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MACEDONIAN CONVERGENCE AND THE ROLE OF EXCHANGE RATE IN THE RUN-UP TO EU ACCESSION

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Abstract

To cope with competitive pressures and market forces within the EU in the medium-term, the SEE6 needs to address important challenges through determined implementation of structural reforms. Progress with structural reforms can help for macroeconomic stability, for example, by reducing the structural external deficits. Also it helps nominal convergence, as the productivity realizes the improvement of competitiveness and helps disinflation by maintaining low unit cost. So in terms of macroeconomic convergence for SEE6 countries and the case of Macedonia, EU membership requires convergence of the Macedonian economy with that of the EU in realistic conditions, indicating income per capita and economic structure, and in nominal terms, meaning convergence of prices, inflation and interest rates.

Also, in the paper the focus is on the importance of the exchange rate regime as available tool in meeting the requirements needed for entering into the EU. Using the exchange rate as anchor for inflationary expectations, on long run have been effective so far, producing a low and stable inflation rates. However, in periods of low inflation and deflationary pressures, exchange rate anchors do not allow sufficient space for fiscal and monetary stimulus. In this respect, policy makers are under following dilemma: to deviate from exchange rate anchor and increase the space for fiscal and monetary stimulus; to accelerate structural reforms and competitiveness and on short run deepen the recessionary pressures; and to

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increase foreign debt and thus increase scope for fiscal and monetary stimulus while preserving the exchange rate anchor.

Key words:
EU accession, economic convergence, SEE6, exchange rate, Macedonia

JEL classification: O11.

Introduction

Because of the fact that Southeast European countries rely mainly on exchange rate anchors to reduce inflation, the appreciation of the real exchange rate among countries in the region is significant, although it is slightly lower when compared to countries in the EU member states. As a result, these countries suffer from loss of competitiveness. This can be clearly seen from the movements of the deficit on their current account, which are important in all these countries. Using the exchange rate as anchor for inflationary expectations, on long run have been effective so far, producing a low and stable inflation rates. However, in periods of low inflation and deflationary pressures, exchange rate anchors do not allow sufficient space for fiscal and monetary stimulus. In this respect, policy makers are under following dilemma: to deviate from exchange rate anchor and increase the space for fiscal and monetary stimulus; to accelerate structural reforms and competitiveness and on short run deepen the recessionary pressures; and to increase foreign debt and thus increase scope for fiscal and monetary stimulus while preserving the exchange rate anchor.

Economic policies can be instrumental for growth in the near- and the medium-term in SEE6. On the fiscal side, sustained reform effort is needed to address structural rigidities in the budgets of SEE6. Priorities include: changes in the composition of public expenditure toward investment and away from wages, public expenditure targeting and prioritization as well as improvements in revenue collection and the broadening of the tax base, among others. On the monetary policy side, with regional inflation at a very low 1.2 percent and big output gaps remaining, some scope for short-term easing of monetary conditions exist, especially in those countries where deficits have begun to decline.

Importance of exchange rates and macroeconomic challenges with EU accession in Southeast European countries

To acceding into the European Union (EU), countries are facing with macroeconomic challenges on their way to this membership. Countries should meet a number of economic, political and legal criteria. For countries in transition, formal economic criteria for accession are primarily focused on establishing a functioning market economy. The formal process for access puts more emphasis on progress of transition reforms in the early stages of accession, as countries struggle to establish market economies, while compliance with specific criteria for macroeconomic stability are prevailing in the later stages. Fulfillment of economic criteria, in fact, is real and nominal convergence. The progress with market

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reforms can be measured through various indicators of transition. These reforms are essential for improving real convergence or revenue growth to the level of the EU, which helps countries to advance the competitive pressures in the economic union (Bishev 2002). Macroeconomic stability and nominal convergence of key macroeconomic indicators such as inflation and fiscal deficits to the EU levels, is also important for development and progress of a functioning market economy.

