CHAPTER IV

ECONOMIC CRITERIA IN ALBANIA, MONTENEGRO AND NORTH MACEDONIA

In this chapter, the author explains the progress of economic development and competitiveness in Albania, Montenegro and North Macedonia in order to meet economic criteria to have the full EU membership. The author will analyse the obstacles that those countries encountered in terms of this criteria that set by European Union.

1. Albania Economic Development and Competitiveness

In order to have full EU membership, the candidate countries were not only asked to fulfil political and legal criteria but also economic criteria in which EU requires candidate countries to have a functioning market economy and the capacity of country to cope with competitive pressure and market forces within the EU. In its early 1990's of its economic transition, Albania was the poorest country in Europe (Panagiotou, 2011). The country had difficulty moving from a centrally planned economy to an open market economy. Fortunately, Albania has made some good strides in recent years, and has been reasonably prepared to reform its economy.

1.1. The existence of a functioning market economy in Albania

Economic governance has become an important element in the enlargement process. Therefore Albania remained committed to reinforcing macroeconomic stability and fiscal consolidation in this case. The

Albanian economy has made some good progress in terms of its macroeconomic stability, by continuing to expand due to domestic and foreign demand. The annual real GDP growth was 2.2 percent on average between 2010 and 2015, accelerated to 3.8 percent in 2017, and averaged 4.2 percent during the first three quarters of 2018. In 2018 all domestic demand components contributed positively to the expansion of output. Employment rise and low interest rates and inflation contribute to private consumption, which has been the main driver. (European Commission, pp. 43-44).

Moreover, Albania's tourism sector has a great potential which brought impact to the increasing of country's revenues from foreign tourism between 2016 and 2018. Moreover, the high current-account deficit has continued to decline, helped by higher remittances and rising exports of both goods and services, and the fiscal deficit of the government in 2019 is now 50 percent below its average in 2010-2015. In 2017, the general government deficit dropped from 4.1 per cent in 2015 to 2.1 per cent of GDP. The deficit reduction between 2015 and 2016 has been helped by the IMF program's successful clearing of arrears in 2014.

In addition, lower government expenditure and higher revenues have also been seen as causes for lowering the deficit in the last 3 years. Therefore, public finance could not fill the large infrastructure hole, so the government was trying to raise private capital–primarily through public-private partnerships (PPPs). Public investment grew by an average of 6.2 percent per year in 2013-2018 and accounted for an average of about 18 percent of total public spending. (European Commission, pp. 45-46). However, increasing dependence on PPPs generates contingent liabilities and therefore fiscal risks. Moreover, at the same time, in terms of public debt, the high level of undeclared work and tax evasion open a room for increasing tax revenues without raising tax rates. Unrecorded arrears undermine the credibility of the public debt position.

Since the beginning of transition, Albania has pursued an extremely open model of economic development that has resulted in limited barriers in factor movements. Prices are fully liberalized, and the Albanian currency is fully convertible. In terms of functioning of product markets, in 2016, the active domestic enterprises growth was deceased from 5.5% to 1% in 2017. Similarly, in 2017, the number of foreign companies in industry and construction actually fell compared to 2015, as did the number of greenfield investments. Foreign enterprises, however, grew strongly in the services industry and in agricultural production in 2017 compared to 2015. (European Commission, p. 47).

Moreover, the private sector became prominent in the economy and Albania is well advanced in global market reform. However, widespread of corruptions and malfunctioning judicial system has drastically hindered businesses as well as the effectiveness of fiscal and monetary policies (Bertelsmann Stiftung, p. 24).

