road Fund, are budgeted to increase by 0.8 percentage points of GDP to 2.3 percent; spending on capital remains relatively low, however, following a number of years of restraint. The budget also includes a small contingency reserve of 0.3 percent of GDP.

14. Foreign financing is expected to provide a source of funds of denar 2.5 billion (reflecting privatization receipts from the sales of Stopanska Banka and the Okta refinery). These proceeds will be saved and the government deposits at the NBM will increase by 2.2 billion denar.

15. The general government accounts are projected to have a deficit of 1.3 percent of GDP in 2000 (Table 30). The general government deficit exceeds that of the central government by externally financed expenditures of the Road Fund from the EIB and World Bank; projects include road construction in Skopje and upgrades to roads to the Greek and Albanian borders. The Health and Employment Funds are expected to be in balance in 2000 and the Pension Fund is expected to incur a small deficit of denar 100 million which will be financed by the sale of shares.

E. The Structure of Public Expenditure and Revenues

16. General government revenues and expenditures in FYRM (equivalent to 36–37 percent of GDP) are high for a transition economy. This reflects FYRM's extensive social safety net and a large civil service. Social security contributions equal 11½ percent of GDP and account for about one-third of total government revenues. Individual income taxes are another 5 percent of GDP. All told, social security contributions and individual income taxes equal 75–80 percent of after-tax pay.

17. Indirect taxes account for slightly more than 40 percent of government revenues, or about 15 percent of GDP. Excise taxes are levied on oil derivatives, tobacco products, alcoholic beverages, cars, and coffee, and account for about 15 percent of revenues. In spite of a number of preferential trade agreements in recent years, import duties remain an important source of revenues, accounting for 11 percent of revenues. The average effective

[3] Under the Program for Employment, the government paid social security contributions on personal income tax for new hires who were long-term unemployed, whose firms were bankrupt, or who were laid off.

tariff rate increased substantially in 1999 as imports that would normally have come from FRY and subject to only a 1 percent administrative fee were sourced from countries for which (higher) general tariffs applied. Sales taxes account for 14 percent of revenues; collections have suffered from administrative deficiencies, including the application of exemptions and preferential rates; the replacement of the sales tax by the VAT should increase the buoyancy of indirect tax collections.

18. Nondiscretionary expenditures, mainly in the form of wages and salaries, social transfers, spending on health, and interest payments account for 85 percent of government expenditures. The largest single component is wages and salaries, equivalent to 9.3 percent of GDP in 1999. In turn, this reflects the high levels of government employment (see below). Expenditures on health, a large component of which is wages and salaries, are equal to 6 percent of GDP. The various transfers—pensions, social assistance, unemployment benefits, employment subsidies, child allowances, and veterans' allowances—are 13.6 percent of GDP. Interest payments are relatively small, at 1.6 percent of GDP. Discretionary spending on other goods and services (mainly operations and maintenance) and capital is relatively small. Capital expenditures, for example, are well below those of middle- and lower-income countries.

F. The Extrabudgetary Funds

19. The operations of the four extrabudgetary funds are summarized in Table 31.

The pension fund

20. Public pensions in FYRM are funded on a pay-as-you-go basis. The Pension Fund makes payments for old age, disability, and survivors pensions. There are currently 120,000 old age pensioners, 52,000 disability pensioners, and 62,000 survivors pensioners. Pensions are indexed to the average wage in the noneconomic sector, with a six-month lag. Average pensions were denar 6,300 per month in 1999, up from denar 5,750 per month reflecting the court-mandated increase of 8 percent on September 1, 1999. With this increase, the ratio of the average pension to the average wage rose from 59 percent in 1998 to 65 percent in 1999. The courts also ruled that the government could be liable to pay the 8 percent increase retroactively back to 1994 or 1995. This liability is estimated by the Pension Fund to be as high as DM 700 million or 10 percent of GDP.

21. Principal revenues of the Pension Fund are a payroll tax of 20 percent on gross wages (72 percent of revenues) and transfers from the state budget (20 percent). The Pension Fund also receives 9.2 percent of excises from oil derivatives.

22. Near-term financial pressures on public pensions are being addressed in a number of ways. Legislation was adopted in March 2000 that will lower the replacement rate from 80 percent to 72 percent; increase the retirement age for men gradually from 63 to 65 years and for women from 60 to 63 years, for those with a minimum of 15 years of pension service; and pensions will be indexed to 20 percent in terms of wages and 80 percent in terms of the

CPI, after the freeze on civil service wages is lifted. These changes are scheduled to take effect from September 2000.

The health fund

23. FYRM inherited a highly decentralized and locally funded health system that were merged into a single, centralized Health Fund in 1991. Principal expenditures are for hospital treatment, outpatient care, and medicines. The main revenue source is an 8.6 percent payroll tax on gross wages, accounting for almost 60 percent of revenues. Transfers from the Pension and Employment Funds for social security contributions accounted for an additional 30 percent of revenues. There are no regular transfers from the state budget to the Health Fund, although in 1999 there was a small transfer vis-à-vis the Program for Employment.

24. There have been serious problems with respect to expenditure control in the Health Fund. It is estimated by the Health Fund that at end-1998 there was a cumulative deficit of denar 3.6 billion, of which about 0.7 billion was bank credits and 2.9 billion arrears to suppliers. The statutory basis for this bank borrowing is unclear. The true amount of arrears, however, is unknown and may well be overstated. Accounting practices in the Health Fund are poor in that they include a mix of cash and accrual accounting. Moreover, inadequate management practices and the lack of commitment recording encourages over-invoicing. The authorities are working with the World Bank to improve expenditure management and control in the Health Fund.

25. A new Law on Health Insurance has recently been passed, as per agreement with the World Bank. The new statute provides for a board of directors for the Health Fund; at present no board exists. Different types of co-payments are being considered. The costs of medicines are very high by international standards and the government intends to open up procurement to international tender.

The employment fund

26. The Employment Fund pays unemployment benefits, pension contributions for the recipients of benefits, and health insurance contributions for the registered unemployed. Unemployment benefits are relatively small, considering FYRM's unemployment rate, because new entrants to the labor force, who constitute a large share of the unemployed, and the long-term unemployed are not eligible for benefits. To be eligible for benefits an individual has to have worked continuously for at least 9 months or for a 12 month consecutive period in the last 18 months. At present about 30,000 individuals receive unemployment benefits whereas there are about 260,000 unemployed according to the labor force survey.

27. Unemployment benefits account for only 40 percent of expenditures of the fund, with social security contributions accounting for the remainder. Revenues include contributions from a payroll tax of 1.5 percent on gross wages, accounting for 25 percent of revenues; transfers from the central government account for the rest. The Employment Fund was balanced in 1999; there is no statutory basis for the fund to borrow.

28. Recipients receive benefits equal to 50 percent of their average wage for the first 12 months of benefits and 40 percent for the remaining 6 months. The duration and size of benefits ranges from 3–18 months depending on the contribution period. In 1997, the maximum benefit period was reduced from 24 months and benefits reduced from 50 percent of average wages for the entire period of receiving benefits. Individuals with over 25 years of contributions are eligible for unemployment benefits until retirement.

The road fund

29. The Road Fund is responsible for the road construction and maintenance. Its activity varies considerably from year to year, owing mainly to the availability of external financing, but also to the size of transfers from the central government. Expenditures rose from 0.8 percent of GDP in 1997 to 1.9 percent of GDP by 1999. In recent years, about one-half of spending was for capital and one-third for maintenance.

Local governments

30. The activities and responsibilities of local governments are minor, which is not surprising in a small unitary state like FYRM. Expenditures in 1999 were about denar 1 billion, equal to 1½ of general government expenditures or ½ percent of GDP. Expenditures are mainly for garbage collection, the maintenance of parks, culture, and sports. Revenues are derived from a property tax and sales tax on real estate—where local governments have exclusive occupancy of the field—charges for public utilities, and a few fees. Transfers from the central government are negligible.

G. Structural Fiscal Issues

31. A key element in the 2000 budget is the introduction of a VAT on April 1, 2000. The introduction of the VAT is an important step in bringing Macedonia's tax structure in line with international practice; its implementation is being assisted by a resident advisor from the Fund.

32. The VAT has the following features (see Annex IV, Tax System Summary, for more detail). It has standard exemptions for health, medical, dental, education, and financial services; there are also standard exemptions for renting and leasing residential accommodation. The first provision of residential accommodation and apartments—within five years of construction—are taxed, and subsequent supplies are exempt. Exports are zero-rated, as are services related to imports and exports and international air passenger transport. Full input tax credits are provided for the purchases of capital goods. The standard rate is 19 percent and there is a reduced rate of 5 percent. Goods that benefit from the lower rate include: food; fuel; public transportation; personal care; medicines; books, newspapers and periodicals; water; and the services of lawyers, accountants and auditors. Staff estimates indicate that goods taxed at the reduced rate account for one-half the tax base.

33. The threshold for which taxpayers are required to register for the VAT is annual turnover of denar 1 million (about US$ 17,000). The threshold for large taxpayers that are required to file monthly is denar 25 million; other taxpayers are required to file quarterly. The relatively high threshold for monthly filing is a positive feature of the tax. Payments bureau data indicate that will be 1,800 monthly filers, constituting less than 10 percent of the total number of filers but accounting for 90 percent of sales tax collections. All told, it is estimated that there will 22,500 filers under the VAT compared with more than 38,000 filers in the previous sales tax system.

34. Another important change in the 2000 budget is the cash servicing of frozen foreign currency deposits. Foreign currency deposits are liabilities to households that the government assumed from commercial banks at the time of independence from the FRY. Until now, withdrawals were permitted only on the basis of social need, for the purchase of government enterprises and apartments, or paying for education abroad. The deposits are for the most part denominated in deutsche marks. Interest accrues on the deposits at various rates depending on their currency of denomination and maturity; in 1999, interest rates averaged 2–2½ percent. The stock of outstanding deposits is large—DM 1,050 million at the end of 1999, or 17½ percent of GDP (Table 34). Of the total number of deposits, about 650,000 or three-quarters are for accounts less than DM 200 (about 100 Euro).

35. In order to reduce the administrative burden of servicing small accounts and regularize the servicing of all deposits, the government is introducing legislation to make cash payments to depositors with balances up to Euro 50 and 3 percent for all other deposits, and to issue bonds. The bonds have a two-year grace period, an amortization period of 10 years, and will pay interest of 2 percent. The bonds will be transferable and can be swapped for land. They will be denominated in Euros, but payments will be made in denar.

36. Public expenditure management is another area where reforms are being accelerated, with the help of technical assistance from the Fund. In FYRM the lack of expenditure control has been a persistent problem. There is an absence of detailed information on the operations of budget institutions and almost all budget institutions have special revenue accounts. These accounts comprise earmarked receipts from various fees, charges, fines and other nontax revenues that the budget institutions can spend as they wish. Expenditure control has been further weakened by an excessive reliance on cash rationing as the principal means of controlling budget execution; this is disruptive to budget institutions' operations and has inevitably resulted in arrears. There is also a lack of financial planning and no recording of expenditure commitments.

37. The ZPP is designated as an agent for treasury operations, but the ZPP account structure is too big to be used for management purposes. The authorities now operate a treasury single account that consolidates all bank balances, but financial limits are set at too aggregate a level for real financial control. In addition, the absence of financial planning coupled with poor revenue forecasting has led to a poor match between ministries cash needs

and financial limits; this has resulted simultaneously in large unused cash balances in some ministries and expenditure arrears in others.

38. A Fund treasury advisor has been a resident in Skopje since January 2000. The advisor is helping to: develop analytical fiscal reports from the ZPP database; coordinate the work of the Ministry of Finance and ZPP in designing a treasury system based on expenditure commitments; improve budget classifications, particularly for the special revenues accounts; and integrate the special revenue accounts and associated expenditures into the budget and budget planning. The work on special revenue accounts will be used to determine which activities will be privatized, leased, or remain in government.

39. In addition, the authorities plan to begin in 2000 a program of civil service reductions through cutbacks and early retirement. Government sector employment in FYRM is about 95,000, or about 17 percent of total employment. Employment levels are particularly excessive in the education and health sectors. Employment in these two sectors accounts for close to 60 percent of general government employment. Employment in education as a proportion of the labor force exceeds that of industrialized OECD countries by about 20 percent, as student-teacher ratios are relatively low, the number of support staff is high, and the provision of education is almost exclusively in the public sector. In the health sector, employment per population is in line with more advanced market economies, reflecting both excessive numbers of doctors and support staff; in addition, hospital capacity is underutilized and the costs of medicines are high compared with international levels. In both sectors, these large levels of employment have been maintained in spite of budget constraints, resulting in a squeeze on capital expenditure and maintenance as well as on operating costs.

40. The authorities have developed a register of civil service employment. This will assist in the determination of the ministry-by-ministry reductions in employment and provide the structure of employment by grade and pay in order to be able to cost out policies to decompress the government's pay scales.

H. Special Revenue Accounts

41. In FRYM, many government ministries and agencies raise revenues that are not included in the budget, but in so-called special revenue accounts. The associated expenditures are not included in the budget either, and are spent at the discretion of the receiving organization. The revenues are large, more than denar 9 billion or equivalent to about 4.7 percent of GDP in 1999 (Table 32).

42. Expenditures from the special revenue accounts on wages and benefits increased sevenfold in 1999, from denar 400 million in 1998 to almost denar 2.9 billion (another indicator of the breach in wage discipline) (Tables 32 and 33). In addition, expenditures on supplies and services grew markedly to denar 4.8 billion in 1999. Expenditures from the special revenue accounts on wages are equivalent to 16 percent of spending on wages in the central government budget while spending from the accounts on goods and services is

equivalent to more than 90 percent. Clearly, a large component of government activity is outside the scope of the budget. There is a basic lack of transparency by these accounts, as spending is determined by the access to revenues rather than priorities in the budget and the expenditures out of these accounts put pressure on the spending of budget institutions, notably for higher wages and allowances.

I. Total Government Debt

43. From 1996 to 1999, the government debt-to-GDP ratio rose from 41.5 percent to 53.2 percent (Table 34). The rise in the debt ratio is accounted for by foreign debt; the domestic debt to GDP ratio was unchanged. Domestic debt in nominal terms was little changed until 1998 but rose in 1999 on account of the bond issue to finance the clean-up of Stopanska Banka's balance sheet. The recording of government debt and guarantees is weak. Different ministries have extended guarantees without seeking approval from nor reporting to the Ministry of Finance.

VII. External Sector Developments[1]

A. Current and Capital Accounts Developments

1. FYRM's external sector developments during 1998–99 could be divided into three distinct phases: developments before the Kosovo crisis (1998-March 1999); disruption in the midst of the crisis (April-May 1999); and recovery after the crisis (June 1999 onward).

Developments before the Kosovo crisis

2. Despite a generally favorable external environment, the current account deficit remained high. For 1998, as a whole, the current account deficit widened to 8.8 percent of GDP from 7.4 percent of GDP in 1997 (Table 35 and Figure 8; also see Boxes 5 and 6 for external competitiveness of FYRM). However, the capital account position strengthened, as a large amount of foreign direct investment (FDI) poured in and the private sector resorted to foreign borrowing. Thus, gross official reserves increased by about US$50 million.

3. Exports continued to increase on account of the lagged impact of the July 1997 devaluation and a cooperation agreement with the European Union.[2] The strong growth in exports was concentrated in exports of clothes and textiles as well as iron and steel;[3] these two product categories accounted for nearly half of the FYRM's exports in 1998 (Figure 9). The principal destinations for FYRM's exports in 1998 were Germany (21.2 percent), the FRY (18.2 percent), and the United States (13.2 percent) (Table 37).

4. Imports also grew strongly owing to increased domestic demand and a surge in imports of intermediate inputs for processed goods exports. Imports of investment goods rose by 30 percent. FYRM has a trade structure that links exports and imports closely; most of exporters of textiles and clothes, and iron and steel took processing contracts with foreign firms. Because of this, imported inputs for processing rose in line with hikes of exports of these products. The main sources of imports were Germany (13.3 percent) and FRY (12.8 percent) (Table 38).

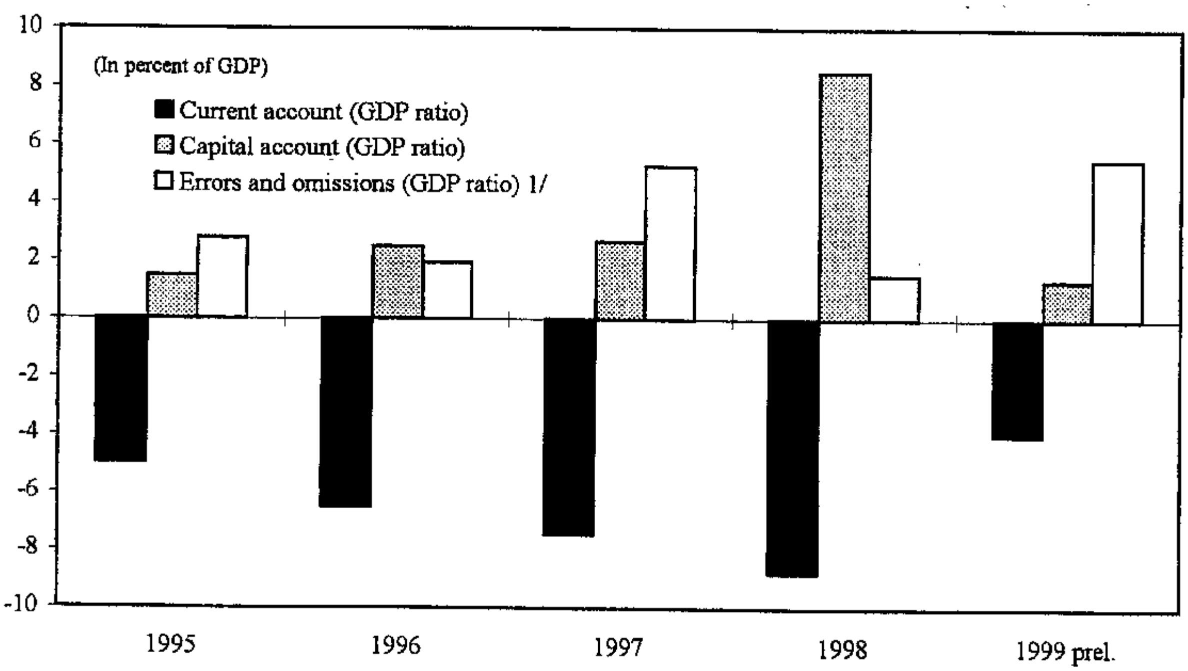
5. The balance of nonfactor services also deteriorated in 1998. This was mainly attributable to a decrease in receipts of construction services (Table 40). Meanwhile, private

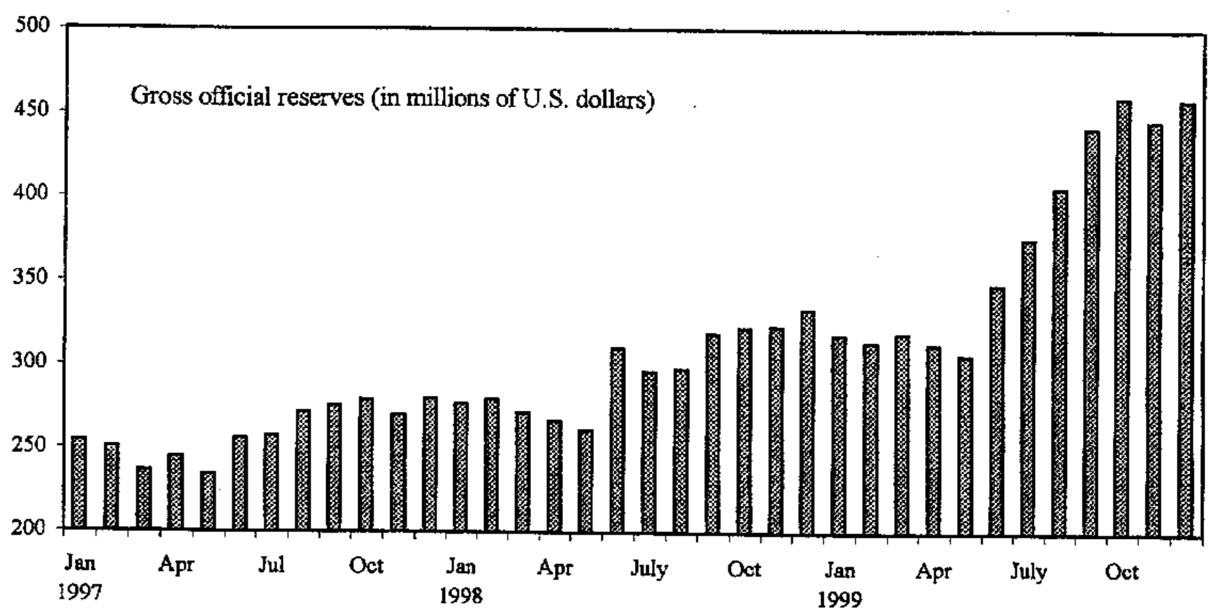
[1] Prepared by Toshitaka Sekine.

[2] Signed in November 1997. The agreement simplified the customs clearance system between FYRM and the EU and provided financial assistance in the development of the FYRM's transportation system through the European Investment Bank.

[3] This also reflected the resumption of operations of a major iron and steel factory from the latter half of 1997 after its sale to a Swiss company.

Figure 8. FYRM: Balance of Payments Developments, 1998–99





Sources: FYRM authorities; and IMF staff estimates.
1/ Including short-term capital.

Box 5. FYRM: External Competitiveness

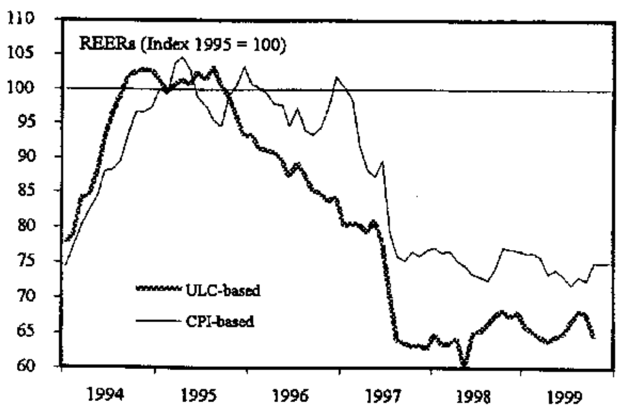
Competitiveness indicators in terms of real effective exchange rate (REER) indices show that FYRM's competitiveness has been broadly maintained since the devaluation of July 1997. The CPI-based and ULC-based REERs exhibit similar trends.[1] In terms of depreciation of REERs as well as of bilateral real exchange rates, competitiveness has improved much more for FYRM than for several other Balkan countries.

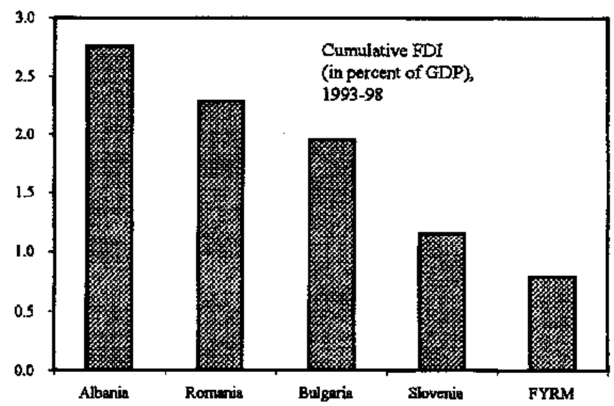
The shares of FYRM's exports in the markets of its major trade partners have not increased much since 1996. There was a gain in market share with Germany in 1998, which reflected the resumption of operations of a major iron and steel factory following its privatization, but the share remained well below the peak achieved in 1995. The share in the United States market rose significantly in 1996 after cessation of the Greek trade sanction, but there has been no gain in share since then. These trends are in sharp contrast to the more positive experience of Romania and Albania.