Referring to the macroeconomic stability and progress in the transition, both are closely related and important for sustainable growth and progress towards a functioning market economy. Progress with structural reforms can help for macroeconomic stability by reducing the structural external deficit. It also helps to nominal convergence, as productivity realizes the improvement of competitiveness and helps to disinflation by maintaining low unit cost. The challenge for the accession process is to realize a nominal and real convergence with macroeconomic stability and stable development. Further, this could be complicated by the need of facing with potential shocks as large and volatile capital flows and to finalize the transition to a market economy

Like many countries in the early stages of transition, Southeast European countries rely mainly on the exchange rate to reduce inflation (DeBroeck 2006:362-383). Aside from Albania, Romania and Serbia, all other Southeast European countries have neither the currency nor the boards tightly controlled management or pegging for a specific time. Initially, inflation declined with the exchange rate, but increasing of external deficits prompted a move towards managing fluctuation in 2003 (Buiter 2003). Inflation continued again, oppressed administrative prices were adjusted and growing euroisation contribute for increasment of foreign currency-exchange rate shift to the prices. Moving of the regime may hit the credibility of monetary policy adversely, as it is shown through growing euroisation. The drivers were less successful in reducing external imbalances, suggesting trade off with inflation. Although large fiscal deficits can contribute for external imbalances in some countries (Croatia). They also reflect the slow progress in reforming the real economy. The largest current account deficit is among the countries with the most progress on structural reforms (Serbia, Montenegro, Bosnia and Macedonia), which are measured with the same transition indicators or the share of private sector in GDP. This confirms that nominal convergence and macroeconomic stability are closely connected with real convergence and the introduction of market economy.

Exchange rate as fundament and slow structural reforms put pressure on competitiveness (Oskooee 2001). Fixed or nearly fixed exchange rate could lead to unsustainable real appreciation and loss of competitiveness, unless fiscal and income policy remain closely tied and structural reforms increase productivity. For example, in Serbia, the exchange rate in 2002 became unsustainable as real wages grew up and external deficit increased. Pressure for real appreciation in the region is also growing due to large inflows of foreign currency. The sustainability of the exchange rate in Southeast Europe in particular will depend on the accompanying policies. So far, the slow progress of structural reform in many of these economies increases the risks associated with soft pegging. Competitiveness can also be torn over time through a lack of fiscal discipline or weak-income policies. In Serbia and Macedonia, where fiscal policy is tight, exchange rate as fundament can become problematic if competitiveness is lost. This can happen if income policies are also lost or structural reforms fail to boost productivity. Croatia,

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which has significant fiscal deficits and exchange rate as an anchor may also face with problems of competitiveness over time. This can be activated if the currency inflows to the tourism sector or strong capital inflow leads to real appreciation, with opposite effects on other sectors of traded goods. Any move toward more flexible arrangements in Southeast Europe should be carefully considered to avoid market distortions successfully.Various indicators show that the economies of Albania, Bosnia, Macedonia, Serbia and Montenegro need more progress in transition reforms to become functioning market economies, a key criterion used by EU for moving the countries from one phase of the approach to another. Slow structural reform is also reflected through low levels of FDI and this may limit the potential for growth in the medium term - or real convergence. Slow structural reform also affects macroeconomic stability, which is the core of large external imbalances in some countries. Especially in Bosnia and Serbia, large current account deficit reflects low level of competitive exports, while imports is increased by foreign remittances, strong credit growth or potential flexibility of required management.

Macroeconomic challenges in other countries of Southeastern Europe are related with viability of their monetary framework, risks of rapid financial deepening and future fiscal consolidation in supporting growth and stabilization. Many current actors for exchange rate may not be sustainable over the whole time, unless if they are better supported by fiscal consolidation and structural reforms. Also, various indicators haven't show a clear sign of problems with the competitiveness of these countries now. Large external deficit and weak supportive policies in some countries may increase these risks over time. The shift towards more flexible monetary framework is complicated by high euroisation, resulting in weak monetary transmission mechanism. In future, this underlines the need for fiscal consolidation and increased flexibility of fiscal policy in responding to the shocks as the need for structural reforms in lowering external imbalance too. Rapid credit growth, especially in foreign currency, add further pressure on the external balance and inflatory dynamic in many countries. This is challenging supervisory capacity in mitigating the risks in the financial sector. Most Southeast European countries have "space" to reduce public spending and to increase the share of growing consumption. A lower deficit will increase private sector, leading to growth as it facilitates macroeconomic management too. Also growth will increase by reducing high taxes on labor in many countries. But the biggest fiscal adjustment blow should come by reducing bigger salaries in the public sector, subsidiary and transfers.

