ASSESSING AND STREAMLINING POTENTIALS OF OPEN BALKAN INITIATIVE

RAPID MACRO-FORECAST:

POTENTIAL MACRO-EFFECTS OF COHESION POLICY – NORTH MACEDONIA

Center for Economic Analyses-CEA

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CENTER FOR ECONOMIC ANALYSES-CEA IS CONDUCTING A ONE-YEAR OSF PROJECT TITLED:

<u>ASSESSING AND STREAMLINING POTENTIALS OF THE OPEN BALKAN INITIATIVE (OBI).</u>

BACKGROUND

Recognizing the lack of interest of the EU in enlargement in the Western Balkans, Serbian President Aleksandar Vučić, the Prime Minister of North Macedonia, Zoran Zaev, and Albanian Prime Minister Edi Rama decided to "take destiny in their own hands" and launch a "mini-Schengen" in October 2019. In July 2021, this idea evolved into a regional initiative **"Open Balkan[1]".** The initiative is no substitute for membership in the EU, but a path to accelerated membership and utilization of the existing but insufficiently used potentials in these countries, which might facilitate additional economic growth and development, and thus, welfare for their citizens.

CHALLENGES TO KEEP THE MOMENTUM

Developing and cultivating neighbourly relations in the Western Balkans in expectation of economic prosperity will require eliminating border controls and other barriers in order to facilitate the movement of people, goods and services, and capital in the region. Regional disparities analyses (for example, coastal vs. internal, NUTS 2 and NUTS 3 regions, urban vs. rural, capital cities vs. other cities) of the Open Balkan countries might offer insights when determining priorities for more accelerated growth and internal convergence of the Open Balkan region. **At the moment, there is a lack of properly elaborated analyses to assess the existing challenges.**

The Covid-19 pandemic, the food and energy crises, and the war in Ukraine illuminate the importance of internal cooperation and coordination and need for mutual understanding and solidarity among Open Balkan countries. Internal coordination and cooperation, exchange of experiences, and solidarity in the region bring value to future EU integration if the Open Balkan countries can speak in one voice.

The region's external environment, especially now with the war in Ukraine, emphasizes the importance of cooperation and coordination and the need for mutual understanding and solidarity.

TOOLS AND INSTRUMENTS FOR ASSESSING THE POTENTIALS FOR ACHIEVING COOPERATION AND COORDINATION

While on the highest political level there is still evidence of political will for Open Balkan, on the administrative level, or "on the ground", people cannot really sense the benefits of this initiative just yet. **At the very least, what is missing is more evidence-based policy research on the bottlenecks in cooperation and potential of the six countries of the Open Balkan.**

ACTIVITIES OF THE PROJECT

An independent pool of experts from the six countries diagnosing and investigating the bottlenecks for cooperation and coordination among the Open Balkan countries will add value to the already demonstrated political will for the Open Balkan Initiative, leading to its more structured, priority-focused, and systematic development.

[1] By Open Balkan Initiative, we will define the territorial space of six countries of the Western Balkan-WB6: Albania, Bosnia and Herzegovina, Montenegro, North Macedonia, Kosovo, and Serbia.

The need for potential macro-effects of cohesion funds and link with OBI

<u>The primary goal of this sub-task is to estimate the possible effects of the cohesion policy funds once available, implying membership, in contributing towards shortening the convergence of North Macedonia with the EU.</u>

The disparities among WB6 countries are significant but not that much at NUTS 2 and NUTS 3 level (CEA, 2023a). Both regional processes OBI and BP, have advantages and benefits for the WB countries in terms of economic growth as a region and as countries individually (CEA, 2023b).

Even more, in the disparity analysis of the WB region countries (CEA, 2023a) we discuss the way forward for the region, concluding that the **WB6 countries have fallen into the trap of becoming and staying poorer,** indicating that it might be that the WB6 countries' poor performance means they cannot grow faster than the poorer countries because they have possibly exhausted their capacity to compete and are unable to grow faster than their richer peers as their capital stock is depreciated, have a capital stock deficit while their capital investments and FDI are on a lower level compared to their peers, etc. All this may **infer that the regional cooperation in any form, whether OBI or BP, may contribute to the convergence of the region to a certain degree, however the question is whether the full-fledged EU membership** (thus being able to tap into the cohesion policy funds) **may be more beneficial in fast forwarding the region via membership** rather than being 'trapped' into the hallway of the EU attempting to converge from the outside.

The forecasts indicate that in spite of the positive impact that the OBI initiative has on certain areas of the economy in the WB region, there is no clear evidence for the process to contribute to speeding up the economic growth of North Macedonia, or at least not without other economic measures and policies to complement the process. Furthermore, assumed that **all WB countries participate in the OBI initiative, projections showed that economic growth would pick up the pace, as firmer ground for export and investment growth is probable.**

Based on the same forecast (CEA, 2023b), Berlin Process on the other hand, provides the same advantages, though the overall regional impact would be somewhat less pronounced, compared to a scenario of full participation within the OBI initiative, despite certain differences observed on a country level. In simple terms, the forecast **implies to a degree that the OBI participating members will predominantly gain from the support enhanced movement of people, while the BP's contribution is more prominent via enhanced investment in infrastructure.**

Triggered by these finding, a quick macro testing was conducted for North Macedonia and the potential effects when access to the cohesion policy funds may be available. Regardless of the OBI or BP processes the access to the cohesion policy funds (CPF) as one of the pivotal policy, will become available with full member state (MS) status, **although the candidates are advocating for access to the CPF prior their full membership, exactly with the argument that this may contribute to the convergence of the region more effectively at the pre-accession period.** Compared to the OBI and BP tackling issues from different angles placing more emphasis on either labour, good and services vs. investments streamlining, the CPF are tacking via significant amounts of financial funds for both human as well as physical capital, increased administrative capacities and dealing with governance issues, with the overarching intent to reduce the inter-regional development gaps and enable convergence and cohesion on economic, social and territorial level.

Thus, it is our intend with this analysis to indicate that being outside of the EU will take WB6 countries' GDP per capita to catch up with the average EU-27 around 70 years, versus the possibility to tap into the possibilities the cohesion policy funds offer (implying full-fledged member state status), and whether and by how much the convergence period may be shortened.

