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Abstract

With the disintegration of former Yugoslavia, Macedonia became an independent state. Similar to other Republics of the former Yugoslavia, Macedonia had to carry out double transitions, i.e. transition to a market economy and transition from a regional economy to a national economy. For a newly independent small country to survive the environment of market economy, it is required to settle domestic conflicts, establish good relationship with neighboring countries and secure economic independence. Western Balkan countries, which have experienced ethnic conflicts and still have domestic ethnic problems, would not be assured of their survival as long as they remain outside the European Union. This paper examines how Macedonia has been tackling the above mentioned problems, proceeding toward EU accession in the context of EU's Stabilization and Association Process. In the discussion a successful small country Slovenia, which consisted of the former Yugoslavia, is utilized as a benchmark.

Keywords

Macedonia, EU Accession, Stabilization and Association Agreement (SAA), Ohrid Framework Agreement, CEFTA 2006

1. Introduction

Macedonian nation did not have its own state until the 20th century. After World War II Macedonia formed a Republic within the Socialist Federal Republic of Yugoslavia (former Yugoslavia). The region where Macedonians live is not confined to this Republic but it extends over to the western part of Bulgaria and the northern part of Greece. This fact has been an underlying cause of disputes with the neighbouring countries. With the disintegration of former Yugoslavia in 1991, Macedonia became an independent state. The newly-born country was admitted to the United Nations in April 1993. Similar to other Republics of the former Yugoslavia, Macedonia had to carry out double transition, i.e. transition to a market economy and transition from a regional to a national economy. The Republic of Macedonia has ethnic minorities within the country. According to the census of 1994, Macedonians had the biggest population (66.6%), followed by Albanians (22.7%), Turkish (4.0%), Romanies (2.2%), Serbs (2.1%), and Vlachs 0.4%. Others and people who undeclared their nationalities accounted for 1.9% and 0.1% respectively (Macedonian Academy 1997: XII).

The Balkan Peninsula has been a region where battles were often repeated as it has been called 'Europe's powder keg'. With the regime change, ethnicity problems, which were contained during the socialist period, came to surface. It is still fresh in our memory that ethnic conflicts occurred after the breakup of the former Yugoslavia and also in 1999 over the Kosovo problem. A group of countries – Albania and successor countries of the former Yugoslavia excluding Slovenia – is called the Western Balkans by the European Union (EU). In May 1999 the EU launched a new approach to the Western Balkans, i.e. 'Stabilization and Association Process' (SAP) which was different from the approach to Central European and Baltic countries.

For a newly independent small country to survive a market economy, it is required to tackle the following tasks:

(i) to settle domestic conflicts,

(ii) establish good relationship with neighboring countries and

(iii) secure economic independence. Western Balkan countries, which have experienced ethnic conflicts and still have domestic ethnic problems, would not be assured of their survival as long as they remain outside the European Union. Therefore, a prospect to joint the EU is very important for these countries.

This paper[1] examines how Macedonia has been tackling the above mentioned tasks, proceeding toward EU accession in the context of the EU's Stabilization and Association Process. In the discussion Slovenia, which consisted of the former Yugoslavia and is now an EU member country, is utilized as a benchmark.

1. Transition to a Market Economy and Formation of a National Economy

From November through December 1990 for the first time took place a free election based on multi-party system in which more than 20 political parties participated. Macedonia declared independence in November 1991. The independent Macedonia started with the coalition government which was composed by Socialist Democratic Union of Macedonia (SDSM, the former League of Communists, 31 seats), Party for Democratic Prosperity of Albanians (PDPA, 25 seats), Liberal Reformist Forces of Macedonia (17 seats) and Macedonian Socialist Party (5 seats). The main opposition party was VMRO-DPMNE (Internal Macedonia Revolutionary Organization – Democratic Party for Macedonian National Unity), a center-right and ethnically-based party which originated in the late 19th century. The Presidential election took place in January 1991, and Kiro Gligorov, who was a member of leaders of the League of Communists during the period of the former Yugoslavia, was elected the first President. In the general election in 1998 VMRO-DPMNE leaped ahead, and together with DA (Democratic Alternative) it formed a coalition government with PDPA's support from outside the Cabinet. As the privatization of state-owned enterprises was implemented in the absence of the institutional framework appropriate to a market economy, a developed market and real market actors, it proceeded in a very twisted form.

As of July 1991 when Slovenia and Croatia declared their independence, Macedonia was not ready for independence and therefore the transition to a market economy was lagging behind them[2]. According to Kikerkova (2000: 9), "Almost all of the Macedonian plants were structured and designed to satisfy the needs of the market of 23 million people in the former Yugoslav state". Roughly speaking, 75 percent of the total output of metal industry was supplied to other Republics of the former Yugoslav Federation, and the rest was consumed in Macedonia. Economies of Federal Republic of Yugoslavia and Macedonia have been complementary. During the era of the former Yugoslavia it was very difficult for Macedonia to sell her raw materials and repro-materials on the foreign market. Macedonia produced only a small portion of goods which were exportable to other European countries. 40 percent of her total export went to the COMECON countries. It is considered that the reason why Macedonia wanted to keep the integri-

1 This paper was originally written in Japanese under the title "Macedonia Aiming at EU Accession and Her Challenges" and appeared in Russian and East European Studies, No.38 (published by the Japanese Association for Russian and East European Studies). This paper is a part of the result of the author's project (2007-2008) sponsored by the Japan Society for Promotion of Sciences (JSPS). Owing to the grant-in-aid for scientific research he was able to make a five-day research trip to Macedonia in September 2007. I would like to add that this newly-independent state calls itself the Republic of Macedonia while Greece never accepts the name. In diplomatic relations the country is called 'The Former Yugoslavia Republic of Macedonia', but in this paper I call it simply Macedonia.

