

Economic Views of the EU Integration Process of Macedonia

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Abstract

The purpose of this research is to provide a general overview of the accession process with a special reference to the economic integration and the challenges of the Republic of Macedonia in the road of joining the European Union.

The Stabilization and Association Agreement (SAA) between the Republic of Macedonia and the EU was signed in April 2001 and entered into force in April 2004. The Council adopted the Accession Partnership for the country, including key priorities for reform, in February 2008. In October 2009, the Commission recommended to the Council to open negotiations with the country, as well as to move to the second phase of SAA Implementation. These recommendations were reiterated in 2010. The Council has not yet concluded its deliberations on the Commission's proposals. Visa liberalization for citizens travelling to the Schengen area has been in force since 19 December 2009.

The decision of the European Council of December 17, 2005 granting the candidate status for EU membership is an event of historical importance for the Republic of Macedonia as deserved recognition for the efforts and results achieved in the way of achieving the strategic goal - EU membership.

During the last years, the macroeconomic stability of the country has been maintained despite the continued global economic turbulence. Market entry and exit procedures have been improved and the rule of law has been strengthened. However, structural imbalances on the labor market are still very pronounced and the business environment is still suffering from slow judiciary, and a number of weak and not fully independent regulatory and supervisory institutions. The exchange rate against the euro has remained stable in nominal terms. Price competitiveness has remained largely unchanged. Trade integration with the EU is well advanced, but exports remain concentrated on a few price-sensitive products.

Key words: Economic Criteria, Market Economy, EU, Macedonia, Western Balkan

1. Introduction

The Republic of Macedonia has a small, open economy, and advanced trade integration with the EU. About 64% of all exports currently go to the EU-27 and about 56% of imports originate there.

The country's second largest trading area is the CEFTA (Central European Free Trade Agreement), which accounts for around 24% of exports and around 11% of imports. The export structure has improved, with an increase in the share of higher unit value commodities, such as car emission catalysts. However, textiles, clothing and manufactured iron products still account for more than one third of total exports. FDI accounts for about 50% of GDP, with 80% of the investment stock coming from the EU. The exchange rate against the euro has remained stable in nominal terms. Price competitiveness has remained

largely unchanged. This is reflected in the largely unchanged real effective exchange rate, which in mid-2012 was some 1% lower than a year before.

Generally in 2012, trade integration with the EU is well advanced. The commodity composition of exports has improved, although traditional products, such as textiles, clothing and steel, still predominate. International price competitiveness remained largely unchanged.¹

2. Economic Views of EU Integration Process of Macedonia

Fulfillment of the economic criteria for membership must be a top priority for Macedonia, not only in order to meet the standards of the EU, but also because they are crucial for Macedonia's economic and social progress. Macedonia needs to fully develop a functioning market economy that will allow an even ground for competition and weed out all the oligarchic elements in the economy that stifle its overall growth. The Macedonian economy needs to be able to cope with the intense competitive pressures and market forces within the EU. Consequently, Macedonia needs to be aiming for where the EU economy will be, not where the EU economy is today.

A broad consensus has been maintained on the fundamental features of the country's economic policy set-up. The medium-term policy framework was described in various programs, such as the sixth pre-accession economic program (PEP), covering the period 2012-2014, the labor market strategy for 2015 and the national employment action plan for 2011-2013. In addition, the authorities embarked on a high-level accession dialogue (HLAD) with the EU, which provided another platform for accelerating accession-related reforms in the economy. Cooperation with the International Financial Institutions (IFIs), such as the World Bank and the International Monetary Fund (IMF) continued. Structured dialogue with the business community continued.

2.1 Macroeconomic Indicators About 2011 and 2012

The economy grew by about 3% in 2011, but shrank by about 1% year-on-year in the first half of 2012, compared with growth of nearly 5% in the first half the year before. Rather resilient private consumption helped to prevent a sharper slowdown, while the reduction in public consumption had a negative contribution to growth. Indicators on domestic production point to a marked year-on-year deceleration during the reporting period, with industrial production being on average nearly 9% lower since October 2011 than in the same period the year before. Average per capita GDP improved in relation to the EU average, increasing from 35% of the EU average in 2010 to 36% in 2011. (Ministry of Finance of RM, Annual Economic Report 2011/2012; www.finance.gov.mk).

