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Catching up with the EU - the economic case of Macedonia

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Transformation and Integration in Central and Eastern Europe

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Catching up with the EU - the economic case of Macedonia

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1. INTRODUCTION

The Republic of Macedonia, the first country from the West Balkan's region that in April 2001 signed the *Stabilization and Association Agreement (SAA)* with the European Union, which entered into force on 1 April 2004. The Republic of Macedonia applied for EU membership.¹

Wednesday, 9 November 2005

“ The European Commission has recommended that Macedonia become a candidate country for EU membership:

EU officials say that politically, Macedonia is an *incredibly positive story*, but that it still has a long way to go in terms of the **economy** and the **public administration**.”²

2. GENERAL MACROECONOMIC SITUATION

*Economic Profile*³

GDP per capita (2003)	Approx. 2,050 euro per capita at current exchange rates Approx. 5,200 euro per capita in purchasing power standards
Economic growth	0.9% in 2002; 3.4% in 2003; 2.5% in 2004
Inflation rate (2004)	0.9 % twelve month average year-on-year
Unemployment rate (2003)	36.7 % (ILO definition)
Currency	Macedonian denar (MKD) 1 Euro = MKD 61.4 (rate March 2005)
Government budget balance	2004 budget surplus: 0.5 % of GDP (general government)
Current account balance	End of 2003: -757 million euro = 18.3% of GDP (goods and services), partly offset by current transfers of 651 million euro = 15.7 % of GDP
Foreign debt	38% of GDP in 2004
Trade with EU (2004)	Exports to the EU: 52.3 % of total exports Imports from the EU: 64.4 % of total imports

¹ European Commission, DG Enlargement - Relations between the EU and the Republic of Macedonia
Available at: http://europa.eu.int/comm/enlargement/fyrom/eu_relations.htm

² BBC – “Macedonia backed as EU candidate “
Available at: <http://news.bbc.co.uk/1/hi/world/europe/4420158.stm>

³ European Commission, DG Enlargement, Candidate and Potential Candidate Countries
Available at: http://europa.eu.int/comm/enlargement/fyrom/economical_profile.htm

>>> TARGETS OF THE ECONOMIC PROGRAM OF THE GOVERNMENT OF THE REPUBLIC OF MACEDONIA (2005)

- Sustainable economic growth, with target job creation priority - prime objective of the economic policies;
- Reinforcing the capacity of institutions to carry the burden of the main target and prices stability (permanent market reforms, higher economic growth than the growth of the EU's economies etc.) – criteria that are put into test when the European Commission makes the decision for membership in the EU;
- General consensus for progress towards full membership in the EU and accepting its values and standards.⁴

Fiscal backgrounds

The expenditure from the budget for 2004 had as main objective the implementation of the *2001 Ohrid Framework Agreement*, which as an obligation increased the employment of ethnic minorities in the public administration bodies, *accession to NATO as a strategic stability goal, enforcement of the accession process to the EU*, and very much required structural reform of *fiscal decentralization*. Further consolidation of public finances introduces to reduction of the ratio of gross government debt to GDP (57% in 1999, 46% in 2003, and 45% in 2004).⁵

The economic program of the Government states that in the period that follows, the fiscal policy will include “planning of the budget deficit on a medium term and adjustment of the public consumption structure”.⁶ The unfavorable structure of budget expenses (big salaries,

⁴ *The Government of the Republic of Macedonia, Strategic Documents*
ECONOMIC PROGRAM OF THE GOVERNMENT OF THE REPUBLIC OF MACEDONIA (2005)
http://www.vlada.mk/english/index_en.htm

⁵ “EUROPEAN ECONOMY- The Western Balkans in transition” - **Enlargement Papers**
EUROPEAN COMMISSION, Directorate General for Economic and Financial Affairs, N° 23 - December 2004 ,
p.61-62
Available at: http://europa.eu.int/comm/economy_finance/publications/enlargement_papers/2004/elp23en.pdf