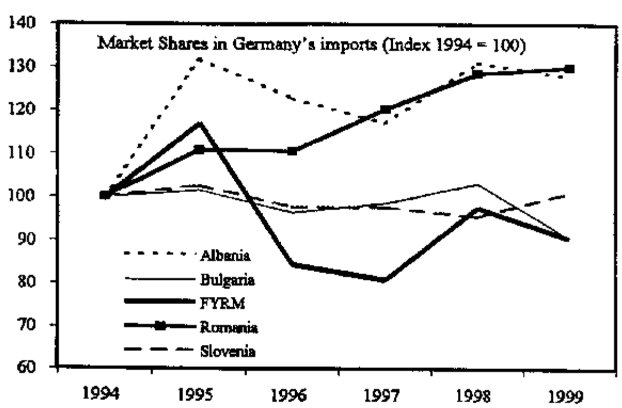
Structural factors seem to underlie this disappointing export performance. One factor may be FYRM's limited success in attracting foreign direct investment (FDI). Although there was some pick up in 1998, FYRM has absorbed far less FDI (relative to GDP) than other countries in the region. Albania and Romania, who had the largest gains in export market shares, were also the leaders in terms of FDI inflows.

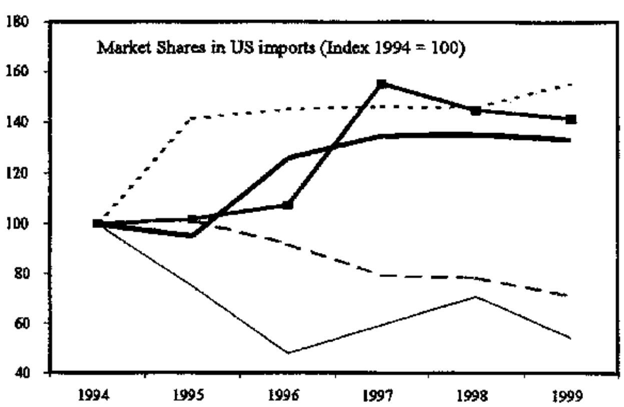
Under this circumstance, the authorities should refrain from exchange rate adjustment. The focus should be on enhancing competitiveness through productivity gains from enterprise restructuring and cut in payroll taxes. Premature introduction of flexibility in the exchange rate market, say by introducing an intervention band, would undermine credibility of the authorities' commitment to the current parity. In the future, FYRM may choose to exit from the current de facto DM peg policy if it is warranted by change in the underlying fundamentals owing to structural transformation of the economy. However, prior to introducing more market elements in exchange rate determination, FYRM needs to secure a well-developed money market and restore the health of the banking system.

[1] The calculations were based on the chain index method, where trade weights change each year (see Box 6 for more details).









Box 6. FYRM: Real Effective Exchange Rate Indices

The real effective exchange rate (REER) is widely used for gauging the external competitiveness of a country. For this reason, the Fund's *Information Notice System* (INS) calculates REERs of almost all of its members, including that of FYRM, and disseminates that information to the public through its monthly publication of *International Financial Statistics*.

For FYRM, the INS-REER is based on the weights obtained from the 1995 trade structure and deflated by the CPI.[1] In order to see the robustness of findings from the INS-REER, two alternative REER measures are constructed.

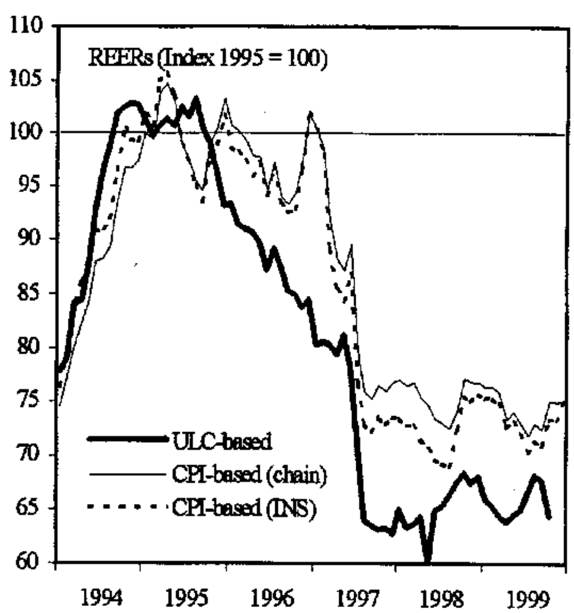
- The chain-type REER. Like other transition countries, FYRM has experienced a rapid change in its trade structure. To capture this effect, a chain-type of REER index, which accommodates a change in trade weights, is calculated. Trade data are obtained from *Direction of Trade Statistics* and the third market competition is taken into account on that basis. A three-year moving average is taken for smoothing irregularities caused by trade sanctions (e.g., the 1998 weight is based on 1995-97 average.)

- The ULC-based REER. The CPI covers not only tradable goods, but also nontradable goods. Furthermore, it may well be affected by temporary movements associated with "pricing to market." For this reason, it is argued that the REER deflated by the unit labor cost (ULC) of the manufacturing sector provides more accurate information concerning external competitiveness.[2] Weights are based on 1995-97 trade data, but because of data limitation some trade partners (such as Bulgaria) are excluded. For FYRM, labor incomes are all industry basis. For calculation of the ULC, the cyclical movement of productivity is normalized by the Hodrick-Prescott filter.

REERs thus obtained, although subject to data limitations,[3] are by and large in line with the INS CPI-based REER.

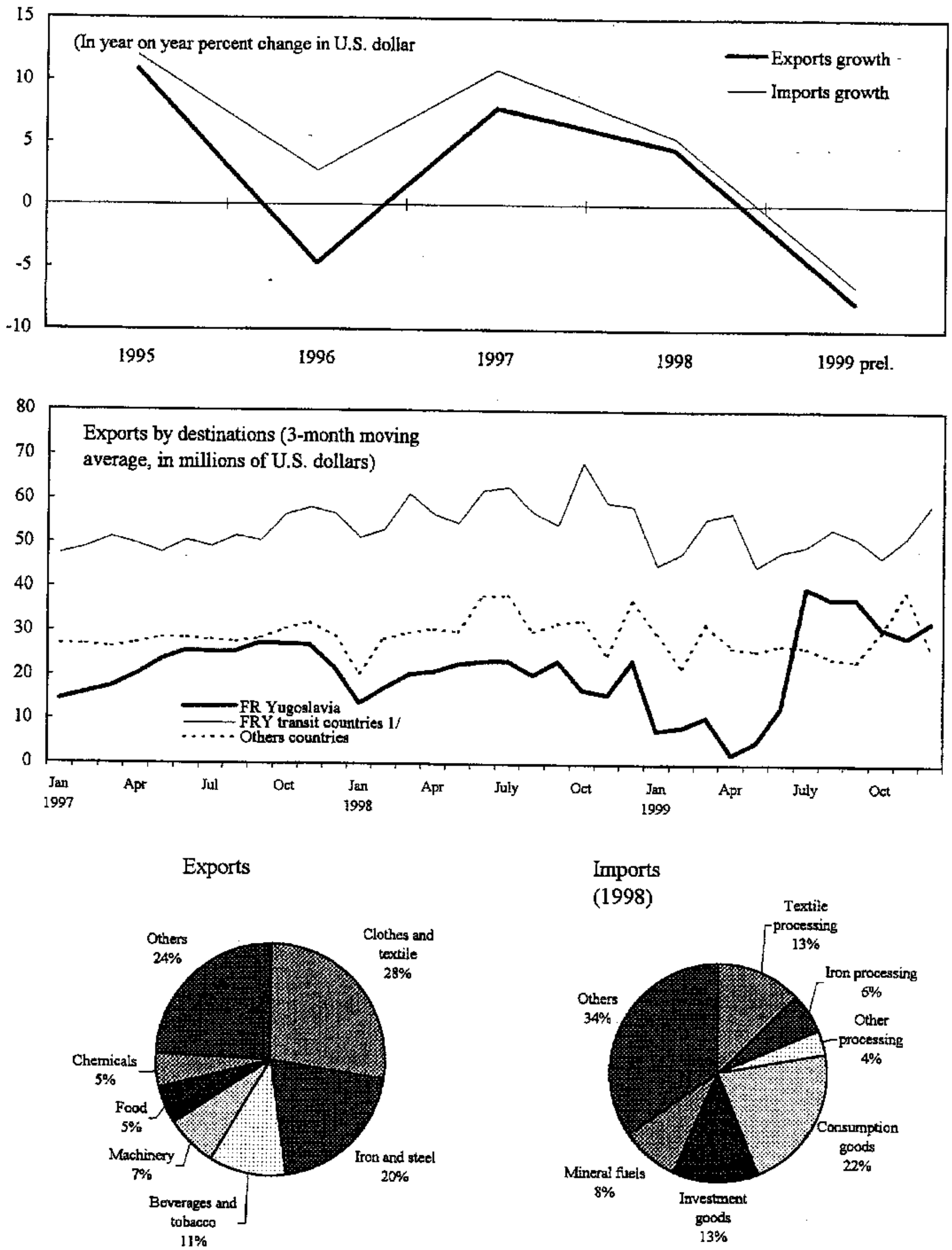
FYRM: REER Weights (percents)

	INS CPI based	Chain index method 1994	1995	1996	1997	1998	1999	ULC based
Albania	2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Austria	2.6	0.0	2.7	3.3	3.7	3.4	3.3	4.2
Belgium	1.3	2.2	2.3	2.4	2.4	2.2	2.2	2.7
Bulgaria	17.5	5.5	11.0	13.0	12.8	9.4	5.5	0.0
Canada	0.0	0.0	0.0	0.0	0.0	1.1	1.3	1.4
Croatia	4.5	5.1	4.1	3.6	3.2	3.5	3.8	4.2
Czech Republic	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
France	2.5	5.7	5.0	4.9	4.8	4.5	4.3	5.5
Germany	18.3	4.3	12.5	16.3	19.7	19.3	18.5	23.5
Greece	3.6	8.9	4.3	2.8	4.0	7.5	11.8	9.1
Hungary	0.0	0.0	0.0	0.0	0.0	0.0	1.2	0.0
Italy	10.5	18.1	17.6	17.6	17.0	14.7	12.6	17.9
Japan	0.0	1.7	1.4	1.3	1.2	1.3	1.5	1.6
Netherlands	0.0	4.9	4.7	4.5	4.6	4.3	4.2	5.3
Romania	0.0	1.6	1.5	1.4	0.0	0.0	0.0	0.0
Russia	9.8	6.7	5.4	5.2	3.9	3.0	1.9	0.0
Slovenia	12.8	14.9	11.6	9.6	8.4	7.7	8.2	9.4
Spain	0.0	0.0	0.0	0.0	0.0	1.2	1.2	1.5
Sweden	0.0	0.0	0.0	0.0	1.2	1.3	1.8	1.6
Switzerland	2.7	4.0	3.9	3.4	3.2	3.0	3.2	3.7
Turkey	4.1	3.0	3.1	3.2	3.5	3.8	3.9	0.0
Ukraine	0.0	0.0	0.0	0.0	0.0	1.7	1.6	0.0
United Kingdom	1.4	7.5	4.4	3.5	2.5	2.5	2.8	3.0
United States	4.6	5.9	4.5	4.1	3.9	4.5	5.1	5.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0



[1] Zanello, A. and D. Desruelle (1997). "A Primer on the IMF's Information Notice System," IMF Working Paper, WP/97/71.
[2] Turner, A.G. and S.S. Golub (1997). "Towards a System of Multilateral Unit Labor Cost-Based Competitiveness Indicators for Advanced, Developing, and Transition Countries," IMF Working Paper, WP/97/151.
[3] FRY is excluded from the calculation owing to data limitations, although it is one of the most important trade partners of FYRM. For the ULC calculation, poor quality of monthly labor statistics, which shows a continuous decline in employment, may bias towards improvement of the ULC-based REER.

Figure 9. FYRM: External Trade Developments, 1995–99



Sources: FYRM authorities; and IMF staff estimates

1/ Exports to all European countries (including Russia, Ukraine, and Belarus) other than Albania, Bulgaria, Greece, and Turkey.

transfers continued to run a large surplus, thanks primarily to remittances from abroad and net foreign cash exchange receipts.[4] Official transfers increased because of EU-PHARE financed projects.

6. Capital inflows increased markedly in 1998. FDI took off on account of the sales of a brewery (US$33 million) and a cement factory (US$31 million), as well as investment in Macedonian Telecom[5] (US$50 million). In addition, the private sector began to resort to foreign borrowing. About two-thirds of such transactions were import-related finance. The remaining one-third was project-related finance, most of which were related to the Kozjak hydroelectric power plant (US$18 million). In the meantime, disbursements from multilateral sources decreased somewhat, with the completion of some EBRD financed projects (Table 41).

7. The balance of payments performance began to deteriorate in the first quarter of 1999 even before NATO started a bombing campaign against FRY on March 24. Exports to FRY in the first quarter fell to one-half of the previous year's level because of trade barriers[6] erected by FRY and the escalation of fighting in Kosovo. In addition, exports of iron and steel were threatened with anti-dumping measures from the European Union and the United States. As a result, total exports fell by about 15 percent compared with the same period in 1998, and gross official reserves declined by US$14 million.

Impact of the Kosovo crisis

8. FYRM's balance of payments were severely hit by the Kosovo crisis. Total exports fell in April-May 1999 to about 75 percent of the previous year's level. Exports to FRY were down by about 80 percent (Figure 9). Exports that had previously transited through FRY (one-half of total exports) were also hurt because the use of an alternative transit route through Bulgaria and Romania or Greece increased transportation costs and prolonged delivery lags, thereby making Macedonian products less competitive. Furthermore, exports to other countries were also affected because export processing contracts (mainly in the textile

[4] Foreign cash exchange records purchases and sales of foreign currencies through foreign exchange bureaus. Although some inflows may represent genuine transfer payments (for instance, workers' remittances received by cash), this item may also include some transactions in goods and services, such as travel, government services, and unrecorded trade.

[5] Convertible bonds amounting to US$50 million were issued for the pre-privatization of Telecom by IFC and ING Bank. These bonds are treated as FDI on the assumption that the bonds will be converted to shares when the privatization process is completed.

[6] Macedonian pharmaceutical products were removed from the approved list of medicine. Up-front foreign exchange deposits equivalent to 50 percent of the value of FRY imports were required from importers for consumption goods.

and clothes industry) were canceled owing to concern about delivery risk. In addition, FDI and private borrowing, which had begun to suffer in the first quarter, worsened following the start of the NATO bombing campaign because of loss of investor confidence.

9. The loss of official reserves was however, small because of the import compression. Imports collapsed to a similar extent as exports, mainly reflecting a temporary suspension of oil and cereal imports, and a drawdown of inventories by enterprises. At the same time, nonfactor services improved because of a greater number of visitors associated with humanitarian agencies, NATO forces, and the media. Domestic payments made by these visitors contributed to an increase in private transfers and errors and omissions.[7] Thus, gross official reserves fell by only US$12 million during April-May.

Recovery from the Kosovo crisis

10. The balance of payments performance improved markedly after the cessation of the bombing campaign on June 10. Exports to FRY surged, to nearly double the pre-crisis level. About two-thirds of these exports went to Kosovo (mainly foods; beverages and tobacco; and mineral fuels),[8] while exports to Serbia remained below the pre-crisis level, given the shortage of purchasing power of the population. Receipts of nonfactor services also improved as transit transportation to Kosovo increased. Meanwhile, the recovery of exports to other destinations took time because of the difficulty in recapturing the canceled export processing contracts. At the same time, imports swelled rapidly, owing to the resumption of oil and cereal imports and the re-building of inventories by enterprises.

[7] Because of the difficulty of directly monitoring these expenditures, in FYRM's balance of payments statistics, these inflows appeared as either private transfers (because an increase in foreign cash exchanged through exchange bureaus was recorded under private transfers) or errors and omissions (if those who received foreign exchanges from these sources used them to finance their imports or transferred them to foreign countries, then it widened the gap between current/capital accounts and a change in official reserves).

[8] The UN Interim Administration Mission in Kosovo (UNMIK) did not collect customs duties from Macedonian products until it established customs controls at key crossing points in September.

Table 10. FYRM: External Assistance Pledged at the May 1999 Consultative Group Meeting (US$ millions)

	Pledged	Disbursed (as of 12/31/99)
Belgium	1	1
Finland	1	1
France	15	7
Japan	22	0
Netherlands	10	12
Norway	1	0
USA	28	6
Paris Club deferral	42	24
European Commission	27	15
World Bank	95	40
IMF	30	19
Total	**272**	**125**

Source: World Bank, European Union, and the FYRM authorities

11. Foreign financing improved remarkably. Following an emergency Consultative Group meeting on May 5,1999, official financing (grants and disbursements) increased rapidly. This included a drawing from the IMF under the CCFF (US$19 million); a World Bank emergency loan (US$40 million); and grants from various bilateral donors (about US$25 million) and the European Union (US$15 million). In addition, Paris Club creditors agreed to a nonconcessional deferral of all debt-service payments due during April 1999-March 2000 (US$42 million).[9] At the same time, private financing (transfers, disbursements, FDI, and the commercial banks' net position) also increased sharply in response to reduced uncertainty about the regional situation. Private transfers exceeded the pre-crisis level, and errors and omissions remained at the high level.[10] Although the recovery of FDI remained

[9] The form of the deferral included five years' maturity including one year's grace, and the capitalization of moratorium interest on the same terms.

[10] Since banking activities were not established in Kosovo, Kosovars transferred foreign exchange to Macedonian banks. This, in addition to domestic payments by humanitarian agencies and NATO forces, contributed to increases in private transfers as well as errors and omissions.

slow, the private sector resumed its foreign borrowing.[11] As a result, gross official reserves grew by about US$150 million during June-December, to reach US$458 million or the equivalent of 3.1 months of imports (c.i.f. base) by end-December.

B. External Debt and Reserve Adequacy

12. Before the Kosovo crisis, FYRM normalized the relations mainly through the following two reschedulings.

- *Paris Club creditors* agreed[12], in July 1995, on a rescheduling of about US$330 million in arrears (including late interest) and debt-service falling due between July 1, 1995 and June 30, 1996. The agreement provided for a rescheduling of arrears on pre-cutoff-date debt over 15 years, with a four-year grace period. Although the term of this rescheduling is nonconcessional, it is exceptional since the deferral of arrears on non-reschedulable post-cutoff-date debt and late interest of about US$70 million was contemplated, with a two-year grace period and repayment over the following four years.

- *London Club creditors* agreed, in March 1997, to defer US$80 million in debt over 15 years, with a four-year grace period and capitalization of the first four years' interest payments. Associated with this deferral, FYRM issued the U.S. dollar bonds, which were listed on the Luxembourg Stock Exchange.

[11] For 1999, as a whole, the capital account surplus narrowed mainly because of the slow recovery of FDI. This also reflected that FDI in 1998 was exceptionally high owing to the Telecom privatization.

[12] As noted in Paragraph 11, Paris Club agreed in May 1999 to a noncessional deferred of all debt-service payments due during April 1999–March 2000.

Table 11. FYRM. Debt and Reserves Indicators

	1995	1996	1997	1998	1999 Prel.
External debt					
External debt-to-GDP ratio (percent)	23.8	25.4	31.5	41.1	43.3
Debt service-to-exports ratio (percent)	10.4	11.1	8.7	10.1	13.0
Gross reserves					
In months of cif imports	1.9	2.0	1.9	2.1	3.1
Ratio to base money	1.7	1.5	1.8	2.4	3.1
Ratio to M3	0.4	0.5	0.5	0.6	0.6
Ratio to the short-term debt 1/	1.9	2.2	2.0	1.9	2.1

Source: IMF staff estimates.

1/ Calculated as the next year's debt service.

13. Even though external debt increased substantially for the past two years, FYRM still managed to keep its debt-service payments reasonably modest. As of end-1999, FYRM's external debt stood at about US$1.5 billion (43.3 percent of GDP) compared with about US$1.1 billion (31.5 percent of GDP) at end-1997 (Table 43).[13] Although the private sector accumulated external debt recently, more than 85 percent of total debt outstanding was the debt owed by the public sector to multilateral institutions, and Paris Club and London Club creditors. While the external debt-service ratio increased from 8.7 percent of exports of goods and services in 1997 to 13.0 percent in 1999, the level was still low.

14. FYRM improved its external reserve position to a satisfactory level. Owing to the reserve buildup after the Kosovo crisis, the external reserve position rose to 3.1 months of imports at end-1999 from 2.1 months of imports at end-1998. Reserve ratios to monetary indicators and short-term debt also improved from the already very prudent levels.

C. Exchange and Trade Regime

15. FYRM accepted the obligations of Article VIII in June 1998 and became free from restrictions on current payments. With the Fund's approval, the authorities maintained an

[13] An increase in the external debt burden in terms of GDP ratios from 1996 to 1997 is attributable to the 1997 devaluation, since the debt outstanding in U.S. dollar terms increased little during the period.

exchange restriction arising from the freeze on certain foreign currency deposits.[14] The authorities are planning to exchange these deposits for government bonds. On capital account transactions, FYRM kept some restrictions including the prohibition of outward portfolio investment by residents, and the limitation of financial credits from nonresidents to residents (only credits for export-oriented projects or import-related transactions are permitted).

16. FYRM had already established a fairly open trade regime after the 1996 trade reform.[15] There is no non-tariff restriction other than for security or public health reason. The range of current tariff rates is from zero to 60 percent, but most items fall into rates below 35 percent; the number of tariff bands is 16; and the simple and trade weighted average rates are 15 percent and about 11 percent respectively. In addition, there is a 1 percent fee for custom documentation, and in August 1999, the Ministry of Trade began to collect 0.1 percent fee from exporters for export promotion. The 1 percent fee for custom documentation had been scheduled to be repealed on April 1, 2000, when the new customs law became effective,[16] but the government had decided to postpone its repeal to end-2000. Besides enacting the new customs law, FYRM adopted or envisages the following legislative changes:

- At the onset of the Kosovo crisis, the government imposed import restrictions on selected commodities (mostly food products, which became subject to higher tariff rates and/or import approvals from the Ministry of Trade),[17] but even before the crisis was over, the government began to remove some of these restrictions and all of them were eliminated at the beginning of January 2000.

- The government is preparing amendments of the tariff law to increase the effective protection level—under the proposed tariff structure, while the tariff rates on raw material would be reduced, those on agricultural products would be increased to protect

[14] Since the freeze implied blockage of withdrawal of interests on the deposits by foreign entities, it constituted an exchange restriction under Article VIII.

[15] The Fund's overall trade restrictiveness index of the current trade regime of FYRM is calculated as 3, where 1 is the most open and 10 is the most restrictive.

[16] At the same time, some of tax exemptions were repealed. However, most of exemptions (such as those due to free trade agreements, diplomatic reasons, etc) remained.

[17] Effective from 4/10/99, imports of the following goods became subject to the import approvals: pork; milk; vegetables (tomatoes, onions, cucumbers, peppers); cooking oil; processed meat products; mineral waters; shoes; and batteries. Import duties on the following goods were raised: pork; processed meat products; milk; cooking oil; margarine; chocolate; pasta; sweet biscuits; fruit juices; mayonnaise; and soups.

domestic production. As a result, the simple average tariff rate would be about 0.5 percent lower than the current average.

- The Parliament adopted the law on free trade zones in July 1999, and construction of the zone will start in 2000.

17. Multilateral and bilateral trade agreements were the principal vehicles for trade liberalization during 1998-99. FYRM's request for accession to the World Trade Organization (WTO) is progressing. A memorandum on the foreign trade regime and a reply to the questionnaire on the memorandum have already been submitted. The Working Party on FYRM's accession request is scheduled to be held early 2000. Following free trade agreements with FRY (1996), Slovenia (1996), and Croatia (1997), FYRM signed free trade agreements with Turkey and Bulgaria in 1999. The agreement with Bulgaria became effective from January 2000 and the agreement with Turkey is expected to be enacted in the first half of 2000.[18] FYRM is in the negotiation process of free trade agreements with Albania, Romania, Bosnia and Herzegovina, Ukraine, and EFTA. In the meantime, following the 1997 cooperation agreement, FYRM expects to initiate negotiations for Stabilization and Association agreement with the European Union from early 2000.

