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PRESIDENCY CONCLUSIONS OF THE MINISTERIAL DIALOGUE BETWEEN THE ECONOMIC AND FINANCE MINISTERS OF THE EU AND THE CANDIDATE COUNTRIES ON 14 MAY 2008

On 14 May 2008, the Economics and Finance Ministers of the EU and the candidate countries, representatives of the Commission and the European Central Bank as well as representatives of the central banks of the candidate countries met for their tenth economic policy dialogue with a view to enhancing the dialogue on fiscal and economic policy, in line with the 26/27 November 2000 Ecofin Council statement.

Ministers welcomed the economic policies in the 2007 Pre-accession Economic Programmes (PEP) of Croatia, the former Yugoslav Republic of Macedonia and Turkey. They acknowledged the progress achieved by the candidate countries in stabilising and transforming their economies and endorsed the following conclusions regarding the assessment of these programmes:

Croatia

- Croatia's fourth Pre-Accession Economic Programme for 2008-2010 presents a largely coherent medium-term macroeconomic and fiscal policy framework. Its key objectives are to ensure solid growth, reduce unemployment and improve the competitiveness of the Croatian economy.

- The Croatian economy has recently performed relatively well with robust growth, relatively low, though recently increasing, inflation and exchange rate stability. The process of fiscal consolidation has continued, but external imbalances remain high. Following the changes in the external environment, the programme's macroeconomic scenario which was finalised in November now appears optimistic, in particular with respect to its projections of growth and inflation. Risks ensuing from a less benign international environment seem more pronounced than in last years' programme. In this context, it is important to raise awareness about potential risks of excessive credit growth, both in domestic and in particular in foreign currency. Higher volatility of commodity prices, less buoyant export markets and a stronger impact of the international financial market turbulences could undermine growth prospects and increase external vulnerabilities.

- The policy mix of the programme, which puts considerable onus on continued fiscal consolidation, remains appropriate. The envisaged overall reduction of public spending over the medium term is welcome against the background of high spending ratios. However, the credibility of the fiscal scenario would be enhanced by further clarifications of the underlying measures that will support subsidy reduction, wage containment and a streamlining of social benefits over the medium term. Moreover, the challenges of an ageing society would require a more thorough policy response.

- The broad orientation of the structural reforms remains appropriate, although a more strategic approach would be appropriate in particular with respect to enterprise restructuring, labour market reforms and improvements of the overall business environment including addressing corruption. Further efforts to increase the productivity of the economy remain important in order to increase its longer-term growth potential. The full implementation of the reform agenda will require determined and intensified efforts to accelerate reforms in a number of important policy areas.

Overall, ministers welcomed the further progress achieved by the Croatian authorities towards making the economy more competitive. Ministers called on Croatia to be vigilant with respect to the worsening external environment and related risks such as further increases in commodity prices creating inflationary pressures, less benign growth prospects with the main trading partners and the turbulences in international financial markets. Strong support for fiscal consolidation and structural reforms is important to ensure continued convergence towards EU income levels.

The former Yugoslav Republic of Macedonia

- The Pre-Accession Economic Programme for 2008 - 2010 of the former Yugoslav Republic of Macedonia is a comprehensive economic policy document, containing an optimistic economic scenario, an ambitious fiscal strategy and a description of a wide area of structural reforms.

- The economic performance in the last years has shown higher economic growth, until recently low inflation, narrowing external deficits and largely balanced public sector accounts and a low and declining debt ratio. The programme's scenario of strong growth appears optimistic in view of the country's demonstrated trend growth and of the worsening international environment as well as a significant increase in inflation mainly due to food price increases. However, when taking into account the experience of other candidate countries, the scenario may be attainable. Risks to the macro-economic programme are however significant and more pronounced than in last years' programme, mostly related to the higher uncertainty in the international environment, where risks are likely to increase in the form of a higher volatility of prices for energy and raw materials and less buoyant exports markets, reflecting an overall slowdown of global demand after the boom during the recent years. Overall, the document suffers from a lack of reliable statistical data, impeding the analysis of the country's position in the business cycle and of the assessment of reform measures.

- The PEP's public finance agenda consists of a substantial project of reducing the tax burden while maintaining the general government deficit at around 1½% of GDP. The lower tax burden is expected to stimulate investment and to strengthen disposable incomes, and, thereby, economic growth and employment. The estimates of expected public revenues are based on cautious assumptions, compatible with significantly lower nominal growth. Like last year, the programme would have benefitted from more information on the envisaged development of various revenue and expenditure categories and on measures how to improve the quality of public finances.

- The country's structural reform programme aims to support the establishment of a functioning market economy, particularly by improving the business climate and strengthening the competitiveness of the country's enterprises. Against the backdrop of the ageing population, there are also challenges related to the pension system, in particular the transition to a second pillar pension system. The programme's reform agenda is broadly in line with the fiscal scenario, but would have benefited from a closer alignment with the reform requirements in view of the country's EU accession perspectives, as spelled out in the latest Progress Report and the Accession Partnership. It would also have gained from a more in-depth assessment of key challenges to the economy, such as the weak performance of its labour markets.

