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## INTENSIFICATION OF TRADE BETWEEN THE REPUBLIC OF MACEDONIA AND THE COUNTRIES IN THE REGION OF SOUTHEASTERN EUROPE

### INTENZIFIKÁCIA OBCHODU MEDZI MACEDÓNSKOU REPUBLIKOU A KRAJINAMI JUHOVÝCHODNEJ EURÓPY

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The paper deals with the preferential trade arrangements which the Republic of Macedonia has concluded with the countries of the region of Southeastern Europe. The key features of the Free Trade Arrangements (FTAs) are presented, and their main shortcomings are also identified. Particular emphasis is put on the exemptions of free trade regime related to the sensitive products and to services, as these activities are important in the production structure of the Macedonian economy. Then we deal with the issue of the supply response of the Macedonian economy to the improved access to the markets of the countries with whom FTAs have been concluded. The paper concludes with discussion of the possible improvements in the implementation and enforcement of the FTAs.

**Key words:** free trade agreements (FTAs), trade liberalization, supply response, sensitive products, trade in services, Republic of Macedonia, Southeastern Europe

The Republic of Macedonia is a small transition country, located in the centre of the Balkans. It is a cross-road for some strategic transport routes that connect the Western and Central Europe with Greece, and further, via Turkey, with the Middle East. The intensification of the foreign trade of Macedonia with the countries in the region of South-Eastern Europe has a strategic importance for the country, at least for two reasons: **first**, the economic cooperation with the neighbouring countries is based on the comparative advantages which come from the proximity of the markets, the lower transportation costs, the complementarities of the production structures of the countries, better understanding of the consumer preferences, and the like; and **second**, the Republic of Macedonia has recently become a candidate country for EU membership, a status which creates additional obligations for the country in terms of becoming more active in promoting the regional economic cooperation. Macedonia's southern neighbour, Greece, is an EU member state, and its eastern neighbour, Bulgaria, will join the EU, on 1. 1. 2007. Those two neighbouring countries are the two most important Macedonia's trading partners. In the wider region, Slovenia is an EU member state, and Romania will also become one on 1. 1. 2007.

The focus of our research in this paper will be on the trade relations of Macedonia with the countries of the closer region, which are still not EU members, and with which Macedonia has preferential trade agreements, i.e. Free Trade Agreements: Serbia, Montenegro, Albania, Bosnia and Herzegovina, and Croatia. Particular emphasis in the paper will be put on the issues that inhibit the trade and have still not been eliminated despite the existence of the Free Trade Agreements; such issues include: the problem of the so-called "sensitive goods"; the exclusion of trade in services from the Free Trade Agreements; administrative and bureaucratic obstacles related to the customs offices; issues related to the bilateral nature of the Agreements; the lack of mechanisms for effective resolution of trade disputes; and etc. In the final part of the paper, some

alternative approaches to resolving such issues will be suggested.

#### The key features of the existing Free Trade Agreements which the Republic of Macedonia has concluded

At the end of 2006, there were 11 preferential trade agreements which Macedonia had concluded either with individual countries in the region, or with the two integrations such as the EU and the EFTA.<sup>17</sup> In fact, Macedonia had Free Trade Agreements (FTAs) with all its three non-EU neighbours (Serbia, Bulgaria and Albania), whereas the trade with its fourth neighbour (Greece) was covered by the Interim Agreement on Trade with the EU.

In general, the FTAs with individual countries include:

- elimination or time schedule for reduction of tariffs, mainly for industrial products;
- import quotas within which imports are tariff-free, whereas the import quantities outside the quotas are treated under the principle of most favoured nation;
- provisions for certain agricultural products that include quantitative restrictions, and a country-specific;
- provisions for technical standards, and for sanitary and phytosanitary measures;
- provisions for some protective measures, such as antidumping and compensatory tariffs, in cases when serious damage to the country's economy can be established.

These individual country FTAs cover around 36% of the exports and 28% of the imports of the Macedonian economy.

<sup>17</sup> The nine countries with which Macedonia has concluded FTAs are: Albania, Bulgaria, Bosnia and Herzegovina, Croatia, Moldova, Romania, Serbia and Montenegro, Turkey, and Ukraine.