[18] In the agreement with Bulgaria, both FYRM and Bulgaria will progressively reduce tariff rates to zero until 2005. In the agreement with Turkey, Turkey will immediately cut tariff rates to zero subject to certain quota, while FYRM will progressively reduce tariff rates to zero until 2008.

UNEMPLOYMENT IN FYR MACEDONIA[1]

1. The unemployment rate in FYRM is extremely high, at an estimated 32.5 percent in 1999. Unlike in most other transition economies, the high unemployment is not the outcome of reform-related layoffs. Rather, the unemployment has been historically high, hovering around 30 percent in the past decade, mainly reflecting anemic economic growth and rigidities in the labor market. While the structural reforms undertaken in the context of the Special Restructuring Program in 1995–96 may have contributed to the worsening of the unemployment situation, it did not fundamentally alter the nature of the underlying problem. The pickup in economic growth in the past two years has had a positive impact on the unemployment dynamics, with the new qualified entrants into the labor market being able to secure jobs with relative ease and with the unemployment rate declining (Table 12).

2. This annex examines the nature of unemployment in FYRM, identifies factors that have potentially contributed to the high levels of unemployment, and discusses recent labor market measures undertaken to alleviate the problem. The analysis is based on the results of annual labor force surveys.[2]

A. The Nature of Unemployment

3. Several features of the unemployment in FYRM suggest that unemployment is essentially structural and that it is a problem of entry into the labor market, rather than of lay-offs. These features are: (i) the concentration of unemployment among the entrants into the labor market, the young, and the less educated/low-skilled; (ii) its long duration (Table 13); (iii) the low rates of inflow into and outflow from unemployment; and (iv) the low share of unemployment due to layoffs.[3]

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[1] Prepared by Aliona Cebotari.

[2] The LFS has been conducted annually in April since 1996. The short time-series provided by the LFS is not sufficient to infer the factors that led to the high rate of unemployment (especially that 1996–99 are the years when positive economic growth was experienced). A second source of unemployment data—the Employment Bureau (EB)—tends to significantly overestimate unemployment (by about 30 percent), as many workers not registered by their employers register with the EB as unemployed in order to take advantage of the health insurance benefits.

[3] Another feature of unemployment is its concentration among some minority groups. The unemployment rates are highest among the Roma (76 percent in 1998), Albanians (about 60 percent), and Turks (about 43 percent), even though their shares in the total number of unemployed is small (5, 22, and 3 percent, respectively). This may reflect the traditionally lower access to good education among these ethnic groups and perhaps other, non-education-related, difficulties in securing jobs.

4. The incidence of unemployment is high among the new entrants into the labor market, the young and the less educated. About three quarters of the unemployed do not have previous work experience.[4] Relatedly, the share of unemployed youth (15–24 years of age) in total unemployed is very high, at about 30 percent in 1999, compared with less than 3 percent in virtually all OECD countries. The unemployment rate falls with age, particularly up to the age of 40 years (and is relatively stable thereafter), with the unemployment rate among the youth being around 50–70 percent. The unemployment rate is also high among those with low education and decreases with the level of education. In particular, post-secondary education appears to greatly reduce the probability of unemployment. For example, the unemployment rate among the uneducated and those with at most 4 years of secondary education is in the range of 30–40 percent, whereas less than 20 percent of those with higher education are unemployed.

5. The share of long-term unemployment (i.e. over one year) is very high and has increased in the past several years. In 1998[5], about 83 percent of the unemployed had been without a job for more than one year. This pattern is disquieting for several reasons. First, as the long-term unemployed lose their skills and their chances of reemployment diminish, "effective" unemployment—the pool of unemployed from which firms can draw to fill vacancies—is shrinking. This may create supply bottlenecks down the line, when a pickup in growth boosts demand for labor. Second, the likelihood of a continued increase in long-term employment is exacerbated by the very low rates of inflow into, and outflow from, unemployment that render the already large unemployment pool a stagnant one.[6] Third, the share of those unemployed due to layoffs is very small by the standards of an adjusting economy (about 9 percent at end-1999, compared with about 60 percent in Poland). The development of the large and stagnant pool of unemployed even in the absence of serious structural reforms raises concerns about the unemployment implications of the recent acceleration in the pace of economic restructuring.

6. The dynamics of the labor market in the past couple of years, however, indicate that the employment opportunities opened up during the 1998–99 growth episode have increased the ease with which qualified entrants into the labor market could secure jobs. In 1998, for example, the highest-growth year of the past decade, not only were all new entrants into the

[4] The Statistical Yearbook, Government of Macedonia, 1998. The figures refer to end-1997, as more recent data are not available.

[5] The LFS questionnaire was modified in 1999 to allow respondents not to indicate the duration of their unemployment, which impairs comparison of 1999 duration data with previous years; the most recent references to duration are, therefore, made to 1998.

[6] The rate of inflow into unemployment - the ratio of those unemployed for less than 30 days to the labor force - was 0.6 percent in 1998, down from 1 percent in 1996. The outflow rate, proxied by the ratio of the newly (within 30 days) hired to total unemployment, is similarly small and has ranged from 1 to 3 percent during 1996–98.

labor market able to find employment, but so did many unemployed (most likely those who had been without a job for a short duration).

Table 12. FYR Macedonia: Selected Labor Force Indicators, 1996-99

	1996	1997	1998	1999
Working age population 1/	1,436,603	1,489,621	1,503,368	1,518,249
Labor force	789,082	800,511	823,828	806,675
Employed	537,592	512,297	539,763	545,223
Unemployed	251,490	288,214	284,065	261,452
Nonemployed	899,011	977,324	963,605	973,026
		(In percent)		
Labor force participation rate	54.9	53.7	54.8	53.1
Employment rate	68.1	64.0	65.5	67.6
Unemployment rate	31.9	36.0	34.5	32.4
Nonemployment rate 2/	62.6	65.6	64.1	64.1
		(Percent change)		
Working age population		3.7	0.9	1.0
Labor force		1.4	2.9	-2.1
Employed		-4.7	5.4	1.0
Unemployed		14.6	-1.4	-8.0
Nonemployed		8.7	-1.4	1.0

Source: Labor Force Survey.

1/ Defined as the population between ages 15 and 80.
2/ Defined as the ratio of unemployed and nonactive to working age population.

B. Causes of Unemployment

7. There are two main underlying causes of unemployment in FYRM: anemic economic growth and labor market rigidities, including high labor costs.[7] Over the past 10 years, economic growth averaged about -2 percent, with positive growth rates experienced only in the past four years (Table 2). Industry, the main source of employment in the economy, has declined at an average annual rate of 6 percent during this period. This tepid economic performance has both directly constrained the economy's ability to create jobs and has made the rigidities in the labor market a constraining factor for faster employment growth.

[7] The high rates of unemployment among the young and those with relatively low skills suggest that a mismatch of skills is probably another important cause of unemployment; data, however, are not readily available to support such an analysis.

8. Rigidities in the labor market, which inhibit hiring and job creation, have resulted from (a) high costs of dismissal; and (b) high labor costs.

9. The labor legislation makes it very difficult and costly to dismiss workers. For example, employers must exhaust all available opportunities to keep the worker prior to dismissal, including redeploying him to other parts of the firm, reducing overtime for other workers, limiting new hires, providing vocational training and paying a generous lump sum in severance[8] in case of firing. In case of group layoffs, employers are required to provide as much as three months' advance notice to workers (in Poland, for example, the advance notice for mass layoffs is only 45 days). Notwithstanding these safeguards, the dismissed worker retains the right to resort to courts, a process that can be very costly for the firm.[9] The high dismissal costs embedded in the labor code have discouraged employers from hiring new workers for fear of being unable to downsize the labor force during economic downturns.

10. Hiring is also directly inhibited by high labor costs imposed by the wage legislation and the fiscal code. These are a result of (i) high payroll taxes, (ii) high nonwage benefits, and (iii) mandatory wage floors for tax assessment.

(i) Payroll taxes currently constitute about 75 percent of the employee's net earnings. The high level of taxation has both discouraged new hiring and has led to the widespread practice of employing workers without registering them officially as employed as a way of avoiding payment of taxes and contributions. This practice, in turn, accounts for the large discrepancies between official ("administrative") employment/unemployment data and those obtained from the LFS (Table 21).

(ii) High nonwage benefits are mandated by national- and branch-level collective agreements and are mandatory for all enterprises that are less than 70 percent private (these account for about three quarters of total employment in the economic sector). The main nonwage benefits are food allowances (about 25 percent of the average monthly wage), transportation allowances, and holiday allowances (equivalent to one average monthly salary).

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[8] The maximum amount of severance is 12 monthly wages (as compared with only 3 in Poland, for example) and was based, until recently, on workers employment with all previous firms (rather than the firing firm).

[9] For example, if the worker is reinstituted with the firm by court decision, the firm has to compensate him for his forgone earnings. Given the lengthy court procedures and the high probability of courts ruling in favor of the workers, firing can turn out to be a very costly undertaking for the employer.

(iii) While there is no institutional minimum wage in FYRM, the Law on Wages imposes a mandatory floor[10] (65 percent of the average wage in the branch) for assessing taxes and contributions. Thus, the tax burden on enterprises with average wages that fall below this floor is particularly high. This puts at a disadvantage small and medium-size private enterprises, the backbone of job creation in the country, and also inhibits the hiring of the young or uneducated to the extent that the productivity of these groups of workers is below that justified by the wage floor, which also accounts for the high incidence of unemployment among the young and less educated.

Assistance to the unemployed

11. To alleviate the unemployment problem there is a well-developed social safety net. Unemployed persons who have been laid off are entitled to receive unemployment benefits which are quite generous in relation to other countries in the region.[11] Unemployed persons who have not held jobs previously (about 75 percent of all unemployed) do not qualify for unemployment benefits, but receive health insurance and social assistance. Thus, only about 12-13 percent of all the unemployed in 1999 were receiving unemployment benefits. While over 60 percent of the unemployed still qualify for health/social insurance, this appears to have provided incentives for employers to hire shadow workers, rather than for the unemployed to stay out of work.

C. Recent Labor Market Measures

12. The authorities have undertaken several measures over the past few years to mitigate the severe restrictions on firing imposed by the labor legislation and to make the labor market more flexible.

13. The Law on Labor Relations (LLR), a major component of the labor code, was originally adopted in 1993, but underwent two rounds of important amendments in 1997–98 as part of World Bank's social sector programs. These amendments aimed at easing labor market restrictions, in particular restrictions on firing and hiring, as well as the high costs of terminating labor.[12] More recently, new amendments to the LLR were adopted at

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[10] Apart from being relatively high, the wage floor is based on wage estimates that are likely to have a strong upward bias. This is because the surveys on which wage estimates are based cover mainly large, state or partially-privatized, firms that pay higher wages, but cover poorly small private firms that pay relatively lower wages.

[11] For example, unemployment benefits are paid for as long as 18 months, or even indefinitely for some groups, compared to at most 12 months in virtually all countries in the region; and the replacement ratio is 50 percent for the benefits of up to 12 months and 40 percent thereafter, also among the highest in the region.

[12] The amendments included, among other things, (i) establishing severance pay on the basis of length of service with the terminating employer only, rather than with all previous

(continued...)

end-March 2000 that further reduced labor market rigidities by decentralizing wage bargaining and lowering dismissal costs.

14. The Law on Employment and Insurance in case of Unemployment, the second major component of the labor code, was adopted in 1997, also in the framework of a World Bank's program, with the view of increasing labor market flexibility by reducing the amount and the duration of the unemployment benefits. The law also aimed at directly encouraging employment by exempting firms from payroll taxes on new hires for a period of three years and providing wage subsidies to employers who hire an unemployed person. Subsequently, a new set of amendments was adopted at end-March, 2000 that restricted eligibility for open-ended unemployment benefits.

15. Apart from addressing labor market rigidities embedded in the labor code, some of the measures aimed at encouraging employment directly. These include the adoption in 1998 of the Law to Increase Employment that aimed at encouraging hiring through payroll tax exemptions. While the law helped increase hiring, it was repealed in 1999, as the new government found it largely ineffective and burdening to the budget.[13]

16. While important steps have been taken so far to ease labor market restrictions, further reforms aimed at minimizing disincentives to hire by reducing the high costs of adjustment of the workforce during changing demand conditions, both through the labor legislation and through decentralized wage bargaining, will be essential for coping with the unemployment problem. Without deeper structural reforms and a pickup in economic growth, it is difficult to see how the unemployment problem can be reduced in a meaningful way.

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employers; and (ii) allowing employers to hire workers without a medical examination or a public announcement through the Employment Bureau.

[13] According to press reports, firms hired over 41 thousand employees following the introduction of the law, but most of these were suspected to be workers whose employment status was simply legalized, rather than new hires. 8 thousand of these were subsequently laid off after the law was repealed, as firms were reluctant to start paying payroll taxes for these employees.

Table 13. FYR Macedonia: Structure of Unemployment, 1996–1999

(in percent)

	1996	1997	1998	1999	1996	1997	1998	1999	1996	1997	1998	1999
	Unemployment rates 1/				Participation rates				Share in total unemployment			
Age Structure of Unemployment												
15-24	69.5	74.2	70.9	62.9	43.3	43.0	43.5	38.8	36.7	35.2	35.1	30.2
25-29	48.2	53.8	51.8	51.2	75.3	76.2	75.5	73.4	19.6	20.7	20.0	21.2
30-39	28.0	32.0	30.7	31.3	80.5	79.3	79.5	79.3	25.1	25.4	24.7	26.8
40-49	15.3	19.1	18.0	17.0	77.2	75.3	76.9	75.6	12.1	13.9	13.8	14.0
50-59	16.1	13.1	16.5	17.0	48.0	47.2	49.1	52.6	5.8	4.2	5.8	7.0
60-64	10.1	7.7	8.1	8.8	16.3	14.5	18.8	18.6	0.6	0.4	0.5	0.6
65-80	3.0	6.6	1.5	5.0	5.3	4.5	5.5	4.3	0.1	0.2	0.0	0.1
Unidentified	0.0	28.2	0.0	0.0	40.3	36.4	0.0	0.0	0.0	0.2	0.0	0.0
Education Structure of Unemployment												
Without education	41.7	40.2	35.6	34.0	18.9	19.0	16.4	12.0	3.4	2.8	2.0	1.4
Incomplete education	30.9	29.0	31.0	27.3	33.1	31.4	29.7	29.0	7.7	6.3	6.3	6.0
Primary education	40.6	46.7	44.7	40.3	47.5	46.6	46.3	43.4	35.2	35.8	37.3	34.4
3 years of secondary	34.0	38.8	37.8	36.9	74.3	70.2	74.6	72.1	14.9	14.3	16.0	16.3
4 years of secondary	28.9	33.0	32.2	31.9	72.0	71.2	70.4	69.0	28.5	30.1	31.7	34.6
Higher education	16.2	20.2	17.8	18.5	79.8	75.4	76.9	77.1	2.9	2.9	2.7	3.2
University and higher	14.5	18.9	16.2	15.0	85.1	82.6	80.6	80.6	7.4	7.9	4.0	4.1
Duration Structure of Unemployment												
less than 1 month									3.2	2.4	1.8	0.1
1-5 months									5.2	5.4	6.0	4.4
6-11 months									10.9	9.1	9.3	4.2
12-23 months									13.9	13.7	12.1	11.3
2 yrs									11.7	14.1	1.5	7.5
3 yrs									8.4	9.6	12.2	0.9
more than 4yrs									44.5	43.6	55.4	10.9
Other									...	...	...	59.3
Gender Structure of Unemployment												
Males	29.1	33.0	32.5	31.9	67.0	66.5	67.4	65.5	55.5	56.1	58.1	60.5
Females	36.2	40.8	37.6	33.3	42.9	41.2	42.2	40.8	44.5	43.9	41.9	39.5

Source: Data provided by the FYRM authorities.

1/ The ratio of unemployed to the labor force within each category.

Pricing of Oil Derivatives[1]

1. The government regulates the prices of a number of domestically sold oil derivatives at the producer and the retail levels. In January 1999 a new, transparent, system of pricing oil derivatives was introduced, replacing an arbitrary and opaque price-setting mechanism.[2] This annex explains how the government administers the prices of oil derivatives under the new system and summarizes recent adjustments in these prices.

A. Pricing Mechanism

2. The price-setting mechanism *at the producer level* aims at ensuring that producer prices are in line with producer costs, including the cost of imported crude oil and a set profit margin for the refinery.[3] The price commission, set up specifically for this purpose, meets at least once every two weeks and adjusts producer prices whenever the estimated production costs have changed by more than 5 percent in either direction during the previous three-month period. This pricing mechanism safeguards the profit margin to the refinery, since failure to increase producer prices in line with costs would result in the compensation of the producer for the losses incurred due to non-adjustment. Producer prices, therefore, are always adjusted in line with international prices for crude oil.

3. In contrast to producer prices, the ultimate authority for setting *retail prices* rests with the government. Retail, or pump, prices consist of (i) the producer price; (ii) the cost of transporting the oil derivative from the refinery to the gas station; (iii) the profit margin of the gas station; and (iv) excise taxes. Transportation costs and the profit margins, which vary across oil derivatives, are set and have been unchanged throughout 1999. Thus, once the government sets the retail price for various oil derivatives, it defines, by default, a specific, but variable, excise rate. Every change in the producer prices enacted by the commission, in the absence of an equal change in the retail price, will translate into a change in the tax rate. In particular, if the government fails to raise (lower) retail prices in response to an increase (decrease) in crude oil prices, the excise tax rate will be lower (higher), as will government revenues. Thus, given that the adjustment in producer prices is pseudo-automatic, the

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[1] Prepared by Aliona Cebotari.

[2] This new system was intended to pave the way for the privatization of the Okta refinery, the largest refinery in the country. It should be noted, however, that while the pricing mechanism described was legislated in January 1999, it was not implemented until July 1999, after the sale of the Okta refinery to the strategic investor.

[3] Producer prices cover all the costs of the oil refinery associated with the import and transportation of crude oil, the production of oil derivatives and the profit margin of the refinery (8 percent after the sale of the oil refinery Okta to foreign investors).

achievement of the government target for oil excise collection depends on government's discretion in adjusting retail prices of oil derivatives.

4. This pricing mechanism clearly aims at preserving the producer profit margin. It, however, passes through to the consumer higher costs of oil derivatives only to the extent that, for the year as a whole, excise collections are expected to fall short of government's budgeted target because the average effective excise rate is lower than the statutory rate on which the excise revenue target was based. This partial passthrough reflects the government's desire to ensure stable domestic oil prices.

B. Recent Price Adjustments

5. Retail prices of oil derivatives remained virtually unchanged in 1998, despite the 16 percent fall in world crude oil prices during the year. Retail prices were lowered by about 10 percent in January 1999, as the international prices of crude oil continued to fall (see Table 14). However, with the sharp recovery in world oil prices in the spring of 1999, the government increased domestic retail prices at end-June (by about 12 percent, on average). Thereafter, despite the continued increase in world oil prices, the government waited until August 25, 1999 to further adjust domestic prices further (by an average of about 3 percent).[4] This, as well as the subsequent, delay threatened the achievement of the excise revenue target and prompted the authorities to make an additional adjustment in early December 1999 of an average of 14 percent. This adjustment ensured that the excise rates were well in excess of the statutory rates legislated in July 1999, thereby compensating in part for the excise losses incurred earlier in the year.

6. In 2000, the authorities have continued to pass through increases in world oil prices, reflecting this time their de facto commitment at the beginning of the year to follow flexible oil pricing policies.

[4] Only the retail price of mazut has been increased several times between end-June and end-August.

Table 14. FYRM: Prices of Oil Derivatives, 1999-2000.

	Average price 1/ (denar per liter 2/)			Percentage change			Cumulative percentage change since June 30, 1999		
	Producer Prices	Retail Prices, actual	Retail Prices, full passthrough 3/	Producer Prices	Retail Prices, actual	Retail Prices, full passthrough 4/	Producer Prices	Retail Prices, actual	Retail Prices, full passthrough
31-Dec-98	10.23	23.09							
1-Jan-99	7.96	20.72		-22.15	-10.26				
30-Jun-99	10.00	23.29	23.29	25.56	12.40				
15-Jul-99	10.95	23.35	24.25	9.56	0.24	4.10	9.56	0.24	4.10
26-Jul-99	11.49	23.48	24.78	4.88	0.58	6.14	14.91	0.83	6.40
9-Aug-99	11.20	23.48	24.49	-2.54	0.00	4.29	12.00	0.83	5.15
25-Aug-99	11.56	24.34	24.85	3.25	3.64	5.84	15.64	4.49	6.71
25-Sep-99	11.79	24.34	25.09	2.01	0.00	3.08	17.96	4.49	7.71
5-Oct-99	12.67	24.34	25.96	7.39	0.00	6.66	26.68	4.49	11.45
13-Oct-99	13.09	24.34	26.38	3.32	0.00	8.39	30.89	4.49	13.26
10-Nov-99	12.03	24.34	25.32	-8.07	0.00	4.05	20.32	4.49	8.72
15-Nov-99	13.19	24.34	26.49	9.66	0.00	8.82	31.95	4.49	13.71
29-Nov-99	14.45	24.34	27.75	9.58	0.00	14.01	44.58	4.49	19.14
10-Dec-99	14.50	27.61	27.79	0.31	13.45	14.20	45.03	18.54	19.33
16-Feb-00	16.45	27.88	29.75	13.49	0.99	7.74	64.58	19.72	27.72
23-Feb-00	16.78	30.25	30.12	2.01	8.50	8.02	67.89	29.89	29.31
8-Mar-00	17.35	30.79	30.69	3.38	1.76	1.43	73.56	32.18	31.75

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

1/ The average price of oil derivatives is calculated as the weighted average of the price of all oil derivatives, weighted by their estimated shares in 1999 sales.
2/ Except for mazut denar per kilogram.
3/ Full passthrough retail price is calculated as the sum of the actual producer price, transportation costs and profit margin, and the statutory excise rate as of June 30, 1999.
4/ This columns shows the percentage change in the actual retail price that would be required to reach the full-passthrough retail price.

DID PRIVATIZATION INCREASE PROFITABILITY IN FYRM?[1]

A. Introduction

1. A substantial empirical literature suggests that privatization improves the profitabilty of firms but much of this literature fails to correct for potential sources of bias. A number of studies suggest that privatized firms tend to be more efficient and more profitable than those that have remained in the state sector (e.g. Boardman and Vining, 1989; Megginson, Nash and van Randenburg, 1994). However, many of the studies that compare the performance of privatized, or private firms, with firms in the state sector have not addressed the fact that privatization is endogenous (Claessens and Djankov, 1998). In particular, there is reason to believe that more profitable, or potentially profitable, enterprises are likely to be privatized early in the process. A simple comparison of the performance of enterprises that have been privatized with those still in the state sector will therefore be subject to selection bias. Comparisons of pre- and post-privatization performance have often failed to account for changes in economic conditions that may affect all firms. This is a particular concern for economies in transition where privatization is often accompanied by other reforms, such as stabilization, which may lead to a general improvement in profitability in the enterprise sector.

2. More recent studies have addressed these biases and find mixed evidence on the effect of privatization. Three recent studies have controlled for selection bias by comparing the change in profitability of firms that have been privatized with the change in profitability of other firms. La Porta and Lopez-de-Silanes (1999) find that privatization leads to an increase in various measures of profitability whether or not there is a change in management as part of the privatization process. Frydman et al (1999), find no increase in profit margins as a result of privatization. They do find an increase in revenue in enterprises sold to outsiders but not in those sold to insiders. Claessens and Djankov (1998) find greater growth in total factor productivity in privatized firms compared to those that remained in the state sector.