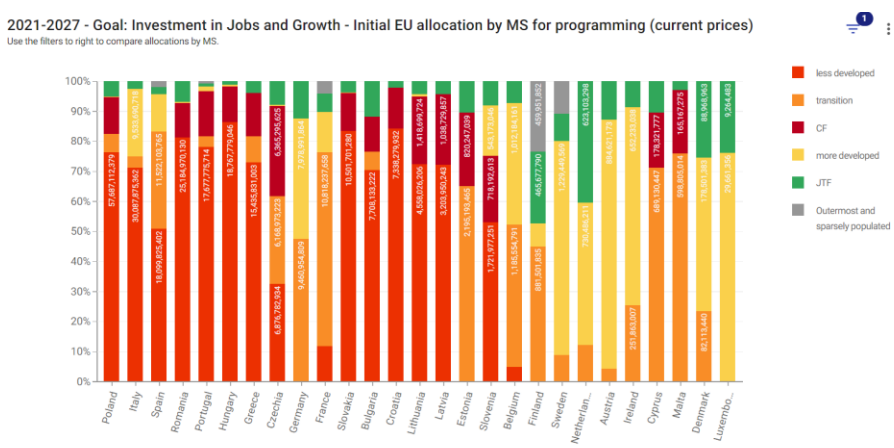
Understanding of the EU's Cohesion policy funds

The purpose of the Cohesion Policy Funds (CPF) of the European Union (EU) (also known as the Structural and Cohesion funds) is one of the five European Structural and Investment Funds (ESIF[2]), which was set up in 1994, and it is legally based on the Article 177 of the Treaty on the Functioning of the European Union (TFEU)[3]. The CPF was established for the **purpose of strengthening the economic, social and territorial cohesion of the EU in the interests of promoting sustainable development**[4].

The CPF are available to the 'poorest' member states and regions and are intended to help these regions achieve similar levels of economic development to other EU countries. **The eligible EU member state countries for using the CF are those whose gross national income (GNI) per capita is less than 90% of the EU average.** As of the current programing 2021-2027, the support is aimed at fifteen member states that satisfy the criteria[5] among which are the North Macedonia's neighbouring EU and peer countries such as Bulgaria, Croatia, Slovenia, etc. to strengthen the economic, social and territorial cohesion of the EU

The current CF programing for the 2021-2027 programming period is focused on providing support to the eligible member states (MS) by **funding environmental and trans-European network projects** (a) Investment in the environment, including areas related to sustainable development and energy which present environmental benefits; b) Trans-European networks in the area of transport infrastructure (TEN-T); c) Technical assistance. The budget for the CF 2021-2027 period, is set at EUR 42.6 billion with co-financing rate of the fund of up to 85%, while at the same time 37% of the total financial allocations are expected to contribute to EU climate objectives. The size of the budget per country varies and in absolute value, the largest percentage are dedicated for Poland and Czechia (European Parliament, 2023).

Figure 1 Initial EU allocation for programming 2021-2007



Source: Cohesion Open Data Platform *https://cohesiondata.ec.europa.eu/*

Since the mid-1980s, the specific weight of cohesion policy in the EU budget has increased and evolved. Historically, the reason for this has been the belief that increasing the support towards less competitive regions will counterbalance the negative consequences of economic integration. In 2001, the largest beneficiaries of structural funds in absolute terms were Spain (7 billion), Germany (3.5 billion), and Greece

[2] European Structural and Investment Funds (ESIF) - Over half of EU funding is channeled through the 5 European structural and investment funds (ESIF). They are jointly managed by the European Commission and the EU countries. The purpose of all these funds is to invest in job creation and a sustainable and healthy European economy and environment.

[3] Full legislative on CF here: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32021R1058

[4] See more here: https://www.europarl.europa.eu/factsheets/en/sheet/96/cohesion-fund

[5] Member States eligible for CF 2021-2027: Bulgaria, Croatia, Cyprus, Czechia, Estonia, Greece, Hungary, Latvia, Lithuania, Malta, Poland, Portugal, Romania, Slovakia and Slovenia

(2.9 billion)[6], which due to the enlargement with new member states (MS) that followed the distribution per country resulted in major changes to the ranking, with and increasing share of the new MS. Recently, for example in 2021, the top beneficiaries were Hungary (2.6% of gross national income), Poland (2.4%), Lithuania (2.2%), and Slovakia (2.2%)[7] (Saraceno & Cerniglia, 2020).

However, the extent to which cohesion policy has reduced social and economic disparities is open to question. Greece, since 1981 when it joined the then EEC, has been particularly favoured by the Structural Funds and Cohesion Policy. Even today, despite the enlargements, and due to the sharp decrease of public investments after 2010, 80% of public investments in Greece are co-financed.

The cohesion policy is not considered a classic 'welfare policy', as the EU subsidies are **primary spent on infrastructure projects and programs to upgrade human capital with the aim of improving competitiveness of the recipient regions**. For example, cohesion policies in the period 2021-2027 will be guided by five main objectives which include projects on climate, strategic networks, innovation and digitalization, employment and healthcare, and sustainable urban development).

Furthermore, cohesion policy does not only benefit the 'poor' MSs, but it is a regional policy, and the objectives are designed in such a way that every member state can claim to have a region which qualifies for aid from one of the different structural funds (from the ERDF and ESF+) allocated in three categories of regions: less developed, more developed, and regions in transition. While some countries benefit from the Cohesion Funds, some regions with specific needs receive dedicated funding such as the outermost regions and sparsely populated regions, and all countries benefit from the Just Transition Fund (Papalexatou, 2023).