External imbalances declined, but their financing deteriorated. In the first half of 2012, the current account deficit was at about -2.8% of the estimated full-year GDP, compared to -3.5% of GDP the year before. The most important factor for the improvement was a further increase of current transfers to about 10% of the estimated full-year GDP. The trade balance of goods and services deteriorated slightly, reaching -12% of estimated full-year

¹ Source of the selected data's:

State Statistical Office of Macedonia, www.stat.gov.mk, and the Ministry of Finance of RM, www.finance.gov.mk

GDP, compared to -11% of GDP the year before, mainly as a result of weaker export revenues. The capital and financial account surplus shrank to a similar extent, declining to about 2.6% of GDP by June 2012, compared to a surplus of 4% a year before. FDI inflows and other investment declined to about 1% of the estimated full-year GDP and 0.6% of GDP respectively, compared to 2% of GDP and 4% of GDP a year before. As a result, the financing of the current account deficit was less based on investment inflows but on external credits. (Ministry of Finance of RM, Annual Economic Report 2011/2012; www.finance.gov.mk)

Unemployment was very high at 31.2% and remained largely unchanged year-on-year in the second quarter of 2012, while during winter it had been about 1 percentage point higher than in the year before. Employment was about 1% higher than a year before but its impact on unemployment was limited, as most newly employed persons appear not to have been registered in the labor market before. The main sectors with employment growth in the second quarter of 2012 were education, the textile industry and municipal services. Youth unemployment increased slightly, from 54.6% in the second quarter of 2011 to 54.9% in the second quarter of 2012. The young account for about 10% of the labor force, but their share in unemployment rose from 18.5% in the second quarter of 2011 to 18.8% in the second quarter of 2012. Unemployment among the less-well educated, who makes up nearly 30% of the labor force, has declined, from 39% in the second quarter of 2011 to 36% in the second quarter of 2012. Employment in the public sector increased by about 1% year-on-year, mainly in the education sector. However, as a share in total employment the share of public sector employment has declined from 22% in mid-2011 to 21% in mid-2012. (Ministry of Labor and Social Policy of RM, www.mtsp.gov.mk)

Monetary policy cautiously supported the gradual recovery, while the exchange rate policy remained geared to maintaining price stability and the *de facto* peg to the euro. The Central Bank has slightly lowered its key policy rate, from 4% to 3¾%. In order to support the lending activities of the financial sector, the Central Bank amended the rules on minimum reserve requirements and collateral. It also introduced a number of measures to stimulate financial market activity, such as establishing new monetary instruments, a new overnight deposit facility and a one-week deposit facility, a standing 7-day repo facility and by lowering the interest spreads between overnight deposit rates and Central Bank bills. (Central Bank of RM, Annual Report 2012, www.nbrm.mk)

Inflation was markedly lower than a year before, with an average inflation in the first eight months of 2012 of 2.4%, compared to 4.4% the same period a year before. However, during recent months, inflationary pressures have increased. The main sources for the increase lie in higher energy prices, but also rising food prices and rent costs. Prices for food and beverages account for about 40% of the consumer basket. Core inflation, which excludes the impact of energy and food prices on the overall price level, remained fairly stable and below 2%. (Ministry of Finance of RM, Annual Economic Report 2011/2012; www.finance.gov.mk)