Exchange rate regimes in the region are different, ranging from currency board in Bosnia and Herzegovina to almost free fluctuation without inflationary targeting in Serbia. The common is that due the transition process these countries have dedicated special attention to their exchange rate regime and most of them used fixed exchange rates, reflecting their large trade openness and their efforts to set up a strong monetary authority. Regardless the exchange rate regime, the appreciation of the real exchange rate of the countries in the region is significant, though slightly lower when it is compared with the EU Member States. As a result, these countries also suffer from a competitive loss. This can be clearly seen from the movements of the deficit in the current account, which is important in all these countries. For example, current account deficits in 2007 ranged from 3.1% of GDP in Macedonia to 36.2% of GDP in Montenegro.

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Using the exchange rate as the hope for inflation expectations have been effective until now, producing low and stable inflation rates (Goswami 2011:263-274). In terms of high import dependence and relatively slow implementation of structural reforms realized in increased export potential, contributed to the importance of high trade deficit, was mainly financed by higher private transfers. The transition process in Macedonia is specific because of the relatively slower process of real convergence and continuing real depreciation of the Macedonian Denar.In many cases productivity in the tradable sector is compared with growth of foreign partners with relative lower rates (Loko and Tuladhar 2005). This was due to the absence of large foreign companies and loss of important foreign markets, especially after independence. In such conditions, the only way to maintain the competitiveness of macedonian producers was the specialization and exports of lower quality products. These developments have generated inflationary pressures, which caused absence of real appreciation that was evident in other transition countries. In the past few years, Macedonia moves quickly and closer to the more advanced transition economies. As regards nominal convergence in the context of European Union integration, Macedonia faces with challenges which are common to the most economies in the region and beyond. Since 2007, there has been acceleration of the inflation rate, which is mostly caused by the global price rise of food and energy. Thus, uncertainty in the movements of these prices, and expectations of pressure caused by the process of real convergence, are the main challenges for monetary policy in the medium term.

Convergence of Macedonia and SEE6 - economic condition and recovery

The SEE6 countries exited from recession in 2013 with economic growth supported by the recovery in high-income countries, particularly those in the European Union (EU) (NBRM 2013). External demand for SEE6 exports was the key driver of this growth recovery, reflecting an improving European and global economy. An export-led recovery combined with depressed domestic demand resulted in a significant narrowing of current account imbalances in all SEE6 countries. The increases in exports and the declines in imports lowered the trade deficit of SEE countries by 4.7 percent of GDP and the current account deficits by 3.4 percent of GDP in 2013 (World Bank 2013e). Exports to the EU grew strongly, especially in Bosnia and Herzegovina, Macedonia, and Serbia. Montenegro's and Kosovo's share of exports to the SEE6 region increased. Manufactured goods were the largest share of exports from SEE6 followed by machinery and transport equipment. Jointly they comprised over 60 percent of exports in 2013 in the region. The major increase in 2013 came from export of machinery and transport equipment from Serbia. Exports in Macedonia grew also on the back of machinery and transport equipment as well as chemical materials. Mineral fuels exports were quite significant in Albania and Montenegro, while base metals were around a quarter of exports from Kosovo in 2013 (World Bank 2013c).

The reports by NBRM showed improved performance in the current account in 2013 due to the improved balance of goods and services, amid reduced net inflows in current transfers and higher net outflows in income (NBRM 2014). The reduction in the trade deficit by 3 percentage points of GDP was mainly caused by a narrowing of the energy deficit, although the non-energy had the same, however significantly milder effect. The individual components of trade registered divergent movements. Exports, driven by the

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enhanced activity of the new capacities in the economy with foreign ownership, registered an annual growth of 3.2%, while the reduced demand for energy products and the annual decline in energy prices reduced the import component, causing an annual decline of 1.5%. Divergent movements in exports and imports caused stagnation of total foreign trade on annual basis. The exports of the companies from the industrial development zones were the most important driver of Macedonian exports in 2013, increasing their resilience, amid still unfavorable global conditions that caused a decrease in the exports of the metal industry. Also, increased exports of new companies were sufficient for offsetting the significant decline in the exported petroleum products, caused by the simultaneous reduction of the exported quantities and lower export prices. Price competitiveness indicators of the Macedonian economy showed a negligible appreciation of the Denar in 2013. The CPI-deflated real effective exchange rate rose by 0.9%, while the PPI-deflated REER recorded an annual appreciation of 0.4%. The change was entirely caused by the movement of the nominal effective Denar exchange rate, as a result of the appreciation of the domestic currency against the Russian Ruble and Turkish Lira, with favorable slower movements of domestic relative to foreign prices. Depreciation of the Ukrainian hryvnia, Russian ruble and Turkish lira against the denar had a influence for the further appreciation of the nominal effective exchange rate by 2% on an annual basis,and this caused upward pressures on both REER indices (NBRM 2014). The growth of foreign consumer prices and as faster growth in foreign versus domestic prices of industrial products, led to a decline in relative prices by 2.3% and 0.4% in the domestic price competitiveness. The REER deflated by producer prices appreciated by 1.5%, while the REER deflated by consumer prices depreciated by 0.7% on an annual basis. Also, relative prices of industrial products recorded a growth of 0.5%, driven by higher domestic prices. NEER appreciation continued in August 2014, annual change driven by the depreciation of the Turkish lira and the Serbian dinar against the denar.