⁶ *The Government of the Republic of Macedonia, Strategic Documents*
ECONOMIC PROGRAM OF THE GOVERNMENT OF THE REPUBLIC OF MACEDONIA (2005)
http://www.vlada.mk/english/index_en.htm

insufficient capital investments) will have to be turned around in the period that follows. The government is planning to issue Eurobonds in order to boost international credit rating and FDI. It is considered that the public debt “is within reasonable frameworks”.⁷

Monetary policy

“The maintenance of the *price stability* is a primary objective of the National Bank of the Republic of Macedonia, established by a Law.”⁸ The *Denar* (domestic currency) is pegged to the Euro (MKD 61 per Euro). The interest rate was gradually increased because of the pressures of devaluation and as a consequence of a steep fall of foreign reserves (8% in March 2004, 9% in August 2004, 9, and 5 % in September 2004)⁹. “From the aspect of compliance with the other basic criteria for membership in EMU (long-term orientation of the Republic of Macedonia), it should be *underlined* that the Republic of Macedonia is *among the most successful countries in transition with regard to the inflation*.”¹⁰

External situation, troubles and the solutions

Close cooperation was established with **IMF**, was agreed *the Stand-by arrangement* (2003), and is as positive outcome as it could be in such complex situations: “The *external current account deficit* (excluding official grants) is expected to improve to about 8.5 percent of GDP in 2003, from 11.3 percent in 2002, and to improve further to 8.2 percent in

⁷ *The Government of the Republic of Macedonia, Strategic Documents*
ECONOMIC PROGRAM OF THE GOVERNMENT OF THE REPUBLIC OF MACEDONIA (2005)
http://www.vlada.mk/english/index_en.htm

⁸ **National Bank of the Republic of Macedonia - Monetary Policy-Design**
Available at: <http://www.nbrm.gov.mk/default-en.asp?ItemID=E05D538D6D8CC741928090C4E578CE30>

⁹ “EUROPEAN ECONOMY- The Western Balkans in transition” - **Enlargement Papers**
EUROPEAN COMMISSION, Directorate General for Economic and Financial Affairs, N° 23 - December 2004 , p.62

Available at: http://europa.eu.int/comm/economy_finance/publications/enlargement_papers/2004/elp23en.pdf

¹⁰ **National Bank of the Republic of Macedonia - Monetary Policy-Design**
Available at: <http://www.nbrm.gov.mk/default-en.asp?ItemID=E05D538D6D8CC741928090C4E578CE30>

2004.¹¹ The new arrangement is designed to boost forcefully the structural reforms on the way.

The **World Bank Group** is also very active in respect to monitoring and enforcing structural reforms (2003 program aimed public sector management, social protection implementation and health sector management).¹² *The Programmatic Development Policy Loan (PDPL 1)* was allowed (Washington, October 27, 2005) with couple of targets restructuring: 1.labour market, 2.health sector management, 3.judicial reforms, 4.improvement of the business environment, 5.improvement investment climate.”*The reforms that the Programmatic Development Policy Loan supports are designed to promote sustainable economic growth and job creation, says Bruce Courtney, head of the World Bank team designing the project...The reform program is also consistent with country’s aspiration for eventual EU membership.*”

Another very important institution that helps a lot bringing up the economic activity is **EBRD** with focus on sectors like “telecoms, transport, energy, banking and infrastructure“¹³

The main and most concerning problem is high payment-balance deficit, which in permanence that brings worries to Macedonian policy creators. So, as the *ECONOMIC PROGRAM OF THE GOVERNMENT OF THE REPUBLIC OF MACEDONIA (2005)* states the strong economic growth in following years will reduce the income-based and technological gap with the EU countries. That will have positive rebound on the payment-balance and the convergence process.