3. This study finds that once selection bias is controlled for, there is little evidence that privatization in FYRM has led to an improvement in firm profitability, at least in the short run. This paper examines data on the financial position of 661 enterprises which had undergone privatization or were due to undergo privatization in FYRM in 1996–97. A simple comparison of privatized and yet to be privatized firms would suggest that privatized firms were more profitable than those that had not yet been privatized. However, firms that were more profitable prior to privatization were more likely to be privatized early. Once this selection bias is controlled for, there is little evidence that privatization improves profitability, at least in the short run. This result may reflect the predominance of insider buyouts and the lack of supporting legislation and institutions to ensure creditor and shareholder rights.

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[1] Prepared by Rachel Glennerster.

4. The remainder of this paper is divided into four sections. Section B provides some background on the overall performance of the enterprise sector in FYRM and a description of the privatization process. Section C describes the data. Section D describes the methodology and presents the results. Section E draws some conclusions.

B. Background

5. At the start of the reform process, the majority of workers were in socially-owned enterprises. In 1994, less than two percent of workers were in fully private firms, according to official statistics, although there were likely to be more in unregistered enterprises and on small private farms not fully captured in these statistics. Private enterprises tended to be small shops and other service sector enterprises. There were also a small number of workers in cooperatively-owned enterprises. Roughly four percent of workers were in state owned firms which included most of the utilities. Roughly two thirds of workers in FYRM, however, were in enterprises which were neither owned by the state nor by workers but by "society". Managers in these enterprises were elected by worker's councils but property rights were very unclear. The remainder of the workforce was in enterprises with mixed ownership.

6. In 1998, over 50 percent of employment was in privatized firms. By the end of 1998, 1,435 enterprises, with over 213,013 employees, had been privatized (Table 27). According to figures from the centralized payments bureau (ZPP), 51 percent of employment in 1998 was in privatized firms.[2] Employment in firms which had been founded with private capital (i.e. had never been state- or socially-owned) was also rising during this period, from 20 percent in 1996 to 26 percent in 1998. Only 24 percent of employment were in state or socially-owned enterprises in 1998.

7. Enterprise sector profitability has improved since 1995, but it is not clear whether this is due to privatization. The enterprise sector as a whole ran substantial losses prior to reform; in 1995, losses before tax and depreciation were equivalent to 4 percent of GDP. The aggregate financial position of the enterprise sector improved considerably from 1995 to 1998. By 1998, losses before tax and depreciation were equivalent to 1 percent of GDP. However, it is not clear how much of this improvement is due to privatization and how much is a reflection of other factors, such as macro-economic stabilization.

The privatization process

8. Mass privatization got underway in late 1994. The first steps towards reform and privatization were taken in 1990, while FYRM was still part of the Socialist Federal Republic of Yugoslavia (SFRY), with the introduction of the Markovic law. Under this law, enterprises could be corporatized and employees could purchase shares, usually at a

[2] ZPP data is based on a subset of firms and is therefore not fully consistent with that provided by the Statistical Office.

substantial discount to their market value. However, few enterprises were fully privatized before the law was suspended in 1991. The reform process in general was delayed until after FYRM's political and monetary independence was completed in late 1992. A new privatization law (the Law on the Transformation of Social Capital) was passed in June 1993 but only in November 1994 were the first companies privatized under this law. By the end of 1999, 1,488 enterprises representing 215,951 workers had been privatized (Table 27).

9. While the law allowed for several different models of privatization, most enterprises were sold to insiders. Existing management was responsible for choosing the timing and method of privatization, while an independent valuation of all firms undergoing privatization was carried out under the auspices of the Privatization Agency. This valuation was based partly on an assessment of the value of the enterprises' assets, and partly on projected profits.[3] Workers and managers were permitted to purchase shares at a discount to the official valuation and were permitted to buy their shares in installments over several years. The vast majority of companies were privatized under some form of insider buyout. Forms of outsider privatization included, debt/ equity conversions, foreign equity, and sale of assets (Table 27). Most of the enterprises sold under the foreign equity model were branches of enterprises registered in other former SFRY republics that were purchased by the parent company.

10. Managers of profitable enterprises had the ability and incentive to push for early privatization of their enterprise. Under the Law on the Transformation of Social Capital, all enterprises with social capital were required to undergo privatization. However, managers had considerable control over when and how an enterprise was privatized. Because managers could purchase shares at a discount to their assessed value, managers of profitable enterprises, or potentially profitable enterprises, could expect to benefit personally from privatization.

C. Data

11. The paper uses data on the financial results of 661 privatized firms. The data used in this paper was constructed from two data sets. The first data set was provided by the centralized payments bureau, known by its Macedonian acronym ZPP. It consisted of information on the 1996 and 1997 financial results of 901, mainly large, enterprises. The second data set was provided by the Privatization Agency and included information on the date and type of privatization for all enterprises privatized by mid-1999. The two data sets were merged to create a database of 661 companies representing 66 percent of all privatized firms.

12. Various measures of profitability were used and all yielded similar results. Return on capital would be the most appropriate measure of profitability. However, no data was available on the level of, or return on, capital. The level of profits, profits per worker, and profits as a proportion of sales revenue were available as alternative measures of profitability.

[3] To the extent that the valuation was based on the value of assets there would be less incentive for managers to depress reported profits prior to privatization.

The level of profits is likely to be noisy. Profits per worker will be a less noisy measure but may be subject to bias if privatized firms are more likely to reduce excess labor. Profits over sales revenue (or profit margins) may not be a good indicator as firms that maximize profits are unlikely to maximize profit margins. However, the results were very similar whichever measure was used. Only the results for profits per worker are presented here. In all cases profits were before tax and depreciation. [4]

D. Methodology and Results

Levels estimator

13. The profitability of privatized and yet to be privatized firms was compared. The level of profitability of firms that had already been privatized in 1996 and those which had yet to be privatized were compared. This was done using an OLS regression with firm profits per worker as the dependent variable (profit96/worker). The independent variable was a dummy (private95) set equal to 1 for those enterprises that had been privatized by December 31, 1995 and 0 for those enterprises that had not yet been privatized. The comparison was repeated for 1997. Dummies for the sector in which the industry operated (sector dummies) were included.

14. The relationship between time since privatization and profitability was estimated. It is possible that privatization improves profitability but only after a lag. Profits per worker were therefore regressed against the days since privatization by end 1996 (t96) and the sample was restricted to those firms that had been privatized by end 1996. The regression was repeated for 1997.

Results

15. Privatized firms were found to be more profitable than nonprivatized firms and profitability increased with time since privatization. Privatized firms in 1996 had higher profits per worker (before tax and depreciation) than nonprivatized firms (Table 15, regression 1). This result also holds in 1997 (regression 2). The coefficients on t96 and t97 are positive suggesting that firms which were privatized earlier had higher profits per worker than those privatized more recently (regressions 3 and 4).

Selection bias

16. Levels estimators may be subject to selection bias. As discussed in the introduction, a simple levels estimator which compares the performance of enterprises which have been privatized with those that have not yet been privatized may be subject to selection bias. The selection bias results from the fact that managers of profitable or potentially profitable

[4] Given that firms have considerable discretion about the level of depreciation they declare, profits before depreciation has been deducted is likely to contain more information than profits after depreciation.

Table 15. FYRM: Levels Estimator and Selection Bias 1/

Regressions	(1)	(2)	(3)	(4)	(5)
Dependent variable 2/	profits96/ worker	profits97/ worker	profits96/ worker	profits97/ worker	profits96/ worker
Independent variables:					
private95 3/	37,344 **				
	(12,333)				
private96 4/		33,897 **			
		(15,050)			
t96 5/			60.3 **		
			(24.5)		
t97 6/				50.9 **	
				(19.4)	
privatized98 7/					-169,067 **
					(49,662)
privatized99 8/					33,164
					(64,609)
constant	-29,894 **	-18,753	-20,912 **	-17,868	-56,755 **
	(9,215)	(14,441)	(12,109)	(14,439)	(20,961)
sector dummies	yes	yes	yes	yes	yes
Sample size	506	506	394	489	112
Adjusted R squared	0.036	0.009	0.058	0.036	0.064
F ratio	2.9	1.5	2.2	1.6	1.9
Prob>F	0.002	0.154	0.066	0.093	0.001

Sources: Data provided by Privatization Agency and Payments Bureau (ZPP); and calculations by IMF staff.

1/ Standard errors are shown in parenthesis. Note ** indicates coefficient is significantly different from zero at the 5 percent level of confidence.
2/ Firm profits per worker for 1996 and 1997.
3/ Dummy variable set equal to 1 for those enterprises privatized by December 31, 1995; zero otherwise.
4/ Dummy variable set equal to 1 for those enterprises privatized by December 31, 1996; zero otherwise.
5/ Variable takes the value of the number of days since privatization by end-1996.
6/ Variable takes the value of the number of days since privatization by end-1997.
7/ Dummy variable set equal to 1 for those enterprises privatized in 1998; zero otherwise.
8/ Dummy variable set equal to 1 for those enterprises privatized in 1999; zero otherwise.

enterprise had the ability and incentive to push for early privatization of their enterprises as they were able to purchase shares in the enterprise at discounted prices. Given this endogeneity, privatized firms would be more profitable than yet to be privatized firms even if privatization itself had no impact on the level of profitability. As a result, the levels estimators discussed above would have an upward bias.

17. Evidence of selection bias was tested for. Data on pre-privatization profitability was only available for firms privatized after 1996. For these firms, the relationship between pre-privatization profits and the year of privatization was determined. Data on pre-privatization profits was available by sector for firms privatized prior to 1996. The average profitability of different sectors was examined to see whether firms in more profitable sectors were privatized earlier.

Results

18. Firms in more profitable sectors tended to be privatized earlier. A disproportionate share of enterprises in the trade, construction and crafts had been privatized by end 1995. These three sectors had the highest level of net profits per worker, or lowest level of net losses per worker, among all the sectors in the economy in 1995 (Table 16) (no data on profitability by sector is available for 1994).

19. Enterprises privatized in 1997 had higher pre-privatization profitability than those privatized in 1998. The relationship between pre-privatization profit per worker and the timing of privatization is confirmed by regression 5 (Table 15). This shows that enterprises privatized in 1998 had significantly lower profits per worker in 1996 than those privatized in 1997 (the omitted category). The coefficient on enterprises privatized in the first half of 1999 is not significant. However, this is not surprising as the number of firms privatized during the first half of 1999 were small.

Difference estimator

20. Selection bias can be partially corrected by using a difference estimator. This method uses the change in profitability between 1996-1997 (dprofits per worker) as the dependent variable and change in privatization status as the independent variable (privatized96 etc).[5] This approach is similar to using a firm-level fixed effect. The firms in the data set fall into three groups: those which have been privatized for some time, those which have just completed privatization, and those not yet privatized. If privatization leads to

[5] Comparing changes in profitability against change in ownership status will correct for endogeneity in the timing of privatization with respect to the level of profits. However, it is still possible that there is selection bias due to the endogeneity in the timing of privatization with respect to the change in profits. In other words those enterprises which were more likely to see an increase in profitability may have been privatized early in the process. This would create an upward bias in the difference estimator.

Table 16. FYRM: Net Profits by Sector, 1995–97

(In thousands of denar)

	1995			1996			1997		
	Total	Per enterprise	Per employee	Total	Per enterprise	Per employee	Total	Per enterprise	Per employee
Mining and industry	-2,923,000	-675	-21	-3,871,000	-893	-30	-2,155,000	-497	-17
Agriculture	-945,000	-928	-41	-1,373,000	-1395	-69	-661,000	-672	-34
Forestry	-67,000	-882	-17	-88,000	-1189	-22	-5,000	-68	-1
Water management	-148,000	-6,167	-52	-126,000	-5,250	-48	-115,000	-4,792	-44
Construction	-97,000	-49	-3	-146,000	-73	-5	-263,000	-132	-8
Transport and communication	-644,000	-308	-26	-972,000	-450	-42	-796,000	-368	-34
Trade	-167,000	-8	-3	-903,000	-49	-23	-393,000	-21	-10
Tourism and catering	-78,000	-58	-11	-133,000	-97	-19	-123,000	-90	-17
Crafts	-48,000	-25	-9	-91,000	-45	-16	-44,000	-22	-8
Other sectors	-16102000	...	...	-19023000	...	...	-16180000	...	...
Total economy	-21219000	...	...	-26726000	...	...	-20735000	...	...

Sources: Data provided by the Payments Bureau (ZPP) and World Bank staff.

an improvement in profitability, the hypothesis is that those that have just completed privatization will see a larger improvement in profitability than the other two groups. This should be the case whether or not those firms with a higher level of profitability were privatized earlier. In one regression, a dummy was set equal to 1 for all enterprises which had just completed privatization (i.e. had been privatized during 1996) and 0 for the other two control groups (i.e. those privatized either before or after 1996). In a slightly modified specification, the two control groups (privatized for some time and not yet privatized) were separated out by including another dummy for firms that were already private by end 1995. Those not yet privatized were the omitted category. Finally, it is not clear how quickly the impact of privatization is reflected in improved performance. The estimations, therefore, were repeated on the assumption that privatization took 2 years to impact profitability. Previous studies, which have found a positive impact of privatization on profits, have found that the impact is evident within the first 2 years following privatization.

Results

21. There is little evidence that privatization is associated with an increase in profits. There is little evidence that enterprises privatized in 1996 experienced a larger increase in profits per worker between 1996 and 1997 than those in the control groups. This is true if the two control groups (already privatized and not yet privatized) are taken together (Table 17, regression 6) or taken separately (regression 7). It is also the case if the impact of privatization on profits per worker is assumed to take effect the year after privatization (regressions 6 and 7) or only after a 2-year lag (regressions 8 and 9). [6]

E. Conclusion

22. There is little evidence that privatization in FYRM has increased profits in the short run. While privatized firms are more profitable than nonprivatized firms, this may be a reflection of the fact that more profitable firms were privatized earlier. After controlling for selection bias there is little evidence that privatization has led to an improvement in profitability in privatized enterprises, at least in the short run. It is possible, therefore, that the KMgeneral improvement in profits in the enterprise sector as a whole has more to do with the improved macro and trade environment than privatization itself. It is also possible that privatization will have an effect but that this effect will only be apparent over a longer period.

23. The disappointing short term results of privatization may reflect problems with insider privatization and the weak regulatory environment. This paper's finding that privatization in FYRM appears to have had little impact on enterprises profitability, at least in the short run, may be a reflection of the predominance of insider privatization whose

[6] The result is strengthened by the fact that any bias resulting from endogeneity in the timing of privatization with respect to change in profits would likely create an upward bias in the difference estimator, i.e. make it less likely that the estimator would be insignificantly different from zero.

Table 17. FYRM: Difference Estimator 1/

Regressions	(6)	(7)	(8)	(9)
Dependent variable 2/	dprofits/ worker	dprofits/ worker	dprofits/ worker	dprofits/ worker
Independent variables:				
private94 3/				-3,042
				(18,795)
private95 4/		-14,391		
		(13,091)		
privatized95 5/			-2,422	-3,067
			(9,993)	(10,403)
privatized96 6/	-7,797	16,815		
	(9,589)	(12,681)		
constant	30,857 **	40,040 **	27,630 **	28,616 **
	(8,323)	(11,876)	(7,288)	(8,193)
sector dummies	yes	yes	yes	yes
Sample size	506	506	506	506
Adjusted R squared	0.040	0.038	0.038	0.035
F ratio	2.9	2.5	2.8	2.4
Prob>F	0.001	0.002	0.001	0.004

Sources: Data provided by Privatization Agency and the Payments Bureau (ZPP); and calculations by IMF staff.

1/ Standard errors are shown in parenthesis. Note ** indicates coefficient is significantly different from zero at the 5 percent level of confidence.
2/ Change in profits per worker between 1996–97.
3/ Dummy variable set equal to 1 for those enterprises privatized by December 31, 1994; zero otherwise.
4/ Dummy variable set equal to 1 for those enterprises privatized by December 31, 1995; zero otherwise.
5/ Dummy variable set equal to 1 for those enterprises privatized in 1995; zero otherwise.
6/ Dummy variable set equal to 1 for those enterprises privatized in 1996; zero otherwise.

effectiveness has recently been questioned (Barberis et al, 1996; Shleifer and Vishny, 1996; and Frydman et al, 1999).[7] The results may also reflect the fact that shareholders purchased their shares in installments over several years. Immediately following privatization, therefore, shareholders may have had less incentive to push for improvements in the profitability of enterprises. It is also possible that privatization is not very effective at increasing profitability in the absence of an appropriate legal and regulatory environment, which enforces creditor and shareholder rights. In particular, privatization may be more effective if firms face a realistic threat of takeover or liquidation. This requires that hard budget constraints are imposed, creditors are able to seize the assets of delinquent debtors, shareholders are able to freely trade their shares, and minority shareholders have their rights protected. In 1996–97, none of these conditions prevailed in FYRM. Bank lending practices were poor, the majority of enterprises were permitted to restrict the sale of shares,[8] the majority of share registries were held by companies,[9] and creditors were not permitted to seize an asset if the asset was essential to the functioning of the enterprise. Measures to impose hard budget constraints and improve creditor and shareholder rights were an important component of the second year ESAF arrangement.

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[7] A regression using dummies for different methods of privatization did not show a significant coefficient on insider privatization but given the relatively small number of time sold to outsiders this may not be conclusive.

[8] Under Article 290 of the Law on the Transformation of Social Capital, it was legal for companies which were not fully private (i.e. where share installment plans had not been completed) to restrict sale of their shares. As the majority of shares had been sold through installment plans that lasted several years, most privatized enterprises were able to restrict the sale of shares in 1998.

[9] Shares in FYRM are de-materialized and ownership is determined by the share register. If the company has control over the register, it can exercise control over the transfer of shares.

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FYRM: Tax Summary as of April 1, 2000

Tax	Nature of Tax	Exemptions and Reductions	Rates
Central Government			
1. Taxes on Income and Profits			
1.1 Profit Tax	A tax on annual aggregate business profits. Resident legal entities and physical persons are taxed on their global profits. Nonresidents are taxed on profits earned in the FYRM. An entity is a resident of the FYRM if it is established and registered there. The taxable base is the difference between total revenues and expenses. Deductible expenses include business, financial, and extraordinary expenses, as well as depreciation. Taxpayers make monthly advance payments based on the previous year's profits, adjusted for inflation. Payments for the period July – January are adjusted based on actual profits.	Fixed assets used for: (i) Technological modernization, (ii) Structural adjustment, (iii) Protection of the environment, receive accelerated depreciation. Reinvested profits are deductible. Investments in economically undeveloped districts, border regions and certain mountain districts are deductible. The profits of: (i) Joint ventures with foreign partners, where the foreign partners hold at least a 20 percent share, (ii) Foreign enterprises, are exempt for the first three years of operation. Rehabilitation firms employing disabled persons are exempt.	Standard rate: 15 percent For remitted dividends: 15 percent

Tax	Nature of Tax	Exemptions and Reductions	Rates
1.2 Personal Income Tax	A tax on annual aggregate net personal income from all sources. Residents are taxed on their worldwide income. Nonresidents are taxed on income earned in the FYRM. The tax is withheld at source on a monthly basis.	All social security contributions are deductible. ¼ of the average salary amount is deductible. Investment in land improvement or in land consolidation is deductible by 50 percent and 100 percent, respectively. Investment in farm buildings and agricultural implements is deductible for up to 30 percent of the cadastral income. Interest on demand deposits is exempt. Distributed dividends are 50 percent exempt.	Progressive tax rates are applied as follows: (i) Income below two times the average monthly wage (AMW): 23 percent (ii) Income between two and five times AMW: 27 percent (iii) Income over 5 times AMW: 35 percent Withholding rates are as follows: (i) Employment, pension, economic and professional earnings: Same as tax rates (ii) Independent contract work, copyright, patents, technical improvements, capital property and gambling earnings: 23 percent

Tax	Nature of Tax	Exemptions and Reductions	Rates
2.Value-Added Tax (VAT)			
A VAT is scheduled was introduced April 1, 2000.	A tax on consumption, calculated at all stages of production and supply, using the destination-based credit invoice method. The threshold for monthly filers is denar 25 million (US $ 417,000) and quarterly filers denar 1 million (US $17,000). Payments are due within 15 days from the end of the tax period. Refunds are paid within 30 days.	The following are zero-rated: exports; goods transported to/or dispatched from duty-free zones; services related to import and export; services performed by brokers and other intermediaries; aircraft leases used in international commercial air traffic; and international air transport of passengers. The following are exempt from VAT: residential building and apartments except the first supply; rents; postal services; banking and financial services; insurance; health services; medical and dental services; educational services; and funeral services.	General rate: 19 percent. Reduced rate: 5 percent The reduced rate applies to: food products except alcoholic beverages and soft drinks; basic agricultural products; water; electricity, coal, wood, gas, air conditioning and heating; drugs; personal care products; books, pamphlets, newspapers, and periodicals; public transportation; waste disposal and public sanitation; and services of lawyers, accountants, and auditors.
2.1 Excise Tax	A tax on the sale or import of goods. Excises are generally imposed at the manufacturing and import stage. However, excises on luxuries are imposed at each distribution stage. Control marks are widely used to enforce payment of all excises.	Exports are exempt.	**Oil** Gasoline MF86 22.963 denar/liter MF98 24.611 denar/liter BMB95 22.072 denar/liter Diesel D1 12.429 denar/liter D2 11.759 denar/liter Heating Oil EL 3.123 denar/liter SL 38.3 percent Jet fuel 17 percent LPG: Standard rate 5 percent LPG: For cars / vessels 40 percent Fuel Oil Mazut 0.099 denar/liter Others 11 percent

Tax	Nature of Tax	Exemptions and Reductions	Rates
2.1 Excise tax (continued)			**Alcohol** Alcohol (3 denars per percentage of alcohol / liter) Spirits (2 denars per percentage of alcohol / liter) **Beer** 15 denars / liter **Tobacco** Cigarettes Domestic 1,350 denar/kilo Imported 40 percent Imported tobacco 40 percent **Automobiles** Up to 2-liter cylinder 25 percent Over 2-liter cylinder 55 percent **Luxury items** 50 percent Applies to ornaments, precious metals and stones, pearls, perfume, cosmetic products, handmade rugs, reptile leather and fur products. **Coffee** Unroasted 70 denars / kilo Roasted 85 denars / kilo Instant 90 denars / kilo
2.2 Import Duties	Tax on imported goods.	Exemption for these items: (i) Re-exports. Must provide a bank guarantee for the amount of duty, in case re-export does not occur. (ii) Raw materials. Must pay duty, but after exporting finished product receive a duty-drawback. Exemption for these organizations: (i) Diplomatic and consular missions.	Rates range from 0 percent to 25 percent. Lower rates on raw materials. No duty on cotton or crude oil. Preferential trade agreements, specifying 1 percent 'statistical charge' alone, apply to trade with:

Tax	Nature of Tax	Exemptions and Reductions	Rates
2.2 Import Duties (continued)			(i) Slovenia (Agreement signed 2.96). Exception: tariffs on industrial goods reduced gradually, with final elimination by 2000. (ii) Yugoslavia (Agreement signed 10/96). Beyond a specified quantitative limit, general tariff rates apply. (iii) Bosnia (Agreement signed 1.97). (iv) Croatia (Agreement signed 3.97). Exception: refined oil is subject to prohibitive tariffs. 1997 average tariff rate: 6.3 percent.
3. Taxes on Property			
3.1 Inheritance & gift tax	A tax on inheritance and gifts.	In general, recipients within the first degree of kinship (a spouse, child, or parent) are except. Recipients within the second degree of kinship (a grandchild, brother, or sister) are exempt only if they lived in the donor's household at the time of death or when the gift was given.	For recipients within the second degree of kinship: 3 percent. (Prior to 1997: 5 percent) All others: 5 percent (Prior to 1997: 10 percent)
	Social Security Funds		
4. Social Security Contributions	All persons are liable to compulsory monthly social security contributions. For employed persons, the contributions, together with the income tax, are withheld at source. Self-employed persons pay the Contributions with their monthly income tax.		Rates are the same for employed and self-employed persons: Pension & Disability Fund: 20 percent Health Care Fund: 8.6 percent Employment fund: 1.5 percent