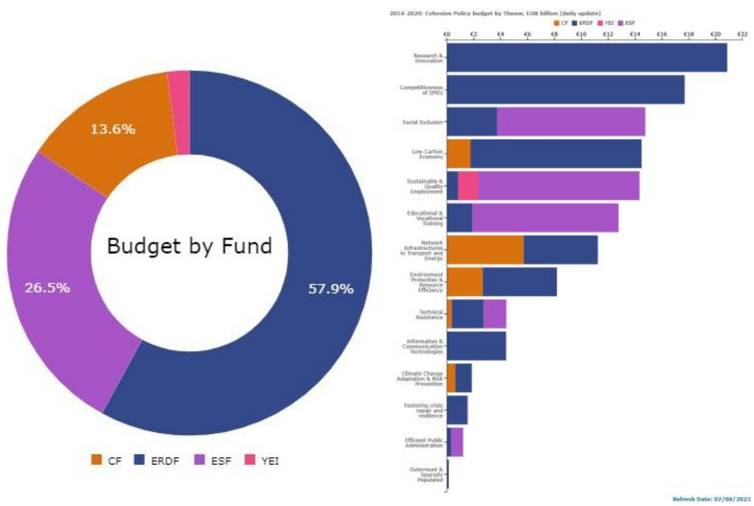
- Cohesion Funds 2014-2020 - The cohesion policy has an overall budget of €63 billion for 2014-2020, and is still under implementation, until the end of 2023 (n+3) for completion of the ongoing investment projects. The largest budgeted portion is for the European Regional Development Fund (ERDF) with 57%, followed by European Social Fund (ESF) with 27%, the Cohesion Fund (CF) with 14% and the remaining for the Youth Employment Initiative (YEI)[8]. On the side of the themes supported by the funds, the largest by far is the support from ERDF for Research and Innovation, followed by SME competitiveness. Further down is the support for social inclusion and low-carbon economy, etc. as a combination support from one or more of the funds. (See Figure 2).

[6] As a percentage of gross national income, Greece (1.9%) was in first place, while Portugal (1.5%), Spain (1%) and Ireland (0.6% of gross national income), the "cohesion countries", followed at some distance

[7] Greece was in 12th place (1.3% of gross national income). In last place, the Netherlands received cohesion funds corresponding only to 0.02% of its gross national income.

[8] When referred to in the text as cohesion policy funds – CPF, we refer to all cohesion policy funds jointly unless specified

Figure 2 Cohesion Policy Budget by Fund, EUR billion



Source: Official data portal on Cohesion Policy

Allocation process is complex - The cohesion policy is considered as one of the most significant areas as it is accounting for around a third of the budget of the union. Each MS is entitled to spend a fixed sum, channelled through different funding mechanisms, pursuing cohesion objectives. The processes determining the amounts available to each of the Member States are relatively complicated considering an array of aspects, conditions and criteria. The allocation principles based on a methodology with general principles (followed by alternations) is valid since the 2000-2006 programing period, with largest effect of the relative wealth of a region (regional population and the prosperity gap), as well as other criteria for allocation concerning labour market and education (ECA, 2019).

- The planned support is different for three types of regions (less developed, in transition and more developed regions). For each of the regions the criteria are adjusted and further differentiated by the funding mechanism. Each strand is then based on main factors (regional prosperity gap, population), adjusting coefficients (GNI weights, or socio-economic criteria, etc.), and additional premiums (unemployment, youth unemployment, education, greenhouse emissions, etc.) which further on are defined by national caps and safety nets (ECA, 2019). For example, the cap for the current programing period in terms of GDP is set at 2.3% (if GNI/head is <60% of EU average), which has been reduced from 2.59% of the former programing period. Nevertheless, the planned amount is executed to a different degree depending on the absorption capacities of the country and region (for example the average absorption capacity 2007-2013 has been in average 53% (Zaman, 2014).

Brief review of approaches on assessing cohesion policy effects

As EUs primary investment policy is cohesion policy and second largest only to the Common agricultural policy-CAP, the effectiveness in delivering its objectives of promoting a balanced development and reducing disparities is on one hand essential however, particularly challenging for macroeconomic aspects. The challenge arises from the aspect that the abundance of monitoring data from the programmers concern the output or at best the outcome of the interventions however, cannot provide information on their global impact.

The empirical literature primarily takes two main approaches to assess the macroeconomic impact of cohesion policy, through econometric analysis and through model simulations. Econometric estimations are based on cross-country or cross-region growth regressions augmented with cohesion policy variables. The results of these studies have generally two outcomes, which depend on the coverage, timeframe, territorial coverage, the methodological approaches and indicate either**: a) a positive impact of cohesion policy on economic growth or b) report inconclusive impact (as statically insignificant).**

Some contributions which conclude on a positive and significant impact, for example Dallerba (2005) finds a positive relationship between regional growth and structural funds (for the 1990s), Beugelsdijk et al. (2005) as well (for the period 1995-2001) prior the joining of the then new MS also find positive impact, especially in closing the regional dipartites of the poorer countries, and further discuss that larger share will be reallocated to the new MS however the expectations are that it will contribute to higher economic growth in these countries as well. They estimate that if the change in the rate between the structural funds and the GDP changes by 1 pp, the GDP growth will increase by a 0.32 pp.

Other empirical studies find conditional factors contributing to the economic growth, induced by the cohesion funds such as the country's degree of trade openness, level of institution quality, or regions' absorption capacity, etc. And the last group are empirical studied pointing to no evidence of statistically significant impact of the funds on the economic growth and regional disparity.

The second group of studies analysing the cohesion policy impact are based on model simulations using various models which have been focused on specific regions. In general, the model-based simulations[9] incline to report sizeable impact of the policy, with some sufficient drawbacks of the model approach primarily pointing at the assumption of fully efficient spending. The RHOLOMO model is particularly used for the assessment of the last program period policy (EC, 2022) with the application of dynamic spatial general equilibrium models (Lecca et al. 2018). The estimates for the 2021-2020 are that the EU's GDP is estimated to be up to **0.4pp higher by the end of the policy as compared to no policy**; furthermore, the estimates indicate that in the long-run the policy continues to have positive impact and returns in the next two decades from 0.3 to 0.25pp per annum to the GDP.

Disparity between the Macedonian and MSs' economies

The Macedonian economy measured through the GDP per capita (in PPS) and compared to the EU's average as one general comparative indicator used in the cohesion funds policy (Figure 3) has reached 42% in 2022, from 34% in the 2011 and is below the 50% mark, as are all Western Balkan aspiring countries[10].

