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REPORT FROM THE COMMISSION

**On the feasibility of negotiating a
Stabilisation & Association Agreement
with the former Yugoslav Republic of Macedonia**

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I. RELATIONS BETWEEN THE EU AND THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

In its conclusions of 26 April 1999, the General Affairs Council *'welcomed the intention of the European Commission to examine urgently, in the context of the regional approach and the EU contribution to a future Stability Pact, the upgrading of the contractual relations between the European union and the former Yugoslav Republic of Macedonia [...] towards an Association Agreement.'* Then, in its Conclusions of 31 May 1999, the General Affairs Council noted *'the intention of the Commission to present, at the GAC on 21 June, its feasibility study.'* Furthermore, the European Council, in its conclusions of 4 June 1999 reaffirmed *'the readiness of the European Union to draw the countries of [South-Eastern Europe] closer to the prospect of full integration into its structures. This will be done through a new kind of contractual relationship taking into account the individual situations of each country, including progress in regional cooperation, and with a prospect of European Union membership on the basis of the Amsterdam Treaty and fulfilment of the criteria defined at the Copenhagen European Council in June 1993.'*

The Cooperation Agreement between the EC and the former Yugoslav Republic of Macedonia entered into force on 1 January 1998. It has successfully been implemented since then, as shown by the positive trend in the trade exchange, but there is still room for a full use of its potential in the years to come. Bilateral relations have also developed in the framework of other instruments: the Agreement in the field of Transport, in force since 28 November 1997; the textiles agreement, applied as of 1 January 1997. Negotiations for a Wine and Spirit Agreement have not yet started. A Political Dialogue was established between the European Community and its Member States and the former Yugoslav Republic of Macedonia on the basis of a Joint Declaration separate from the Cooperation Agreement. A mission on the EC visa regime took place on 8-11/2/99.

The preamble as well as article 45¹ ('evolutionary clause') of the Cooperation Agreement include references to the upgrading of contractual relations between the EC and the former Yugoslav Republic of Macedonia. The subject was discussed in various meetings that took place since February 1998. In the statement issued at the end of the second Cooperation Council, on 5 March 1999, after stock had been taken of the progress achieved so far, this perspective was more explicitly mentioned². At the same occasion, the Commission stressed its readiness to consider the possibility of a report on the feasibility of moving towards a closer relationship between the EU and the former Yugoslav Republic of Macedonia. Finally, in its communication COM(99)235 of 26 May 1999 to the European Council and Parliament on the Stabilisation and Association process to the countries of South-Eastern Europe, the Commission explained that it *'will present a report on the feasibility of the opening of negotiations*

¹ 'The Contracting Parties shall examine, in due course, when conditions are met, the possibility of strengthening their contractual relations, bearing in mind the aspiration of the former Yugoslav Republic of Macedonia for an advanced relationship towards an association with the European Community.'

² 'The Cooperation Council, on the basis of the positive record achieved so far, as well as of the evolutionary clause, agreed that the future joint activities to intensify and strengthen bilateral cooperation could contribute to early upgrading of the level of contractual relations between the former Yugoslav Republic of Macedonia and the EU towards an Association Agreement.'

for a Stabilisation and Association Agreement with this country. Taking into account discussions in the Council, the Commission could make recommendations for negotiating directives.'

The purpose of this report, therefore, is to assess the feasibility of an upgrading of the contractual relations between the EC and the former Yugoslav Republic of Macedonia. It focuses on technical aspects of a possible future Stabilisation & Association Agreement, notably in key areas of the EC Internal Market.

2. PARAMETERS OF A STABILISATION & ASSOCIATION AGREEMENT

The negotiation of a Stabilisation & Association Agreement with the former Yugoslav Republic of Macedonia will depend on the latter's capacity to fulfil the obligation under this new type of contractual relations, as well as on the appreciation by the European Council and Parliament of the progress accomplished by the country in the different fields potentially covered by such an agreement, as described by the Commission in its communication COM(99)235 of 26 May 1999 to the European Council and Parliament on the Stabilisation and Association process to the countries of South-Eastern Europe.