Tax	Nature of Tax	Exemptions and Reductions	Rates
Local Government			
5. Taxes on Property			
5.1 Property tax	A tax on the market value of: (i) Immovable property, e.g., houses, apartments, business premises. (ii) Movable property, e.g., motor vehicles, vessels and aircraft.	Exemptions for: (i) Buildings used by government. (ii) Buildings used for education, health, sport, and cultural purposes. (iii) Buildings used for religious and humanitarian purposes. (iv) Farm land. (v) Buildings registered as historical monuments. (vi) Buildings housing foreign diplomatic or consular representatives, or international organizations. Residential buildings enjoy a 50 percent deduction.	0.10 percent
5.2 Property sales tax	A tax on the market value of sales of real estates and rights.		3 percent

Table 18. FYRM: Gross Domestic Product at Current and Constant Market Prices by Economic Activity, 1995–99

	1995	1996	1997	1998	1999 Est.	1995	1996	1997	1998	1999 Est.
	(In millions of denars, at current market prices)					(In millions of denars, at constant 1995 market prices)				
Mining and industry	33,277	34,390	38,351	41,680	40,516	33,277	34,932	35,941	37,559	36,620
Agriculture and fisheries	18,015	18,876	19,780	19,105	18,027	18,015	17,487	17,487	18,162	18,212
Forestry	905	922	984	866	940	905	1,045	979	854	937
Water management	738	740	755	653	648	738	784	821	704	706
Construction	8,917	9,073	10,131	10,840	12,350	8,917	8,863	8,880	9,137	10,255
Services	107,668	112,443	114,981	117,683	122,803	107,668	108,419	109,891	112,704	117,178
Transport and communications	10,336	10,425	11,301	12,238	14,046	10,336	10,375	10,717	11,457	13,025
Trade	18,750	19,775	20,104	20,447	21,599	18,750	18,956	18,613	18,780	20,038
Tourism and catering	2,690	3,145	3,068	3,738	4,127	2,690	2,800	2,699	3,247	3,546
Personal services, crafts, and trade	3,373	3,769	4,200	3,912	3,873	3,373	3,589	3,831	3,540	3,540
Utilities and public services	3,547	3,830	4,149	4,224	4,182	3,547	3,611	3,827	3,866	3,866
Financial and business services	9,913	9,774	10,157	10,686	10,780	9,913	9,174	9,605	10,025	10,216
Education, science, culture, and information	10,346	10,765	11,124	11,067	11,088	10,346	10,626	10,382	10,247	10,370
Health care and social security	9,005	8,819	9,538	9,730	9,748	9,005	8,917	9,122	9,232	9,342
Public administration	11,312	11,761	11,609	11,994	12,017	11,312	11,485	11,681	11,973	12,116
Other 1/	28,397	30,378	29,730	29,645	31,343	28,397	28,886	29,413	30,338	31,119
Gross domestic product	169,521	176,444	184,982	190,827	195,284	169,521	171,530	174,000	179,120	183,908
	(In percent of GDP)					(Annual percent change)				
Mining and industry	19.6	19.5	20.7	21.8	20.7	-8.9	5.0	2.9	4.5	-2.5
Agriculture and fisheries	10.6	10.7	10.7	10.0	9.2	2.3	-2.9	0.0	3.9	0.3
Forestry	0.5	0.5	0.5	0.5	0.5	-2.8	15.4	-6.3	-12.7	9.7
Water management	0.4	0.4	0.4	0.3	0.3	7.0	6.2	4.7	-14.2	0.2
Construction	5.3	5.1	5.5	5.7	6.3	-1.9	-0.6	0.2	2.9	12.2
Services	63.5	63.7	62.2	61.7	62.9	1.0	0.7	1.4	2.6	4.0
Transport and communications	6.1	5.9	6.1	6.4	7.2	-1.1	0.4	3.3	6.9	13.7
Trade	11.1	11.2	10.9	10.7	11.1	1.0	1.1	-1.8	0.9	6.7
Tourism and catering	1.6	1.8	1.7	2.0	2.1	-12.6	4.1	-3.6	20.3	9.2
Personal services, crafts, and trade	2.0	2.1	2.3	2.1	2.0	-15.0	6.4	6.7	-7.6	0.0
Utilities and public services	2.1	2.2	2.2	2.2	2.1	1.7	1.8	6.0	1.0	0.0
Financial and business services	5.8	5.5	5.5	5.6	5.5	-5.5	-7.5	4.7	4.4	1.9
Education, science, culture, and information	6.1	6.1	6.0	5.8	5.7	6.4	2.7	-2.3	-1.3	1.2
Health care and social security	5.3	5.0	5.2	5.1	5.0	4.1	-1.0	2.3	1.2	1.2
Public administration	6.7	6.7	6.3	6.3	6.2	4.6	1.5	1.7	2.5	1.2
Other 1/	16.8	17.2	16.1	15.5	16.0	3.8	1.7	1.8	3.1	2.6
Gross domestic product	100.0	100.0	100.0	100.0	100.0	-1.1	1.2	1.4	2.9	2.7

Source: Data provided by the Statistical Office.

1/ Including imputed rent, import duties, sales tax, and subsidies, minus imputed banking services.

Table 19. FYRM: Gross Domestic Product by Aggregate Demand Components, at Current and Constant Market Prices, 1995-99 1/

	1995	1996	1997	1998	1999 Est.	1995	1996	1997	1998	1999 Est.
	(In millions of denars, at current market prices)					(In percent of GDP)				
Gross domestic product, at current market prices	169,521	176,444	184,981	190,827	195,283	100.0	100.0	100.0	100.0	100.0
Total domestic demand	186,021	194,672	211,644	223,069	223,052	109.7	110.3	114.4	116.9	114.2
Consumption	150,872	159,239	168,147	174,408	181,343	89.0	90.2	90.9	91.4	92.9
Private	119,381	127,254	136,350	140,878	144,205	70.4	72.1	73.7	73.8	73.8
Public	31,491	31,985	31,797	33,530	37,138	18.6	18.1	17.2	17.6	19.0
Gross investment	35,149	35,433	43,497	48,661	41,709	20.7	20.1	23.5	25.5	21.4
Gross fixed capital formation	28,027	30,654	32,189	33,982	34,949	16.5	17.4	17.4	17.8	17.9
Changes in inventories	7,122	4,779	11,308	14,679	6,760	4.2	2.7	6.1	7.7	3.5
Foreign balance	-16,500	-18,228	-26,663	-32,242	-27,769	-9.7	-10.3	-14.4	-16.9	-14.2
Exports of goods and services	55,923	49,770	68,245	77,499	81,028	33.0	28.2	36.9	40.6	41.5
Imports of goods and services	72,423	67,998	94,908	109,741	108,797	42.7	38.5	51.3	57.5	55.7
	(In millions of denars, at constant 1995 prices)					(Annual percent change)				
Gross domestic product, at constant 1995 prices	169,521	171,530	174,000	179,120	183,908	-1.1	1.2	1.4	2.9	2.7
Total domestic demand	186,021	189,011	196,627	205,121	205,461	3.8	1.6	4.0	4.3	0.2
Consumption	150,872	154,472	157,525	163,133	170,408	-2.3	2.4	2.0	3.6	4.5
Private 1/	119,381	122,927	126,737	131,077	135,118	-4.3	3.0	3.1	3.4	3.1
Public	31,491	31,545	30,788	32,056	35,290	5.7	0.2	-2.4	4.1	10.1
Gross investment 2/	35,149	34,540	39,101	41,988	35,053	37.3	-1.7	13.2	7.4	-16.5
Gross fixed capital formation	28,027	29,854	28,570	29,001	29,337	10.2	6.5	-4.3	1.5	1.2
Changes in inventories	7,122	4,686	10,531	12,987	5,716	3,649.7	-34.2	124.7	23.3	-56.0
Foreign balance 2/	-16,500	-17,481	-22,627	-26,001	-21,553	90.6	5.9	29.4	14.9	-17.1
Exports of goods and services	55,923	48,794	63,017	70,049	71,803	-3.3	-12.7	29.1	11.2	2.5
Imports of goods and services	72,423	66,275	85,643	96,051	93,357	8.9	-8.5	29.2	12.2	-2.8
Memorandum items:										
GDP per capita (in US$)	2,276	2,226	1,852	1,744	1,699					
Gross domestic saving (as percent of GDP)	11.0	9.8	9.1	8.6	7.4					
Implicit GDP deflator (annual percentage change)	17.1	2.9	3.4	0.2	-0.3					

Source: Data provided by the Statistical Office and IMF staff estimates.

1/ Data provided by the Statistical Office has been adjusted to reflect revised trade data.

Table 20. FYRM: Price Indices, 1995–99

(Year-on-year percent change)

	Consumer Price Index								Retail Prices	Industrial Producer Prices	Agricultural Producer Prices
	Total	Food	Tobacco, Beverages	Clothing, Footwear	Housing	Hygiene, Health	Education, Culture	Transport, Telecom			
1995	15.8	8.6	3.9	12.5	29.3	14.1	18.0	9.7	15.8	4.8	1.2
1996	2.3	-0.1	1.4	0.1	4.4	1.9	5.6	3.3	2.9	-0.3	0.3
1997	2.6	4.2	-4.0	-1.5	3.7	-0.5	-8.6	19.4	4.4	4.2	73.2
1998	-0.1	-0.2	3.6	2.4	0.5	0.1	-10.3	2.4	0.8	4.0	-14.6
1999	-0.4	-0.7	0.2	1.2	0.3	-1.4	-2.2	-0.8	-1.1	-0.1	-5.2
1997 January	0.5	-5.7	1.2	-0.2	3.7	-0.7	3.1	24.6	4.5	0.7	-4.3
February	-0.1	-5.5	-5.9	-1.9	3.2	-0.2	3.2	24.9	4.1	2.2	-0.4
March	0.0	-5.5	-5.6	-2.7	3.3	-0.3	3.6	25.1	3.6	1.9	-14.3
April	-2.1	-8.3	-5.7	-2.9	0.8	-1.6	2.6	25.1	2.2	1.4	9.4
May	-0.1	-1.1	-6.3	-2.9	0.6	-3.3	-10.0	24.9	3.1	0.6	-31.8
June	1.7	3.0	-6.4	-3.2	0.9	-4.1	-10.1	24.9	3.4	0.8	26.6
July	3.3	7.4	-3.3	-3.3	0.9	-3.9	-16.1	25.2	5.1	1.8	137.9
August	4.4	8.9	-2.7	-2.3	1.8	0.7	-16.4	27.0	6.4	7.1	186.6
September	3.8	6.9	-2.2	-1.0	1.7	1.3	-15.4	26.0	6.5	8.7	28.9
October	3.3	6.2	-2.0	-0.9	1.1	1.8	-15.6	25.3	6.1	8.3	126.1
November	3.5	6.4	-3.3	0.9	1.4	1.6	-16.1	25.4	6.0	8.3	161.5
December	3.2	6.1	-3.5	0.6	0.8	2.3	-16.2	24.6	5.9	8.3	154.2
1998 January	1.5	5.7	-1.5	0.9	0.8	1.1	-16.7	2.5	2.1	7.4	91.7
February	2.2	6.2	6.8	1.3	0.8	0.5	-16.1	2.7	3.0	5.6	91.9
March	2.3	6.6	6.6	2.2	0.8	0.8	-18.1	2.7	3.0	6.0	79.7
April	3.3	8.5	6.3	2.8	1.0	1.2	-18.0	3.2	3.6	6.1	96.2
May	4.2	8.2	6.7	3.0	0.6	2.3	-6.2	3.3	4.4	6.8	-46.0
June	0.3	-1.0	6.3	3.2	0.6	3.5	-6.2	3.3	2.7	6.8	-19.6
July	-1.3	-5.3	3.0	4.1	0.5	3.0	-1.3	3.3	1.0	6.8	-28.2
August	-2.3	-5.4	2.4	2.3	-0.5	-1.7	-6.1	1.9	0.1	1.9	-49.1
September	-2.3	-5.2	2.2	2.7	-0.3	-1.5	-7.9	1.6	-0.4	2.0	-0.6
October	-2.1	-4.9	1.0	2.3	0.1	-2.4	-7.7	1.6	-0.4	-0.1	-4.4
November	-3.1	-7.1	2.1	1.5	0.1	-2.1	-7.5	1.6	-0.9	-0.1	-56.8
December	-3.1	-7.5	2.4	2.4	0.1	-2.5	-6.8	2.2	-0.8	-0.1	-57.2
1999 January	-3.3	-6.6	-1.4	2.0	0.2	-1.8	-6.4	-2.1	-2.5	-2.3	-58.9
February	-3.2	-6.4	-2.0	3.3	0.2	-1.1	-6.5	-2.8	-3.1	-1.5	-59.4
March	-2.9	-5.9	-2.3	2.7	0.0	-1.0	-3.6	-2.5	-2.5	-2.2	-60.2
April	-3.9	-7.9	-2.1	2.6	-0.1	-1.0	-4.1	-2.9	-3.2	-1.8	-60.2
May	-4.1	-8.3	-2.1	2.4	0.1	-1.3	-4.5	-3.1	-3.3	-2.0	-4.9
June	-2.0	-3.2	-1.6	1.7	-0.2	-1.9	-5.0	-3.2	-2.4	-2.0	20.5
July	-1.6	-2.0	-1.1	0.6	-0.3	-1.8	-5.0	-3.2	-2.2	0.2	-33.1
August	0.8	1.2	2.4	0.6	0.6	-1.3	0.3	-0.1	-0.5	-0.1	-6.0
September	0.7	0.3	2.6	-0.3	1.0	-1.4	2.2	1.0	-0.1	0.1	5.4
October	0.9	0.5	3.7	-0.1	0.9	-1.2	2.1	1.3	0.1	2.6	-8.5
November	1.3	1.7	3.7	-0.5	0.8	-1.8	2.4	1.4	0.6	2.9	-12.8
December	2.4	3.1	3.4	-0.8	0.8	-1.2	2.4	7.0	2.3	4.1	-12.0

Source: Data provided by the Statistical Office.

Table 21. FYRM: Employment, According to Administrative Sources and the Labor Force Survey (LFS), 1996–98

	1996 (April)		1997 (April)		1998 (April)		1999 (April)	
	Adm.	LFS	Adm.	LFS	Adm.	LFS	Adm.	LFS
Total employment	348,984	537,591	331,525	512,301	315,525	539,762	313,647	545,222
Economic Activities	263,618	436,323	247,411	409,625	230,980	435,141	226,581	440,341
Industry and mining	131,050	155,453	123,598	140,413	117,792	152,096	116,341	151,063
Agriculture and fisheries	22,284	95,269	20,602	90,403	17,639	102,201	16,181	111,701
Forestry	3,398	4,798	3,810	4,529	3,502	5,048	3,280	3,660
Water management	2,339	2,746	2,529	2,219	2,592	2,780	2,413	2,923
Construction	31,189	35,776	30,212	32,020	26,583	35,798	25,290	31,297
Transport and communications	20,875	26,696	19,907	24,800	19,043	26,792	19,267	27,515
Trade	21,650	62,455	19,104	55,212	17,745	53,571	17,222	55,270
Catering and tourism	7,579	14,867	6,343	16,602	5,365	14,801	5,779	14,563
Crafts and personal services	4,260	14,300	3,658	16,745	3,728	18,582	3,678	15,768
Utilities and services	8,184	9,101	8,164	10,046	8,152	8,840	8,119	9,555
Financial and other services	10,827	14,862	9,502	16,636	8,857	14,632	9,029	17,026
Noneconomic activities	85,366	101,267	84,114	102,675	84,545	103,916	87,066	103,948
Education	36,497	42,985	36,723	41,442	35,668	41,636	36,491	40,526
Health and social welfare	33,447	30,356	32,685	33,139	33,229	31,862	33,414	31,191
Administration and defense	15,405	27,926	14,688	28,094	15,630	30,418	17,143	32,231
			Percent change					
Total employment			-5.0	-4.7	-4.8	5.4	-0.6	1.0
Economic Activities			-6.1	-6.1	-6.6	6.2	-1.9	1.2
Industry and mining			-5.7	-9.7	-4.7	8.3	-1.2	-0.7
Agriculture and fisheries			-7.5	-5.1	-14.4	13.1	-8.3	9.3
Forestry			12.1	-5.6	-8.1	11.5	-6.3	-27.5
Water management			8.1	-19.2	2.5	25.3	-6.9	5.1
Construction			-3.1	-10.5	-12.0	11.8	-4.9	-12.6
Transport and communications			-4.6	-7.1	-4.3	8.0	1.2	2.7
Trade			-11.8	-11.6	-7.1	-3.0	-2.9	3.2
Catering and tourism			-16.3	11.7	-15.4	-10.8	7.7	-1.6
Crafts and personal services			-14.1	17.1	1.9	11.0	-1.3	-15.1
Utilities and services			-0.2	10.4	-0.1	-12.0	-0.4	8.1
Financial and other services			-12.2	11.9	-6.8	-12.0	1.9	16.4
Noneconomic activities			-1.5	1.4	0.5	1.2	3.0	0.0
Education			0.6	-3.6	-2.9	0.5	2.3	-2.7
Health and social welfare			-2.3	9.2	1.7	-3.9	0.6	-2.1
Administration and defense			-4.7	0.6	6.4	8.3	9.7	6.0
			Ratio of LFS employment to administrative employment					
Total		1.54		1.55		1.71		1.74
Economic Activities		1.66		1.66		1.88		1.94
Industry and mining		1.19		1.14		1.29		1.30
Agriculture and fisheries		4.28		4.39		5.79		6.90
Forestry		1.41		1.19		1.44		1.12
Water management		1.17		0.88		1.07		1.21
Construction		1.15		1.06		1.35		1.24
Transport and communications		1.28		1.25		1.41		1.43
Trade		2.88		2.89		3.02		3.21
Catering and tourism		1.96		2.62		2.76		2.52
Crafts and personal services		3.36		4.58		4.98		4.29
Utilities and services		1.11		1.23		1.08		1.18
Financial, technical and other services		1.37		1.75		1.65		1.89
Non-economic activities		1.19		1.22		1.23		1.19
Education		1.18		1.13		1.17		1.11
Health and social welfare		0.91		1.01		0.96		0.93
Administration and defense		1.81		1.91		1.95		1.88

Source: Data provided by the FYRM authorities.

Table 22. FYRM: Nominal and Real Net Average Wages by Sector, 1995–99

	1995	1996	1997	1998	1999 Prel.	1995	1996	1997	1998	1999 Prel.
Nominal net average wage (denars)	(In denars)					(Percent change)				
Total	**8,581**	**8,817**	**9,063**	**9,394**	**9,664**	**10.7**	**2.8**	**2.8**	**3.7**	**2.9**
Economic activities	**8,302**	**8,569**	**8,888**	**9,288**	**9,620**	**12.3**	**3.2**	3.7	**4.5**	**3.6**
Industry and mining	8,286	8,588	8,782	9,057	9,192	11.1	3.6	2.3	3.1	1.5
Agriculture and fisheries	6,876	7,256	7,720	7,958	8,498	14.2	5.5	6.4	3.1	6.8
Forestry	7,461	7,815	8,029	7,948	8,945	2.9	4.7	2.7	-1.0	12.5
Water management	8,325	8,496	8,182	8,462	8,716	25.8	2.1	-3.7	3.4	3.0
Construction	6,388	6,529	6,552	6,851	7,232	11.5	2.2	0.4	4.6	5.6
Transport and communications	9,604	9,957	10,230	10,208	10,874	8.9	3.7	2.7	-0.2	6.5
Trade	9,034	9,903	10,716	11,886	11,899	21.2	9.6	8.2	10.9	0.1
Catering and tourism	6,948	7,515	7,770	8,434	8,873	5.8	8.2	3.4	8.5	5.2
Crafts and services	7,710	7,773	7,857	8,051	8,929	14.8	0.8	1.1	2.5	10.9
Housing-communal services	9,361	9,686	9,740	9,972	10,613	15.8	3.5	0.6	2.4	6.4
Financial and other services	13,228	12,128	13,167	14,631	15,543	6.6	-8.3	8.6	11.1	6.2
Noneconomic activities	**9,373**	**9,445**	**9,469**	**9,623**	**9,754**	**4.0**	**0.8**	**0.3**	**1.6**	**1.4**
Education	9,217	9,241	9,231	9,406	9,434	4.3	0.3	-0.1	1.9	0.3
Health and social care	9,333	9,423	9,377	9,503	9,671	4.3	1.0	-0.5	1.3	1.8
State administration	9,760	9,900	10,126	10,254	10,542	3.0	1.4	2.3	1.3	2.8
Real net average wage (in 1998 prices)										
Total	**8,995**	**9,034**	**9,054**	**9,394**	**9,703**	**-4.4**	**0.4**	**0.2**	**3.8**	**3.3**
Economic activities	**8,702**	**8,780**	**8,879**	**9,288**	**9,659**	**-3.0**	**0.9**	**1.1**	**4.6**	**4.0**
Industry and mining	8,686	8,799	8,773	9,057	9,229	-4.0	1.3	-0.3	3.2	1.9
Agriculture and fisheries	7,208	7,434	7,712	7,958	8,532	-1.4	3.1	3.7	3.2	7.2
Forestry	7,821	8,007	8,021	7,948	8,981	-11.1	2.4	0.2	-0.9	13.0
Water management	8,726	8,705	8,174	8,462	8,751	8.6	-0.2	-6.1	3.5	3.4
Construction	6,696	6,690	6,545	6,851	7,261	-3.7	-0.1	-2.2	4.7	6.0
Transport and communications	10,067	10,202	10,220	10,208	10,918	-5.9	1.3	0.2	-0.1	7.0
Trade	9,470	10,147	10,705	11,886	11,947	4.7	7.1	5.5	11.0	0.5
Catering and tourism	7,283	7,700	7,762	8,434	8,909	-8.6	5.7	0.8	8.7	5.6
Crafts and services	8,082	7,964	7,849	8,051	8,965	-0.8	-1.5	-1.4	2.6	11.4
Housing-communal services	9,812	9,924	9,730	9,972	10,656	0.0	1.1	-2.0	2.5	6.9
Financial and other services	13,866	12,426	13,154	14,631	15,605	-7.9	-10.4	5.9	11.2	6.7
Noneconomic activities	**9,825**	**9,678**	**9,460**	**9,623**	**9,793**	**-10.1**	**-1.5**	**-2.3**	**1.7**	**1.8**
Education	9,661	9,468	9,222	9,406	9,472	-10.0	-2.0	-2.6	2.0	0.7
Health and social care	9,783	9,655	9,368	9,503	9,710	-9.9	-1.3	-3.0	1.4	2.2
State administration	10,231	10,143	10,116	10,254	10,584	-11.1	-0.9	-0.3	1.4	3.2

Source: Data provided by the FYRM authorities.

