How To Prepare the EU Integration: Banking System, Monetary Policy, and Exchange Rate in Macedonia

Giorgio Dominese¹,²,³

¹ CEEUN Coordinaton Desk
² Faculty of Economics, Udine University, Udine, Italy
³ Faculty of Political Science, Libera Università Internazionale degli Studi Sociali, Rome, Italy
(E-mail: giorgio.dominese@uniud.it)

Abstract. The significant progress in the reform of the financial sector, including the amendments to the banking law and the reinforcement of the deposit insurance scheme, has been reflected in increased confidence in the Macedonia banking sector. Monetary policy and exchange rates represent a crucial aspect for the countries of Southeast Europe which would like to position themselves on the threshold of negotiations on their accession to the European Union. In the case of Macedonia, which has already formally applied for EU membership, a very cautious approach has to be taken in order to facilitate the stability of the economic system as a whole. Such a policy will make an important contribution to the stabilization of the whole West Balkan area and in particular to the quadrangle of Albania, Kosovo, Montenegro, and Serbia. The preparation of a favourable ground for EU membership negotiations leads first and foremost through a strict monetary and exchange rate policy, which the National Bank is pursuing firmly. Macedonia is now facing optimal conditions for creating the prerequisites for a faster negotiation with less rigorous internal repercussions of the pre-adhesion period. One should not forget the indirect impact of the shadow economy in the general context of efficiency of the instruments of economic and monetary policy. Finally, there is the question to be answered on the interrelation existing between transmission mechanisms linking productivity to the real exchange rate in Macedonia. At first glance, the stylized facts – low labor productivity growth and a trend of real depreciation – could even suggest that a Balassa–Samuelson effect is in play. But the depreciation of the real exchange rate could reflect mainly the behaviour of prices in the tradable sector and a prolonged transition associated with slow technological growth and the low quality of the country's tradable-goods basket.

Keywords: banking system; foreign investments; exchange rate; EU enlargement.

In the Stability Pact with the Balkans, the EU gave these countries a perspective for eventual entry into the EU. A strategy that has been now fostered
by the need to resolve definitively the precarious relations among some countries of the region, first of all the future “status” of Kosovo and the pending referendum for the independence of Montenegro. Events that would fuel the radicalism still affecting the region and eventually worsen the relations with Macedonia and Croatia, not to talk of Bosnia-Herzegovina.

Macedonia and the EU enlargement

The good story to be told is represented by Macedonia, where crucial political and ethnic tensions have been put on the tracks of a constitutional solution, and all sides indicated it as the main road or general criteria to be followed, in the different conditions, by the other suffering situations around. Acceleration of the EU integration process seems, day after day, the only positive and long-lasting answer to the de facto still unstable situation. Apparently the setback of the European Constitution in some relevant countries and the growing concern about a supposed “fatigue” of EU members deriving from the too large enlargement in 2004 could be now imagined and populistically evoked as a real deadlock on the way of the Western Balkan adhesion itinerary but we should not really think the concerns and lament party will have a long life ahead, looking to the agenda in the region in the next few years and to the 2007 membership of Romania and Bulgaria.

But is the prospect of full membership the sole option for achieving economic and political stability on the external borders of the EU – especially when the external borders keep shifting? According to research by the Deutsche Bank (Böttcher 2003) after the first wave of enlargement, the EU way of internalising, rather than eliminating, the numerous regional flashpoints on its external borders through wide-ranging integration threatens to result in a self-blockade of the EU in the medium term. Unimpeded growth of EU membership harbours the risk that the EU will ultimately fall prey to its own economic and political attractiveness. In Copenhagen in 1993, i.e., at the beginning of the enlargement process, the European Council warned that “maintaining the momentum of European integration” was an important consideration when absorbing new members. In a pan-European framework, the EU must develop, as an alternative to enlargement, a consistent strategy for putting economic and political relations with its neighbours on a basis that is satisfactory to all concerned. The very different forms of cross-border cooperation that already exist, continues Böttcher, will have to be reinforced to narrow the stability and welfare gap along the EU’s future borders. The concept behind the European Economic Area, which results in the “export” of economic (and hence ultimately political) stability when the rules of the internal market are fully applied, offers good prospects. The EU will need years to digest its biggest enlargement economically, politically, and institutionally and to strengthen cohesion among the old and new members.