Economic policies can be instrumental for growth in the near- and the medium-term in SEE6. On the fiscal side, sustained reform effort is needed to address structural rigidities in the budgets of SEE6. Priorities include:

Changes in the composition of public expenditure toward investment and away from wages;
Public expenditure targeting and prioritization, as well as
Improvements in revenue collection and the broadening of the tax base, among others.

On the monetary policy side, with regional inflation at a very low 1.2 percent and big output gaps remaining, some scope for short-term easing of monetary conditions exist, especially in those countries where deficits have begun to decline (European Commission 2014).
However, caution needs to be exercised in the economies with flexible exchange rates to ensure that these do not come under pressure. In terms of financial sector policies, addressing the high NPLs would be critical to ultimately restoring the growth of credit and supporting entrepreneurship and job creation. The region that provides greater long-term rate of real economic growth, and sustainable GDP growth based on profitable production with sufficient export content has a better chance of attracting foreign capital.

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Namely, international investors rightly expect to achieve high rates of return on invested capital in that region enjoying long-term sustainable economic growth. Thus, the trend of the movement of the real exchange rate euro / dollar mostly affect the sustainable rate of real economic growth, which is associated with net capital flows. Financial stability and the efficient allocation of macroeconomic level appear in each economy as an indirect product of successful political coordination. Variables such loans, the cost of funds and the real exchange rate are not aim of any instrument; transparency limits the extent to which they could be involved in decisions. The experiences of this region confirmed that alternative monetary and fiscal regimes, giving adequate political support, can provide very well low inflation. Much more difficult for assessment are the risk characteristics of the regimes.

In Southeast Europe, the conspirators for fixed and floating regime can easily underestimate the dangers which monetary policy are facing with during pre-assessment period (Bisev and Petkovski 2003):

Hard pegging is linked with the region with credible policy management, and they insulate the economy from shocks to the nominal exchange rate. But they may accelerate the expansion of non-hedging borrowing in foreign currency, and they put a high premium on the flexibility of the real sector in terms of shocks;

Meanwhile, the dynamics of inflation can question the early adoption of the euro as an exit strategy from that pegging. Flexible exchange rate facilitates the adjustment, and as part of a coordinated political effort can help in slowing the growth of risk in the balance sheet items. But to the extent that such risks are created over time, these modes offer no more than qualified safety valve in case of exogenous or policy caused shocks;

Regarding the stability of the money, i.e. price and exchange rate stability, in Maastricht Treaty is guaranteed that the stability of the price level is the main priority of monetary policy in the Euro area. What will be the actual performances of the monetary policy of the ECB does not only depend on the formulation of monetary policy objectives but also from the real sector movements in the economy;

It can be estimated that the real effects of monetary policy will be influenced by two conflicting groups of real factors. The increasment of competitiveness of the society will act to strengthen the internal and external power of the euro, and therefore the attractiveness of the euro as an international currency too. On the other side, there is a potential danger that may arise from low rates of economic growth combined with pressures in the direction of large fiscal deficits, which were associated with lower rates of growth and a greater participation of old population;

The challenge of managing rapid financial convergence is something that calls for risk-averse macroeconomic policies. But it also depends to a large extent by strong structural policies. Structural reforms are key for strengthening the tradable sector and other productive activities, but also in providing capacity for sharing resources between sectors and generally adjustment to the economy over time;

The process of real convergence should has balanced path of economic growth, with manageable external current account and real exchange rate dynamics during the convergence, as well as

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adequate capacity for adjustment in the medium term;

Challenges for fostering sustainable growth and preserving financial stability on the road to EU accession, are with full complementarity;

What can be concluded from the first aspect of the monetary framework which is best suited for managing the real and nominal convergence on the road to the euro, starts exactly from the view that inflation targets seem to have a better set of available tools than those that peg for managing the process of convergence with balance towards adopting the euro;

The main risk for targeters are excessive fluctuations in exchange rates, but if the policies are aimed at macroeconomic stability, the probability to make this reality is reduced. Then, the possibility danger is excessive appreciation of the nominal exchange rate, which is likely to lead the country toward expensive interventions or reduction of domestic interest rate that could fuel a credit boom. Options are limited for those who peg.