2.1. Political aspects and Political Dialogue

Since the declaration of independence of the country, in 1991, it has undertaken deep political reforms in order to transform itself into a democratic country. It has also shown its growing respect for human rights and the rule of law, including the rights of ethnic and national groups and minorities, despite difficulties pointed out by the Council of Europe and OSCE. The former Yugoslav Republic of Macedonia is a member of the Council of Europe and a participating State to the OSCE since 1995. The recent political transition, which took place after free and fair elections, confirmed the political maturity of the country. This political maturity is also reflected in its foreign policy towards neighbouring countries and its cooperation with the international community in seeking a peaceful solution to the Kosovo crisis, even if its attitude towards the Kosovar refugees was also influenced by internal policy considerations on the ethnical balance.

Since April 1997, Political Dialogue meetings have taken place regularly at all levels (ministerial, senior-official and parliamentary). This means that provisions on Political Dialogue in a Stabilisation & Association Agreement would be an acknowledgement and a necessary continuation of the work carried out so far.

2.2. Economic Aspects

The former Yugoslav Republic of Macedonia's authorities have continued to pursue stabilisation policies, in line with the IMF-supported ESAF programme. As a result of both the tight monetary policy and the effects of external factors such as the fall in world food market prices, prices were kept low. The budgetary situation is under control, with an estimated overall fiscal deficit of 0.7 percent of GDP in 1998. GDP registered a 3.5 percent growth in 1998 (below the targeted 5 percent growth under the ESAF programme), but the aggregate demand grew even more, revealing a relatively strong demand position, compared to a weak response of the production system (the country has a current account deficit of 9% of the GDP in 1999). Unemployment remains high, at 34.5%. By the end of 1998, 1,435 enterprises have been privatised.

which means that 88.2 % of total enterprises are private. However, restructuring production so as to respond to demand flexibility is very difficult. Foreign direct investment remains at a low level. Private sector development is hampered by the situation of 9 out of 12 state-owned enterprises having large losses or large arrears, putting a heavy burden mainly on the banking sector, but also on public finances, and absorbing significant financing resources, which would be otherwise available for more efficient investments.

To increase the country's overall competitiveness, therefore, there is still a need to focus on improving the framework for private sector development, and rehabilitating the banking sector. These issues are being addressed in the framework of PHARE through the ongoing programmes: Private Sector Development Cooperation, Technical Assistance for the reform of the banking sector, support to the reform of the Payment Operating System, technical assistance to the Central Bank and Public Administration Reform. The obligations linked to a Stabilisation & Association Agreement could therefore help the country in implementing the measures necessary to improve its competitiveness.

2.3. Trade in Goods (see annex)

Liberalisation of trade has been almost fully achieved in the former Yugoslav Republic of Macedonia as a result of both the application of the Law on Customs Tariff, and the various Trade Agreements signed. Trade relations with the EU have considerably improved: between 1997 and 1998, EU exports to the country increased by 7% while imports from the country increased by 21%, thus reducing the trade deficit of the former Yugoslav Republic of Macedonia from € 285 Mio in 1997 to € 245 Mio in 1998. The EU represents 44% of the country's exports and 35% of its imports. In view of the progress achieved so far, an asymmetrical opening of the markets of the EU and the former Yugoslav Republic of Macedonia in favour of the latter, in view of the establishment of a Free Trade Area within a period of 10 to 12 years, could be envisaged. The liberalisation on the EU side would probably be quicker (keeping in mind that the country already enjoys duty-free access to the EC market). As far as the former Yugoslav Republic of Macedonia is concerned, the structural reforms now implemented will have reinforced the competitiveness of the country's economy by the time the potential Free Trade Area actually enters into force. In any case, in line with GATT Article XXIV, a substantial part of the bilateral trade should be covered as well as all sectors (industrial and agricultural goods). The country would also be included in the pan-European diagonal cumulation of rules of origin, which would allow further trade expansion. The recent safeguard measures taken by the country, albeit temporary, are not consistent with the country's commitment to continued liberalisation of trade and application to WTO membership.

2.3.1. Industrial

The existing Cooperation Agreement provides for a preferential - essentially duty-free - regime for imports into the Community of industrial products originating in the former Yugoslav Republic of Macedonia. However, some products are subject to tariff ceilings. In the framework of a Stabilisation & Association Agreement, there would be a mutual obligation to achieve a large degree of free movement of industrial goods. But a preferential asymmetric regime could be maintained, including a progressive reduction of duties, to allow the country to strengthen progressively the competitiveness of its industry.

