

# Economic and financial integration of the candidate countries to the EU

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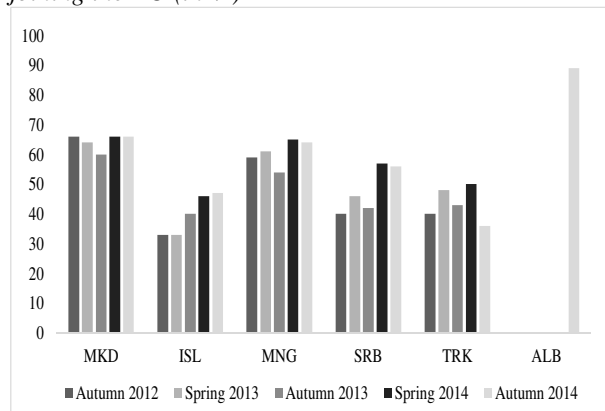
## 1. Introduction

The public opinion on the EU in the candidate countries during the crisis period has remained largely supportive, indicating clearly their EU orientation. In uncertain dynamic global environment, a need for small countries to be linked and integrated may be even more pronounced. Between the expected benefits of joining the EU, according to the public pools, are certainly those related to the economic prosperity. In this view, restructuring of the EU and EMU towards better performing union would be in favour of the candidate countries, as well. The candidate countries have already established strong economic and financial linkages to the EU, however on the way to the EU accession still facing variety of challenges in implementing structural reforms and improving economic performances. EU members in Central and Eastern Europe - the Visegrád Four in particular - are calling for a strengthening of their own national sovereignty and are espousing authoritarian tendencies.

## 2. Economic and financial integration to the EU

The public opinion on the EU in the candidate countries during the crisis period has remained largely supportive, although it varies across the countries and across the time. Between the expected benefits of joining the EU are certainly those related to the economic prosperity.

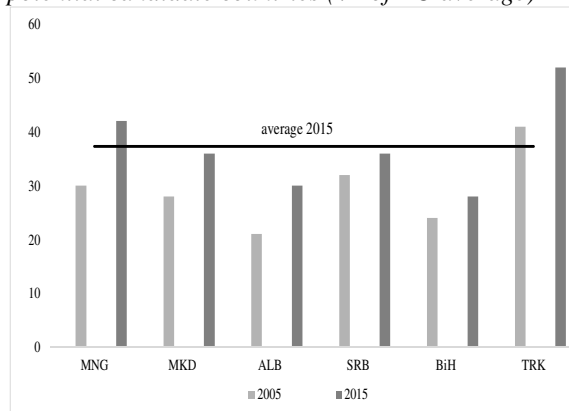
Chart 1: Public opinion: answers for a benefit of joining the EU (in %)



Note: Albania became a candidate country in June 2014.

Source: Bulletin of the Secretariat of EU Affairs of RM, 2014, based on EU data sources.

Chart 2: GDP per capita (PPP) in the candidate and potential candidate countries (% of EU average)



Source: Eurostat

From the historical viewpoint, although there is a progress regarding real convergence to the EU, the candidate and potential candidate countries are still lagging behind the average GDP per capita at Purchasing Power Parity (PPP) in the EU. However, some of the candidate countries are relatively close to some of the new EU member states with lowest economic performances. Within the overall EU integration process, these countries have been undertaking intensive structural reforms and activities in the last years, aiming at approaching to the EU standards in all areas of functioning. The

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recommendations from the EU institutions, based on the Economic reforms programs (ERP) submitted by the candidate and potential candidate countries for the period 2016-18, are mainly related to the reforms in the fiscal sector, regulatory and business environment, labor market and financial system.