Acceptance of the euro: pressure for early date or achieving higher level of real convergence?

Leaving hard pegging before adopting the euro brings danger of losing the confidence and depreciation of the currency, which can create a deep recession in negative effects on the debt of households and firms in the country (where the debt is high euroized), as in the Baltic countries (Begg 2011:376). If the output is well communicated as a transition step towards early adoption of the euro, the recession may not occur or would be mild, in the country would become better positioned to contain inflation. Here the danger is that the appreciation of the nominal exchange rate can shift thus leading to loss the competitivity or worsening already weak competitive position.

So when the question is about the time for adoption of the euro: whether to make pressure for early date or to obtain a greater real convergence? The question of optimal time for adoption of the euro must be resolved. Potentially the most difficult criterion of nominal convergence is precisely the criterion for inflation. This is because it means bringing the convergence of price levels that can be achieved either through higher inflation or exchange rate appreciation. Control of the authorities in these two areas is limited because of the unlimited flow of capital and related restrictions on domestic monetary policy. Quitting tools of foreign policy can be a problem. If the approach associated with the factors that feed inflation as structural convergence of price levels and low levels of financial deepening that drives demand for credit is still strongly present in the economy, the loss of foreign exchange policy could lead to increased destructive cycles and derailing smooth convergence process, such as difficulties related to Latvia to cool the overheating economy. This is because it seems easier to keep the appreciation of the real exchange rate inherent in the process of approaching a greater or lesser balance by allowing nominal exchange rate to appreciate than keeping inflation steady direction after leaving all the flexibility, however limited independence of monetary policy. If overheating of the economy leads to loss of competitiveness and slow growth, it is difficult to recover through price and wage disinflation after the surrender of the independence

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of monetary policy in the eurozone, as the experience of Portugal.
It is not that easy to keep the nominal exchange rate equilibrium on appreciate current direction in terms of free movement of capital and globalized financial markets. These issues further developed their own assessment of the advantages and disadvantages of:

Pressure for early adoption of the euro and address the risks of higher inflation and the need to regain competitiveness without available tool exchange rate; or

Postponement of membership in the euro and its advantages and confronting the risks arising from volatility of exchange rates.

This dilemma could be approached from the perspective - where the country is in the process of convergence. If the gaps are close to GDP per capita and price levels are still quite large as the speed of convergence is on real high level, the country will have difficulties in controlling inflation in the monetary union. Consequently, it may be proposed to postpone adoption of the euro until they reduce gaps or differences.
Research can be seen that all new members in terms of traditional optimal currency area, their stance should not be an obstacle for adoption of the euro. Empirical studies show that membership in the monetary union promotes synchronization of business cycles and financial integration. New researches underline that the strength of the endogenous variables in the euro area is strengthened by the fiscal discipline embodied in the supervisory structure of the EU by reducing the probability of characteristic fiscal shocks (Ferrando *et al.* 2004).

Considerations for adoption the euro in a small and open economy – the case of Republic of Macedonia

As part of the EU accession, from Macedonia is expected to adopt the euro as its currency some time after the accession. The time for accession to the euro depends of two factors: is the country able to meet the necessary conditions and where the benefits of EU membership outweigh the costs (Buiter and Grafe 2002).

Macedonia appears to be relatively well positioned in bidding early entry into the EU as long as its macroeconomic policy can withstand the shocks to join into the EU. The adoption of the euro should promote increased trade volume with other members of the eurozone (Schadler 2004). Considering the size of Macedonia and dependence of the trade volume, trade expansion should be seen as an important benefit of the adoption of the euro. Therefore, Macedonia expects capital inflows, including more FDI, even before the adoption of the euro; there will appear political challenge in the short term as benefit in the long run too. As a small country, Macedonia has limited room for independent monetary policy. The standard arguments for optimum currency area in view of the importance of synchronization of shocks among the members has some validity, but many transition economies that once were joined into the EU didn’t experience a strong correlation of the shocks (Schadler 2005). Thus, the argument that appears is to