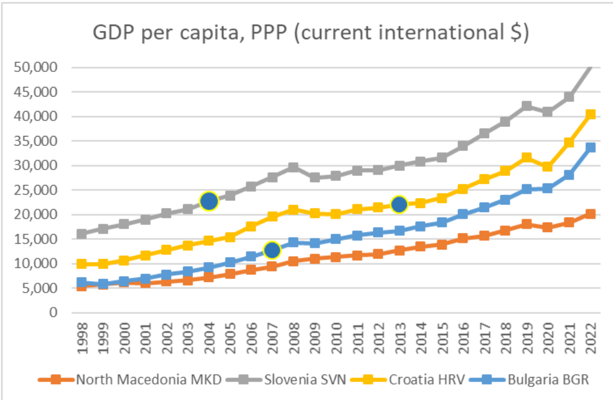
Compared to certain neighbouring and regional peer countries which are already MS, for example Bulgaria as a longer time MS, reached 59% of the EU(27) average GDP per capita (from 46% in 2011), while Croatia as most recent member state, has improved from 61% of the GDP per capita in the accession year (2014) to 73% of the EU's average in 2022.

The intracountry regional disparities though also remain large, not only among the aspiring members but also among the MS. All the same, according to the EC's latest eighth cohesion report, *"[due] to Cohesion funding, the GDP per capita of less developed regions [in EU] is expected to increase by up to 5% by 2023. The same investments also supported a 3.5% reduction in the gap between the GDP per capita of the 10% least developed regions and the 10% most developed regions."*

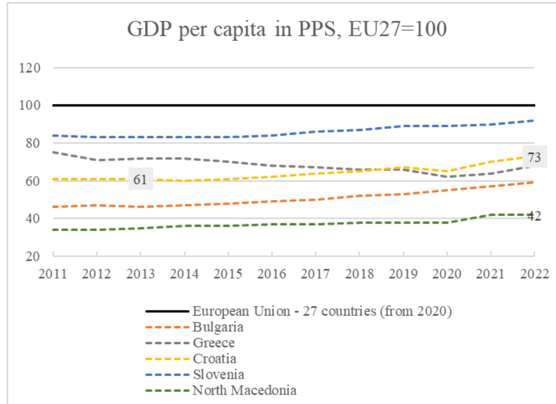
[9] For example, models used and reported in empirical studies on the macro effects of cohesion policy funds among others: HERMIN, EcoMod, GIMF, QUEST, SIBILA, RHOMOLO, etc.

[10] Source: Eurostat, GDP per capita in PPS EU(27)=100, for 2022, BiH=35; Montenegro=50; North Macedonia=42; Albania=34; Serbia=44

Figure 3 GDP per capita, EU(27) and selected countries in the region



Source: World Bank Data, WDI database
Note: * year becoming MS



Source: EUROSTAT, GDP per capita in PPS

The access to the cohesion funds especially the ERDF is an immense opportunity for North Macedonia, as for the other WB candidates, as it has been for the member states, since it contributes with different degrees to speeding up the economic growth and reduce the gap with the rest of the EU via the channel of taping into the opportunities especially of increased public capital investments and reduce the capital infrastructure quality gap as well as human capital.

With a scarce and limited domestic level of funding for public investments, the policy is perceived as the 'unique opportunity' to boost economic growth and improve overall the living of the citizens. The rate of public capital investments in North Macedonia have been fluctuating in the past decade with significant rate of underutilization of the state budget plans compared to the actual investments. The relative indicator of the capital investment to the country's GDP has been on average around 3%. In the last five-year period on a per capita level it has been annually in average around ~160 EUR, which has increased from 140 EUR per capita in 2019 to 254 EUR per capita in 2022[11].

Compared to the much lesser amount and experience in access and managing pre-accession funds it is an **imperative precondition for cohesion policy to build adequate absorption capacities of the countries administrative and management structures.**

The degree of actual utilization of the potential cohesion policy funds especially and mostly aimed at the increased investments will highly depend on the former efforts and investments in building human capacities for larger undertakings in hard capital investments together with necessary structures for management of large capital projects.

The question of the absorption capacities i.e. the limited capacity, has been a significant bottleneck for former candidate countries, now MS, as well. For example, Croatia, although it had a fairly good performance in the pre-accession funds absorption capacities. Learning from the Croatian experience, there is a necessity **to pre-emptively prepare for increasing capacities for improved absorption and efficiency and effectiveness**. Insufficient institutional capacities have been highlights as a major obstacle for Croatia therefore the proper and effective usage of the precession funds for building administrative and management capacities, preparation and management of complex infrastructural projects (continuous delays and struggles) preparation of the new programming, legislative and management framework for the

[11] 2022 has been a peak in the total capital investments from the state budget reaching 465 mil EUR, furthermore the Census 2021 indicated a population decrease from the population estimates of 2.07 million to 1.84 million, which is a decrease of over 11%.

management while transitioning from pre-accession funds, which has caused 'absorption shock' in the new MS post-accession.

Furthermore, the usage of the **investment funds is conditioned by thematic investments, and performance conditioned.** In the last 2022 EU progress report of North Macedonia the issue of weak administrative capacities for IPA II pre-accession funds is clearly stated: ["*The institutional framework for the management of the EU funds under IPA II is established but its performance is jeopardized by the weak administrative capacity… The low staffing levels across IPA structures continue to put pressure on the established financial management and control systems and to negatively affect the quality of procurement, evaluation, contracting, control, monitoring and implementation functions. The low staffing levels and weak administrative capacities across IPA structures cause delays in the implementation…*].

Important to stress is that although the cohesion funds all together are primarily perceived as a predominantly source for investments especially for enhancement of hard infrastructure investments, these are merely solely the direct and largest monetary opportunities. However**, it is an error to equate cohesion policy only with increased investment opportunities, especially for the new comers with lower governance capacity, as the cohesion policy provides a range of policy benefits resulting in tangible benefits for the citizens and for the private sector**, due to the necessity of multiannual planning, partnership, monitoring and evaluation for policy learning (Bachtler and Gorzalek, 2007; Mairate, 2006).

Furthermore, it influences significantly the shift of a national policy interventions away from the traditional infrastructure and business financial assistance and focus on human capital development, research and innovation, social development and as of lately environmental transformation. These shifts that may not be directly tangible however particularly relevant for newly entering members with underdeveloped regional policies. (Adams et al. 2011)

Croatia as a baseline for the assumed cohesion macro-effects

The considerable resources devoted to the cohesion policy in 2014-2020 amounted to around 355 billion EUR (current) which is an injection of ~0.3% of the EU's GDP per year. Behind the total amount there is a territorial heterogeneity as the funding is channelled to less developed regions, thus some MS receive more than 2% of the GDP per year on average which peaked for Croatia of 2.5% of the GDP.