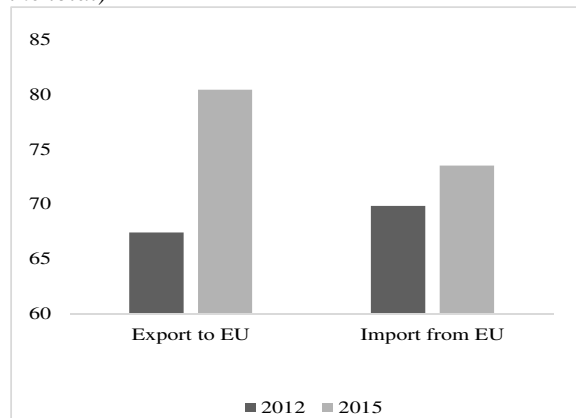
Table 1: EU recommendations to the candidate and potential candidate countries based on ERP 2016-18

recommendation	number of countries	recommendation	number of countries
<b>Fiscal sector</b>		<b>Business and regulatory environment</b>	
Public debt	1	Regulatory environment	3
Public expenditures	4	Administrative capacity	2
Fiscal consolidation	3	Energy market	4
State owned enterprises	1	Small and medium size enterprises	2
Public finance management	3	Informal economy	1
<b>Financial sector</b>		<b>Labour market</b>	
Non performing loans	5	Labour market reforms	6
De-euroization	3	Education	2
Financial system reforms	2	Research and development	1

Source: European Commission.

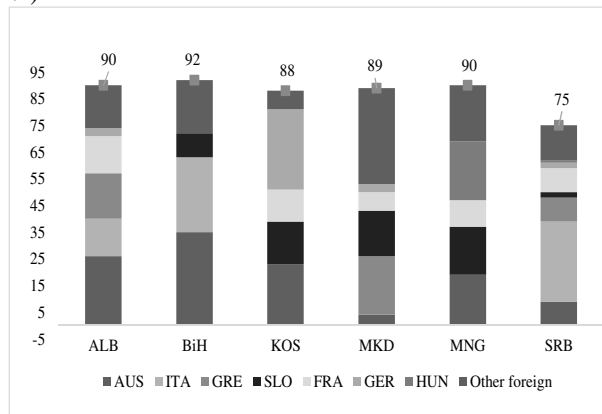
The Western Balkan countries have high degree of trade integration into EU, which is stronger on the site of their export to the EU. Additionally, in the last years the share of the export to the EU noted stronger increase, eventually pointing to higher competitiveness of Western Balkan economies. The banking system in the candidate and potential candidate countries is dominated by the foreign capital, mainly from the EU. Despite quite strong economic and trade linkages to the EU, the empirical findings (Miteski and Georgievska, 2016) on the economic and financial cycles point to not strong synchronization to the EU, that is an argument in favor of keeping autonomous monetary policy for dealing with the asymmetric shocks. However, the strong financial integration in practice could impose constrains regarding autonomous monetary policy implementation, therefore requiring for stronger international coordination efforts in view of the financial regulatory framework.

Chart 3: Trade of Western Balkans-6 with EU (% of the total)



Source: European Commission, DG Trade.

Chart 4: Assets share of foreign owned banks, 2012 (in %)



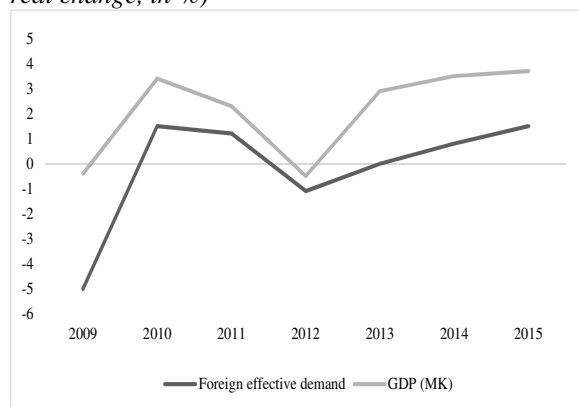
Source: World Bank Report on Western Balkans, 2014.