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be relatively early adoption of the euro if the process can be well managed. In doing so, this implies to the decisions on exchange rate policy and strong macroeconomic management. What kind of regime is needed to follow before or after accession depends of a certain part on how quickly the new Member States wishing to adopt the euro as its currency. The experience of the new EU Member States in terms of their choice of exchange rate is limited on two regimes: it can be called highly pegging, including the currency board arrangement and a floating exchange rate with monetary policy based on inflation targeting. The most advanced Member States have decided for a flexible regime and inflation targeting, while those with a higher volume of real convergence should begin to realize, such as Bulgaria and the Baltic countries, which opted for a strong pegging.

New Member States which adopt the euro were relatively well positioned in meeting the requirements of ERM II, and they have made significant progress in terms of real convergence. The consensus of researchers is that in ERM II and even before getting here, fluctuating exchange rate regime is the most appropriate for countries that are facing with greater capital inflows or euroization and there should be avoid soft pegging (Begg 2006). Leaving hard pegging before adopting the Euro can lead to confidence loss and the depreciation of the currency. The advantages of the strong pegging or fluctuation with inflation targeting poses several serious dilemmas for Macedonia, which has long maintained de facto pegged to the euro. Macedonian exchange rate regime serves reasonably well to the country. Currency maintains its value against the euro in trade and financial regime that grew with openness to the global forces. Reserves, in the time till the crisis period, increased and capital inflows are managed at acceptable costs of sterilization. But it is clear that the road to EU accession involves real rapid convergence, and it will release strong inflationary pressures through the Balassa-Samuelson effect, lower interest effects and so on (Schadler 2004). Macedonian competitiveness, measured by unit labor costs, is not in line with neighboring countries, so there is little reliance on the real appreciation of the currency without exposing the fragility of the balance of payments. To the extent that real and interest convergence will precede the EU accession, de facto pegging may come under pressure in inappropriate time. This, again, highlights the need for correction in energy prices and public conditions well ahead of access and development of measures as tax policy.

In the past few years, Macedonia rapidly moves closer to the more advanced transition economies. Several years in a row there is positive and stable growth rate. Although economic growth rates are lower compared to those of the Baltic countries, and in some countries in the region, this is a sure sign of acceleration of the process of real convergence. This process is also supported by FDI and portfolio investment as rapid credit expansion too (Hochreiter and Tavlas 2004).

Regarding nominal convergence, Macedonia is facing with challenges that are common for the most economies in the region and beyond. Thus, uncertainty regarding the movements of prices and expectations of pressure caused by the process of real convergence, are the main challenges for monetary policy in the medium term. Further, Macedonia is facing with significant transition challenges and only through effective decision of these challenges the country will be able successfully to compete on the EU market. To formulate effective policy, it is necessary researching of the growth of total factor productivity

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in Macedonia as well as the reasons for low business investment. Macedonia's membership in the EU can improve the industrial situation only if access to a large extent makes Macedonia location from which foreign investors can serve to the EU market. This means that the domestic industry, with FDI must make the necessary changes to its output. These long-term structural shifts in employment and output, can be accelerated through the accession of Macedonia to the EU, i.e. sectoral change can be an important driver of change in aggregate factor productivity and income of workers in different sectors of the economy.

Given the large gap in price and income per capita between Macedonia and the EU, price accepting will be an important source of inflationary pressure, as it faces the existing price distortions in the energy, municipal services, etc. Before accession it can move this factor as inflationary engine around the time of access where the effect of real convergence on inflation is combined with negative short-term effects of EU accession on fiscal balance, falling interest rates and so on. This will require careful management of the exchange rate. This means that, if the Macedonian real growth accelerates, Macedonia will be more attractive candidate for EU membership, but it will face with more intensive pressures to the exchange rate regime and macroeconomic policies. Labor, capital and product market, all these are transmitters of the monetary and fiscal policy, i.e. creation of a functioning and flexible markets is important, not only in terms of meeting demand competitive single market but in terms of creating a more effective government macroeconomic policy. Regarding Republic of Macedonia, it is important to keep in mind that the economic policies and reforms should be consistent with the reforms and policies of convergence and integration with the EU, as long-term strategy.