Table 23. FYRM: Monetary Survey, 1995–99 1/

(In millions of denars, end of period)

	1995	1996	1997	1998				1999			
	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
Net foreign assets	15,297	12,111	16,500	15,252	15,688	15,582	16,772	15,978	19,585	27,227	30,377
National Bank 2/	8,841	8,342	10,903	10,718	12,089	11,568	12,227	12,921	15,323	19,404	21,812
Assets	10,732	11,274	15,785	15,665	17,639	16,759	17,535	18,311	20,635	25,610	27,949
Liabilities	1,891	2,932	4,882	4,947	5,550	5,191	5,308	5,390	5,312	6,206	6,137
Domestic money banks	6,456	3,769	5,597	4,534	3,599	4,014	4,545	3,057	4,262	7,823	8,565
Assets	9,670	9,512	15,892	14,561	14,072	13,722	17,507	14,775	17,280	22,990	24,390
Liabilities	3,214	5,743	10,295	10,027	10,473	9,708	12,962	11,718	13,018	15,167	15,825
Net domestic assets	8,075	10,873	11,588	11,405	10,507	14,291	15,262	14,353	12,982	11,441	11,259
Domestic credit	59,082	52,303	55,872	54,308	50,837	33,334	38,133	39,538	38,770	38,665	43,014
of which to government	7,376	5,036	4,919	5,228	3,197	2,723	3,283	3,350	1,366	-237	6,429
Domestic money banks	59,645	53,573	52,734	50,732	49,150	31,953	36,134	37,391	38,451	39,849	45,156
Denar	52,919	49,941	46,277	43,810	41,657	24,377	29,165	29,776	29,817	30,829	29,730
Government	4,958	6,306	1,781	1,652	1,510	1,342	1,284	1,203	1,047	947	1,285
Credit	4,924	6,291	1,768	1,640	1,496	1,325	1,265	1,180	1,025	924	1,260
Accrued interest	34	15	13	12	14	17	19	23	22	23	25
Social and private	47,961	43,635	44,496	42,158	40,147	23,035	27,881	28,573	28,770	29,882	28,445
New credit	16,792	20,848	19,703	19,192	18,597	18,264	24,502	24,391	23,958	24,461	23,834
Accrued interest	31,169	22,787	24,793	22,966	21,550	4,771	3,379	4,182	4,812	5,421	4,611
Foreign currency	6,726	3,632	6,457	6,922	7,493	7,576	6,969	7,615	8,634	9,020	15,426
Government	2,981	0	0	0	0	0	0	0	0	0	7,286
Nongovernment	3,745	3,632	6,457	6,922	7,493	7,576	6,969	7,615	8,634	9,020	8,140
NBM credit to government, net	-563	-1,270	3,138	3,576	1,687	1,381	1,999	2,147	319	-1,184	-2,142
Other assets, net	-51,007	-41,430	-44,284	-42,903	-40,330	-19,043	-22,871	-25,185	-25,788	-27,224	-31,755
Accrued interest	-31,203	-22,802	-24,806	-22,978	-21,564	-4,788	-3,398	-4,205	-4,834	-5,444	-4,636
Claims for frozen FOREX	0	0	0	0	0	0	0	0	0	0	0
Other	-19,804	-18,628	-19,478	-19,925	-18,766	-14,255	-19,473	-20,980	-20,954	-21,780	-27,119
M1	12,533	12,178	14,257	13,108	12,847	14,828	15,821	15,478	16,735	19,552	20,620
M1, nongovernment	12,533	12,143	13,985	12,795	12,455	14,379	15,178	14,969	16,057	18,639	19,694
Currency in circulation	5,965	6,698	7,130	6,026	6,220	6,635	7,137	7,311	6,780	7,303	8,169
Demand deposits	6,568	5,480	7,127	7,082	6,627	8,193	8,684	8,167	9,955	12,249	12,451
Banks	5,677	4,947	6,552	6,339	5,759	7,316	7,979	7,352	9,043	10,852	11,385
Nongovernment	5,677	4,912	6,280	6,026	5,367	6,867	7,336	6,843	8,365	9,939	10,459
Government	0	35	272	313	392	449	643	509	678	913	926
Demand deposits with NBM	891	533	575	743	868	877	705	815	912	1,397	1,066
M2	18,785	18,761	23,360	21,906	21,387	24,489	26,930	25,481	27,235	32,569	35,247
M2, nongovernment	18,785	18,490	22,726	21,243	20,695	23,866	26,003	24,689	26,165	31,104	33,720
Quasi money - nongovernment	6,252	6,345	8,741	8,448	8,240	9,487	10,825	9,720	10,108	12,465	14,026
Denar	3,187	3,639	3,887	3,878	3,883	4,719	4,683	4,457	4,713	5,392	6,815
Foreign currency	3,065	2,706	4,854	4,570	4,357	4,768	6,142	5,263	5,395	7,073	7,211
Government	0	236	362	350	300	174	284	283	392	552	601
Denar	0	131	351	338	288	174	271	257	365	519	570
Foreign currency	0	105	11	12	12	0	13	26	27	33	31
NBM quasi deposits	0	2	0	0	0	0	0	0	0	0	0
M3	23,372	23,484	28,088	26,658	26,196	29,871	32,034	30,331	32,567	38,668	41,636
M3, private sector	22,654	22,439	26,707	25,238	24,740	28,469	30,273	28,697	30,595	36,225	39,227
Nonmonetary deposits	4,587	4,723	4,728	4,752	4,809	5,382	5,104	4,850	5,332	6,099	6,389
Domestic banks	4,473	4,722	4,726	4,751	4,808	5,381	5,104	4,850	5,332	6,099	6,389
Denar	3,418	3,592	3,640	3,646	3,686	4,012	3,810	3,852	4,047	4,340	4,698
Social and private	2,700	2,818	2,893	2,889	2,922	3,233	2,976	3,010	3,145	3,362	3,816
Government	718	774	747	757	764	779	834	842	902	978	882
Foreign currency	1,055	1,130	1,086	1,105	1,122	1,369	1,294	998	1,285	1,759	1,691
NBM (nongovernment)	114	1	2	1	1	1	0	0	0	0	0
Denar	1	1	2	1	1	1	0	0	0	0	0
Foreign currency	113	0	0	0	0	0	0	0	0	0	0

Source: Data provided by the National Bank of Macedonia (NBM).

1/ At current exchange rates. Excludes frozen foreign currency deposits.

2/ Data on NFA sometimes differ from data provided by the Foreign Reserves Department, which are used for program purposes.

Table 24. FYRM: National Bank Accounts, 1995–99 1/

(In millions of denars, end of period)

	1995	1996	1997	1998				1999			
	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
Net foreign assets	8,841	8,342	10,903	10,718	12,089	11,568	12,227	12,921	15,323	19,404	21,812
Net domestic assets	-2,571	-1,227	-3,348	-4,309	-5,500	-4,590	-4,568	-5,217	-8,059	-11,648	-13,297
Banks	2,690	4,299	942	95	727	475	526	1,186	34	-1,693	-2,858
Credit	4,045	4,860	2,720	1,861	2,261	1,998	2,557	2,775	1,918	1,132	984
Instruments 2/	-1,355	-561	-1,778	-1,766	-1,534	-1,523	-2,031	-1,589	-1,884	-2,825	-3,842
Government	-563	-1,270	3,138	3,576	1,687	1,381	1,999	2,147	319	-1,184	-2,142
Credit	1,860	2,348	6,010	6,018	5,957	5,642	5,592	5,556	5,529	5,178	5,219
Deposit	-2,083	-3,828	-5,077	-4,799	-6,102	-6,869	-6,152	-7,144	-8,609	-9,300	-9,734
Credit for external operations	-340	210	2,205	2,357	1,832	2,608	2,559	3,735	3,399	2,938	2,373
Other, net 3/	-4,698	-4,256	-7,428	-7,980	-7,914	-6,446	-7,093	-8,550	-8,412	-8,771	-8,297
Reserve money	6,271	7,115	7,556	6,410	6,590	6,979	7,659	7,704	7,264	7,756	8,515
Currency	5,965	6,698	7,130	6,026	6,220	6,635	7,137	7,311	6,780	7,303	8,169
Other 4/	306	417	426	384	370	344	522	393	484	453	346

Source: Data provided by the National Bank of Macedonia (NBM).

1/ At current exchange rates.
2/ Mandatory reserves and holdings of National Bank instruments.
3/ Includes non-financial sector deposits with the NBM.
4/ Vault cash and banks' excess reserves.

Table 25. FYRM: Deposit Money Bank Accounts, 1995–99 1/

(In millions denars, end of period)

	1995	1996	1997	1998				1999			
	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
Net foreign assets	6,456	3,769	5,597	4,534	3,599	4,014	4,545	3,057	4,262	7,823	8,565
Assets	9,670	9,512	15,892	14,561	14,072	13,722	17,507	14,775	17,280	22,990	24,390
Liabilities	3,214	5,743	10,295	10,027	10,473	9,708	12,962	11,718	13,018	15,167	15,825
Net domestic assets	9,945	12,481	14,784	15,353	15,508	18,344	19,647	19,148	20,613	22,145	23,837
In denar	52,919	49,941	46,277	43,810	41,657	24,377	29,165	29,776	28,779	30,829	29,731
1.Government	4,958	6,306	1,781	1,652	1,510	1,342	1,284	1,203	1,047	947	1,286
Credits	4,924	6,291	1,768	1,640	1,496	1,325	1,265	1,180	1,025	924	1,261
Of which: overdue claims	0	4	0	0	0	0	0	0	0	0	0
Accrued interest	34	15	13	12	14	17	19	23	22	23	25
2. Social and private sector	47,961	43,635	44,496	42,158	40,147	23,035	27,881	28,573	27,732	29,882	28,445
Credits	16,792	20,848	19,703	19,192	18,597	18,264	24,502	24,391	23,958	24,461	23,834
Of which: overdue claims	4,219	4,680	5,910	6,185	5,434	3,423	2,997	3,121	3,774	4,861	5,606
Accrued interest	31,169	22,787	24,793	22,966	21,550	4,771	3,379	4,182	3,774	5,421	4,611
In foreign currency	6,726	3,632	6,457	6,922	7,493	7,576	6,969	7,615	8,634	9,020	15,426
1. Government	2,981	0	0	0	0	0	0	0	0	0	7,286
Of which overdue claims	0	0	0	0	0	0	0	0	0	0	0
2. Social and private sector	3,745	3,632	6,457	6,922	7,493	7,576	6,969	7,615	8,634	9,020	8,140
Of which: overdue claims	1,744	354	633	662	401	464	343	749	1,385	1,554	1,594
Other items, net	-49,700	-41,092	-37,950	-35,379	-33,642	-13,609	-16,487	-18,243	-16,800	-17,704	-21,320
Total liabilities	16,401	16,250	20,381	19,887	19,107	22,358	24,192	22,205	24,875	29,968	32,401
Demand deposits	5,677	4,947	6,552	6,339	5,759	7,316	7,979	7,352	9,043	10,852	11,385
Social and private	5,677	4,912	6,280	6,026	5,367	6,867	7,336	6,843	8,365	9,939	10,459
Of which: self-management funds	89	0	0	0	0	0	0	0	0	0	0
Government deposits	0	35	272	313	392	449	643	509	678	913	926
Sight and short-term time deposits	6,251	6,581	9,103	8,798	8,540	9,661	11,109	10,003	10,500	13,017	14,627
Denar	3,186	3,639	3,887	3,878	3,883	4,719	4,683	4,457	4,713	5,392	6,815
Foreign currency	3,065	2,706	4,854	4,570	4,357	4,768	6,142	5,263	5,395	7,073	7,211
New	3,065	2,706	4,854	4,570	4,357	4,768	6,142	5,263	5,395	7,073	7,211
Frozen	0	0	0	0	0	0	0	0	0	0	0
Government	0	236	362	350	300	174	284	283	392	552	601
Nonmonetary deposits	4,473	4,722	4,726	4,750	4,808	5,381	5,104	4,850	5,332	6,099	6,389
Denar	2,700	2,818	2,893	2,888	2,922	3,233	2,976	3,010	3,145	3,362	3,816
Foreign currency	1,055	1,130	1,086	1,105	1,122	1,369	1,294	998	1,285	1,759	1,691
New	1,055	1,130	1,086	1,105	1,122	1,369	1,294	998	1,285	1,759	1,691
Frozen	0	0	0	0	0	0	0	0	0	0	0
Government	718	774	747	757	764	779	834	842	902	978	882

Source: Data provided by the National Bank of Macedonia (NBM).

1/ At current exchange rates. Includes frozen foreign currency deposits until June 1995.

Table 26. FYRM: Interest Rates, 1995–99 1/

(In percent, monthly average)

	1995	1996	1997	1998				1999			
	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
NBM interest rates:											
Discount rate	15.0	9.2	8.9	8.9	8.9	8.9	8.9	8.9	8.9	8.9	8.9
Interest on Lombard credit	...	14.4	14.4	14.4	14.4	14.4	18.5	18.5	18.5	18.5	18.5
Default interest rate	27.6	27.6	26.7	26.7	26.7	26.7	26.7	26.7	26.7	26.7	26.7
Interest on central bank bills	...	8.8	8.2	8.2	8.2	8.2	10.0	10.0	10.0	10.0	10.0
Interest on required reserves 1/	3.6	3.6	3.4	3.4	6.2	6.2	6.2	6.2	6.2	6.2	6.2
Commercial bank interest rates:											
Deposit rates											
Household sight deposits	2-5	3-6	3-6.1	3-6.1	3-6.1	3-6.1	3-6.3	3-6.3	3-7	3-7	3-7
Household time deposits (3-6 months)	9-21	9-21	9-20.5	9-20.5	9-20.5	9-20.5	9-20.5	9-20	9-19.2	9-19.2	9-19.2
Enterprise sight deposits	2-5	4-7	2.5-8	2.5-8	2.5-8	2.5-8	2.5-8	2.5-8	2.5-8	2.5-8	2.5-7
Enterprise time deposits (3-6 months)	9-21	5-21	5-20.5	5-19.2	5-19.2	5-19.2	5-19.2	5-16	5-16	5-16	5-15
Lending rates:											
Short-term rates	25-30	19-30	17-47	17-47	16-47	16-47	16-47	16-58.9	16-58.9	16-58.9	12-47
Long-term working capital	25-30	19-30	9-27	9-27	9-27	9-27	9-27	9-29	9-41.6	9-41.6	9-31.9
Small-scale industry	25-30	20-30	20-36	20-26.7	20-26.7	19.1-36	17-26.7	17-26.7	18-26.7	18-26.7	12.9-26

Source: Data provided by the National Bank (NBM).

1/ Interest rates on sight deposits up to three months and over three months unified since June 1994.

Table 27. FYRM: Privatization by Model of Transformation, 1995–99 1/

Model of Transformation	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
Number of firms						(As percent of total)				
Old Law	59	65	66	67	66	9.8	7.1	5.8	4.7	4.4
Buy-outs	267	511	649	764	780	44.2	55.9	57.3	53.2	52.4
Employee buy-out	210	301	331	363	384	34.8	32.9	29.2	25.3	25.8
Management buy-out	42	123	190	253	247	7.0	13.5	16.8	17.6	16.6
Other buy-out	15	87	128	148	149	2.5	9.5	11.3	10.3	10.0
Sale of ideal participation	12	23	35	59	67	2.0	2.5	3.1	4.1	4.5
Leasing	3	4	4	4	4	0.5	0.4	0.4	0.3	0.3
Additional capital	5	14	16	19	20	0.8	1.5	1.4	1.3	1.3
Residual	11	35	27	26	28	1.8	3.8	2.4	1.8	1.9
Debt/equity conversion	1	15	36	63	75	0.2	1.6	3.2	4.4	5.0
Foreign equity	153	154	156	156	156	25.3	16.8	13.8	10.9	10.5
Private equity	60	55	95	113	128	9.9	6.0	8.4	7.9	8.6
Liquidations	33	38	48	164	164	5.5	4.2	4.2	11.4	11.0
Total	604	914	1,132	1,435	1,488	100.0	100.0	100.0	100.0	100.0
Number of employees										
Old law	9,750	11,545	11,548	11,548	11,522	16.3	8.0	6.2	5.4	5.3
Buy-outs	30,952	92,952	127,048	141,495	140,043	51.6	64.3	68.2	66.4	64.8
Employee buy-out	8,430	12,239	16,520	17,894	17,738	14.1	8.5	8.9	8.4	8.2
Management buy-out	16,406	44,660	66,349	74,358	72,720	27.4	30.9	35.6	34.9	33.7
Other buy-out	6,116	36,053	44,179	49,243	49,585	10.2	24.9	23.7	23.1	23.0
Sale of ideal participation	6,291	7,266	11,016	14,979	15,812	10.5	5.0	5.9	7.0	7.3
Leasing	0	217	217	217	217	0.0	0.2	0.1	0.1	0.1
Additional capital	1,145	3,892	4,993	5,613	6,924	1.9	2.7	2.7	2.6	3.2
Residual	4,669	13,989	15,519	14,663	14,717	7.8	9.7	8.3	6.9	6.8
Debt/equity conversion	120	8,269	9,519	16,587	18,656	0.2	5.7	5.1	7.8	8.6
Foreign equity	1,806	1,922	1,933	1,933	1,933	3.0	1.3	1.0	0.9	0.9
Private equity	3,193	1,869	3,370	4,994	5,143	5.3	1.3	1.8	2.3	2.4
Liquidations	2,040	2,618	1,096	984	984	3.4	1.8	0.6	0.5	0.5
Total	59,966	144,539	186,259	213,013	215,951	100.0	100.0	100.0	100.0	100.0
Equity (in millions of DM)										
Old law	68	112	114	114	114	7.3	4.1	3.2	2.9	2.8
Buy-outs	556	1,379	2,359	2,599	2,551	59.7	50.5	66.7	65.1	61.6
Employee buy-out	73	124	145	157	155	7.9	4.5	4.1	3.9	3.8
Management buy-out	406	882	1,312	1,433	1,391	43.6	32.3	37.1	35.9	33.6
Other buy-out	77	372	902	1,009	1,005	8.2	13.6	25.5	25.3	24.3
Sale of ideal participation	130	142	182	239	364	13.9	5.2	5.1	6.0	8.8
Leasing	1	2	2	2	2	0.1	0.1	0.1	0.0	0.0
Additional capital	14	415	87	103	137	1.5	15.2	2.5	2.6	3.3
Residual	98	295	295	295	307	10.5	10.8	8.3	7.4	7.4
Debt/equity conversion	2	317	401	529	552	0.2	11.6	11.3	13.3	13.3
Foreign equity	11	52	53	53	53	1.2	1.9	1.5	1.3	1.3
Private equity	53	11	45	58	58	5.6	0.4	1.3	1.4	1.4
Liquidations	0	6	0	0	0	0.0	0.2	0.0	0.0	0.0
Total	933	2,731	3,537	3,991	4,138	100.0	100.0	100.0	100.0	100.0

Source: Data provided by the Privatization Agency.

1/ Privatizations completed since the beginning of privatization in late 1994.

Table 28. FYRM: Main Indicators of Enterprise Sector Activity by Type of Ownership, 1996–98

	1996	1997	1998	1996	1997	1998	1996	1997	1998	1996	1997	1998
	Private			Transformed			State and Socially-owned			Total enterprises		
Number of firms (as percent of all firms in each sector)												
Loss-makers	54.7	50.4	46.7	47.3	45.5	45.0	57.0	47.6	51.6	54.6	50.2	46.8
Profit-makers	45.3	49.6	53.3	52.7	54.5	55.0	43.0	52.4	48.4	45.4	49.8	53.2
Employment (as percent of employment in all firms in each sector)												
Loss-makers	14.4	12.1	12.0	40.8	35.9	37.7	55.1	42.3	43.8	33.8	25.9	26.2
Profit-makers	85.6	87.9	88.0	59.2	64.1	62.3	44.9	57.7	56.2	66.2	74.1	73.8
Average number of workers per firm												
Loss-makers	1	1	2	127	125	125	106	72	56	7	6	7
Profit-makers	10	11	11	164	186	169	115	90	77	17	18	17
Wage bill (as percent of total sales in loss/profit makers)												
Loss-makers	12.6	12.8	14.1	23.7	22.8	24.2	26.7	26.0	26.0	22.1	20.7	22.0
Profit-makers	4.7	4.5	4.7	15.0	14.5	13.4	21.6	18.0	19.7	12.3	11.2	10.4
Average monthly wages (in denar/month)												
Loss-makers	8,696	8,995	8,868	10,650	9,779	11,760	11,318	12,419	12,505	8,895	8,657	9,078
Profit-makers	2,236	2,292	2,808	14,677	14,798	15,159	16,019	16,313	17,578	8,014	8,024	8,284
Wage arrears (as percent of wage bill in loss/profit makers)												
Loss-makers	42.5	30.1	30.5	69.7	68.5	66.6	63.5	51.7	59.1	62.3	54.8	58.0
Profit-makers	14.4	11.8	11.3	11.6	14.9	17.0	10.3	9.0	7.5	11.5	12.5	13.4
Sales (as percent of total sales)												
Loss-makers	7.2	6.1	5.1	8.1	7.7	8.9	12.0	6.1	4.8	27.4	19.9	18.7
Profit-makers	29.8	31.8	35.8	25.8	32.5	34.2	17.1	15.7	11.3	72.6	80.1	81.3
Operational balance												
(as percent of loss/profit-makers' sales in each sector)												
Loss-makers	-11.5	-11.5	-11.6	-13.6	-16.6	-16.9	-23.9	-20.1	-14.7	-17.6	-16.1	-14.9
Profit-makers	2.0	2.2	2.1	-0.2	1.6	1.2	1.6	4.0	10.5	1.1	2.3	2.9
(as percent of GDP)												
Loss-makers	-1.4	-1.3	-1.1	-1.9	-2.3	-2.8	-4.8	-2.2	-1.3	-8.1	-5.7	-5.3
Profit-makers	1.0	1.3	1.4	-0.1	0.9	0.8	0.5	1.1	2.3	1.4	3.3	4.5
Memorandum item:												
Number of enterprises	33,583	32,570	31,240	747	872	981	1,150	1,026	1,026	35,480	34,468	33,247
Loss-makers	18,359	16,414	14,588	353	397	441	656	488	529	19,368	17,299	15,558
Profit-makers	15,224	16,156	16,652	394	475	540	494	538	497	16,112	17,169	17,689
Number of workers	179,242	198,236	203,788	109,367	138,064	146,258	126,491	83,546	68,178	415,100	419,846	418,224
Loss-makers	25,891	23,953	24,385	44,668	49,595	55,208	69,659	35,311	29,841	140,218	108,859	109,434
Profit-makers	153,351	174,283	179,403	64,699	88,469	91,050	56,832	48,235	38,337	274,882	310,987	308,790

Sources: Data provided by the Payments Bureau (ZPP); and IMF staff calculations.