2 See the title of Koyama (2004): Unprepared Independence and Delayed Transition. Chitose (2000b) expresses Macedonia's independence as a deeply-troubled choice without euphoria.

ty of the former Yugoslav Federation until the final moment derives from such an industrial structure of the country. Macedonia inherited low technological level and the outdated equipment of domestic firms. In addition, she is handicapped with high transportation costs due to the fact that the country is land-locked. As a result of independence, the country became obliged to adapt itself to a small market with population of 2 million as well as competitive foreign markets. The country was obliged to become independent without enough preparation. Thus this small country was thrown into heavy seas of the world economy at a single stroke.

According to Nikolovska and Siljanovska-Davkova (2001: 30), the inclusion of Macedonia into the global economic system was done through the IMF's stabilization and structural program. The country suffered from trade deficit and hyperinflation, which recorded triple-digit since 1990 and reached 1664 percent in 1992. With powerful support by the IMF and the World Bank in the planning and implementation of the stabilization policy to overcome the hyperinflation, a shock therapy was adopted. As a result, the hyperinflation was suppressed with the inflation rate fluctuating at single-digit since 1995. At that time there was no way other than to get support from these international financial institutions. However, the IMF's policies had serious problems. Its conditionality (conditions to be satisfied by a country which gets a loan) was based on the philosophy of neo-liberalism, and its application to Macedonia caused harsh results especially on the labour market[3].

The fixed exchange rate was expected to serve as an anchor against inflation. Denar, the Macedonian currency, was linked to German Mark at an overestimated rate of Denar. Such an exchanged rate stimulated imports but an increase in the export was held in check. The physical volume of industrial production decreased constantly during 2002, falling to less than 50 percent of level recorded in 1990. With this decrease in industrial production, total employment fell by more than a half (Veljkovic 2004: 147-148). A restrictive monetary policy was adopted and the rate of increase in money supply was kept low. Banks' interest rates were as high as 15-16 percent, which discouraged firms' willingness to investment. Such a high interest rate urged outflow of capitals from manufacturing to financial sphere, increasing the level of financial speculation (Nikolovska and Siljanovska-Davkova 2001: 32).

A strict fiscal policy has been consistently adopted. Discretionary fiscal policies, which should stimulate the economy, were not permitted, but instead a balanced budget was encouraged with budget deficit being kept at very low level. Thus restrictive fiscal and monetary policies have brought low inflation and a sound budget, however, the economic growth has been held in check and the unemployment rate escalated to 35 percent. Industry has declined. According to data in 1999, agriculture, forestry and fishery produced 9.7 percent of GDP, mining and industry with construction and handicraft 29 percent and the remaining branches more than 60 percent (Government of the Republic of Macedonia 2000: 125). The share of service sector in the economy has considerably risen, but not all jobless people were absorbed by this sector. It is informal sector that enabled jobless people and low-wage workers to live. It is estimated that the informal sector corresponds to 30 to 40 percent of GDP[4]. Concretely speaking, it

3 Fiti (2004) severely criticizes the IMF's therapy based on neo-liberal philosophy (pp. 123-140).

4 Nikolovska and Silijanovska-Davkova (2001), p.18.

presumably includes services, handicraft, commerce, agriculture and tiny manufacturing[5], but also criminal business such as smuggling and sales of drugs[6]. It cannot be neglected that remittance by Macedonians living abroad amounts to a significant level[7].

2. EU' Stabilization and Association Process

In the 1990s the EU was almost unable to device any appropriate measures toward the Western Balkans and adopted approaches similar to those toward Central European and Baltic countries and therefore it could not prevent a civil war in the former Yugoslavia[8] in the first half of the 1990s and the Kosovo war in 1999[9]. At last towards the end of the 1990s the EU devised a specific approach toward the Western Balkan, i.e. the Stabilization and Association Process (SAP). The Kosovo war in 1999 gave impetus to the EU to reexamine its policy toward South Eastern Europe. In order to stabilize the region the EU felt it necessary to give South East European countries a more positive prospect in such a way that accession to the EU would not be so distant future as far as these countries continue to make efforts. That is why the distinction between the first wave and the second wave for the EU accession was removed, and Bulgaria and Romania became treated on the same basis (Welfens 2001: 93). The Stability Pact for South Eastern Europe, which was concluded in June1999, constitutes a pillar of the process.

Already in the mid-1990s, Bulgaria and Romania concluded with the EU the European Agreement, a kind of Association Agreement. SAP is targeted especially for the countries of the Western Balkans. The difference from approaches taken so far is that the EU lays emphasis on 'regional approach', in which the EU aims to establish and develop regional cooperation among countries of the Western Balkans rather than its own cooperation with individual potential candidate countries.

As potential candidate countries, the countries of the Western Balkans have the prospect of future membership of the EU, an objective endorsed by the European Council in June 2000. The European Council in Brussels in March 2003 states that "the future of the Western Balkans is within the EU" (EU 2003a: 36). The European Commission states that the unification of Europe will not be completed until these countries join the European Union (EU 2003b: 2).

5 Explanation by Professor Irena Kikerkova at Faculty of Economics, the University of Skopje. She estimates the size of the informal sector at 50-60%. An interview on September 18, 2007.

6 According to Nikolovsaka and Silijanovska-Davkova (2001), in Kosovo and the adjacent western Macedonia a distribution center for illegal drugs was secretly established and this area became an important relay point of global underground criminal network (p. 42).