¹¹ **IMF – “ Republic of Macedonia—Letter of Intent, Supplementary Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding”**, September 29, 2003

Available at : <http://www.imf.org/External/NP/LOI/2003/mkd/02/index.htm>

¹² **The World Bank – “MEMORANDUM OF THE PRESIDENT OF THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT TO THE EXECUTIVE DIRECTORS ON A COUNTRY ASSISTANCE STRATEGY FOR THE REPUBLIC OF MACEDONIA “**

South East Europe Country Unit , Europe and Central Asia Region, August 14,2003

Available at:<http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/0,,contentMDK:20649729~menuPK:258604~pagePK:146736~piPK:146830~theSitePK:258599,00.html>

¹³ **European Commission, DG Enlargement - Economic profile**

Available at : http://europa.eu.int/comm/enlargement/fyrom/economical_profile.htm

3. THE VERY MUCH NEED STRUCTURAL REFORMS

Enterprise restructuring and privatization

The method used to privatize was heavily criticized on the insufficient and not yet finally formed market for corporate control, which hit the corporate governance and efficiency gains. The main action plan (2000), liquidation or privatization of 40 large loss-making enterprises, is already finished.

At the moment the major issue is privatization of the national Company for Electricity Production (ESM), and difficulties are expected both in the economic and political arena. The main help is expected to come from EBRD and the process to last for a couple of years for sure.

The government is heavily investing in the SMS in order to build a flexible structure that is resistant on both economic and political shocks, that the region is used to produce. Introduced were new institutions, like the Agency for Promotion of Entrepreneurship. “The authorities also endorsed the principles of the *European Charter for Small Enterprises*, and set up a strategy for their implementation.”¹⁴

Very impotent adjustment of the public administration to new managerial methods

The public administration still lacks restructuring. Attempts are made constantly and are expected to give positive effect in the future. The efficiency and capabilities of the administration have been very difficult, and must be considered in the light of the environment (micro and macro level). The process of the integration into the European Union structure asks for enforced functions of the administrations, meaning fast and up to the point performance.

¹⁴ “EUROPEAN ECONOMY- The Western Balkans in transition” - **Enlargement Papers**
EUROPEAN COMMISSION, Directorate General for Economic and Financial Affairs, N° 23 - December 2004 ,
p. 64
Available at: http://europa.eu.int/comm/economy_finance/publications/enlargement_papers/2004/elp23en.pdf

The government's ambitions stated in the program (2005) are directed to certain types of basic institutions that are expected to create sustainable growth, like: "institutions responsible for creating market economy, regulatory institutions, institutions responsible for market stabilization and institutions responsible for market legitimacy."¹⁵ Important and long expected reform is also the fiscal decentralization.

The financial sector

There e was a steady restructuring of the banking sector over the years. Major reforms were introduced during the transfer from state ownership to private property, but the sector remains uncompetitive and still with too many banks (20 banks and 15 saving houses), There is absence of major world commercial banks, although there is mixed ownership with dominant three banks like : 1. *Stopanska Banka AD Skopje*- National Bank of Greece S.A. Athens, European Bank for Reconstruction and Development, International Finance Corporation¹⁶ ; 2. *Komercijalna Banka A.D. Skopje* - 90.90% privatized with 4223 shareholders¹⁷ ; 3. *Tutunska banka A.D. Skopje* - LHB Internationale Handelsbank AG Frankfurt (35, 2%), LB Intefinanz AG Zurich (24, 9%), Nova Ljubljanska Banka d.d. Ljubljana (17, 1%)¹⁸ .