Table 29. FYRM: Summary of Central Government Operations, 1996–2000

	1996	1997	1998	1999 Budget	1999 Kosovo Scenario	1999 Actual	2000 Budget	1996	1997	1998	1999 Budget	1999 Kosovo Scenario	1999 Actual	2000 Budget
	(In millions of denars)							(In percent of GDP)						
Total revenues and grants	40,189	38,501	39,818	41,393	38,571	47,281	46,961	22.8	20.8	20.9	20.2	20.4	24.2	22.0
Tax revenues	37,715	35,500	36,861	38,053	35,572	41,851	43,396	21.4	19.2	19.3	18.6	18.8	21.4	20.3
Individual income tax	9,161	8,753	9,177	9,425	8,690	10,233	10,033	5.2	4.7	4.8	4.6	4.6	5.2	4.7
Profit tax	2,030	1,295	1,752	1,871	1,650	2,559	2,613	1.2	0.7	0.9	0.9	0.9	1.3	1.2
Sales tax/VAT	8,777	8,816	8,804	9,127	8,605	9,959	9,700	5.0	4.8	4.6	4.5	4.6	5.1	4.5
Excises	11,100	11,052	10,237	10,820	9,975	10,673	12,309	6.3	6.0	5.4	5.3	5.3	5.5	5.8
Import duties	6,647	5,525	6,810	6,810	6,557	8,303	8,600	3.8	3.0	3.6	3.3	3.5	4.3	4.0
Other taxes	0	59	81	0	95	124	141	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Nontax revenue	2,369	2,964	2,869	3,241	2,905	2,722	3,260	1.3	1.6	1.5	1.6	1.5	1.4	1.5
Capital revenue	6	37	88	99	94	154	305	0.0	0.0	0.0	0.0	0.0	0.1	0.1
Grants	99	0	0	0	0	2,554	0	0.1	0.0	0.0	0.0	0.0	1.3	0.0
Total expenditures	41,396	40,792	41,518	41,768	49,197	45,581	47,174	23.5	22.1	21.8	20.4	26.1	23.3	22.1
Current expenditure	36,894	38,168	38,729	38,804	46,706	43,080	38,906	20.9	20.6	20.3	18.9	24.7	22.1	18.2
Goods and services	19,970	19,929	21,542	20,957	20,954	22,947	21,504	11.3	10.8	11.3	10.2	11.1	11.8	10.1
Wages and salaries	15,245	15,148	15,940	15,860	16,054	17,757	15,955	8.6	8.2	8.4	7.7	8.5	9.1	7.5
Goods and nonlabor services	4,725	4,781	5,602	5,097	4,900	5,190	5,549	2.7	2.6	2.9	2.5	2.6	2.7	2.6
Refugee-related expenditure	31	23	24	405	6,298	2,456	148	0.0	0.0	0.0	0.2	3.3	1.3	0.1
Transfers	13,681	14,260	13,862	13,959	16,090	14,621	14,178	7.8	7.7	7.3	6.8	8.5	7.5	6.6
Pension Fund	3,419	4,066	3,618	3,250	4,145	3,302	3,890	1.9	2.2	1.9	1.6	2.2	1.7	1.8
Social programs	6,654	7,101	7,702	8,548	9,674	8,911	7,572	3.8	3.8	4.0	4.2	5.1	4.6	3.5
Social assistance program	2,661	2,822	2,550	2,625	2,953	2,990	3,187	1.5	1.5	1.3	1.3	1.6	1.5	1.5
Employment fund	2,885	2,981	3,263	3,100	3,908	3,099	3,050	1.6	1.6	1.7	1.5	2.1	1.6	1.4
Program for Employment	0	0	597	1,091	1,091	1,287	110	0.0	0.0	0.3	0.5	0.6	0.7	0.1
Other social programs	1,108	1,298	1,293	1,732	1,722	1,536	1,225	0.6	0.7	0.7	0.8	0.9	0.8	0.6
Subsidies	1,175	475	167	78	188	270	122	0.7	0.3	0.1	0.0	0.1	0.1	0.1
Other transfers	2,433	2,618	2,375	2,083	2,083	2,137	2,594	1.4	1.4	1.2	1.0	1.1	1.1	1.2
Interest	3,212	3,956	3,302	3,483	3,364	3,056	3,076	1.8	2.1	1.7	1.7	1.8	1.6	1.4
Capital expenditure	4,338	2,505	2,616	3,311	2,766	2,957	4,897	2.5	1.4	1.4	1.6	1.5	1.5	2.3
Reserves	95	98	100	100	100	107	734	0.1	0.1	0.1	0.0	0.1	0.1	0.3
Arrears (increase + / repayment -)	185	55	-289	-447	-374	-494	0	0.1	0.0	-0.2	-0.2	-0.2	-0.3	0.0
Allocation for structural reforms	0	0	0	0	0	0	1,617	0.0	0.0	0.0	0.0	0.0	0.0	0.8
Allocation for administrative reforms	0	0	0	0	0	0	1,020	0.0	0.0	0.0	0.0	0.0	0.0	0.5
Discrepancy	-116	-34	362	0	0	-68	0	-0.1	0.0	0.2	0.0	0.0	0.0	0.0
Balance	-1,207	-2,291	-1,700	-375	-10,626	1,700	-213	-0.7	-1.2	-0.9	-0.2	-5.6	0.9	-0.1
Cash balance	278	-1,076	-1,153	131	-10,046	2,159	-213	0.2	-0.6	-0.6	0.1	-5.3	1.1	-0.1
Financing	1,207	2,291	1,700	375	10,626	-1,700	213	0.7	1.2	0.9	0.2	5.6	-0.9	0.1
Domestic financing	582	1,631	77	52	-706	-4,117	-2,311	0.3	0.9	0.0	0.0	-0.4	-2.1	-1.1
Arrears	1,485	1,215	547	506	579	459	0	0.8	0.7	0.3	0.2	0.3	0.2	0.0
Interest on frozen foreign currency deposits	1,300	1,160	836	953	953	953	0	0.7	0.6	0.4	0.5	0.5	0.5	0.0
Other arrears	185	55	-289	-447	-374	-494	0	0.1	0.0	-0.2	-0.2	-0.2	-0.3	0.0
National Bank of Macedonia, net	-1,013	4,061	-869	-268	-1,013	-4,331	-2,167	-0.6	2.2	-0.5	-0.1	-0.5	-2.2	-1.0
Commercial banks, net	-212	-4,180	-476	-186	-272	-595	-144	-0.1	-2.3	-0.2	-0.1	-0.1	-0.3	-0.1
Other domestic financing	322	535	875	0	0	350	0	0.2	0.3	0.5	0.0	0.0	0.2	0.0
Foreign financing, net	625	660	1,623	323	11,332	2,418	2,523	0.4	0.4	0.9	0.2	6.0	1.2	1.2
Disbursements	...	...	...	...	11,990	3,337	1,474	...	...	...	...	6.4	1.7	0.7
Rescheduling	...	...	...	...	1,292	1,391	1,195	...	...	...	...	0.7	0.7	0.6
Amortization (-)	...	...	...	...	-1,950	-2,311	-2,424	...	...	...	...	-1.0	-1.2	-1.1
Privatization receipts	...	...	...	...	0	0	2,278	...	...	...	...	0.0	0.0	1.1
Memorandum items:														
Government debt	73,191	88,957	87,140	...	...	103,913	113,971	41.5	48.1	45.7	...	...	53.2	53.3
Defense expenditures	3,855	3,708	3,839	3,809	...	...	4,652	2.2	2.0	2.0	1.9	...	...	2.2
Defense and security expenditures	8,017	7,850	8,357	8,560	...	...	9,524	4.5	4.2	4.4	4.2	...	...	4.5
Nominal GDP	176,444	184,982	190,827	204,839	188,800	195,284	213,833							

Sources: Ministry of Finance; National Bank of Macedonia (NBM); and IMF staff estimates.

Table 30. FYRM: Summary of General Government Operations, 1996–2000

	1996	1997	1998	1999 Budget	1999 Kosovo Scenario	1999 Actual	2000 Budget	1996	1997	1998	1999 Budget	1999 Kosovo Scenario	1999 Actual	2000 Budget
	(In millions of denars)							(In percent of GDP)						
Total revenue and grants	63,014	64,649	64,908	68,579	63,719	73,534	75,542	35.7	34.9	34.0	33.5	33.7	37.7	35.3
Total revenue	62,915	64,649	64,908	67,556	63,276	70,980	75,542	35.7	34.9	34.0	33.0	33.5	36.3	35.3
Current revenue	62,909	64,564	64,770	67,404	63,132	70,766	75,187	35.7	34.9	33.9	32.9	33.4	36.2	35.2
Tax revenue	59,688	59,876	60,237	62,419	58,568	66,148	69,846	33.8	32.4	31.6	30.5	31.0	33.9	32.7
Taxes on income and profits	11,191	10,048	10,929	11,296	10,340	12,792	12,646	6.3	5.4	5.7	5.5	5.5	6.6	5.9
Social insurance contributions	20,785	22,701	21,675	22,562	21,312	22,720	24,572	11.8	12.3	11.4	11.0	11.3	11.6	11.5
Local taxes	411	944	1,006	1,067	983	983	1,050	0.2	0.5	0.5	0.5	0.5	0.5	0.5
Sales tax/VAT and excises taxes	20,654	20,599	19,736	20,684	19,280	21,226	22,837	11.7	11.1	10.3	10.1	10.2	10.9	10.7
Import duties	6,647	5,525	6,810	6,810	6,557	8,303	8,600	3.8	3.0	3.6	3.3	3.5	4.3	4.0
Other taxes	0	59	81	0	95	124	141	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Nontax revenue	3,221	4,688	4,533	4,984	4,565	4,618	5,341	1.8	2.5	2.4	2.4	2.4	2.4	2.5
Capital revenue	6	85	138	152	144	214	355	0.0	0.0	0.1	0.1	0.1	0.1	0.2
Foreign grants	99	0	0	1,024	443	2,554	0	0.1	0.0	0.0	0.5	0.2	1.3	0.0
Total expenditure	65,515	65,352	68,289	72,933	78,326	73,617	78,255	37.1	35.3	35.8	35.6	41.5	37.7	36.6
Current expenditure	60,164	63,322	64,642	65,747	71,918	69,308	67,503	34.1	34.2	33.9	32.1	38.1	35.5	31.6
Goods and services	21,080	21,166	22,876	22,278	22,280	24,184	22,799	11.9	11.4	12.0	10.9	11.8	12.4	10.7
Wages and salaries	15,608	15,603	16,476	16,401	16,595	18,225	16,489	8.8	8.4	8.6	8.0	8.8	9.3	7.7
Goods and nonlabor services	5,472	5,563	6,400	5,877	5,685	5,958	6,310	3.1	3.0	3.4	2.9	3.0	3.1	3.0
Refugee-related expenditure	31	23	24	405	6,298	2,456	148	0.0	0.0	0.0	0.2	3.3	1.3	0.1
Transfers	25,619	26,848	26,440	26,294	27,228	26,615	27,927	14.5	14.5	13.9	12.8	14.4	13.6	13.1
Subsidies	1,175	475	167	78	188	270	122	0.7	0.3	0.1	0.0	0.1	0.1	0.1
Social programs	6,040	6,234	6,006	6,271	7,121	6,280	6,032	3.4	3.4	3.1	3.1	3.8	3.2	2.8
Pensions and disability payments	15,989	17,533	17,908	17,874	17,848	17,927	19,179	9.1	9.5	9.4	8.7	9.5	9.2	9.0
Other	2,415	2,606	2,360	2,071	2,071	2,137	2,594	1.4	1.4	1.2	1.0	1.1	1.1	1.2
Interest	3,520	4,020	3,566	4,134	3,437	3,161	3,196	2.0	2.2	1.9	2.0	1.8	1.6	1.5
Other and unclassified	9,914	11,265	11,737	12,635	12,677	12,893	13,433	5.6	6.1	6.2	6.2	6.7	6.6	6.3
Capital expenditure	3,889	2,649	3,561	7,534	6,681	5,006	7,381	2.2	1.4	1.9	3.7	3.5	2.6	3.5
Arrears (increase + / repayment -)	1,449	-677	-379	-447	-374	-494	0	0.8	-0.4	-0.2	-0.2	-0.2	-0.3	0.0
Reserves	95	98	100	100	100	107	734	0.1	0.1	0.1	0.0	0.1	0.1	0.3
Allocation for structural reforms	0	0	0	0	0	0	1,617	0.0	0.0	0.0	0.0	0.0	0.0	0.8
Allocation for administrative reforms	0	0	0	0	0	0	1,020	0.0	0.0	0.0	0.0	0.0	0.0	0.5
Discrepancy	-82	-41	365	0	0	-311	0	0.0	0.0	0.2	0.0	0.0	-0.2	0.0
Balance	-2,501	-703	-3,381	-4,354	-14,606	-83	-2,713	-1.4	-0.4	-1.8	-2.1	-7.7	0.0	-1.3
Cash balance	248	-220	-2,924	-3,848	-14,028	376	-2,713	0.1	-0.1	-1.5	-1.9	-7.4	0.2	-1.3
Financing	2,501	703	3,381	4,354	14,606	83	2,713	1.4	0.4	1.8	2.1	7.7	0.0	1.3
Domestic	2,021	217	847	345	-413	-4,319	-2,311	1.1	0.1	0.4	0.2	-0.2	-2.2	-1.1
Arrears	2,749	483	457	506	579	459	0	1.6	0.3	0.2	0.2	0.3	0.2	0.0
Interest on frozen foreign currency deposits	1,300	1,160	836	953	953	953	0	0.7	0.6	0.4	0.5	0.5	0.5	0.0
Other arrears	1,449	-677	-379	-447	-374	-494	0	0.8	-0.4	-0.2	-0.2	-0.2	-0.3	0.0
National Bank of Macedonia, net	-1,013	4,061	-869	-268	-1,139	-4,499	-2,167	-0.6	2.2	-0.5	-0.1	-0.6	-2.3	-1.0
Commercial banks, net	-37	-4,862	-185	7	-146	-629	-144	0.0	-2.6	-0.1	0.0	-0.1	-0.3	-0.1
Other domestic financing	322	535	1,444	100	293	350	0	0.2	0.3	0.8	0.0	0.2	0.2	0.0
Foreign financing, net	480	486	2,534	4,009	15,019	4,402	5,023	0.3	0.3	1.3	2.0	8.0	2.3	2.3
Disbursements	...	...	...	...	15,677	5,149	3,874	...	...	...	...	8.3	2.6	1.8
Rescheduling	...	...	...	...	1,292	1,391	1,195	...	...	...	...	0.7	0.7	0.6
Amortization (-)	...	...	...	...	-1,950	-2,311	-2,424	...	...	...	...	-1.0	-1.2	-1.1
Privatization receipts	...	...	...	...	0	173	2,378	...	...	...	...	0.0	0.1	1.1
Memorandum item:														
Nominal GDP	176,444	184,982	190,827	204,839	188,800	195,284	213,833							

Sources: Ministry of Finance; National Bank of Macedonia (NBM); and IMF staff estimates.

Table 31. FYRM: Summary of Special Fund Operations, 1996-2000

	1996	1997	1998	1999 Budget	1999 Kosovo Scenario	1999 Actual	2000 Budget	1996	1997	1998	1999 Budget	1999 Kosovo Scenario	1999 Actual	2000 Budget
	(In millions of denars)							(In percent of GDP)						
Pension Fund														
Revenue	18,502	20,686	19,912	20,464	20,561	20,511	22,008	10.5	11.2	10.4	10.0	10.9	10.5	10.3
Current revenue	18,502	20,638	19,862	20,411	20,511	20,451	21,958	10.5	11.2	10.4	10.0	10.9	10.5	10.3
Capital Revenue	0	48	50	53	50	60	50	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	18,771	19,516	20,534	20,564	20,661	20,689	22,108	10.6	10.6	10.8	10.0	10.9	10.6	10.3
Pensions	16,059	16,694	17,734	17,696	17,638	17,739	18,985	9.1	9.0	9.3	8.6	9.3	9.1	8.9
Other	2,712	2,822	2,800	2,868	3,023	2,950	3,123	1.5	1.6	1.5	1.4	1.6	1.5	1.5
Balance	-269	1,170	-622	-100	-100	-178	-100	-0.2	0.6	-0.3	0.0	-0.1	-0.1	0.0
Health Fund														
Revenue	9,143	10,492	10,747	11,321	11,299	11,935	12,300	5.2	5.7	5.6	5.5	6.0	6.1	5.8
Revenue before transfers	6,299	7,314	7,139	7,435	7,071	7,698	8,320	3.6	4.0	3.7	3.6	3.7	3.9	3.9
Transfers	2,844	3,178	3,608	3,886	4,228	4,237	3,980	1.6	1.7	1.9	1.9	2.2	2.2	1.9
Expenditure	10,312	10,320	10,977	11,514	11,492	11,935	12,300	5.8	5.6	5.8	5.6	6.1	6.1	5.8
Expenditure excl. additional measures	10,312	11,138	11,906	11,989	11,989	11,577	12,300	5.8	6.0	6.2	5.9	6.4	5.9	5.8
Additional measures	0	-819	-929	-475	-497	358	0	0.0	-0.4	-0.5	-0.2	-0.3	0.2	0.0
Balance	-1,169	172	-230	-193	-193	0	0	-0.7	0.1	-0.1	-0.1	-0.1	0.0	0.0
Employment Fund														
Revenue	3,801	3,981	4,262	4,135	4,863	4,129	4,125	2.2	2.2	2.2	2.0	2.6	2.1	1.9
Revenue before transfers	930	1,001	977	984	905	1,015	1,065	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Transfers from budget	2,871	2,980	3,284	3,151	3,958	3,114	3,060	1.6	1.6	1.7	1.5	2.1	1.6	1.4
Expenditure	3,579	3,990	4,172	4,135	4,863	4,135	4,125	2.0	2.2	2.2	2.0	2.6	2.1	1.9
Expenditure excl. transfers and additional measures	2,183	2,275	2,253	2,094	2,626	1,920	1,818	1.2	1.2	1.2	1.0	1.4	1.0	0.9
Transfers	1,395	1,715	2,116	2,179	2,473	2,216	2,307	0.8	0.9	1.1	1.1	1.3	1.1	1.1
Additional measures	0	0	-198	-138	-236	0	0	0.0	0.0	-0.1	-0.1	-0.1	0.0	0.0
Balance	222	-9	90	0	0	-6	0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Road Fund														
Revenue and grants	1,450	1,643	1,741	3,141	3,141	1,940	2,615	0.8	0.9	0.9	1.5	1.4	1.0	1.2
Revenue and grants before transfers	633	1,098	1,073	2,141	2,141	1,076	1,115	0.4	0.6	0.6	1.0	0.8	0.6	0.5
Transfers from budget	818	545	668	1,000	1,000	864	1,500	0.5	0.3	0.3	0.5	0.5	0.4	0.7
Expenditure	1,528	1,397	2,660	6,827	6,916	3,752	5,015	0.9	0.8	1.4	3.3	3.4	1.9	2.3
Balance	-78	246	-919	-3,686	-3,775	-1,812	-2,400	0.0	0.1	-0.5	-1.8	-2.0	-0.9	-1.1
Memorandum item:														
Nominal GDP	176,444	184,982	190,827	204,839	188,800	195,284	213,833							

Sources: Ministry of Finance; National Bank of Macedonia (NBM); and IMF staff estimates.

Table 32. FYRM: Special Revenue Accounts and Expenditure Financed from Special Revenue Accounts, 1998–99 1/

	Revenue					Expenditure				
	(In millions of denars)		(In percent of total revenue)		(Percent change)	(In millions of denars)		(In percent of total expenditure)		(Percent change)
	1998	1999	1998	1999	1999	1998	1999	1998	1999	1999
Common services unit	37.3	71.8	0.7	0.8	92.5	26.0	58.4	0.7	0.7	124.6
Ministry of defense	414.8	1,318.1	8.3	14.5	217.8	340.1	1,275.7	8.5	15.7	275.1
Ministry of interior	356.3	1,730.1	7.1	19.0	385.6	293.5	1,654.0	7.3	20.4	463.5
Ministry of finance	72.5	187.6	1.4	2.1	158.8	59.5	145.4	1.5	1.8	144.4
Customs	22.9	243.3	0.5	2.7	962.4	20.0	70.2	0.5	0.9	251.0
Ministry of economy	38.1	170.1	0.8	1.9	346.5	26.2	42.5	0.7	0.5	62.2
Ministry of transportation	219.7	248.9	4.4	2.7	13.3	184.9	246.2	4.6	3.0	33.2
Air traffic control	217.5	439.6	4.3	4.8	102.1	173.1	275.5	4.3	3.4	59.2
Ministry of agriculture	157.9	208.8	3.1	2.3	32.2	132.0	227.4	3.3	2.8	72.3
Social protection of children	201.8	289.8	4.0	3.2	43.6	181.4	293.1	4.5	3.6	61.6
Ministry of education	524.1	556.0	10.4	6.1	6.1	299.2	23.6	7.5	0.3	-92.1
Ministry of athletics	444.6	0.0	8.9	0.0	-100.0	401.0	147.4	10.0	1.8	-63.2
Elementary and high school education	624.6	1,162.6	12.5	12.8	86.1	645.8	1,356.8	16.2	16.7	110.1
Ministry of post-secondary education	756.5	785.7	15.1	8.6	3.9	611.0	872.3	15.3	10.7	42.8
Sports clubs	0.0	472.2	0.0	5.2	...	0.0	348.9	0.0	4.3	...
Scientific institutes	170.7	311.3	3.4	3.4	82.4	273.6	330.7	6.8	4.1	20.9
Cultural activities	108.0	158.0	2.2	1.7	46.3	72.3	88.7	1.8	1.1	22.7
Ministry of health	25.2	62.6	0.5	0.7	148.4	17.0	58.8	0.4	0.7	245.9
Geodesics institute	49.5	67.0	1.0	0.7	35.4	38.4	54.5	1.0	0.7	41.9
Agency for economic development	51.4	25.4	1.0	0.3	-50.6	42.5	25.5	1.1	0.3	-40.0
Courts, prosecutors, and prisons	95.6	168.2	1.9	1.8	75.9	81.5	164.3	2.0	2.0	101.6
Others	427.4	428.2	8.5	4.7	0.2	77.3	354.7	1.9	4.4	358.9
Total	5,016.4	9,105.3	100.0	100.0	81.5	3,996.3	8,114.6	100.0	100.0	103.1
Memorandum items:										
Strategic Reserve Fund	1,140.6	3,588.8				1,060.1	2,391.1			
Expenditure by economic category										
Current expenditure						3,712.7	7,660.2	92.9	94.4	106.3
Wages and contributions						395.6	2,865.0	9.9	35.3	624.2
Goods and services						3,301.9	4,791.8	82.6	59.1	45.1
Interest payments						15.2	3.4	0.4	0.0	-77.6
Capital expenditure						283.6	454.4	7.1	5.6	60.2

Sources: Payments Bureau (ZPP); and IMF staff estimates.

1/ Excluding commodity trading activity by the Strategic Reserve Fund.

Table 33. FYRM: Expenditure Financed from Special Revenue Accounts by Agency and Economic Category, 1998–99 1/

	Wages and contributions		Goods and services		Interest		Capital		Total	
	1998	1999	1998	1999	1998	1999	1998	1999	1998	1999
Common services unit	0.0	19.8	25.5	38.6	0.0	0.0	0.5	0.0	26.0	58.4
Ministry of defense	23.9	276.3	309.8	870.7	0.0	0.0	6.4	128.7	340.1	1,275.7
Ministry of interior	16.3	1,063.5	276.9	590.1	0.0	0.0	0.3	0.4	293.5	1,654.0
Ministry of finance	0.0	48.9	31.8	72.6	0.0	0.0	27.7	23.9	59.5	145.4
Customs	0.6	43.1	19.4	27.1	0.0	0.0	0.0	0.0	20.0	70.2
Ministry of economy	0.0	1.5	20.0	37.9	0.0	0.0	6.2	3.1	26.2	42.5
Ministry of transportation	1.7	6.1	183.2	240.1	0.0	0.0	0.0	0.0	184.9	246.2
Air traffic control	36.3	67.5	85.5	161.5	3.9	0.0	47.4	46.5	173.1	275.5
Ministry of agriculture	0.0	5.6	117.8	187.8	0.0	0.0	14.2	34.0	132.0	227.4
Social protection of children	10.6	53.6	162.0	226.7	0.0	0.0	8.8	12.8	181.4	293.1
Ministry of education	0.9	2.1	297.0	21.5	0.0	0.0	1.3	0.0	299.2	23.6
Ministry of athletics	33.8	11.2	350.1	132.9	7.3	0.0	9.8	3.3	401.0	147.4
Elementary and high school education	54.6	674.1	541.9	593.4	0.0	0.0	49.3	89.3	645.8	1,356.8
Ministry of post-secondary education	109.3	241.4	448.3	573.6	0.0	0.0	53.4	57.3	611.0	872.3
Sports clubs	0.0	31.4	0.0	315.1	0.0	0.0	0.0	2.4	0.0	348.9
Scientific institutes	71.5	105.2	197.3	216.9	3.9	3.3	0.9	5.3	273.6	330.7
Cultural activities	15.7	34.4	53.2	52.9	0.1	0.1	3.3	1.3	72.3	88.7
Ministry of health	0.0	2.1	17.0	55.7	0.0	0.0	0.0	1.0	17.0	58.8
Geodesics institute	0.0	2.3	37.0	52.0	0.0	0.0	1.4	0.2	38.4	54.5
Agency for economic development	0.0	0.5	0.4	0.5	0.0	0.0	42.1	24.5	42.5	25.5
Courts, prosecutors, and prisons	6.8	74.3	69.8	86.3	0.0	0.0	4.9	3.7	81.5	164.3
Others	13.6	100.1	58.0	237.9	0.0	0.0	5.7	16.7	77.3	354.7
Total	395.6	2,865.0	3,301.9	4,791.8	15.2	3.4	283.6	454.4	3,996.3	8,114.6
Memorandum item:										
Strategic Reserve Fund									1,060.1	2,391.1

Sources: Payments Bureau (ZPP); and IMF staff estimates.