7 According to official data from World Bank (2010: 69), in 2006 remittances as percentage of GDP in Macedonia was 4.3%. Possibly the real amount might be much higher. According to Professor Nikola Kljusev, a member of the Macedonian Academy of Sciences and Arts, presumably 200 thousand to 300 thousand Macedonians reside permanently in foreign countries (Australia, Canada, USA, etc.). He says that they remit significant amount of foreign currencies to relatives in their mother country. It is sure that their remittance contributes to an increase in the country's foreign currency reserve in spite of its chronic current account deficit, but he does not know its exact figure. An interview on September 17, 2007.

8 For ethnic conflicts in the former Yugoslavia, see Koyama (2003), Chapter 2.

9 For Kosovo problem, see Koyama (2009).

The same basic entry requirement applies to the countries of the Western Balkans as to countries which joined the EU in 2004. Namely, the political, economic and institutional criteria established by the Copenhagen European Council in 1993 and set out in Article 6 and 49 of the EU Treaty. In addition, countries of the Western Balkans are requested to meet the criteria specific to SAP. Namely, full cooperation with International Criminal Tribunal for the former Yugoslavia (ICTY), respect for human and minority rights, the creation of real opportunities for refugees and internally displaced persons to return and a visible commitment to regional cooperation.

In the case of CEE countries and Baltic countries, prior to the formal application for the full EU membership with the EU, European Agreements were concluded with the EU during the first half of 1990s. In the case of countries of the Western Balkans, Stabilization and Association Agreement (SAA) corresponds to that European Agreement. The first SAA was concluded between the EU and Macedonia in April 2001. Then Croatia concluded SAA with the EU in October 2001. Later Albania (in June 2006), Montenegro (in October 2007), Serbia (in April 2008), and Bosnia and Herzegovina (in June 2008) concluded SAA with the EU.

3. Crisis within the Country and Support by the EU

Shortly after Macedonia concluded SAA with the EU in April 2001 the country fell into a critical situation. The relationship between ethnic Macedonians and ethnic Albanians within the country became worsened[10].

When the NATO's bombardment over Serbia ended in June 1999 the power relationship within Kosovo had completely changed in favor of Albanian's armed forces KLA (Kosovo Liberation Army). The KLA should have been disarmed immediately after the end of the Kosovo war. The KFOR (Kosovo Force) was organized by the NATO and related countries on the basis of the UN Resolution 1244 which was adopted on June 10, 1999. The KFOR's missions were (1) to maintain ceasefire and secure withdrawal of armed forces of FR Yugoslavia and Serbia's Security Corps from Kosovo, (2) to disarm the KLA, and (3) to maintain pub-

10 During the socialist period nations in Macedonia, especially ethic Macedonians and ethnic Albanians coexisted in peace and calm. About a quarter of total Albanian inhabitants live in Skopje and the rest live mostly in western Macedonia which is adjacent to Kosovo (Nikolovska and Silijanovska-Davkova, 2001, p.9). Two thirds of total Albanian inhabitants live in rural settlement (Ibid: 18). Brunnbauer (2001) explains the relationship between both nations as follows: "In Albanian villages in western Macedonia one could perfectly grow up and live one's live without ever coming into contact with ethnic Macedonians. But even in mixed towns and cities social interaction is very limited. … Macedonians and Albanians also hardly communicate with each other … , read different newspapers, go to different primary and secondary schools, listen to different radio stations and watch different TV-programs. Macedonians, especially, are largely ignorant of Albanians because hardly anyone speaks their language. Mutual perceptions are fraught with prejudices" (ibid: 15-16). During the socialist period education at a primary level was obligatory, but bound by family's tradition and custom and religious norms, Albanian inhabitants, especially in rural areas, resisted considerably to send their children, especially female children, to school. Differences in the educational level were reflected in the employment structure. In 1991 80.6 percent of total people working in the public sector (civil servants) were Macedonians while Albanians accounted for only 7.0 percent. 49.3 percent of total people working in the private sector were Macedonians while Albanians accounted 34.9 percent (Nikolovska and Silijanovska-Davkova 2001: 12). Among public servants, 10 percent are Albanians, and in 1997 only 4 percent of the police force were of ethnic Albanian origin (Brunnbauer 2001: 13). However, a prolonged economic crisis gave severe damages to people in the form of a loss in employment and a decrease in wages, and consequently the relationship between both nations became more strained.

lic order in Kosovo. Next spring in Macedonia, however, Albanian forces named 'National Liberation Army' (NLA) began their activities in secret and since then often came into armed conflicts with Macedonian police. Whatever their name, their true color was the KLA. They made military operations across borders for the sake of 'Greater Albania' and 'Greater Kosovo'. The US military unit which consisted of KFOR did not control their activities outside Kosovo. Thus the Kosovo problem spread to Macedonia.

By the end of June 2001, NLA brought the border area towards Kosovo under its control and approached Skopje, the Capital city of the country. Finally the EU and the USA intervened in the conflict. With an agreement (Ohrid Framework Agreement) [11] in August, the Government of Macedonia and the NLA ceased hostilities.

After the ratification process in all EU member countries, SAA between the EU and Macedonia came into effect in April 2004. SAA between the EU and Croatia came into effect in June in the same year. In December 2005 the European Council gave both countries the status of Candidate. In the case of Macedonia, it seems that Macedonians' dissatisfaction that they were forced to make a compromise with Albanians in the country was taken into consideration. Stefano Bianchini, an Italian political scientist, called this political solution of ethnic conflicts Macedonia's 'success' story and commented that she was rewarded by the status of EU Candidate[12]. With this status, Macedonia became eligible for Instrument for Pre-Accession Assistance (IPA), assistance in five areas, i.e. institution building, cross-border cooperation, regional development, human resource development and rural development.