There are new measures undertaken by the authorities in order to increase the efficiency of the banking industry, and are concerned with confidence-building, stability of the banking system, improvements of the capital market.¹⁹

¹⁵ *The Government of the Republic of Macedonia, Strategic Documents*
ECONOMIC PROGRAM OF THE GOVERNMENT OF THE REPUBLIC OF MACEDONIA (2005)
Available at : http://www.vlada.mk/english/index_en.htm

¹⁶ *Stopanska banka AD Skopje*
Available at : http://www.stb.com.mk/eng/ZB_Akcioneri.htm

¹⁷ *Komercijalna Banka A.D. Skopje*
Available at : <http://www.kb.com.mk/en/profil.asp>

¹⁸ *Tutunska banka A.D. Skopje*
Available at : http://www.tb.com.mk/english/about/Shareholders.asp?swich_id=27

¹⁹ *The Government of the Republic of Macedonia, Strategic Documents*
ECONOMIC PROGRAM OF THE GOVERNMENT OF THE REPUBLIC OF MACEDONIA (2005)
Available at : http://www.vlada.mk/english/index_en.htm

Trade

The Republic of Macedonia became a member of the World Trade Organization in April 2003. The most important sources of liberalism used are bilateral agreements and the undertaken obligations of the *Stabilization and Association Agreement*.

4. GENERAL FRAMEWORK RELATIONS WITH THE EUROPEAN UNION THAT HAVE ECONOMIC EFFECT

Stabilization and Association Agreement (SAA)

The *Stabilization and Association Agreement (SAA)* came into a moment when the Republic of Macedonia was on a break of conflict, “spill-over” from Kosovo that threatened to endanger the weak inter-ethnic relations. The important thing was the right timing and the curtail incentive to the country and later to the whole “Western Balkans” region.

“The aims of this Association are: 1. framework for political dialogue, 2. support the efforts of the Republic of Macedonia to develop its economic and international cooperation, 3. to promote harmonious economic relations and develop gradually a free trade area between the Community and the Republic of Macedonia , 4. to foster regional cooperation.”²⁰

SAA TRADE: This part is addressing the trade liberalization and removal of the trade barriers between the EU and the Republic of Macedonia. There are three parts: the first part regulates the trade liberalization of Industrial products (except textile and steel) and gradual abolition of Macedonian Custom duties in a period of 10 years; the second part consists of agriculture and processed agricultural products; the third part regulates the fishery products.²¹

²⁰ “STABILISATION AND ASSOCIATION AGREEMENT” -COUNCIL OF THE EUROPEAN UNION, **Brussels, 26 March 2001**

Available at: http://www.delmkd.cec.eu.int/en/eu_and_fyrom/pdf/saa03_01.pdf

²¹ **The European Commission's Delegation to the Republic of Macedonia**

Available at: http://www.delmkd.cec.eu.int/en/eu_and_fyrom/agreements.htm

The political significance of SAA is that it is the confirmation of possibility to gain the status of *potential candidate* and candidate country (forthcoming Council decision, December 2005).

EU assistance

The main instruments are :

>>> **CARDS** (Community Assistance for Reconstruction, Development and Stabilization)

It is a program that is concerned with overall assistance to the region of Western Balkans, and the frameworks for the period 2000 – 2006 about € 4.6 billion, are spent for investment into institution building. The main aims are democratic stabilization, legislative development and harmonization with European Union norms, economic and social development and regional cooperation.²²

>>> **European Investment Bank (EIB)**

EIB is allocating its resources in the area of transport (reconstructing roads) and SME's. It has been financing in the Republic of Macedonia since 1998.

²² CARDS

Available at: http://europa.eu.int/comm/enlargement/cards/index_en.htm

5. CONCLUSION

There must be done a lot in the period to come to boost the economy. The governing structures have taken the right direction for restructuring the economy. There is a lot of help from international institutions and in recent time the European institutions are taking charge and steering the reforms in order to make Macedonian economy fit into the European growth model.

The accent is given to knowledge spill-over, enforcement of the management skills, as well as entrepreneurship characteristics of the young growing Macedonian economy. Building flexible structure capable to generate growth versus core industrial model is preferred, and therefore the small and medium size enterprises with innovation capacity are a priority. On such strong base inflow of FDI is expected.

The recommendations from the European Union are focused on reforming the institutions that will give the functional backbone of growing economy. As the economic progress takes place, the Republic of Macedonia is expected become full member state of the European Union because of a political decision of the EU main “stakeholders”.

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