**Table 1** Free Trade Agreements and other preferential treatment agreements signed by the Republic of Macedonia (Kostoska, 2006)

	Country/Integration with which the Agreement is signed (1)	Date on which Agreement became effective (2)	Nature of the Agreement (3)
1.	FTA with FR Yugoslavia (4)	1. 10. 1996	Balanced (15)
2.	FTA with Croatia (5)	8. 7. 1998	Balanced (15)
3.	FTA with Bulgaria (6)	1. 1. 2000	Balanced (15)
4.	FTA with Turkey (7)	1. 11. 2000	Asymmetric, in favour of Macedonia (16)
5.	Interim Agreement on Trade and Trade-Related Matters, in the framework of the Stabilization and Association Agreement (SAA) with EU (8)	1. 6. 2001	Asymmetric, in favour of Macedonia (16)
6.	FTA with EFTA countries (9)	1. 5. 2002	Asymmetric, in favour of Macedonia (16)
7.	FTA with Ukraine (10)	15. 7. 2003	Asymmetric, in favour of Macedonia (16)
8.	FTA with Bosnia and Herzegovina (11)	1. 7. 2002	Asymmetric, in favour of Bosnia and Herzegovina (17)
9.	FTA with Albania (12)	15. 7. 2002	Balanced (15)
10.	FTA with Romania (13)	1. 1. 2004	Balanced (15)
11.	FTA with Moldova (14)	1. 1. 2005	Balanced (15)

**Tabuľka 1** Dohody o voľnom obchode a iné preferované dohody podpísané Macedónskou republikou (Kostoska, 2006)  
 (1) krajina/integrácia s ktorou bola dohoda podpísaná, (2) dátum nadobudnutia účinnosti, (3) charakteristika dohody, (4) FTA s Federálnou republikou Juhoslávia, (5) FTA s Chorvátskom, (6) FTA s Bulharskom, (7) FTA s Tureckom, (8) dočasná dohoda o obchode a obchodných záležitostiach v rámci Stabilizačnej a asociačnej dohody s EÚ, (9) FTA s krajinami EFTA, (10) FTA s Ukrajinou, (11) FTA s Bosnou a Hercegovinou, (12) FTA s Albánskom, (13) FTA s Rumunskom, (14) FTA s Moldavskom, (15) vyvážená dohoda, (16) asymetrická v prospech Macedónska, (17) asymetrická v prospech Bosny a Hercegoviny

The trade between the Republic of Macedonia and the EU is regulated by the Interim Agreement on Trade within the broader framework of the Stabilization and Association Agreement (SAA) signed in 2001. This is an agreement which improves the access of Macedonian exports to the EU common market. It envisages either complete elimination or time-scheduled reduction of tariffs on Macedonian exports, with special regime for some food products (for example, beef, fish, and wine). The ultimate aim of the agreement is to achieve a free trade area between EU and the Republic of Macedonia. This agreement has a particular importance for Macedonia, since it covers the trade with the most important trading partners for Macedonia – i.e. 56% of exports and 49% of imports in 2004 – but it also is a significant element in the whole process of Macedonian accession to the EU. Table 1 gives the list and some basic information on the preferential trade agreements Macedonia has signed during its transition period.

#### Shortcomings of the FTAs

There have been, however, some problems which have been related to the nature of the FTAs themselves which have some detrimental effects on the realization of their full potential.

Firstly, the bilateral nature of the agreements has meant that there has been no effective multilateral mechanism for resolution of trade issues between the countries in the region.

Secondly, the FTAs have not been uniform, and this has created an impediment to the effective realization of the potentials of one fully integrated regional market which would be much more attractive to foreign investors than the separate markets of individual countries.

Thirdly, the relatively high degree of liberalization of trade in goods has not been paralleled by a symmetric liberalization of the service sector. This is important for Macedonia, since it has traditionally been an exporter of such service activities as construction and transport. "The FTAs have been quite successful in removing trade and quota restrictions on the exports of Macedonia to its FTA partners. However, the current FTAs are heavily tilted towards liberalizing trade in goods while

services have not been opened up to the same extent. This is unfortunate given the historical ties among countries in the region".<sup>2/</sup>

Fourthly, the liberalization has effectively been absent in the area of the so-called 'sensitive' products under the existing FTAs. Namely, all countries in the region have included quite wide array of 'sensitive' products which have effectively been excluded from the trade liberalization and have negative implication on the extent of overall trade among those countries.

Fifthly, there have been some problems related to the practical implementation of the FTAs, which has sometimes to do with functioning of the customs and border administrations.

#### The impact of Free Trade Agreements on the intensification of trade between the Republic of Macedonia and the countries in the region

Has there been a supply response, i.e. has the FTAs with the countries in the region contributed to an increase in the Macedonian firms' exports in these countries? Of course there is no simple answer to this question, and one of the reasons is that the period in which those agreements had been signed was quite turbulent. Political and economic turbulences in the region has had strong impact on the economic activity in Macedonia and on its export-import flows, which is understandable when having in mind that it is a small economy which functions as a shock absorber. The period until 2000 was marked by embargoes, the refugee crisis (Kosovo) and the NATO intervention in FR Yugoslavia, whereas in 2001 there had been an internal conflict in Macedonia which had a particularly negative impact on the economic activity not only in 2001 but also in 2002.