1/ Excluding commodity trading activity by the Strategic Reserve Fund.

Table 34. FYRM: General Government Debt, by Instrument and Creditor, 1996–99 1/

(In millions of denars, end of period)

	1996	1997	1998	1999
Total domestic debt	41,139	46,395	41,065	46,119
By instrument				
Bonds	7,577	6,433	5,469	12,235
National Bank	5,337	5,030	4,723	4,416
Commercial banks	2,240	1,403	746	7,819
Domestic credit and accrued interest	0	1,834	1,323	1,318
National Bank	0	53	39	33
Commercial banks	0	1,781	1,284	1,285
Frozen foreign currency deposits	32,834	37,345	33,780	32,566
Domestic payments arrears	728	783	494	0
By Creditor				
National Bank	5,337	5,083	4,762	4,449
Bonds	5,337	5,030	4,723	4,416
Big bonds 2/	4,298	3,991	3,684	3,377
BRA bond 3/	1,039	1,039	1,039	1,039
Credit to government		53	39	33
Commercial banks	2,240	3,184	2,030	9,104
Bonds	2,240	1,403	746	7,819
Big bonds 3/	280	260	241	223
Short bonds 4/	1,960	1,143	504	315
New Stopanska Banka bond 5/	0	0	0	7,282
Credit		1,768	1,265	1,260
Budget and line ministries		1,274	513	259
Funds		494	746	996
Central government institutions (e.g. courts)		0	6	5
Accrued interest		13	19	25
Frozen foreign currency deposits	32,834	37,345	33,780	32,566
Domestic payments arrears	728	783	494	0
Suppliers	728	783	494	0
Other	...	...	...	...
Total external debt 6/	32,052	42,561	46,075	57,795
Total debt	73,191	88,957	87,140	103,913
Memorandum items:				
Total domestic debt (as percent of GDP)	23.3	25.1	21.5	23.8
Total external debt (as percent of GDP)	18.2	23.0	24.1	29.6
Total government debt (as percent of GDP)	41.5	48.1	45.7	53.2

Sources: Ministry of Finance; National Bank of Macedonia; and IMF Staff estimates.

1/ Total debt of central government and external debt of general government.
2/ Bonds issued in January 1995 in connection with the rehabilitation of Stopanska Banka.
3/ Bonds issued in 1994 in connection with the elimination of directed credits.
4/ Bonds issued in connection with the reimbursement of frozen deposits for social purposes.
5/ DM 235 million bond issued in 1999 to clean up Stopanska Banka's balance sheet prior to its sale.
6/ See Table 43 for details.

Table 35. FYRM: Balance of Payments, 1995–99

(In millions of U.S. dollars)

	1995	1996	1997	1998	1999 Prel.
Current account	-222	-288	-277	-309	-137
Trade balance (fob)	-221	-317	-386	-419	-408
Exports	1,204	1,147	1,237	1,292	1,192
Imports	1,425	1,464	1,623	1,711	1,601
Services	-200	-155	-147	-173	-75
Receipts	185	154	128	131	248
Payments	385	309	275	304	324
Income	-29	-30	-55	-44	-43
Receipts	37	46	17	24	0
Payments	66	76	72	68	43
Transfers (net)	228	213	311	327	392
Official	27	52	7	28	65
Private	201	161	304	299	327
Capital account	65	108	98	299	46
Disbursements	133	122	156	228	165
Public	133	122	146	120	118
Private	0	0	10	108	47
Amortization	103	86	47	74	106
Direct and portfolio investment (net)	12	12	18	175	27
Commercial banks' position (net)	23	61	-29	-31	-40
Errors and omissions and short-term capital 1/	123	84	195	54	188
Overall balance	-34	-96	16	44	97
Financing	34	96	-16	-44	-97
Net foreign assets (increase, -)	-72	21	10	-44	-123
Of which : IMF (net change)	37	14	22	10	2
Change in arrears	-226	37	-106	0	1
New arrears	84	69	8	0	1
Repayment of arrears	310	32	114	0	0
Rescheduling	333	38	80	0	24
Memorandum items:					
Current account (In percent of GDP)	-5.0	-6.5	-7.4	-8.8	-4.0
Debt-service ratio	10.4	11.1	8.7	10.1	13.0
Debt-to-GDP ratio	23.8	25.4	31.5	41.1	43.3
Gross reserves (In months of c.i.f. imports)	1.9	2.0	1.9	2.1	3.1

Source: Data provided by the National Bank of Macedonia (NBM).

1/ Includes changes in currency and deposit of private sector and unidentified short-term capital, such as trade credits, imports paid by drawdown of accounts held abroad, and unrecorded remittances.

Table 36. FYRM: Commodity Composition of Exports and Imports, 1995-Nov. 99 1/

	1995	1996	1997	1998	1999 Jan.-Nov.	1995	1996	1997	1998	1999 Jan.-Nov.
	(In millions of U.S. dollars)					(In percent of total exports)				
Total exports	1,204.0	1,147.4	1,236.8	1,322.1	1,082.2	100.0	100.0	100.0	100.0	100.0
Food and live animals	131.9	86.0	70.9	66.2	61.7	11.0	7.5	5.7	5.0	5.7
Beverages and tobacco	88.8	154.4	177.1	143.8	146.7	7.4	13.5	14.3	10.9	13.6
Crude materials, inedible, except fuels	92.7	66.5	69.0	56.4	45.9	7.7	5.8	5.6	4.3	4.2
Mineral fuels, lubricants and related materials	4.7	9.5	5.6	10.5	18.7	0.4	0.8	0.5	0.8	1.7
Animal and vegetable oils and fats	0.3	0.0	0.3	0.2	0.5	0.0	0.0	0.0	0.0	0.0
Chemicals	66.9	68.3	72.7	65.4	50.5	5.6	6.0	5.9	4.9	4.7
Manufactured goods	425.1	348.5	422.7	448.5	315.8	35.3	30.4	34.2	33.9	29.2
Machinery and transport equipment	156.6	87.6	95.9	98.4	81.1	13.0	7.6	7.8	7.4	7.5
Miscellaneous manufactured articles	220.7	317.5	321.3	430.3	338.3	18.3	27.7	26.0	32.5	31.3
Unclassified	16.3	9.0	1.4	2.3	23.3	1.4	0.8	0.1	0.2	2.2
						(In percent of total imports)				
Total imports, c.i.f.	1,716.1	1,626.3	1,778.5	1,913.5	1,566.5	100.0	100.0	100.0	100.0	100.0
Food and live animals	280.8	216.9	243.1	255.6	182.0	16.4	13.3	13.7	13.4	11.6
Beverages and tobacco	16.9	17.1	19.7	25.9	27.8	1.0	1.1	1.1	1.4	1.8
Crude materials, inedible, except fuels	78.9	77.1	69.2	67.2	49.7	4.6	4.7	3.9	3.5	3.2
Mineral fuels, lubricants, and related materials	199.0	148.1	197.0	162.5	137.1	11.6	9.1	11.1	8.5	8.8
Animal and vegetable oils, and fats	4.0	19.2	15.5	25.6	20.8	0.2	1.2	0.9	1.3	1.3
Chemicals	205.0	169.9	192.2	203.1	163.7	11.9	10.4	10.8	10.6	10.5
Manufactured goods	268.8	305.0	343.8	277.4	243.8	15.7	18.8	19.3	14.5	15.6
Machinery and transport equipment	331.7	361.2	302.0	365.2	319.6	19.3	22.2	17.0	19.1	20.4
Miscellaneous manufactured articles	155.0	171.9	213.8	93.7	66.5	9.0	10.6	12.0	4.9	4.2
Unclassified	176.0	139.9	182.2	437.3	355.5	10.3	8.6	10.2	22.9	22.7

Source: Data provided by the Statistical Office.

1/ Figures for 1998 and 1999 exports and imports include operational leases of airplanes, which are excluded from exports in Table 35.

Table 37. FYRM: Destination of Merchandise Exports, 1995–Nov. 99 1/

(In millions of U.S. dollars)

	1995	1996	1997	1998	1999 Jan.-Nov.
Total exports	1,204.0	1,147.4	1,236.8	1,322.1	1,082.2
Industrial countries	523.3	616.5	681.1	822.1	651.1
European Union	407.8	490.2	462.0	584.5	485.6
France	23.5	6.0	5.7	17.7	11.8
Italy	118.4	51.4	42.5	96.8	66.2
Netherlands	29.7	47.9	41.3	43.7	36.7
Germany	153.1	214.6	194.8	283.0	232.1
United Kingdom	21.1	30.6	30.2	23.4	22.8
Greece	14.2	102.4	97.4	83.3	79.1
Austria	30.3	20.4	18.5	9.9	5.5
Other	17.5	16.9	31.6	26.7	31.4
EFTA	37.1	33.2	80.6	45.3	27.2
Switzerland	36.7	33.1	64.4	40.3	25.2
Other	0.4	0.1	16.2	5.0	2.0
Other industrial countries	78.4	93.1	138.5	192.3	138.3
Japan	1.1	2.4	1.3	2.1	1.7
United States	35.6	70.7	114.5	175.1	123.4
Turkey	38.3	18.2	22.7	9.1	7.8
Other	3.4	1.8	0.0	6.0	5.4
Former CMEA area	446.2	134.9	116.0	109.5	70.8
Bulgaria	256.0	38.2	31.7	42.6	29.4
Russia	87.2	38.6	25.5	26.1	15.0
Albania	24.7	32.6	30.1	13.3	14.0
Ukraine	29.2	4.9	1.9	3.7	1.5
Other	49.1	20.6	26.8	23.8	10.9
Developing countries	44.0	11.3	20.9	32.8	32.3
Republics of the former SFRY	190.0	380.0	387.4	355.2	314.8
SR Yugoslavia	84.8	245.8	273.9	240.2	222.0
Croatia	32.1	34.0	37.8	54.1	30.7
Slovenia	72.4	82.1	55.5	41.3	44.4
Bosnia and Herzegovina	0.7	18.1	20.2	19.6	17.7
Other countries	0.5	4.7	31.4	2.5	13.2

Source: Data provided by the Statistical Office.

1/ Figures for 1998 and 1999 exports include operational leases of airplanes, which are excluded from exports in Table 35.

Table 38. FYRM: Origin of Merchandise Imports, 1995–Nov. 99 1/

(In millions of U.S. dollars)

Countries	1995	1996	1997	1998	1999 Jan.-Nov.
Total imports, c.i.f.	1,716.1	1,626.3	1,778.5	1,913.5	1,566.5
Industrial countries	860.8	806.2	827.4	927.0	777.7
European Union	689.6	629.8	658.5	693.9	626.1
France	36.1	48.6	35.3	36.6	34.3
Italy	179.3	109.8	94.7	109.1	82.2
Netherlands	43.4	39.8	39.8	42.2	35.4
Germany	283.0	239.9	233.4	255.0	215.2
United Kingdom	20.2	22.5	22.2	30.3	29.7
Greece	28.9	77.4	127.1	113.3	135.6
Austria	44.9	38.2	43.4	53.5	38.2
Other	53.8	53.6	62.6	53.9	55.5
EFTA	20.0	24.9	27.8	35.7	20.7
Switzerland	19.1	23.2	22.5	27.7	18.7
Other	0.9	1.7	5.3	8.0	2.0
Other industrial countries	151.2	151.5	141.1	197.4	130.9
Japan	14.6	15.5	11.7	16.6	15.9
United States	57.8	67.8	80.1	101.6	47.5
Turkey	55.2	44.3	49.3	51.4	47.6
Other	23.6	23.9	0.0	27.8	19.9
Former CMEA area	434.7	344.0	357.4	400.1	340.6
Bulgaria	255.9	107.5	98.2	86.2	82.9
Russia	62.8	122.3	68.5	91.0	88.0
Albania	8.2	5.1	3.9	2.0	2.9
Ukraine	37.3	31.4	91.7	118.9	95.9
Other	70.5	77.7	95.1	102.0	70.9
Developing countries	85.9	97.5	110.4	114.0	85.7
Republics of the former SFRY	334.7	342.1	413.2	465.4	362.4
SR Yugoslavia	161.1	165.6	202.3	244.6	160.2
Croatia	56.3	48.9	68.5	64.4	56.2
Slovenia	116.5	124.3	135.5	148.8	138.7
Bosnia and Herzegovina	0.8	3.3	6.9	7.6	7.3
Other countries	0.0	36.5	70.1	7.0	0.1

Source: Data provided by the Statistical Office.

1/ Figures for 1998 and 1999 imports include operational leases of airplanes, which are excluded from imports in Table 35.

Table 39. FYRM: Exports and Imports by Final Use, 1995–Nov. 99 1/

	1995	1996	1997	1998	1999 Jan.-Nov.
	(In millions of U.S. dollars)				
Exports	1,204.0	1,147.4	1,236.8	1,322.1	1,082.2
Industrial supplies	651.5	567.6	650.0	645.9	508.2
Investment goods and spare parts	50.4	38.5	42.1	52.9	38.9
Consumption goods	446.6	540.3	543.3	621.7	512.6
Other	55.5	1.0	1.4	1.6	22.5
Imports, c.i.f.	1,716.1	1,626.3	1,778.5	1,913.5	1,566.5
Industrial supplies	989.9	904.9	1,087.7	1,242.5	993.6
Investment goods and spare parts	181.2	218.0	188.5	247.3	210.2
Consumption goods	527.9	492.4	491.6	412.1	355.1
Other	17.1	11.0	10.7	11.6	7.6
	(In percent of total exports)				
Exports	100.0	100.0	100.0	100.0	100.0
Industrial supplies	54.1	49.5	52.6	48.9	47.0
Investment goods and spare parts	4.2	3.4	3.4	4.0	3.6
Consumption goods	37.1	47.1	43.9	47.0	47.4
Other	4.6	0.1	0.1	0.1	2.1
	(In percent of total imports)				
Imports, c.i.f.	100.0	100.0	100.0	100.0	100.0
Industrial supplies	57.7	55.6	61.2	64.9	63.4
Investment goods and spare parts	10.6	13.4	10.6	12.9	13.4
Consumption goods	30.8	30.3	27.6	21.5	22.7
Other	1.0	0.7	0.6	0.6	0.5

Source: Data provided by the Statistical Office.

1/Figures for 1998 and 1999 exports and imports include operational leases of airplanes, which are excluded from exports and imports in Table 35.

Table 40. FYRM: Services Account, 1995–99

(In millions of U.S. dollars)

	1995	1996	1997	1998	1999 Prel.
Total services	-200	-155	-147	-173	-75
Receipts	185	154	128	131	249
Payments	-385	-309	-275	-304	-324
Travel, (net)	-8	-6	-13	-16	5
Receipts	19	21	14	15	37
Payments	-27	-26	-27	-31	-32
Transportation (net)	-138	-100	-79	-83	-66
Receipts	54	48	54	61	87
Payments	-192	-149	-133	-144	-153
Other services (net)	-54	-49	-55	-74	-15
Receipts	112	85	60	55	124
Payments	-166	-134	-115	-129	139

Source: Data provided by the National Bank of Macedonia (NBM).

Table 41. FYRM: External Debt Disbursements, 1995–99

(In millions of U.S. dollars)

	1995	1996	1997	1998	1999 Prel.
Total	142	124	153	228	186
Multilateral	128	116	131	112	108
IMF	38	14	22	12	19
IBRD/IDA	62	46	48	49	56
EBRD	13	54	32	14	5
EUROFIMA	15	1	0	0	1
EIB	0	0	0	18	24
IFAD	0	0	0	1	1
IFC	0	0	0	1	2
EU	0	0	29	16	0
Official bilateral	2	8	6	0	26
Commercial creditors	5	0	16	116	50
Commercial banks	0	0	6	8	3
Other	5	0	10	108	47
Other	7	0	0	0	0

Source: Data provided by the National Bank of Macedonia (NBM).

Table 42. FYRM: External Debt-Service Obligations, 1995–99 1/

(In millions of U.S. dollars)

	1995	1996	1997	1998	1999 Prel.
By creditor					
Principal	32	47	53	87	123
Multilateral institutions	28	29	26	30	45
IMF	1	1	0	2	17
IBRD/IDA	19	15	6	6	3
IFC	8	3	1	0	1
EIB	0	2	8	2	2
EBRD	0	1	8	14	16
EUROFIMA	0	7	2	5	4
Council of Europe	0	0	1	1	1
EU	0	0	0	0	1
IFAD	0	0	0	0	0
Bilateral creditors	0	13	18	30	27
Paris Club	0	0	17	26	23
Other	0	0	1	4	4
Commercial creditors	4	5	9	27	51
London Club	0	0	0	0	0
Other	4	5	9	27	51
Interest	12	32	71	56	60
Multilateral institutions	11	18	42	19	25
IMF	2	3	3	3	3
IBRD/IDA	8	7	6	5	6
IFC	1	1	0	0	5
EIB	0	4	28	3	4
EBRD	0	2	4	5	4
EUROFIMA	0	1	1	1	1
Council of Europe	0	0	0	0	0
EU	0	0	0	2	2
IFAD	0	0	0	0	0
Bilateral creditors	0	13	28	21	17
Paris Club	0	0	27	20	17
Other	0	0	1	1	1
Commercial creditors	1	1	1	16	18
London Club	0	0	0	10	8
Other	1	1	1	6	10
Total debt service	44	79	124	143	183
By debtor					
Principal	...	...	...	87	123
Central government	...	...	...	42	42
Special funds	...	...	...	0	0
Other	...	...	...	45	81
Interest	...	...	...	56	60
Central government	...	...	...	41	34
Special funds	...	...	...	0	0
Other	...	...	...	15	26

Source: Data provided by the National Bank of Macedonia (NBM).

1/ Based on medium- and long-term debt outstanding at end-1998.

Table 43. FYRM: External Debt Stock, 1995–99 1/

(In millions of U.S. dollars; end of period)

	1995	1996	1997	1998	1999 Est.
Total external debt	1,062	1,118	1,139	1,437	1,484
By debtor					
Public sector	...	1,012	1,007	1,222	1,300
Government	...	774	775	890	963
Central government	...	766	767	864	921
Road fund	...	...	...	18	33
Health fund	...	1	1	1	3
Other	...	7	7	7	7
National bank	...	80	99	114	113
Public enterprises	...	158	133	218	224
Private sector 1/	...	106	132	214	184
Commercial banks	...	84	92	110	94
Nonbank private sector	...	22	40	105	90
By maturity and creditor					
Medium- and long-term debt	1,062	1,118	1,139	1,380	1,434
Multilateral	398	468	490	687	709
IMF	69	80	103	114	113
IBRD/IDA	178	206	237	296	327
IFC	5	2	0	56	60
EIB	82	76	37	54	68
EBRD	15	69	83	90	76
EUROFIMA	40	29	25	23	17
Council of Europe	10	6	5	5	5
EU	0	0	0	48	41
IFAD	0	0	0	1	2
Bilateral creditors 2/	412	402	377	289	318
Commercial creditors	251	248	272	404	407
Commercial bank creditors	229	229	241	243	250
Other	22	19	31	161	157
Short-term debt	...	...	...	57	50
Memorandum items:					
			(In percent of total)		
Medium- and long-term external debt	99.9	100.0	100.0	100.0	100.0
Multilateral	37.5	41.8	43.1	49.8	49.4
Bilateral	38.8	36.0	33.1	20.9	22.2
Commercial	23.6	22.2	23.8	29.3	28.4
			(In percent of GDP)		
External debt	24	25	32	41	43

Source: Data provided by the National Bank of Macedonia (NBM).

1/ Short-term debt is included in the private sector debt.
2/ Including debt guaranteed or insured by the government or government agencies only.

Table 44. FYRM: Official Gold and Convertible Foreign Exchange, 1995–99

(In millions of U.S. dollars, end of period)

		Gold 1/	SDR Holdings	Reserve Position in the Fund	Foreign Exchange	Total
1995	Q1	16.4	1.0	0.0	161.5	178.9
	Q2	16.4	1.4	0.0	192.1	209.9
	Q3	16.4	0.7	0.0	222.6	239.7
	Q4	17.6	0.2	0.0	257.0	274.9
1996	Q1	19.7	0.4	0.0	229.4	249.5
	Q2	22.2	1.3	0.0	232.0	255.5
	Q3	24.2	0.5	0.0	224.8	249.5
	Q4	28.0	0.0	0.0	239.5	267.5
1997	Q1	26.6	0.1	0.0	209.6	236.3
	Q2	25.4	2.2	0.0	228.2	255.8
	Q3	25.9	1.3	0.0	248.1	275.3
	Q4	23.5	0.4	0.0	256.2	280.1
1998	Q1	23.8	0.1	0.0	247.5	271.4
	Q2	24.4	4.2	0.0	281.4	310.0
	Q3	25.0	1.7	0.0	291.9	318.6
	Q4	28.5	1.1	0.0	303.9	333.5
1999	Q1	28.3	0.2	0.0	290.4	318.8
	Q2	26.3	1.1	0.0	310.9	338.4
	Q3	32.2	1.0	0.0	408.2	441.5
	Q4	29.7	1.0	0.0	427.7	458.4

Source: Data provided by the National Bank of Macedonia (NBM).

1/ At national valuation.

Table 45. FYRM: Exchange Rate Developments, 1995–99 1/

(Period average)

	Official Exchange Rates		Real Effective Exchange Rate Indices 2/	
	Denar/US$	Denar/DM	Deflated by Relative Consumer Prices	Deflated by Relative Unit Labor Costs
1995	38.1	26.5	100.0	100.0
1996	39.9	26.6	96.3	86.3
1997	49.7	28.9	82.2	71.5
1998	54.5	31.0	72.3	63.6
1999	56.9	31.0	73.2	...
1997				
January	42.6	26.6	100.3	76.5
February	44.5	26.6	98.0	80.0
March	45.2	26.6	89.1	80.9
April	45.5	26.6	85.4	82.9
May	45.4	26.6	84.4	85.7
June	46.1	26.7	87.0	75.3
July	53.1	29.7	76.6	66.8
August	55.9	30.9	73.0	62.4
September	54.5	30.9	72.3	64.5
October	54.4	30.9	73.5	61.1
November	54.5	30.9	72.9	62.4
December	54.9	30.9	73.6	59.6
1998				
January	56.1	30.9	73.5	56.9
February	56.1	30.9	72.8	58.5
March	56.4	30.9	72.8	61.8
April	56.2	30.9	71.4	61.4
May	54.9	30.9	70.6	61.5
June	55.4	31.0	69.7	66.3
July	55.7	31.0	69.3	64.7
August	55.4	31.0	69.0	63.3
September	52.8	31.0	72.5	65.3
October	50.7	31.0	75.4	59.2
November	52.0	31.0	75.0	74.2
December	51.8	31.0	75.7	70.4
1999				
January	52.2	31.0	75.4	75.8
February	54.0	31.0	75.4	72.2
March	55.6	31.0	74.9	66.6
April	56.6	31.0	72.7	67.2
May	57.0	31.0	73.1	73.5
June	58.4	31.0	72.1	61.5
July	58.7	31.0	70.3	58.1
August	57.2	31.0	71.4	58.3
September	57.8	31.0	71.0	64.9
October	56.5	31.0	73.4	74.8
November	58.5	31.0	73.3	68.3
December	60.0	31.0	75.0	...

Sources: Data provided by the National Bank of Macedonia (NBM), and IMF staff estimates.

1/ The former SFR Yugoslav denar was the official currency prior to monetary independence on April 26, 1992, when the official currency became the FYR Macedonia denar. In May 1993, a currency reform took place with t introduction of a new denar equal to 100 old denars. All exchange rates shown are expressed in terms of the new denar.

2/ IMF staff estimates. Average 1995=100. An increase in the index indicates an appreciation.