As for the thematic support it also varies as primarily for the less developed countries and regions the primary chunk goes to transport and other infrastructure while in others which are more developed is allocated for research and development and human capital[12]**.**

The cohesion policy funds[13] available for Croatia as planned for the programming period amount around 10 billion EUR (~2.450 EUR per capita). The actual spending of eligible costs for each of the programs to the end of 2022 is totalling to 8.56 billion EUR cumulative, and average per annum of 1.1 billion EUR with increasing trend. The average spending amount per annum per capita for the period 2014-2022, is 237 EUR, with peak annual amount of 503 EUR per capita at 2022.

Provided the process the usage of the funds is incremental with no funds in the first two years of the program with exponential increase and peak in the last years. Beside the increasing usage trend the difference of the planned to the actually eligible spend amount is an indicator of necessary preconditions and the necessary capacities as essential element for actual absorption of the funds.

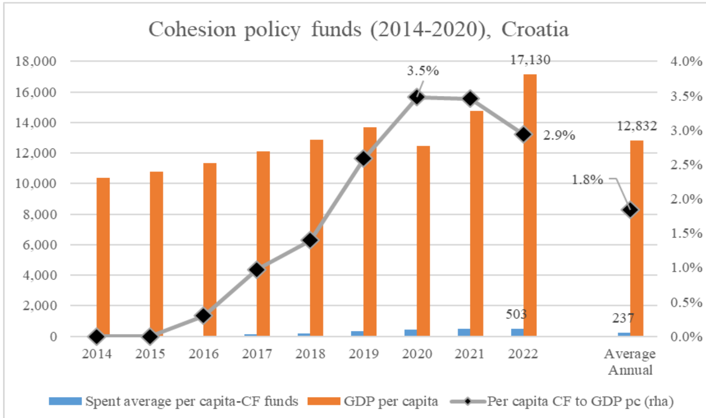
The total decided/selected projects' value to the actual spend up to and including 2022 (with possibility for funding until end of 2023) for Croatia for the programing period is 81.1%. The total average amount per

[12] For the programing period, Romania 62% for transport and infrastructure, Netherlands 12% while 82% for R&D and HC

[13] Cumulatively from European Regional Development fund – ERDF, European Social Fund - ESF , Cohesion Fund - CF and Youth Employment Initiative – YEI,

capita for the period amounted per annum are 1.8% of GDP per capita with incremental rate starting in the start of the period towards the completion of the programing period.

Figure 4 Cohesion policy funds plan spent Croatia



Source: Author calculation based on data for Cohesion fund policy funds and EUROSTAT for GDP

There are however rather limited research that explicitly and conclusively takes that stance of economic output or macro effects of the cohesion policy funds for the countries and especially for the more resent one such as Croatia, due to the complex nature of the overall process and the difficulty in extracting the effects exclusively from the amount as well as quantification of the macro effect, it is more common and part of the evaluation process of the EU to estimate the effects per specific project via different approaches and methods[14].

Scenarios for North Macedonia

Model basis

The assessment of the macro effects of the possible effects of cohesion policies through primarily through injection of capital investments as a possibility is assessed via Micromacro model for North Macedonia. The model is based in a Macroabc methodology for constructing an integrated data, forecasting, through a simulation macro financial programming models.[15] The model is aggregate demand, aggregate supply model (AD-AS) combining macroeconomic theory and pragmatic modelling, with both data and forecasting/ simulation module for medium- to long-term scenarios, which may serve as a base discussing macro-economic policy issues. The model runs in an excel spreadsheet distinguishing between primary variables and secondary variables. Primary variables may be exogenous or endogenous. Endogenous variables may be further subdivided into behavioural, institutional, and identity variables. Equations for behavioural variables are mostly based on a theoretical foundation, while institutional variables reflect the institutional context of the country. Secondary variables are all endogenous, as their equations are identity relationships linking these secondary variables to the primary variables.

Baseline scenario – 'As-is'

The baseline scenario considers a ten-year period scenario of economic development and macro movement based on the historical progress and movement. In this scenario given the past period of the economy of

[14] See more on https://ec.europa.eu/regional_policy/projects/projects-database_en

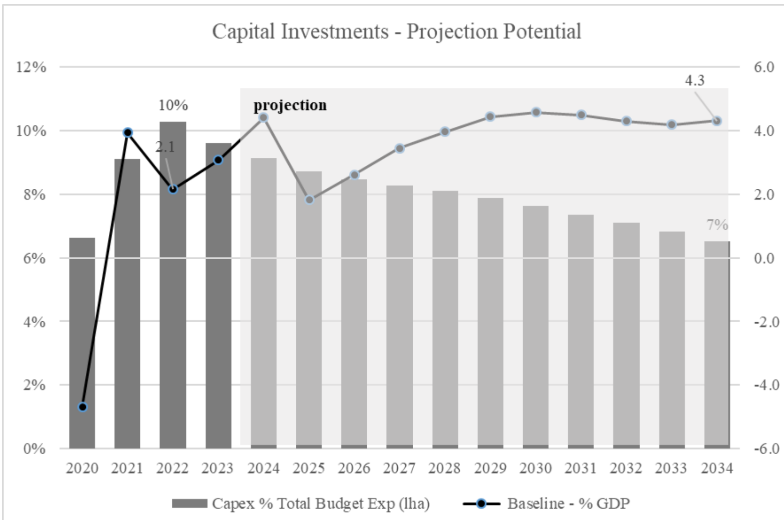
[15] The model is originally designed by MMC from the Netherlands based on models from the Dutch CPB. See more: https://cea.org.mk/tsea-macroabc-mk-model/.

North Macedonia and the Macroabc aggregate demand, aggregate supply model (AD-AS) serves as a no significant change of policy scenario, 'as-usual'.