2.3.2. *Agriculture*

Agriculture is the third most important component of EU trade with the former Yugoslav Republic of Macedonia (both in terms of exports and imports). While the existing Co-operation Agreement provides for unilateral concessions for certain agricultural products originating in the former Yugoslav Republic of Macedonia, taking into account the volume of trade in agricultural products, the particular sensitivity of the markets, of the common agricultural policy of the Community, the role of agriculture in the country's economy, a Stabilisation & Association Agreement would also have to include specific provisions on agriculture. The potential establishment of a free trade area would imply, from the start, a gradual liberalisation of the agricultural trade on both sides.

2.4. **Current Payments and Movement of Capital**

Over the last four years a plan for the rehabilitation of the banking sector has been developed. Measures for the harmonisation of the legislation with European standards in the field of banking are taken. However the banking sector is still unreformed, burdened with bad loans to the same enterprises stakeholders of the banks, and in demand of a full privatisation by foreign strategic investors. A Stabilisation & Association Agreement would include specific provisions on current payment and movement of capital. It would have to be accompanied by a continued commitment to the reform of the banking sector within a fixed transition period.

2.5. **Services, establishment**

The former Yugoslav Republic of Macedonia made some efforts for the approximation of its legislation with the *acquis* and the opening of its economy to foreign firms (e.g. financial services, telecommunications, television). Generally speaking, the country's legislation regarding company law allows the development of private firms (companies or private persons) but the market remains somewhat closed to foreign investors. The existing legislation, however, would be a good base to envisage solutions aiming at access to the market and national treatment of foreign companies in the framework of a Stabilisation & Association Agreement. It would contain dispositions on establishment and supply of services between the EC and the former Yugoslav Republic of Macedonia (in line with the GATS rules).

2.6. **Approximation of laws**

In this field, the former Yugoslav Republic of Macedonia made important efforts that will have to be continued. While the Cooperation Agreement only mentioned the principle of legal approximation, a Stabilisation & Association Agreement would have to include specific provisions and a firm commitment from the former Yugoslav Republic of Macedonia to implement a comprehensive programme of approximation of its legislation with the EC legislation. Institution-building EC assistance would back-up the process, notably to ensure law-enforcement. The legal approximation would build, *inter alia* on the following progress achieved so far:

2.6.1. *Technical Standards and Certification*

Notably through its participation in PRAQ III programme, the country has started its process of alignment of technical standards and certification. Some draft laws have

been prepared in the field of free movement and safety of industrial products, but the process is apparently at its very beginning and needs to be accelerated.

2.6.2. *Competition and State Aids*

A law on restricting competition and a law against unfair competition are being drafted and planned for adoption in 1999. Concerning price liberalisation, over 80% of commodity and services prices are free. A Stabilisation & Association Agreement would have to include provisions on competition, state aids and public undertakings.

2.6.3. *Public Procurement*

The law in force in the field of public procurement has been drafted on the model of laws in force in the EU. Amendments are planned for 1999. In any case, beyond provisions regarding the approximation of legislation in this field, a Stabilisation & Association Agreement could even include provisions on the gradual opening-up of the award of public contracts.

2.6.4. *Intellectual, Industrial and Commercial Property*

In this field, the former Yugoslav Republic of Macedonia has accessed to several WIPO international conventions. The law on copyright is in line with the relevant EC directives. National experts in cooperation with WIPO drafted it. The country should also commit itself to accede to additional international conventions, such as the Protocol to the Madrid Arrangement. A Stabilisation & Association Agreement would have to include provisions on the protection of intellectual, industrial and commercial property rights. A timetable can be expected if efforts in this field are intensified.

2.6.5. *Consumer Protection*

A second draft of the General Law on consumer protection has been submitted to the Ministry of Economy on 25 November 1998, and is in line with basic EC Directives, except for the directives regarding cosmetics and toy safety.

2.6.6. *Equal opportunities for men and women*

In the field of equal opportunities for men and women, a *Consensus* project is being implemented to assess the compatibility of the present legislation with EC Directives in this field.