In terms of the functioning of the financial market, Albania's banking system financial stability is improved due to the declining stock of non-performing loans (NPLs). In addition, in terms of access to finance, credit growth for businesses remained low due to I increased risk awareness of banks; (ii) stricter loaning circumstances; (iii) low financial education for SMEs; and (iv) unbankable business plans. (European Commission, p. 48)

In terms of functioning labour market, an increasing employment and lower unemployment has caused the economic improvement. In 2017, Employment growth was 2.7% that allowed the level of unemployment to decrease from 15.6% in 2016 to 14.1% in 2017 and 12.8% in 2018. However, growth in employment proceeded to sluggish in 2017, dropping to 2.1%. The high rate of youth unemployment (trying to cover the 15-29 age group) continued to decline, falling from 33.2% in 2015 to 25.9% in 2017 and hence to 23.1% in 2018. Working age population started to decline in 2015, and labor supply growth was powered by increasing participation rates (growing from 66.8% in 2017 to 68.3% in 2018). (European Commission, p. 49). However, high youth unemployment and inactivity, low female employment, high share of informal and vulnerable employment, insufficient social care services and low quality of education are still remain as an obstacle in Albania's labour market (EU, 2019).

1.2. Albania capacity to cope with competitive pressure and market forces within the Union

In terms of its ability to deal with competitive pressure and market forces within the Union, Albania has made some good improvements and moderated preparations. In terms of education and innovation, government expenditure on education dropped from 3.5 per cent of GDP in 2013 to 2.4 per cent of GDP in 2018, staying below the national rate and far below the ideal level for a country with a large youth population. Moreover, young graduates often do not meet expectations of the private sector, with only 46.9% of graduates in employment in the year following graduation, as the government's education policy does not systematically calculate the needs of the private sector and often fails to implement quality standards in vocational training institutions.. In addition, Albania’s capacity to absorb technology, research, development and innovation still remained low. (European Commission, pp. 49-50)

In terms of quality of infrastructure, since 2013, Albania’s infrastructure has improved significantly, but compares to the regional and the EU average levels, its infrastructure gap remains large. According to IMF, The 2017 public infrastructure index in Albania calculated a difference of 70 per cent to the EU average infrastructure standard. (European Commission, pp. 50-51).

Albania emerged as the main trading partner for the EU in terms of economic integration with the EU and market competition, but total trade rates remained well below expectations and undiversified. In 2018, total global exports of Albania increased by 17 percent in volume, dominated by exports of electricity. About 58% of Albanian global exports came from commercial services led by tourism dominated exports. In 2018, the EU contributed 76.3 per cent of the goods exports from Albania and 61.1 per cent of its goods imports, marginally less than in 2017. Italy also remained the main destination for Albanian exports and main source of remittances. (European Commission, p. 51)

Inflows from the EU into Albania from foreign direct investment (FDI) have evolved strongly over the last 2 years. FDI flows from the EU to Albania rose in 2016 by 22% and in 2017 by 44%. FDI from the EU accounted for 38.5% total FDI flows into Albania’s in 2017. Moreover, Albania’s trade with

Central European Free Trade Agreement (CEFTA) countries increased on account of a continuously increasing share of exports to CEFTA countries, mainly to Kosovo. Exports to CEFTA increased from about 11% of its total exports in 2013 to about 16% of total exports in 2018. Imports from CEFTA, in contrast, fell back to their 2016 level in 2018 at 6.7% of total Albanian imports. (European Commission, pp. 51-52).

2. Montenegro Economic Development and Competitiveness

Montenegro is the smallest country in the western Balkans, like the political one, the country has also to fulfil economic criteria that set by European Union. In recent years, Montenegro has made some good progress and moderately prepared on its economic development and competitiveness. In these economic criteria, Economic reform plan (ERP) shall be prepared annually by each enlargement country, setting out a medium-term macro-fiscal policy framework and a structural reform agenda to ensure competitiveness and inclusive growth.

2.1. The existence of a functioning market economy in Montenegro

The rate of economic growth continues to be improved as regards macroeconomic stability. From 2012 to 2016, the economy reported growth of 2.9 per cent on its annual average, according to the European Commission report on Montenegro. In the first three quarters of 2017, GDP accelerated further, reporting an average 4.4% growth led by private consumption and investment. Tourism sector dominated the exports growth and boosting domestic demand and employment. In addition, the per capita GDP of Montenegro measured in purchasing power levels rose to 45% of the EU average in 2016, up from 39% in 2012. (European Commission, p. 41) .