Public investments – Budget Capital Expenditure

Provided the trend of volatility of the size of capital expenditure of the budget while the promising last few years increase of the size compared to the overall budget (exceeding the 300 million EUR), within the baseline it is assumed that the capital investment size will remain at the maximum reached (465 mill EUR) in 2022 while the rate of increase of the overall budget will stabilize and will increase by average of 4% per annum in the next decade, thus maintaining the capital expenditure to the budget of an average 8%.

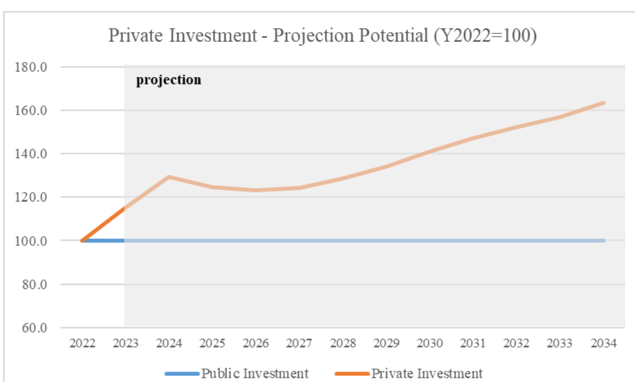
The potential economic growth rate ceteris paribus has the potential to reach 4% per annum. Nevertheless, we are aware that the constant economic growth rate of ~4% is optimistic given the historic trends (average in the past decade of 3%, excluding 2020).



Source: Author calculations based on historical data from MoF and projections on macromodel

Private Investment

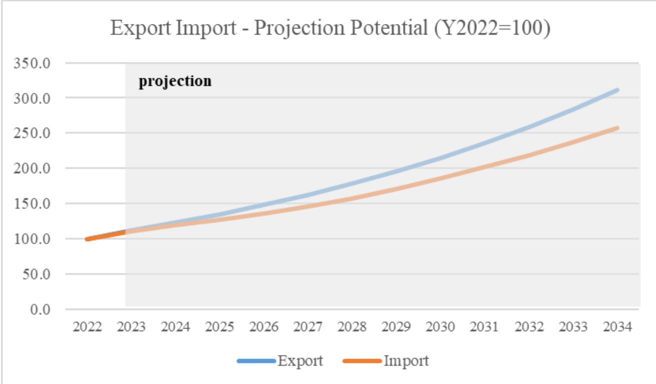
Private sector investments growth pace is expected to catch-up the decline in the covid-19 and post covid-19, and then stabilize with a lower marginal growth rate trend. The slower pace of growth to follow is caused by the decreasing export competitiveness and continued increasing import growth, as well as increasing price of the borrowing capital – domestically.



Source: Author calculations based on historical data from MoF and projections on macromodel

Import / Export

Based on the historical movement of the export and import volume, the baseline scenario assumes the continuation of the trend and average increase of the exports per annum for the next decade of 10% while imports of 8%. The export is expected to have a higher marginal growth compared to import, with increased export price competitiveness.



Note: cumulative change projections, base index Y2022=100

Source: Author calculations based on historical data from MoF and projections on macromodel

Alternative scenario – 'Access to Cohesion Policy'

The alternative scenario assumes a forecast period of ten years, and does not necessarily start immediately but any period when potentially the funds may become available. The nature of the policy and the funds implies that in the first two years there are practically no actual spending - provided the experience and construct, as it is necessary for project preparation, acceptance and then the actual usage of the funds.

Furthermore, however the funds are available for an extended period of time in addition to plus three years beyond the programing period (n+3 rule) due to the same reasons for completion of the accepted projects. Thus is it implied that the effects will continue to have effects beyond the programing period, given the nature as well as the long term effect expectations.

The scenario 1 implicitly takes into account the current state of play, respectively the current structure of the economy and the macroeconomic policies beyond the alternative scenario assumption. The basic assumption is the increases of public capital investments from n+2 with increased spending of public capital investment of increasing amount from as low as 30 EUR per capita per annum (n+3), increasing up to over four hundred euro per capita with an incremental trend,[16] above the baseline scenario, and high degree of efficiency. The public investments under this assumption will have its peak increases compared to the baseline in the year seven to year nine, resulting in expected value of increased capital investments of almost 1.5 times than the baseline scenario in the peak years.

Furthermore, the CP funds are also targeting the human capital development especially through the social funds. Following the same logic, the second assumption is that the social funds will contribute to the increased spending via the channel of the transfers in the current expenditures, from n+2 starting from as low as 4 EUR per capita to one hundred EUR per capita in the peak year with an incremental trend. The social investments under this assumption will have its peak increases compared to the baseline in the year

[16] The assumed trend is following the case of Croatia, under the assumption that the capacities developed will be comparable to the absorption capacity of Croatia

five to year eight, resulting in expected value to increase on average 4% per annum compared to the baseline scenario.

The size of the potential expected funds is under a key assumption that the country, i.e. the institutions within RNM, will have at least the capacity to absorb these funds with the same capacity and incremental capacity build up as did Croatia in the last programing period, as it became a full-fledged MS.

We are aware that the foremost role of the cohesion policy is contributing to closing the gaps of disparities between regions within the countries as well as among the regions, however in a constellation of lack of data however as well the abundance of assumptions and options we will abstract ourselves from such an attempt.

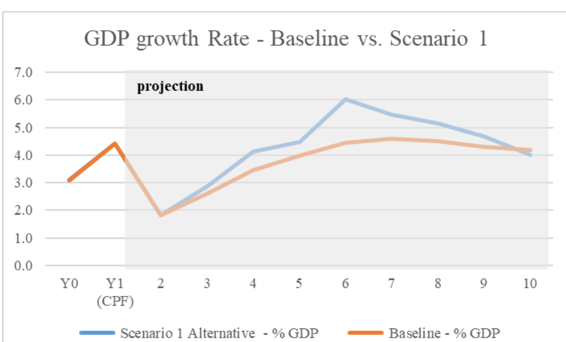
Results

Forecast of a sample of indicators is provided for a period of ten years and does not imply that the forecasting period starts from 2024 but rather that the country given the current and past structural developments if the cohesion policy funds become available 'tomorrow' (implying full fledges membership) there will have expected potential implications. Furthermore, it also implicitly takes into account the current state of play, respectively the current structure of the economy and macroeconomic policies being implemented as basis.