11 The Ohrid Framework Agreement revises some articles of the Constitution which previously gave ethnic Macedonians preferential treatment, approves Albanian as an official language and allows use of Albanian in the education at Universities. The Ohrid Framework Agreement and the relevant Constitutional Amendment cautiously avoids expressions such as ethnic Macedonians, ethnic Albanians and similar. For example, Article 7 prescribes that "Any person living in a unit of local self-government in which at least 20 percent of the population speaks an official language other than Macedonian may use any official language to communicate with a main office of the central government, which shall reply in that language in addition to Macedonian". There are no nations other than ethnic Albanian that has at least 20 percent of the population. It is self-evident that the Article 7 discusses ethnic Albanians and the Albanian language in this case. Previously the proportion of ethnic Albanians in total number of civil servants and policemen was very low, but the Agreement prescribes to promote ethnic Albanians to these positions positively. The Agreement prescribes strengthening of local autonomy and significant devolution of powers to municipalities. Noteworthy is the 'requirement of double majority'. Namely, for laws that 'directly affect culture, use of language, education, personal documentation, and use of symbols', decision by the Assembly requires not only a majority vote of the Representatives attending the Assembly but also 'a majority votes of the Representatives attending who claim to belong to the communities not in the majority of Macedonia'[that is ethnic Albanians]. This principle applies also to elections of one-third of the Constitutional Court judges, the election of three of the members of the Judicial Council and the election of the Ombudsman (Public Attorney).

Under the auspice of President of Republic of Macedonia, the Ohrid Framework Agreement was concluded on August 13, 2001. The signatories were top leaders of two Macedonian parties (VMRO-DPMNE and Social Democratic Union of Macedonia) and two Albanian parties (Democratic Party of Albanians and Party for Democratic Prosperity), Special Representatives of the EU and the USA. Troubles continued even after the formal signing of the Agreement. It was quite difficult for both Macedonians and Albanians to reach agreement on a draft for the new law on local self-government in the Parliament because both parties regarded devolution of power to the local governments as a zero-sum game. It took painstaking international mediation, mainly by Xabier Solana, the EU's High Representative for Common Foreign and Security Policy, finally to reach a compromise that the new law should be passed on January 25, 2002 (Government of Republic of Macedonia, 2001; Brunnbauer, 2002).

12 Concluding remark by Professor Stefano Bianchini, Director of the Institute of Central Eastern Europe and Balkans at the University of Bologna, who organized an international conference on the Western Balkans held at Forli (Italy) in January 2006.

4. The Macedonian Economy in the 21st Century

4.1. Weakness of the Economy

A decade of the 1990s was a period of stagnation. This small landlocked country in the Western Balkans has been often shaken by adverse surroundings. Until 1995 from the independence the economy recorded negative growth rates consecutively. It was 'transformational recession' (Kornai 1995). In addition it was aggravated by the UN sanction imposed over FR Yugoslavia (1992-1995) and Greek embargo on Macedonian exports and imports through the Thessaloniki port (1994-95) [13].

In autumn 1995 the Greek embargo was lifted. Also the US sanction over FR Yugoslavia was lifted after the Dayton Accord in November in the same year. With the improved surroundings Macedonia entered a phase of gradual economic development in 1996. In autumn in 1998, however, the situation in Kosovo became tense. For 78 days from March through June 1999 the NATO bombarded FR Yugoslavia. Although Macedonia did not become a battlefield, the Kosovo war had a negative influence on the country because European (German, British, Austrian, Italian, etc.) and American partners cancelled their business contracts with Macedonian firms.

In mid-1999 the Kosovo war ended, and the EU's SAP began. Thus the environment surrounding Macedonia took a turn for the better. At last in 2000 the economy showed upward turn, but again in 2001 the economy began to stagnate due to the above mentioned crisis within the country (Figure 1, p. 16). The gap between Macedonia and Slovenia has further widened. It seemed that the Macedonian economy started its full-scale development in 2004, but in 2008 it has not recovered its peak yet with its GDP being 96.8 percent of 1989 level. Per capita GDP in 2008 was only € 3,200.

The budget has been relatively sound, and the public debt is not so big with its percentage of GDP being 28 percent. The external debt as percentage of GDP is 48 percent and it is not at so serious level (Table 1, p. 16). However, the economy faces serious problems: First, a high unemployment rate which has been fluctuating at around 35 percent. The reason why people can manage to live is that many people benefited from the informal economy corresponding to 30 percent to 40 percent of GDP. Second, the economy has chronically had a huge amount of trade deficit. Although there are significant amount of public transfer every year, the current account deficit as percentage of GDP rapidly increased from 0.9 percent in 2006 to 13.1 percent in 2008 (*EEM*, January 2010).

It should have been useful for Macedonia to conclude SAA with the EU. Ac-

13 After declaring her independence Macedonia came into conflicts with her neighbour, Greece. The latter opposed the former's independence from a fear that naming of 'Macedonia' might mean an intention to build a greater Macedonia including Macedonians of Slavic origin who lived in Northern Greece. Her admission to the UN was not realized for a while due to Greece's opposition. After a compromise was reached in April 1993 that name should be 'The Former Yugoslavia Republic of Macedonia', Macedonia gained membership to the UN. Even later, however, Greece was reluctant to support Macedonia, and in December 1993 Greece vetoed Macedonia's admission to the OSCE. In March 1994 Greece one-sidedly imposed a blockade on Macedonia and made it impossible for Macedonia to trade through the port of Thessaloniki. The reason was that Greece was dissatisfied with Macedonia choosing to put the sign of Phillip of Macedon on her flag. In autumn 1995 when Macedonia agreed to change her flag Greece lifted the blockade. However, the name dispute has been smoldering till now. Greece never accepts that the country is simply called Macedonia, but the names 'Upper Macedonia' and 'Northern Macedonia' would be acceptable to Greece (Gligorov: 2008).