For 2017, however, the trade deficit for goods rose further to 44.2 per cent of GDP, up from 41.9% a year earlier. The current account deficit has therefore deepened to 19% of GDP, up from 18.1% a year earlier. Thus, despite its good export production the trade deficit continues to decline. In addition, the public deficit amounted to EUR 26 million, or 0.7% of GDP, which reflects a decline of 89.7% compared to the previous year. However, the public debt amounted to EUR 2.309.23 million in 2016, or 61.83% of GDP. By the end of 2017, 66% was attributed to the resumption of the construction of the Bar-Boljare highway. Fiscal and debt policies are about to foster macroeconomic stability, but lack of institutional safeguards. Moreover, between 2015 and 2016, fiscal policy in Montenegro was focused on increasing taxpayers' discipline and reducing tax debt as it aims to rationalize the budget spending, which involves a decrease of non-productive current expenditure in favour of capital expenditure. (Bertelsmann Stiftung, p. 24).

In terms of functioning product markets, Montenegro has made some good improvements in businesses environment by ranked 51st of the 190 countries surveyed by the World Bank (2017) in terms of the ease of doing business, which higher than Albania. However when it comes to building permits, paying taxes and registering land, the country still ranks lower in which can open chance for corrupt practices to reduce the burden or to speed up processes. Privatization has also been a key source of budget revenue. Private companies are seen as the main drivers of economic production that have been heavily privatized in recent decades by made 90% of state property privatized. (Bertelsmann Stiftung, pp. 24-25).

In terms of financial market, the banking system in Montenegro has made some good progress, it is seen from its inflation and foreign exchange policies that brought in line with other economic policy goals and are institutionalized in the country’s largely independent central bank. Moreover, the euro is used by the country as a legal currency that significantly reduces the exchange rate risk and inflation risk, thereby helping to maintain macroeconomic stability and reducing transaction costs. However, despite of the well capitalised of the banking system, the performance of small domestic banks remain rough as Small domestic banks are primarily confronted with having to resolve non-performing loans and cope with high overhead costs which resulting in poor profitability (EU, 2019, p. 51).

In terms of the labor market, the unemployment rate according to the labor force survey declined from 17.1% in the third quarter of 2017 to 15.1%, while the employment rate rose from 51.4% a year earlier to 55.6%. By gender, men's employment rate was 62.1%, compared to women's 49.1%. Youth unemployment, though decreasing from 33.5% a year earlier, is high at 27.5%. The long-term unemployment rate at 73.4% was broadly unchanged. Furthermore, employment fell by 7.6% year-on-year at the end of 2017, while unemployment reached 22.2%, up from 21.1% a year earlier. Furthermore, an inflexible labour costs and labour market are relatively high and affect labour market mobility. Complexities in social support coupled with undeclared work create additional obstacles for formal employment. Skills mismatches, low educational outcomes and insufficient opportunities for reskilling affect transitions to and from employment. (European Commission, pp. 44-45).

2.2. Montenegro capacity to cope with competitive pressure and market forces within the Union

According to 2018 European Commission report on Montenegro, the country has moderately prepared in terms of its capacity to cope with competitive pressure and market forces within the Union. In terms of education and innovation, Montenegro took part in numerous international initiatives and collaboration projects as to prove its investment in research and development. Furthermore, the education system is getting improved, proven by the country's commitment to modernize vocational education in order to facilitate school to work transition, therefore in July 2017, the amendments to the law on vocational education were adopted, it is introducing the so-called 'dual education system', which requires practical training with employers. In addition, the country has also set up an Agency for Control and Quality Assurance in Higher Education and introduced financial incentives to promote the excellence of teachers and students.

In terms of quality of infrastructure, Montenegro is still struggling to achieve sufficient and adequate infrastructure which still remains as a challenge. For example, the quality of the road network is still below European standards. The reconstruction and modernisation of the road network is progressing according to the plan, including the construction of the priority section of the highway. The rail system is cheap; however, services are quite limited, slow and out-of-date. The growing number of passengers requires building the higher capacity of airports.