In general, it could be pointed out that although 85% of the Macedonia's foreign trade has been carried out under some preferential arrangements, during the period 1996–2005, the

<sup>2/</sup> Blue Ribbon Commission for Macedonia (2006)

**Table 2** Exports from the Republic of Macedonia to the countries with bilateral FTAs

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>FRY (2)</b>										
Exports in mln \$ (3)	245.84	273.55	240.04	254.48	335.1	267.01	246.38	273.8	347.51	459.54
Change in % (4)	189.97	11.27	-12.25	6.02	31.68	-20.32	-7.73	11.13	26.92	32.24
<b>Croatia (5)</b>										
Exports in mln \$ (3)	-	-	54.01	48.99	47.69	58.49	59.08	66.1	80.16	81.05
Change in % (4)	-	-	34.47	-9.29	-2.65	22.65	1.01	11.88	21.27	1.11
<b>Bulgar. (6)</b>										
Exports in mln \$ (3)	-	-	-	-	26.94	20.8	21.78	25.83	51.53	76.10
Change in % (4)	-	-	-	-	3.18	-22.79	4.71	18.60	99.50	47.68
<b>B&amp;H (7)</b>										
Exports in mln \$ (3)	-	-	-	-	-	-	18.31	23.75	33.23	50.48
Change in % (4)	-	-	-	-	-	-	12.47	29.71	39.92	51.85
<b>Turkey (8)</b>										
Exports in mln \$ (3)	-	-	-	-	-	8.59	8.46	32.81	53.95	46.31
Change in % (4)	-	-	-	-	-	-16.68	-1.51	287.83	64.43	-14.16
<b>Albania (9)</b>										
Exports in mln \$ (3)	-	-	-	-	-	-	13.8	17.42	23.62	27.52
Change in % (4)	-	-	-	-	-	-	38.42	25.59	35.59	16.51

Source: Own calculations based on Blazevski and Mojsoska (2006), p. 57–58

**Tabuľka 2** Export Macedónskej republiky do krajín s ktorými má bilaterálne dohody o voľnom obchode

(1) rok, (2) Federálna republika Juhoslávia, (3) Export (v mln. \$), (4) zmena v %, (5) Chorvátsko, (6) Bulharsko, (7) Bosna a Hercegovina, (8) Turecko, (9) Albánsko

country's exports grew at annual average rate of 2.18%, whereas the imports grew at annual rate of 4.42%. On one hand, the political turbulences and instability in the region has prevented the realization of the potential positive effects from the reduction in the tariff barriers to trade among the countries in the region. On the other hand, the insufficient intensity of the restructuring in the enterprise sector, as well as the insufficient supply of financial funds at affordable price due to the inadequate banking sector reforms, have all led to the situation in which Macedonian firms did not succeed to improve their competitiveness and to effect the potentials offered by the FTAs. In this context, additional problems have been related to the inadequate dynamism and comprehensiveness of the institutional reforms, leading to insufficient improvement of the business climate.

„Macedonian products do not appear to face extensive foreign barriers – the EU provides preferential access to its market and Macedonia has concluded free trade agreements (FTAs) with many neighbouring countries. As these FTAs were put into place, there was little or no 'supply response' on the part of the Macedonian exporters. It could be that these agreements failed to match Macedonia's export potentials, or this could be evidence that Macedonian firms lack the incentives or the ability to expand their sales abroad and thus would not respond to other export incentives like devaluation either. Macedonian managers may not be aware of international opportunities or sufficiently well versed in international business.“<sup>3/</sup>

Although the above conclusion is basically valid as a synthetic overall conclusion, some data that we can present may allow for a certain modification of such a statement. Namely, we present some data for the Macedonian exports for

2003, 2004, and 2005, the three years which can be considered as non-turbulent ('normal') years. The data presented in the Table 2 show that during the period 2003–2005 the total Macedonian exports has been rising; moreover, Macedonian exports to all the countries in the region with which Macedonia has FTAs has increased during that period. Moreover, in 2005 the relative share of exports to an individual FTA country in total Macedonian exports has been higher than the share in the year in which a particular FTA became effective.<sup>4/</sup>

#### How to improve the economic effects of the FTAs

The possible improvements in the FTAs can be made along two general lines:

- (1) harmonization of the provisions and structure of the agreements;
- (2) introduction of mechanisms for effective resolution of the trade issues.