With the support of the estimation that showed elasticity bigger than 1, in a small and open economy such as the case of Macedonia, using real exchange rate as an instrument, here are recognized the performance of opportunity for export growth, increasing aggregate demand, increase economic growth. So, in future, exchange rates can be seen not only as an instrument for maintaining price stability in Macedonia, but also as a tool that will contribute to the economic stability of Macedonia, strengthening the stability of the financial system and supporting for fast convergence meaning accession to the EU.

Conclusion

The role of the exchange rate as a nominal anchor derives from the characteristics of the domestic economy, as a small and open economy that is highly dependent on the import of primary commodities. According this, Macedonian exchange rate can be used as an instrument for export performances of the country and macedonian policymakers should create policy with several aims focused on exchange rate policy because:

A competitive real exchange rate provides an incentive for exports;

The impact of exchange rates on trade should be seen in the context of continued integration of supply chains;

Exports generally include high import content and impact of foreign currency-exchange appreciation

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or depreciation on any finished product because it is complex. If the depreciation of the exchange rate makes its exports of finished products "cheaper", it makes imported components "expensive" for domestic producers;

Maintaining growth and reducing the unemployment in a small and open economy such as Macedonia depends from improved performance of exports;

Improving the performance of exports can help to preserve macroeconomic stability by closing the gap in the current account to avoid wasting supplies and to stop the growth of external debt;

Improving performance requires improving export competitiveness;

An outward oriented, market-friendly trade regime, which emphasizes the dismantling of import controls and tariffs (permitting access to inputs at world prices), and streamlined bureaucratic procedures, *i.e.* export and import procedures, modern customs administration and efficient value added tax administration will facilitate exports, including from SMEs.

How Macedonia could reach and sustain higher rates of economic growth thus speeding up the process of economic convergence too?

The researches offer options that include increasment of the labor contribution to economic growth by raising labor participation and reducing unemployment (Srinivasan and Archana 2011:49-58).The second options means improvement of allocative efficiency. This understands promotion enterprise restructuring and reforming product market regulation as including regulation in the infrastructure sector. Next options is focused on deepening trade integration by promoting export-oriented FDI and developing the supply of exportable goods, meaning that Macedonia would need to integrate its logistics infrastructure. Accelerating the process of economic convergence will be supported by fostering technological progress. The recommendations are focused on policy-makers, inviting them to identify what policies are politically feasible and to be checked for their consistency with the overall objective of raising and sustaining economic growth. Next, these strategies need to generate institutional requirements that are commensurate with the existing institutional endowment of Macedonia. This will lead to a near-term focus on deepening trade integration and fostering innovation, while measures related to expanding labor participation and employment could be adopted more gradually with a long-term perspective (Srinivasan and Archana 2011:50-53). These measures would better position the country to fully benefit from EU Accession and to better manage the effects of the global financial crisis, by strengthening Macedonia‘s international competitiveness. In addition to the policy measures directly recommended for deepening trade and fostering innovation, the following complementary policy initiatives would be required:

Advancing *enterprise restructuring* (privatization) and the promotion of stronger *market competition* (improving product market regulation and de-regulation);

Adjusting the *life long learning system* to market needs, encouraging *labor training* by firms, and improving the supply of (selected) skills by possibly reviewing *migration rules* for labor market segments where the skills-gap is binding;

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Political resistance to the trade and innovation measures associated to the proposed strategy is likely to be comparatively low, with the exception of enterprise restructuring efforts. C*ompensatory policies* for workers negatively affected by enterprise restructuring should be considered;

Preliminary evidence on the positive association between access to non-banking finance and total factor productivity suggests further examination of the role of non-banking financial institutions in the selection of investment opportunities and thus in fostering growth in Macedonia.

Summarizing, there are starting point to introducing high integration for structural adjustments and growth:

Faster productivity and quality catching – up;

Faster wage catch-up;

Faster upgrading of commodity structure leading to a faster disappearance of asymmetries in income and price-elasticities;

Impact on invisible and income accounts: more trade and transport services (balance impact neutral); more tourism in both directions; more deficits in other services (here lies one of EU's comparative advantages; more personal transfers;

Impact on capital movements: more FDI and portfolio investment; easier access to credits and better conditions for debt servicing;

Greater pressure towards reducing the "undervaluation" of the national currencies: speed up of institutional changes and market functioning will increase convergence of price structures; more pressure to achieve a higher level of international purchasing power because of greater tourist flows and more imports; more pressure to achieve monetary stability and use of the nominal exchange rate as an anchor with the view of coming closer to the Maastricht criteria;

Greater openness of EU market.

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