In terms of economic integration with the EU and market competition, Montenegro's share of trade with the EU and CEFTA countries is high but diminishing as trade with other countries, such as China and Turkey, increases. In 2017, trade with the EU accounted for 34.7% of Montenegro's exports of goods and 47.4% of its imports of goods. 41.1 % of exports and 31.2 % of imports represented by a trade with CEFTA. In addition, financial integration with the EU is also important, in 2017 Montenegro made 88.4% of local banks ' foreign capital share and 38.7% of total FDI inflows.

Montenegro also needs to improve its efficiency at exports, however. The total value of exported goods and services was 103.4 per cent of GDP in 2016, with exports accounting for only 40.5 per cent of GDP. The country has a small manufacturing base which focuses on low value added commodities. Exports of services are however growing rapidly through the tourism sector. Imports are largely concentrated on energy and food, two sectors which offer significant potential for import substitution. Furthermore, due to moderate import prices and low labour costs, price competitiveness has been broadly preserved. Labour costs have declined in real terms each year since 2011, except for a 3.4 % y-o-y increase in 2016. Consequently, domestic producer prices remained flat or recorded some marginal annual increase of less than 0.3 % in each of the last three years, preserving local companies' competitiveness. (European Commission, pp. 46-47).

3. North Macedonia Economic Development and Competitiveness

Same as the two previous countries, which are Albania and Montenegro, North Macedonia has also made some good progress in developing a functioning market economy in order to meet EU economic criteria that in line with the conclusions of the European Council in Copenhagen in June 1993. However, according to 2019 of European Commission report, the country still has many to improve to strengthen its economic growth and competitiveness.

3.1. The existence of a functioning market economy in North Macedonia

In terms of economic governance, the government is trying to implement market-based economic policies by gradually concentrating on social cohesion along with enhancing state aid. The government has introduced reforms to strengthen control of public finances and to introduce progressive income taxation through cooperation with the IMF, the World Bank and the European Commission. This introduced reforms to the pension system, which in the medium term is expected to lead to lower pension costs and higher government revenues. In addition, economic growth picked up in 2018 in terms of macroeconomic stability, but investment remained dim.

Due to political uncertainty, North Macedonia's economic was stagnating in 2017, yet year after the GDP growth accelerated to 2.7% year over year. Consumer spending has been driven by wage increases, transfers and household loans. Convergence with the level of EU revenue remains sluggish. Moreover, actual GDP per capita rose from 34% of the 2012 EU-28 average to 37% in 2017. In addition, the current account deficit decreased year-over-year by 0.7 percentage point to 0.3% of projected GDP in 2018. (European Commission, pp. 45-46) .

Furthermore, the monetary policy stance continues to support price stability and currency. Consumer prices rose on average by 1.5% in 2018, just slightly faster than in the previous year (1.4 per cent). In terms of GDP, public debt fell slightly in 2017 for the first time since 2009 and rose again only marginally in 2018, to 48.4% at year-end. The government has funded much of the fiscal deficit and debt repayment from its central bank deposits and from accumulation of foreign reserves. The government has also continued to improve its public finances by reducing pension and return to progressive income taxation. However, it is not enough to address economic and fiscal challenges as fiscal consolidation and adjustment need planned measures on pension, income and taxes. (European Commission, pp. 47-48)

In terms of functioning of product market, the capacity of institutions in enforcing the law remains poor and time-consuming and expensive for companies when it comes to settling commercial disputes through the case. Moreover, unregistered companies create unfair competition since the size of the informal sector continues to grow in the business environment. The scale of the informal economy, measured by the National Statistical Office at about 17.4% of total output in 2016, has decreased only gradually over the last few years. and limits the opportunities of formal businesses to expand and invest in further development, innovation and productivity. (EU, p. 83).

According the World Bank, political instability and informal sector are two main obstacles to do business in North Macedonia. Moreover, private ownership is dominant, but the transparency of state aid is still a matter of concern, as there is no single State aid registry which undermines the ability of the Commission for Competition Protection (CPC) to report, track or assess the effectiveness of State aid. (European Commission, p. 49).