(1) The harmonization of the existing FTAs should be related to issues such as: the application of the rule of origin provisions; the procedures of the customs administrations; measures for effective protection of competition within countries; provisions that are related to the different forms of state aid; regulations related to the cross-border mergers and acquisitions. Such a harmonization may effectively be facilitated by the fact that all countries in the region aim at EU membership, so that the harmonization of their FTAs can be based on application of European standards in different areas. In this context, harmonization should also include the tariff structures as well as any non-tariff restrictions applied by the countries in the region. What is also important is to reduce to the minimum the scope of the exceptions to free trade related to sensitive products.

This harmonization is of vital importance for Macedonia and its efforts to attract foreign direct investment, since it is such harmonization which would effectively create a truly integrated regional market, thus overcoming the investment barrier which

<sup>3/</sup> Blue Ribbon Commission for Macedonia (2006)

<sup>4/</sup> See Blazevski, Mojsoska (2006)

exists in the form of a very small size of the Macedonia's internal market.

(2) The countries in the region should establish some form of multilateral mechanism for resolution of trade issues among them (one such attempt has been through the joining in the CEFTA). In this respect, they should draw on the principles and experience of WTO as well as of other free trade areas. This would also require adequate institutional and human resource capacities to be built, such as, for example, the training of lawyers in the area of international trade law.

In the final instance, however, countries in the region should probably consider replacing the individual FTAs with a single agreement which would create a free trade area in the region (south-eastern free trade association – SEFTA).

#### Other aspects of regional cooperation on trade matters

It is also important for Macedonia to intensify its cooperation with the countries in the region, and particularly with its neighbours, in the area of modernization and maintenance of the border-crossing points. Macedonia is not only a transit country for exports originating from other countries, it is also located in a region which has witnessed during the last two decades a creation of several new independent states, thus significantly increasing the number and economic consequences of borders between countries. There has been some empirical evidence showing that costs associated with administrative procedures and waiting at the borders, coupled with the costs associated with corruption, may well exceed the costs created by tariff barriers. Therefore, Macedonia's authority should cooperate with authorities in the other countries to minimize those costs which can have significant detrimental effects on the volume of trade in the region.

Additionally, the regional cooperation is very important in the area of effective implementation and enforcement of the technical regulations and standards, as well as sanitary and phytosanitary measures. After Bulgaria became an EU member state, Macedonia has borders with two EU member states whose expertise and experience may be much valuable in helping the effort on the part of Macedonia to effectively implement those standards and regulations.

#### Conclusions

The Republic of Macedonia has been active in establishing trade relations with the countries in the region of South-eastern Europe by way of concluding bilateral free trade agreements. The reasons for this have to do with the strategic location of Macedonia at the centre of the Balkans, the proximity of the regional markets as well as the complementarities in the productive structures of the economies. The aspirations for the EU membership, further strengthened by the candidate status of the Republic of Macedonia, have also been a strong driving force for intensification of the regional economic cooperation. Additionally, preferential trade agreements have been concluded with the EU and the EFTA. As a result, almost 85% of the Macedonian trade has been carried out under some form of preferential trade.

However, the supply response to these preferential trade agreements seems to be relatively weak. Two general factors can be pointed out as leading to such a weak supply response: the regional political instability, and the lack of deep and effective restructuring of Macedonian firms which would lead to their improved international competitiveness. But, this general conclusion needs to be qualified, because during the period

2003–2005, there has been a tendency of increase in the Macedonian exports to the countries with which it has FTAs. Also, in 2005 the relative share of exports to an individual country with FTA in total Macedonian exports has been higher than in the year in which that particular FTA has been concluded.

In order for these FTAs to be more effective, some of their shortcomings need to be overcome. First, there needs to be a harmonization of the individual FTAs, and effective multilateral mechanism for trade issue resolutions should also be put in place. Second, liberalization of trade in goods should be accompanied by wider liberalization of trade in services. Third, the exclusions from free trade regime related to the sensitive products should be significantly reduced.

#### Súhrn

Článok sa zaoberá obchodnými preferenciami Macedónskej republiky s krajinami juhovýchodnej Európy. Opisuje kľúčové znaky dohôd o voľnom obchode (FTA) a definuje ich hlavné nedostatky. Hlavný dôraz kladie na výnimky z režimu voľného obchodu, ktoré sa vzťahujú na citlivé produkty a služby, keďže tieto sú dôležité z hľadiska produkčnej štruktúry macedónskej ekonomiky. Ďalej sa článok zaoberá otázkami odozvy macedónskej ekonomiky na zlepšený prístup na trhy tých krajín, s ktorými boli dohody o voľnom obchode uzavreté. Záver článku tvorí diskusia o možných zlepšeniach v oblasti zavedenia a posilnenia dohôd o voľnom obchode.

**Kľúčové slová:** dohoda o voľnom obchode (FTA), liberalizácia obchodu, reakcia ponuky, citlivé produkty, obchod so službami, Macedónska republika, juhovýchodná Európa

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