2.7. **Economic and Financial Cooperation**

The country has shown a good absorption capacity, as 67% of the 1996 national programme and 99% of the 1996 CBC programme has been contracted. 63% of the 1997 national programme and 54% of the 1997 CBC programme has been contracted to date.

In line with the EC financial perspectives and with the budgets made available by the budgetary authority for the region, a Stabilisation & Association Agreement would foresee a financial assistance, and a financial and monetary cooperation (including references to G24 and IMF); where appropriate, the opening of certain community programmes could be envisaged, on a case by case basis.

The cooperation would cover, *inter alia*, the following fields:

2.7.1. *Customs and Taxation*

In the customs sector, the country is well covered by the PHARE Customs Programme and benefits in full from the relevant Community assistance activities in this respect. New dispositions in a Stabilisation & Association Agreement could build upon what has already been achieved, notably in the framework of the existing Working Party.

2.7.2. *Statistics*

Statistics have been one of the first sectors on which the EC assistance has been focused through PHARE, which has already contributed to the improvement of the quality of the data available. Given the importance of the issue for the economic reform process, further cooperation could be envisaged in a Stabilisation & Association Agreement.

2.7.3. *Industry and SMEs*

This sector has been a major area of cooperation with the EC. Thanks to PHARE, recommendations for improving the legal, administrative and institutional environment to SMEs have been made. Specific dispositions on industrial cooperation and on small and medium-sized enterprises could help the country in strengthening its competitiveness. In fact most of the economic provisions of a Stabilisation & Association Agreement are expected to improve the economic background of the country's SMEs and foster their development.

2.7.4. *RTD*

The country has participated in the 4th framework Programme (FP4). It is eligible to FP5. (*INCO-Copernicus 2* programme). The former Yugoslav Republic of Macedonia has the capacity to pursue the existing cooperation in science and technology through a Stabilisation & Association Agreement.

2.7.5. *Education and Training*

As far as higher education is concerned, the former Yugoslav Republic of Macedonia has been participating in the *Tempus* programme since 1997. From June 2000 on, under the new *Tempus III* programme, the country will continue to be eligible for funding. In the vocational training sector, the European Training Foundation is implementing a programme to support reform of the initial vocational training system, focusing on curriculum reform, teacher training and analysis of labour market needs. In addition, the Foundation has established a National Observatory that since 1997 reports regularly on developments in vocational training.

A Stabilisation & Association Agreement would include specific provisions on cooperation in education and training with reference to the *Tempus III* programme and to the activities of the European Training Foundation.

2.7.6. *Transport*

Since FYROM is an important transit country, forming a key link between Greece and the remainder of the single transport market, there is a particular interest in reinforcing our cooperation in this field. The EC/FYROM Transport Agreement, concluded in November 1997, gives free transit for road traffic and establishes a basis for the harmonisation of road taxation, technical and social legislation. There are also

provisions for the development of infrastructure of common interest and for support measures to improve rail and combined transport. Given the relatively limited scope of the Transport Agreement, and the interest of the Community, and of certain Member States in particular, in ensuring the coordinated development of an integrated transport system and its progressive liberalisation, specific transport provisions should be included in a Stabilisation & Association Agreement.

2.7.7. *Energy*

The former Yugoslav Republic of Macedonia has been participating in Community activities aiming at promoting regional energy co-operation in South-eastern, particularly as regards the development of regional energy interconnections in oil, gas and power sectors. The country plays an important role in regional energy systems, particularly as regards gas transit and interconnections to improve regional power systems, and a Stabilisation & Association Agreement with the Union would help develop this role.

2.8. **Justice and Home Affairs**

In the framework of the existing agreement, cooperation against money laundering is foreseen, as well as the conclusion of bilateral readmission agreements.

A Stabilisation & Association Agreement, concluded under the Amsterdam Treaty, would have to include:

- as far as the new 'first pillar' competencies are concerned, specific dispositions on asylum, migration, external borders, judicial co-operation in civil matters (that includes the issues of readmission and visa regime);

- as far as remaining third pillar subjects are concerned, certain dispositions will cover organised crime and criminal matters.