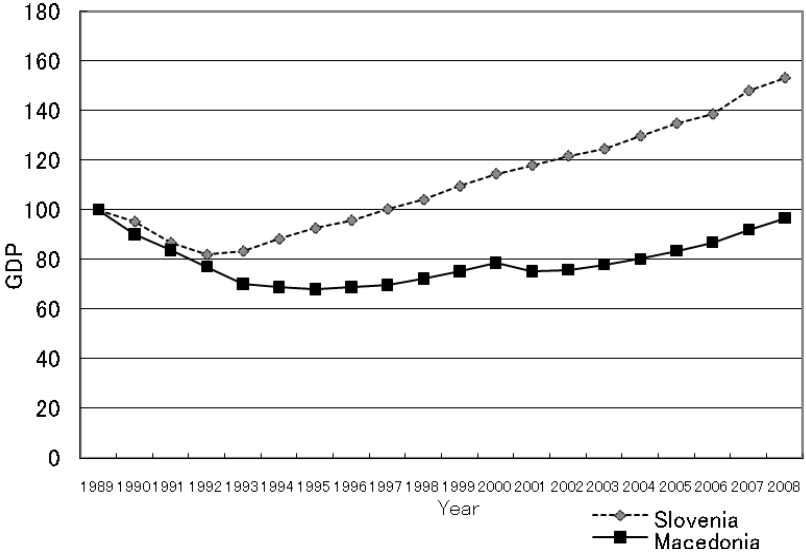

Figure 1. Changes in GDP in Macedonia compare4d with Slovenia 1989-2008
Source: Transition Report 1999 and Transition Report 2008

	2002	2003	2004	2005	2006	2007	2008	2009
GDP growth rate, MKD mn.nom.	0.9	2.8	4.1	4.1	4	5.9	5	-2
GDP/capita (EUR at exchange rate)	1981	2025	2128	2300	2500	2800	3200	3200
GDP/capita (EUR at PPP - wiiw)	5170	5300	5760	6400	6900	7800	8200	8000
Gross industrial production	-4.8	4.1	-2.2	7.1	3.6	3.7	5.5	-7.7
Gross agricultural production	-2.3	4.5	6.8	0.3	4.8	-3	6.9	4.6
Construction output, value added	0.6	13.3	7.4	-20.5	-11.9	9.7	-9.6	-2.1
Consumption of households	12.5	-1.5	8	5.7	6	9.8	7.8	0
Gross fixed capital formation	17.6	1.1	10.9	-5.4	11.6	13.1	4	-2
Unemployment rate (LFS) in % of average	31.9	36.7	37.2	37.3	36	34.9	33.8	32.2
Consumer prices	1.8	1.2	-0.4	0.5	3.2	2.3	8.3	-0.8
General Gov. budget balance in % of GDP	-5	-1.1	0	0.3	-0.5	0.6	-1	-2.8
Public debt in % GDP	n.a.	n.a.	n.a.	46.9	39.9	33.3	28.7	32
Discount rate, % p.a., end of period	10.7	6.5	6.5	6.5	6.5	6.5	6.5	6.5
Current account in % of GDP	-10	-4.1	-8.4	-2.6	-0.9	-7.2	-13.1	-7

Table 1. Macedonia: Selected Economic Indicators
Note: Annual changes unless specified; Data for 2009 are preliminary.
Source; Gligorov 2008; Gligorov, et al 2009: 101; Astrov, et al 2010: 105.

Share of total exports (%)	1996	2005
Food and feed	21.2	16.3
Agricultural raw materials	3.5	0.8
Ores and metals	9.5	3.0
Fuels	0.9	8.0
Chemicals	5.9	4.3
Leather and rubber	0.7	1.2
Wood and papers	0.9	0.5
Textiles and clothing	27.9	26.9
Machinery excluding auto	5.9	4.0
Motor vehicles and parts	1.8	1.4
Miscellaneous manufacturing	21.7	33.5

Table 2. Structure of Macedonian Exports by Major Product Category, 1996 and 2005
Source: Kathuria 2008: 40.

	FDI inflow, million Euro								Per capita inflow, Euro	Per capita stock, Euro
	2001	2002	2003	2004	2005	2006	2007	2008	2008	2008
Bulgaria	903	980	1851	2736	3152	6158	8488	6163	809	4293
Romania	1294	1212	1946	5183	5213	9061	7250	9084	422	2402
Albania	232	143	157	278	213	259	481	682	215	935
Bosnia	133	282	338	567	493	572	1546	690	179	1400
Croatia	1468	1138	1762	950	1468	2765	3667	2930	661	4930
Macedonia	499	112	100	261	77	345	506	413	201	1600
Montenegro	5	76	44	53	393	644	1008	832	1325	4864
Serbia	184	504	1204	777	1265	3516	2272	1879	256	1586

Table 3. FDI Inflow in South Eastern Europe, million Euro
Souce: Hunya 2008: 8; Hunya 2009: 8.