The published central government deficit for 2011 was in line with the 2.5% of GDP target. Revenue, which accounts for some 30% of GDP, was some 7.5% lower than initially expected. In order to meet the deficit target, spending was reduced by about 7%, mainly on purchases of goods and services, which were kept some 19% below their initial budget target. Capital investment was also kept some 16% lower than originally planned. However, as a share of GDP capital spending rose, from 3.5% in 2010 to 3.8% in 2011,

while overall spending declined from 32.0% of GDP to 31.2%. In 2012, revenues have so far remained below forecasts and dropped by 3% in real terms. To compensate for the shortfall, the authorities adopted a supplementary budget and raised the deficit target for 2012 from -2.5% of GDP to -3.5%. So far, the main area of spending cuts was again capital spending, accounting in July for about 1.8% of the estimated full-year GDP, compared to 2.4% a year before. In the first seven months of 2012, published data point to a deficit of about 2% of the estimated full-year GDP, which is a similar level as the year before. The government debt ratio rose to about 30% of GDP in July 2012, compared to around 25% the year before, mainly due to increased domestic lending. (Ministry of Finance of RM, Annual Economic Report 2011/2012; www.finance.gov.mk)

2.2 The Capacity to Cope with Competitive Pressure and Market Forces

During 2012 in Macedonian economy, generally macroeconomic stability has been maintained. Market entry and exit procedures have been improved. Some steps have been taken to strengthen the rule of law. However, so far, those measures have not had significant impact yet. The quality of public finance planning and management has deteriorated and the quality of spending has remained low. Unemployment remains very high, particularly among the young. The business environment continues to suffer from institutional and administrative weaknesses, difficult contract enforcement and corruption. The government has continued its efforts to facilitate market entry and exit. However, partly due to the less supportive international economic environment, the number of newly established companies has declined to slightly below 10% of the total number of enterprises. Limited access to finance is still impeding the growth of many companies, in particular of small and medium-sized enterprises (SMEs). The third phase of the 'regulatory guillotine' project, which focuses on reducing administrative burdens, is being implemented and the fourth phase, concentrating on measures for SMEs, has started. Further progress has been made towards closing down non-operating companies. In the period October 2011 and August 2012, the number of bankruptcy procedures was some 32% higher than a year before. The average duration of company liquidation has been reduced. (Ministry of Economy of RM, www.economy.gov.mk)

There were no major changes in the area of restructuring enterprises. Network industries are dominated by a very small number of incumbent suppliers, which often undermines effective competition. SMEs continue to be by far the biggest group of companies, providing more than 80% of private-sector employment or nearly 60% of total employment. Access to finance improved, partly thanks to additional international credit facilities, primarily provided by the European Investment Bank (EIB). Furthermore, the government continues to subsidize interest costs for SME loans, although on a declining scale in the 2012 budget. (Ministry of Economy of RM, www.economy.gov.mk)

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3. Conclusion

Experience shows that transition economies including all the “new” as well as the Western Balkan candidate countries have by and large met the first of the two Copenhagen economic criteria. All these countries, including Macedonia, are functioning market economies. The differences among them are much larger with respect to the second sub criteria, the ability to cope with the competitive pressures of the single EU market.

The economic results achieved by the Republic of Macedonia during the transition are far lower than the achievements in the South-eastern European countries. The numerous non-economic events in the country and the region in the 1990's and the beginning of the century also contributes to this. With a low inflation rate of 2.5% in last years and a stable exchange rate (with one devaluation of 16% in 1997), Macedonia was a leader among the transition countries in terms of the macroeconomic stability, but numerous non-economic events in the country and the region led to a low average growth in the entire transition period.

In the recent years, the Republic of Macedonia generally meets most of the Maastricht criteria. The single bigger problem that the country is facing is the non-existence of a long term 10-year bond used as a reference instrument when defining the interest rate. In this period, the Maastricht criteria are not obligatory for the Republic of Macedonia but they still have great significance for approximation of our economy to the European Union.

Having in mind the present situation within the EU, regarding the negative atmosphere for enlargement, the implementation of Copenhagen and Maastricht criteria will simply not be good enough for candidate countries such as Macedonia. Knowing that in the past a decision for accession was often made for geo-strategic reasons, obtaining political support is even more important factor for the Macedonian accession to the EU. Taking into consideration this fact, it is a need Macedonia to solve the name issue with Greece.

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