3. **CONCLUSIONS**

In the light of these considerations, and in line with its Communication COM(99)235 to the European Council and Parliament on the Stabilisation and Association process to the countries of South-Eastern Europe, the Commission concludes that:

A new kind of contractual relationship with the EC/EU would suppose major efforts on the side of the former Yugoslav Republic of Macedonia. It would have to implement fully the necessary reforms to be able to cope with the competitive pressure from the Union, and make efforts to take on the *acquis*, particularly as regards effective application in the area of the internal market. Further administrative reform will be indispensable if the former Yugoslav Republic of Macedonia is to be in a position to fulfil its contractual obligations.

Taking into account the political and economic reforms undertaken by the former Yugoslav Republic of Macedonia, notably in the framework of its Cooperation Agreement with the EC, the Commission considers that the country, after reasonable transition periods depending on the areas concerned, could be in line with the requirements of a Stabilisation & Association Agreement.

On this basis, the Commission considers feasible to envisage the opening of negotiations for a Stabilisation & Association Agreement with the former Yugoslav Republic of Macedonia. To this end, and on the basis of Council conclusions confirming the Commission's analysis in this respect, the Commission is ready to submit to the Council draft negotiating directives for a Stabilisation & Association Agreement with the former Yugoslav Republic of Macedonia.

Annex: EU 15 Trade with the former Yugoslav Republic of Macedonia: development 1993-1999

Table 1 : Overall developments 1993 - 1999^{*1}

	Billion (Billion ECU until 1998)			exp/imp	Annual rate of change		Share of TYRoM in extra EU trade	
	EU exp.	EU imp.	Balance	%	EU exp. %	EU imp. %	exp. %	imp. %
1993	0,676	0,534	0,141	126	-	-	0,14	0,11
1994	0,738	0,661	0,078	112	9	24	0,14	0,12
1995 (EU 12)	0,802	0,646	0,155	124	9	-2	0,13	0,11
1995 (EU 15)	0,880	0,664	0,216	132	19	1	0,15	0,12
1996	0,809	0,429	0,380	189	-8	-35	0,13	0,07
1997	0,849	0,491	0,357	173	5	14	0,12	0,07
1997 (January)	0,048	0,034	0,014	141	-	-	0,10	0,06
1998	0,883	0,591	0,291	149	4	20	0,12	0,08
1998 (January)	0,065	0,043	0,022	151	35	26	0,12	0,07
1999 (January)	0,058	0,042	0,016	138	-12	-3	0,12	0,08

*1 January 1999. Annual rate of change is calculated over the same period of 1998.

Table 2 : Most important EU 15 exports in 1999 and corresponding values in 1998 (January)

Sector by section of Common Customs Tariff	1999 (January)			1998 (January)		
	Million	Share of total %	Change over January 1998 %	MECU	Share of total %	Change over January 1997 %
1. Mineral products (V)	16	27	-4	16	25	153
2. Textiles (XI)	13	22	-10	14	22	55
3. Agriculture, incl. processed (I-IV)	8	14	-3	8	12	9
4. Machinery & electrical (XVI)	7	12	7	7	10	-17
5. Transport equipment (XVII)	4	7	-22	5	8	12
6. Chemical products (VI)	2	4	-40	4	6	31
7. Plastic products (VII)	2	3	-17	2	3	12
SUBTOTAL	52	89	-9	56	86	39
ALL SECTORS	58	100	-12	65	100	35

Table 3 : Most important EU 15 imports in 1999 and corresponding values in 1998 (January)^{*2}

Sector by section of Common Customs Tariff	1999 (January)			1998 (January)		
	Million	Share of total %	Change over January 1998 %	MECU	Share of total %	Change over January 1997 %
1. Textiles (XI)	20	48	51	13	31	-15
2. Base metals & articles (XV)	13	31	-22	17	39	120
3. Agriculture, incl. processed (I-IV)	3	8	-43	6	13	20
4. Machinery & electrical (XVI)	2	4	-6	2	4	6
5. Foot/head wear, umbrellas... (XII)	1	3	-27	2	4	43
6. Hides and skins (VIII)	1	1	-36	1	2	-2
7. Pearls, precious/semi-p. stones... (XIV)	1	1	115	0	1	24
SUBTOTAL	40	96	0	40	93	27
ALL SECTORS	42	100	-3	43	100	26

*2 In 1998 Base metals were in first place, Textiles in 2nd place, Footwear in 4th place, Machinery in 5th place, Wood in 7th place, Pearls & prec. st. in 13th place.

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