In terms of functioning of the financial market, the banking sector has made good progress by further improved its resilience. The country's financial sector was dominated by banks, even though their share of total financial sector assets dropped to 83% in 2017, down from 88 per cent in 2013. Compared to previous years, the concentration remains high and constant, with roughly 58% of the assets held by the three largest banks (out of 15). In addition, the percentage of non-performing loans (NPLs) in total non-financial sector loans was 10.3% in 2015 and 5.2% at the end of 2018. (Bertelsmann Stiftung, p. 21).

In terms of the labour market, job creation persisted at a steady but diminishing rate (2.4% on average between 2012 and 2018). The average annual unemployment rate (15-64 age groups) decreased to 21% between 2012 and 2018 due to a reduction in labour force. Nevertheless, systemic labour market issues hinder the ability of the economy to increase productivity. Moreover, the decrease in total unemployment partially reflects low levels of activity. While women make up 50% of the population in northern Macedonia, they are still paid less and rarely have senior positions in both the public and private sectors. (Bertelsmann Stiftung, p. 19).

Indeed, the gender gap remains large, with about 78% of men participating in the labour market compared to 52% of women, with little improvement in the last 5 years. Youth unemployment has been slow but steadily declining in recent years, and remains high. Employment accounted for 44 per cent in 2012 and rose to 51.7% in 2018, but remained low by national comparison. About 80% of the unemployed are long-term unemployed, representing skills mismatch. Moreover, informal employment continues to decline, but the proportion remains high. The proportion of informal jobs decreased from 28.6% in 2008 to 18.1% in 2017, but remained significant, particularly for low-skilled workers. (European Commission, p. 50).

3.2. North Macedonia capacity to cope with competitive pressure and market forces within the Union

North Macedonia has made some good progress and is reasonably equipped to deal with competitive pressures and market forces within the European Union. However, there are some sectors that North Macedonia has to strengthen and improve. In terms of education and innovation, competitiveness and growth is hampering by the skills mismatch.

In addition, Public expenditure on education has averaged around 4% of GDP over the last 5 years. It is only slightly lower than the EU average. However, enrolment and completion rates in secondary education (about 87% completion) and post-secondary education remain below the EU average and have risen only marginally during this period. Education outcomes are lower than most regional peers and lower than expected from the country's income level, according to the latest (2015) PISA ranking and the World Bank's Human Capital Index 2018. The gap between the skills offered by graduates and those sought by companies reduces potential growth and reduces the large-scale migration of highly skilled workers. (European Commission, p. 51).

In terms of physical resources and infrastructure efficiency, investment deficits impede productivity growth. The investment gap in the energy sector is particularly large. However, labor productivity has been negatively affected by the largely obsolete transport, electricity, health and education infrastructure. In terms of industry and company structures, the sectorial and business structure of the economy has remained low as it has remained largely unchanged over the last 5 years. At some 60%, services account for the largest proportion of gross value added. Industry contributed 19.5%, marginally above its share in 2013, and agriculture accounted for 10%. (European Commission, p. 52)

In terms of economic integration with the EU and price competitiveness, Macedonia is a member of the World Trade Organization and the Central European Free Trade Agreement (CEFTA) and has liberalized trade with the EU. In 2015, the EU became the main trading partner with 77% of exports and 62% of imports. (Bertelsmann Stiftung, pp. 21-22).

The importance of the EU as a trading and investment partner continues to grow in recent years. In 2018, with 126% of GDP, the economy has a strong and increasing degree of openness to trade. Exports to the EU, which accounted for 82% of total exports, increased by 18.4% year-on-year and imports from the EU decreased by 11.5%. In addition, EU companies have also increased their share of foreign investment stock in the country in recent years, accounting for some 82% of the total in 2017. The structural restructuring of the economy remains driven by foreign investors. Nevertheless, incorporation into global production networks remains scarce, primarily due to the type of products produced by FDIs and the role of FDIs in the context of global value chains. (European Commission, p. 53).