The forecast encompasses the impact after under the assumptions that a certain level of capacity for absorption are in place and these will increase in the same time. Also, potential multiplying effects that could arise from further policy measures that encompass within the fund and are specific to private investment policies and specific social policies have not been taken into account.

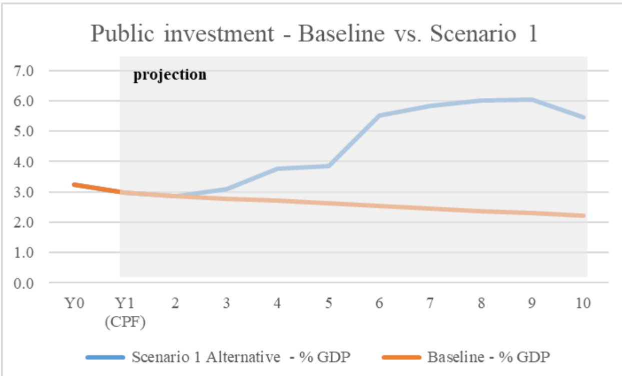
Results in tables per indicators present the average annual difference in pp for a period of ten years relative to the baseline scenario.

- **Accelerated GDP growth:** The access to the cohesion policy funds under the above assumptions is expected to accelerate and to contribute to the growth of the Macedonian economy of the country with noteworthy effect of average 0.5 p.p. per annum in a ten-year period. The intensity of the contribution is expected to be incremental, following the CPF 'spending' trend with highest intensity in the peak period of around the sixth year.

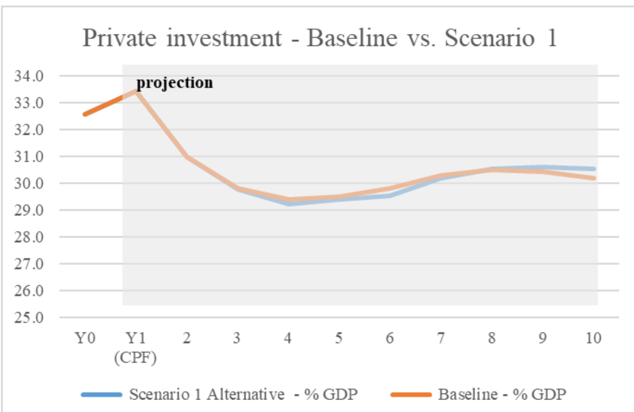


	Annual (%)
S1: Access to CPF	4.3
S0: Baseline	3.8
AVG difference (p.p.)	0.5

- **Gross investments:** the access to the CPF is expected to significantly contribute to intensification of the public capital investments with average 2 pp above the baseline average per annum. The CPFs are largely considered as a unique opportunity for public investments especially in hard infrastructure as an essential production factor. Given the recognized capital stock gap within the WB region (see more in (CEA 2023a) the access to the CPFs will contribute to a certain degree in converging and closing the gap, predominantly through primary and hard infrastructure. Nonetheless, the efficiency of capital investments needs to be intensified (and waste reduced) for the effects to take place. Shortages of core public infrastructure in the WB is considered to be a significant obstacle for higher economic growth and faster income convergence (IMF, 2018).

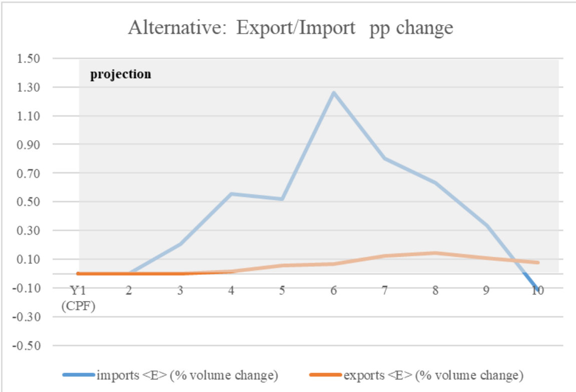


	Annual (%)
S1: Access to CPF	4.5
S0: Baseline	2.6
AVG difference (p.p.)	2.0



	Annual (%)
S1: Access to CPF	30.4
S0: Baseline	30.4
AVG difference (p.p.)	0.0

- **Export / Import** – trade in terms of exports and imports are expected to be intensified given the full fledges membership, implied with the CPF, as it is expected to have open access to the common market. Nevertheless, given the low level of competitiveness of the domestic production it will boost the exports however will open up wider horizons for the imports from the EU market which is even now by the primary trade partner. This assessment confirms the dependency of the economy of the imports and the disparity in competitiveness between the domestic vs the EU market.



	Annual (pp) difference
S1: Export – Access to CPF	0.1
S1: Import - Access to CPF	0.4

Table: Summary of projected ten-year average impact per annum, in pp

	GDP	Public investments	Private investment	Export	Import
Access to CPF vs. Baseline	0.5	2.0	0	0.1	0.4

- **Increased GDP growth rate** averaging with contribution of 0.5 pp per annum, with contribution starting n+3 and with increasing contribution, with reaching peach in year six while with expected multiplication effect following the programing period.

- **Public capital investment is expected to positively increase** by 2 pp per annum in average with CPF access, with a gradual but incremental pace with peak momentum starring from year six and onwards.