### 3. Restructuring process of Macedonian economy

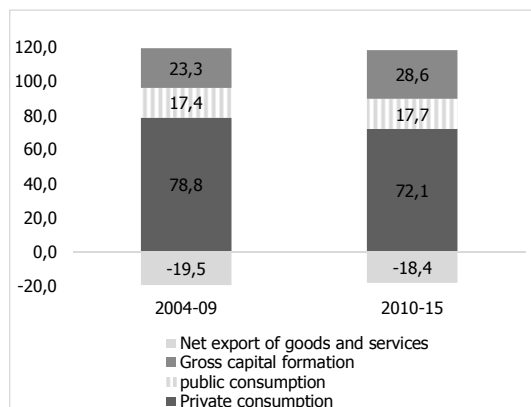
Macedonian economy in recent years has been doing many efforts in structural reforms implementation as well as reshaping of the economic structure, thus the intensive restructuring is visible through different macroeconomic indicators. Macedonian economy went through the global crisis quite well, to some extent due to the structural changes in the economy that significantly contributed towards economic growth in the last years and enabled decoupling from the dynamics of the external demand, approximated by the main trading partners' growth. Regarding expenditure components of GDP in the last years there is an increasing share of investments and exports. The

investments are mainly supported by public investments considering fiscal room before the crisis, as well as FDI inflows. On the side of the exports, the favorable performances are mainly due to the companies based on foreign capital that in few years after their establishment contributed towards export growth and its diversification in favor of higher value added products. Therefore, in 2016 the export was dominated by machines and transport equipment and chemical products (with around 50%) compared to the dominance of iron and steel and textile products in 2009 (with around 40%). Higher production and export diversification could be in favor of improving the economic cycle synchronization with the EU, although it should be analyzed in dynamic terms and forward looking.

Chart 5: GDP and foreign effective demand (annual real change, in %)      Chart 6: GDP components (share, in %)



Source: SSO, Consensus Forecast, NBRM's calculations.



Source: SSO.

In addition to the changes in the economic structure, the structural reforms in different areas in the economy are ongoing, that is confirmed by the improvements in the rankings by the international institutions or agencies dealing with these aspects, including the rankings for competitiveness and business climate. In view of the structural reforms, what is important to mention from the Central Bank viewpoint is that Macedonian economy has de facto fixed exchange rate regime for relatively long time horizon. Therefore, instead of using the exchange rate as corrective instrument for macroeconomic imbalances, there was strong support for implementing structural reforms in the economy, thus this approach confirmed to be valid in our case. Having in mind that the EMU experience has also confirmed that the countries with fixed exchange rate regime prior entering the EMU have been better performers in many aspects within EMU (Bogov and Mitreska, 2015), this is another argument in favor of easier joining to the EMU in the future.

#### 4. Concluding remarks

The EU integration process in the candidate countries seems to be a strong engine for institution strengthening and mobilization of all resources towards same objective. The ERPs of the candidate countries further strengthens the commitment to speed up the structural reforms, while being supported by the guidance and recommendations by the EU as well as by appropriate technical assistance, when needed. Regarding relations of the EU and candidate countries, the efforts of the EU for better preparation of the candidate countries for the future obligations and regular procedures in the EU are more than obvious and they are of mutual interest.

Despite the enlargement prospects, it is worth to highlight the ongoing structural reforms within the EU accession process and their current benefits for the economies of the candidate countries. In addition, the sound macroeconomic and structural policies are needed not only at the entrance in the EU, but thereafter and always. Economic and financial integration of the candidate countries to the EU are ongoing and deepening, therefore higher involvement of the candidate countries in completing the framework of the economic, banking and financial union could be useful and highly appreciated. On the way to the EU, in the current settings, the most important achievement is to build stronger and more competitive economies.

**References:**

Bogov D. and Mitreska A. (2015), Exchange Rate Policy and Interest Rates in Small Open Economies - Some Evidence from Europe, National Bank of the Republic of Macedonia, [www.nbrm.mk](http://www.nbrm.mk);

Miteski M. and Georgievska Lj. (2016), Financial and Real Business Cycle Synchronization in Central, Eastern and Southeastern European Countries, Fifth Annual Research Conference, National Bank of the Republic of Macedonia, Skopje, April, 2016, [www.nbrm.mk](http://www.nbrm.mk).