cording to Kikerkova (2002), the SAA brought asymmetric liberalization of foreign trade between Macedonia and the EU. Namely, the SAA provides an opportunity for relatively easy access to the EU market as all of the quantitative and qualitative barriers (except wine and beef meet) to imports of Macedonian goods are completely removed. At the same time Macedonia is given the opportunity to introduce a phased-in abolishment of custom duties on imports from the EU into the Macedonian market in a 10-year period from the time of the signing of the SAA (Kikerkova 2002: 207). However, she mentions several problems: in contrast to the European Agreements with countries of Central and Eastern Europe which later became the EU members, the SAA lacks such financial support as was extended to these countries except assistance through CARDS (the Community Assistance for Reconstruction, Development and Stabilization) programme; The EU gives subsidies to its agricultural production through the CAP (Common Agricultural Policy) while Macedonia cannot afford to give subsidies to her agricultural production, etc. (Kikerkova 2002: 206-209). The trade balance has been chronically recording negative. The export/import ratio has been fluctuating at around 60 percent (59.5 percent in 2004, 65.7 percent in 2005, 65.1 percent in 2006, 67.5 percent in 2007 and 62.8 percent in 2008. IMF 2009: 30). About 60 percent of total exports went to the EU countries.

Looking at the breakdown of total exports in 2005 (Table 2, p. 17), foods and feeds accounts for 16.3 percent of the total exports. Products of all manufactures (from Chemicals to Miscellaneous manufacturing) account for about 71.6 percent of the total exports. Among them the biggest items are miscellaneous manufacturing (33.5 percent) and textiles and clothing (26.9 percent). In this way, the exports of manufacturing products incline heavily toward unskilled labor intensive industries (Kathuria 2008: 40). Products of Macedonia (but also other countries of the Western Balkan) have been chased by counterparts in China and other Asian countries with their lower wages as a weapon, and the Macedonian industries have had to fight in a tough game on European markets (Kathuria 2008: 6). Macedonia is urged to improve her export competitiveness. Therefore, the country is anxious to get FDI in order to solve shortage of capital, raise its technological capability and improve its access to the world market.

4.2. Regional Economic Integration

Macedonia, which is a small country with population of two million and landlocked, lacks attractiveness to foreign investors. In spite of the 'Ohrid Framework Agreement', which settled ethnic conflicts within the country in 2001, the country was viewed politically unstable, consequently inward FDI was very small and the economy was stagnating until the mid first decade of 2000s

The Western Balkans has population of about 23 million, which is comparable with Romania, but it is composed by six (or seven, if we count Kosovo as a country) small countries. Every time goods were conveyed across borders troublesome procedures were repeated, requiring a long time and a great deal of costs and harassing the persons concerned. If a single market is created the attractiveness of the Western Balkans as a market as well as an object of investment should have risen all at once. It was inconceivable in the 1990s that people would discuss the Western Balkan economic integration taking into account the future EU accession. In the beginning of the 21st century the SAP led by the EU created a mood of public opinion in favor of the economic integration. With support by the EU, seven countries of the Southeastern Europe concluded 'Memorandum of Understanding on Liberalization and Promotion of Foreign Trade' in June 2001 (a year later Moldova joined this).

Subsequently free trade agreements were concluded on a bilateral basis and their number amounted to 32 in total. On the contrary to the expectation, however, the regional cooperation did not develop so much because custom offices in each country responded with red tape to imports and transits of goods from member countries. Then it was a multilateral approach that was conceived. The framework of CEFTA (Central European Free Trade Agreement) was utilized for it.

The original member countries Poland, Hungary, the Czech Republic and Slovakia as well as Slovenia 'graduated' from CEFTA when they joined the EU in 2004. Bulgaria, Romania and Croatia joined CEFTA belatedly. Bulgaria and Romania also 'graduated' from it in 2007 when they joined the EU. In April 2006 the member countries of CEFTA at that time and countries of the Western Balkans agreed on the reorganization of CEFTA. Its existing rule on membership required that member countries should be at the same time WTO member countries and that they should have SAA with the EU. By this agreement, the rule on membership was revised in favor of countries which did not satisfy those requirements at that time (Serbia, Montenegro, Albania, Bosnia and Herzegovina, and Moldova). Thus the modified CEFTA (called CEFTA-2006) was formed. CEFTA-2006, a new framework for multilateral free trade agreement which included the Western Balkan countries and Moldova and replaced previous bilateral free trade agreements, came into effect in July 2007. Since then foreign trade among member countries gradually increased. According to Kikerkova (2009), a free trade area for non-agricultural products began functioning at the end of 2008, a free trade area for agricultural products began functioning in May 2009 and a complete free trade area would come into function at the end of 2010.

In 2006 inward FDI to Macedonia increased presumably due to the fact the Macedonia was awarded the status of Candidate. Looking at FDI stock in Macedonia as of 2007 by investor countries, the biggest investor country is Netherlands (16.9 percent), followed by Hungary (16.6 percent), Greece (15.2 percent), Austria (9.4 percent), etc. From this fact we can find that in spite of her diplomatic dispute with Greece over the name of the country this dispute has not affected the economy so much and the economic relation between both countries is deepening. Looking at FDI stock in Macedonia as of 2007 by areas, manufacturing accounts for only 35.6 percent. Transportation, storage and communication (21.3 percent), financial intermediary (12.6 percent), and trade (10.4 percent) account for rather big share in the FDI stock. It is worrying that the fact that out of the total exports of manufacturing basic metal and metal product accounts for 40 percent and foods, beverage and tobacco 20 percent while almost no direct investment is found in high value added industries (Hunya 2009: 93-94).