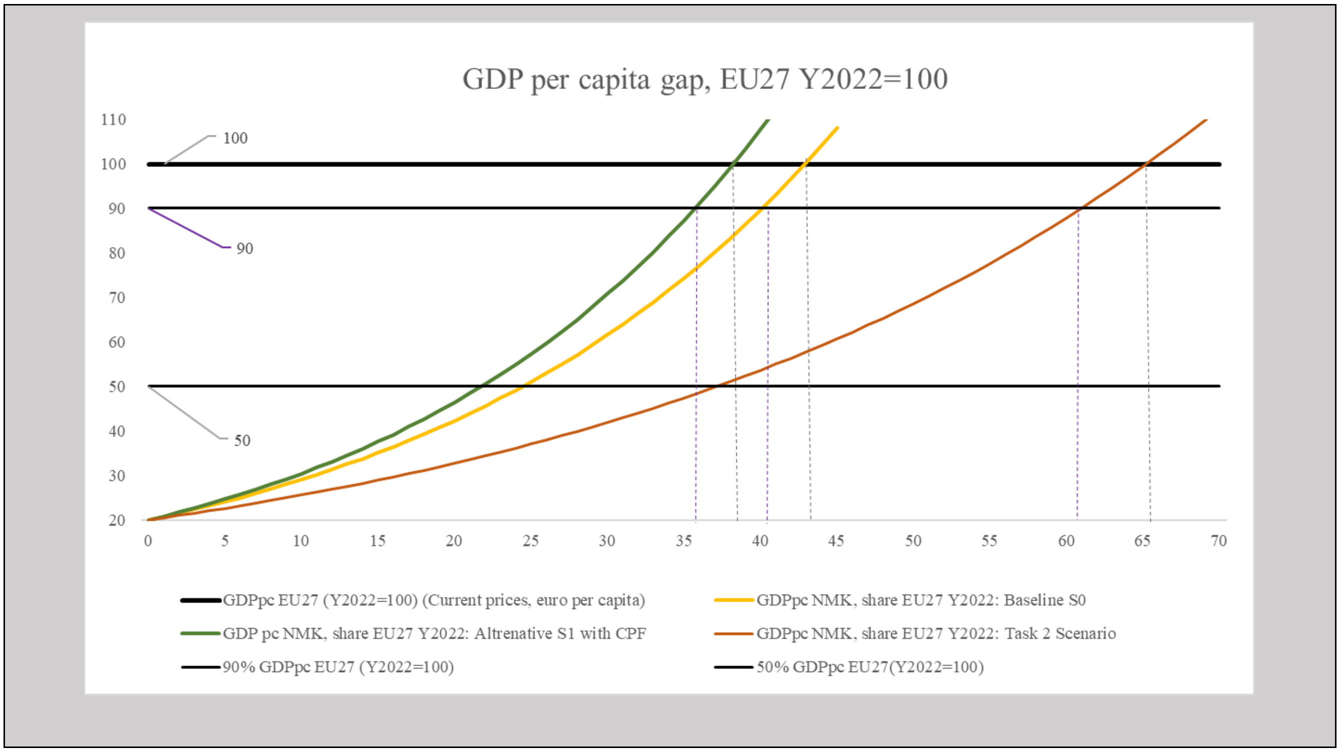
- **Export is expected to react slowly** with annual positive change of 0.1 pp, while imports are expected to react more robustly with 0.4pp average annual change.

Box 1: Converging towards today's EU per capita GDP may take over four decades

Being 'stuck in the transition' and failing to match the standards of the advanced economies is a reality for the WB countries. The forecasts in number of years of reaching the todays' average GDP per capita of the EU are estimated for North Macedonia under three scenarios, all under the assumption that the EU's average GDP per capita stays at 2022 level in the Table

Average EU 2022 GDP/ Scenario	50%	90%	100%
Historical/years	37	61	67
Baseline/years	25	40	44
Access to CPF/years	22	36	39

We illustrate this in the next graph as well.



Conclusion

The OBI participating members are expected to predominantly gain from the process via enhanced movement of people, while the BP's contribution is more pronounced via enhanced investments in infrastructure. All of the WB6 countries are expected to eventually gain access to the EU cohesion policy funds, as member states, thus gaining benefits simultaneously enhancing human and physical capital via significant financial support for converging with the other MSs.

As the WB6 countries can be classified as likely fallen into the trap of becoming and staying poorer with exhausted capacity to compete and grow faster, with the rapid modelling we infer that the regional cooperation in any form whether OBI and/or BP may contribute to the convergence of the region to a certain degree, however the **full-fledged EU membership may be way more significant in accelerating convergence with EU average**.

North Macedonia as a country within the WB a region would have better economic perspectives if part of a certain regional integration initiatives, whereby effects are maximized when participation of all countries is ensured (CEAb, 2023) nevertheless the befits are expected to be higher as part of the EU with access to the CPFs.

Providing that North Macedonia gains access to the CPFs (implying membership status) and has an adequate capacity in making uses of the opportunity as well as efficiently manages the processes, the forecast shows that economic growth would pick up the pace more robustly as there would be a significant influx of investment opportunities, competitiveness enhancement and access to a large market.

- **Economic growth** – is expected to be sped up by 0.5pp per annum with than no cohesion policy access. The impact is expected to be incremental and persistent and it is expected to have impact even after the implementation period. The policy is expected to boost productivity and stock of capital, i.e. especially public capital and stimulate economic activity and improve economic structure. Although the forecast for North Macedonia with the OBI participation and/or BP processes does not forecast a significant impact, the CPF access does significantly have advantage in the growth accelerating role.

- **Investments**, especially in the public sector are to significantly accelerate through the funds as by construct the policy places a pivotal essence on these and providing significantly large pool of funds for capital investments which is very necessary given the current condition of the public capital stock quality. The CPF access compared to the regional initiatives of OBI and/or BP provides superior forecast in acceleration to the public investments. The access to cohesion funds is opportunity for the country to access funds which are scarce however highly needed to boost the economic activity.

- **Export** is evidently an area that it is expected to have a boost from full access to the common market, nevertheless the impact is expected to be lower that the regional initiatives. This implies that the exports of the country may have a greater advantage within the region being more comparable in competitiveness rather than the significantly more developed EU market thus not being ready to deal with the competitive forces yet, versus the accelerated imposts expectation.

- **Overall recommendation:** Results that are presented should be seen also as an indication that attention of policy makers should not drift from the structural reform agenda and the path towards the EU integration as the best possible option for development and regional cohesion. The access to cohesion policies will tighten the gap between the EU and North Macedonia faster, shortening period necessary to converge towards the EU's average.

  To unlock the economic growth possibilities, the country should reform and address key structural challenges in line with the European policies. It is though essential that the preparedness for absorption and capacity for management of the cohesion type of funds is essential ingredient that enters into the public sector management systems and governance structures capacities.

- **This rapid analysis for North Macedonia related to the convergence with the average EU's MSs should be done for all WB6 countries.** Given the constraints our project has in resources we do recommend that this exercise is executed for each of the countries in the WB6 region and make a comparison with the macro modelling results of the OBI and BP estimation effects.

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