4.3. Impact of the Global Financial Crisis

The impact of the global financial crisis on Macedonia was indirect. As a result of a decrease in demand from the EU countries, which were hit hard by the global financial crisis, Macedonian exports decreased. In 2009 industrial production decreased by 8.2 percent y-o-y, and GDP decreased by 0.5 percent. In 2010 GDP is expected to show a slight growth (0.9 percent) (*EEM* December 2010). The impact of the global financial crisis on Macedonia has been more limited compared with other countries of Central and Eastern Europe. The following reasons can be mentioned: First, its economic development has not been led by exports; Second, the weight of financial sector in this economy is still smaller compared with the EU member countries of the Central and East Europe. Let us supplement this point with the IMF' report: "banks rely mainly on domestic deposits rather than international credit lines to fund lending. The banking system's loan-to-deposit ratio is well below 100 percent. Interbank lending is small (6 percent of GDP, largely overnight). Macedonian banks do not seem exposed to sub-prime lending overseas, and the domestic mortgage market is tiny (less than 3 percent of GDP). Foreign banks presence has increased, but few are globally active. The two most important mother banks – National Bank of Greece, which owns the largest Macedonian bank (Stopanska Banka) and Nova Ljubljanska Banka, which owns the third largest bank (Tutunska) – appear not to have incurred major losses in the international financial crisis. Pension funds have invested very conservatively, with foreign equities just 2 percent of assets" (IMF 2009: Box 1). In this way, Macedonian financial sector has been less damaged than in most of other Central and Eastern countries due to "its relative insulation (until recently) from international financial markets" (ibid). However, the 'Report' adds that as a small, open economy, Macedonia would not be immune to a prolonged world recession (ibid). Indeed, the Greek debt crisis, which surfaced in spring 2010, may negatively affect the Macedonian economy[14]. In the meantime, the unemployment rate, which decreased to 32.2% in 2009, is increasing again due to the recession.

5. Steps toward the EU accession

Since the start of the Stabilization and Association Process in 1999 the European Commission has supported Macedonia both financially and politically. Simultaneously with its support, the European Commission has continuously monitored all kinds of activities in Macedonia. Every year in the *Macedonia Progress Report*, which European Commission submits to the European Parliament and the European Council, the European Commission enumerates many problems to be improved in terms of political criteria for membership (stability of institutions guaranteeing democracy, the rule of law, human rights and respects for and protection of minorities), economic criteria (the existence of a functioning market economy and the capacity to cope with competitive pressure and market forces within the Union) and capacity to assume the obligation of membership, i.e. the *acquis communautaire*.

As we have seen, this country is still rather poor from economic point of view and has structural weakness. Nevertheless, *Macedonia Progress Report* published by the European Commission in November 2008 gave a positive evaluation on the economy while it gave a rather severe evaluation on the politics. Although expressing its anxiety on expanding trade deficit and high unemployment, *2008 Progress Report* gave a rather high evaluation on the economy, mentioning that private sector produces about 80 percent of the total value added, the free interplay of market forces was already advanced, market entry and exit became easy, financial intermediary increased remarkably, etc.

As for the economic criteria, *2008 Progress Report* does not recognize that ‘functioning market economy’ exists, but it says that “the country has moved closer towards becoming a functioning market economy. It should be able to cope with competitive pressures and market forces within the Union in the medium term, provided that it vigorously implements its comprehensive reform programme in order to reduce significant structural weakness” (EU 2008). Presumably *2008 Progress Report* argues that sluggishness of legal procedure, which still hinders the rule of law, as well as weakness of supervisory institutions impedes market functioning. The almost same viewpoint is repeated in *2010 Progress Report*.

At the NATO summit held in April 2008 it was decided that the accession negotiations with two candidate countries Croatia and Albania should be begun (both of them were admitted to the NATO in April 2009), while accession negotiations with Macedonia were shelved on the ground that her diplomatic conflict over the name of the country with Greece was continuing. This decision intensified people’s complaint against the government in Macedonia, and the relationship between Macedonians and Albanians became tense again. It was de-

14 For the latest information on Macedonia, see Slaveski (2010).

cided to call an early parliamentary elections in June 1, 2008 in order to improve the situation. According to *2008 Progress Report*, the OSCE-ODIHR (the Organization for Security and Cooperation in Europe – Office for Democratic Institution and Human Rights) election observation mission reported that there were unfair practices in the conduct of the elections and that especially on election day, organized violence, intimidation and stuffing of ballot boxes in predominantly ethnic Albanian area prevented citizens from exercising their democratic rights (EU 2008: 7). The ruling party VMRO-DPMNE won a landslide victory. Opposition parties SDSM and DPA boycotted the parliament for several months from July 2008. During their absence the ruling party passed over 170 laws. *Progress Report* expressed serious concerns about the effective functioning of political institutions and urges significant further efforts for political dialogue (EU 2008: 9). Corruption is prevalent. Objective and merit-based criteria are not consistently used in recruitment and promotion of civil servants. The legal system is still weak (EU 2008: 11-16). In this regard too the almost same viewpoint is repeated in *2010 Progress Report*.

The EU's association negotiations with Macedonia have not begun yet. In October 2008 EU Enlargement Commissioner Olli Rehn said, "Macedonia is not yet ready for EU accession", and explained the reason as follows: Macedonia's failure to make sufficient progress in areas such as political dialogue, implementation of new police laws, tackling corruption, improving the judiciary, public administration reform, measures to boost 'white economy' (formal economy) employment, an improvement of the business climate and freer and fairer elections (*EEM* December 2008). In addition, he mentioned the ongoing 'name' dispute[15].

Although talks about the name issue lasted more than a decade, both countries failed to reach a compromise. Macedonia could not get any results from a crucial NATO summit in November and a EU meeting in December 2010, causing again intensified complaint among people and entanglements in the Parliament in Macedonia. To achieve a breakthrough, Speaker of the Parliament announced in April 2011 that early elections would be held on June 5[16].

6. Lessons from Slovenia's Experience

There are many small countries like Macedonia, but all of them are not necessarily in economic difficulties. Slovenia is a small country too, but her case belongs to a success story because she is not only a member country of the EU (since May 2004) but also a member country of the Euro-zone (since January 2007). Although almost same in area and population, the difference is very big. What makes Slovenia different from Macedonia? Tentatively the following factors can be mentioned: First, although Slovenia has ethnic minorities (Italian, Croats, Serbs, etc.), the country is the most ethnically homogeneous among successor countries of the former Yugoslavia and has not experienced serious conflicts; Second, externally Slovenia has kept good relationship with neighboring

15 On November 17, 2008 the Macedonian government filed a case against Greece at the International Court of Justice in a bid to overturn Greece's veto of Macedonian NATO accession negotiations in April of the same year. eem, January 2009.

16 Macedonia, early election date assigned. http://www.top-channel.tv/english/artikull.php?id=300

countries. In addition, Austria even supported her independence; Third, historical heritage deriving from the Habsburg Empire such as high level of education, permeation of market economy and industrial development, etc.; Fourth, Slovenia has stronger international competitiveness which derives from the legacy from her past and the high level of technological potential[17].

It seems that Slovenia's development strategy is well explained by Svetlicic (1997). His main argument can be summarized in the following two points: First, fundamental technological changes, the information revolution and related change have made small countries more viable today than they were 'yesterday', the external environment is enhancing smallness. In view of globalization tendencies and the increasing importance of economies of scale and scope, the thesis that small countries cannot survive should be rejected; Second, the viability of an small country in the globalized economy depends to a large extent on its ability to swiftly adapt the changing external environment (Svetlicic 1997: 3).

Svetlicic (1997) conducts a SWOT analysis. At first he compares and examines strengths and weaknesses of small countries. The analysis has long lists, but let me introduce only a part of them. One the one hand, weaknesses of small countries such as Slovenia include: a weak position in international relations due to a lack of different kinds of power; a lack of natural resources, labour and local factor condition; an inability to realize economies of scale due to a small domestic markets; limited financial funds and R&D capacities, etc. One the other hand, strengths of small countries include: more easily achieved social (cultural and religious) cohesion, better implemented policies and more stable system; absence of responsibility for the international order which might be costly to large states; stronger and swifter adjustment capability; better possibilities for specialization; computerization and telecommunication which are relatively more powerful weapons for small firms and countries than large ones, etc. Similarly he compares and examines opportunities and threats for small countries. He stresses that small countries can compensate for some of their weaknesses in certain areas with their strengths in others in the globalized era (Svetlicic 1997: 11-16).

In his opinion, smallness of domestic market is not important. Access to the world markets is decisively important. Small countries like Slovenia need not have a whole set of industries. Instead, they should find good areas appropriate to them, i.e. niches and specialize in the areas (Svetlicic 1997: 5). For that purpose, intensive internationalization of the activities of firms of small countries is encouraged (Svetlicic 1997: 17).

Although accession negotiations have not begun yet, the EU has continuously given this country various kind of support. As Greece is the nearest member country of the EU, it is urgently necessary for Macedonia to improve her relationship with this country. Regardless of her diplomatic conflict, the economic relation between both countries is becoming closer. However, as long as Greece opposes, Macedonia will not be able to enter into accession negotiations with the EU. It seems that a compromise between both countries in this regard is not impossible. If both countries reach a compromise on the name dispute, then Macedonia's step toward the EU accession will gather speed at one effort. Besides, if dialogue and cooperation between Macedonians and Albanians within the country develops and accordingly the country achieves social cohesion, then it is likely that also Macedonia can sufficiently compensate for some of her weaknesses

17 For Slovenia, see Koyama (2002), Koyama (2006) and Koyama (2008).

in certain areas with her strengths in others.

As shown by Svetlicic's explanation, the experience of Slovenia as a small country is important for Macedonia. In order to consolidate her economic position, it would be necessary for Macedonia to make efforts to find good areas appropriate to herself, i.e. niches and specialize in the areas whereby Macedonia can produce goods exportable to the EU market and the World market.

Conclusion

From the above discussion we could conclude as follows: as for the task to settle domestic conflicts, the conflicts between ethnic Macedonians and ethnic Albanians were settled for the time being by the Ohrid Framework Agreement in 2001, but the situation is still precarious. Their peaceful co-existence should be consolidated with support from the international community, especially the EU.

As for the task to establish good relationship with neighboring countries, at the turn of the 21st century the relationship with its neighboring countries, except Greece, has been significantly improved. Regardless of the name issue with Greece, the economic relation between both countries is becoming closer. However, as long as Greece opposes, Macedonia will not be able to enter its accession negotiations with the EU. Both countries should reach a compromise, and it seems that a compromise in this regard is not impossible.

Macedonia has been always facing a problem of structural weakness of her economy. Her external debt and domestic public debt are not at so critical levels. However, the unemployment rate is very high and her informal sector has reached an abnormally big scale. It is urgently necessary for this country to increase jobs. Also the problem of chronic trade deficit should be overcome. In this connection, CEFTA-2006, a multilateral free trade agreement, is very important for Macedonia. Western Balkan countries including Macedonia are required to endeavor to make this agreement effectively function in order to increase intra-regional trade, attract more FDI and prepare for their EU accession.

Similar to Macedonia, Slovenia is a small country, but her case is very successful. As there are differences in internal and external environment, historical heritage, etc, Slovenia's experiences cannot be applied to Macedonia as they are. However, there is something that Macedonia can learn.

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