Overall, ministers acknowledged the progress made since last year's first participation of the former Yugoslav Republic of Macedonia in the ministerial dialogue. Against the background of the expected deterioration of the current account balance, they encouraged the authorities to continue their efforts with regard to structural reforms to strengthening the competitiveness of the economy and to increase the country's attractiveness for foreign investors. The authorities should remain vigilant with respect to the risks stemming from possible further price increases of raw materials and energy and declining external demand reflecting weaker growth in important export markets.

Turkey

- Turkey's Pre-Accession Economic Programme for 2008-2010 is a comprehensive economic policy document, which presents a sound and coherent medium-term framework of macroeconomic developments, fiscal policy and structural reforms.

- In 2007, the Turkish economy was faced with financial market turbulences, in particular following the subprime mortgage crisis in the US. This brought about increased stock exchange and exchange rate volatility and some further inflationary pressures. In addition, weak tax collection and election related spending made fiscal discipline loosening in the first half of 2007. The authorities reacted appropriately and firmly by tightening fiscal and monetary policies. Therefore, the programme’s macroeconomic projections seem plausible in the context of the announced policy mix and given the assumption of a stable and benign external environment. However, the inflation and growth outlook have deteriorated. The current global financial turmoil and disruptions in financial markets put the macroeconomic framework at risk. Turkey's reliance on substantial external financing needs makes it vulnerable to the global credit crunch and a waning of confidence. Risks would however have been substantially higher in the absence of the significant improvements in macroeconomic conditions and institutional reforms in all key areas implemented in recent years.

- The programme's fiscal tightening and stability-oriented monetary policies remain appropriate to address challenges arising from considerable external imbalances. While the envisaged reduction of public spending is necessary, the programme remains rather vague and not very comprehensive on the underlying fiscal and structural measures and their respective budgetary effects. More precise monitoring of long-term fiscal sustainability would be appropriate to avoid building up long-term imbalances. The introduction of a new social security system, and more generally, the medium and long-term cost of the pension and healthcare systems should therefore be monitored very carefully. In addition, infrastructure investments may need to increase in less developed regions, given the size of regional disparities in Turkey.

- The PEP's structural reform agenda covers a broad range of measures, including in the areas of the labour market, energy sector, social security reforms and privatisation. The programme broadly supports Turkey's efforts to enhance its capacity to cope with competitive pressures and market forces. However, strong focus on timely implementation of the outlined plans will be of paramount importance. In addition, more emphasis might be put on comprehensive labour market reforms, in particular to support job creation during the economic transformation process, and to improving state aid monitoring. Recently enacted and continued pension reform is vital to secure fiscal sustainability and reduce labour market rigidities. The further reforms are needed to make Turkey more widely attractive for investors. The PEP might have also benefited from a clearer presentation of the reform plans in the areas of R&D and innovation. The programme's reform agenda is largely consistent with the fiscal scenario and partly aligned with the reform requirements in view of the country's EU accession perspective, as spelled out in the latest Progress Report and the Accession Partnership.

Overall, ministers welcomed the successful stabilisation of the Turkish economy achieved in the course of the last years. However the current global financial market turmoil also increasingly exposes the macroeconomic framework of the Turkish economy to risks, notably stemming from increased stock exchange and exchange rate volatility as well as a weaker growth and inflation outlook. They invited the Turkish authorities to remain vigilant and to maintain tight fiscal and monetary policies. It will be important to continue Turkey’s structural reform agenda with determination in order to preserve investor confidence also in view of Turkey’s large current account deficit.

Statistics

Ministers welcomed the Progress Report of April 2008 on the Action Plan on Economic, Monetary and Financial Statistics in the Candidate Countries and the ongoing efforts by them towards fulfilling the requirements set-out in the Action Plan. However, ministers stressed that significant efforts are still needed to achieve full compliance. The implementation of the Action Plan should continue to be a top priority in these countries and statistical authorities should have the necessary resources to be able to meet this objective.

In the area of *economic statistics*, the progress made since 2007 and key areas of further work can be summarised as follows:

- National Accounts: While recognising the progress made by Turkey and Croatia, the former Yugoslav Republic of Macedonia should step up efforts to enhance its capacity in the implementation of annual national accounts following ESA95 concepts. All candidate countries must take actions to ensure full implementation of ESA95 and the regular, complete and timely transmission of the main output and expenditure aggregates, gross national income, employment and population. They are also required to (i) comply with the principles for measuring prices and volumes and urged to align data with the so called Financial Intermediation Services Indirectly Measured (FISIM) regulation; and (ii) to match the data transmission requirements of the ESA95 concerning regional accounts, to ensure a regular transmission, increased coverage and availability, with reference in particular to employment and gross value added figures.

- Government deficit and debt statistics: Efforts should be stepped-up to achieve full compliance with the methodological requirements on annual general government deficit and debt statistics, in line with ESA95 rules and according to the same standards applied by Member States.

- Harmonised Index of Consumer Prices (HICP): Croatia and the former Yugoslav Republic of Macedonia are required to start to transmit data on HICP to comply with the corresponding requirements.

- Infra-annual statistics: Despite some improvements since 2007, important gaps continue to exist in several infra-annual statistics and significant progress is needed in almost all domains, in particular quarterly national accounts, public finance statistics, employment and short-term business statistics. Targets fixed in the updated (Croatia and Turkey) or newly established (former Yugoslav Republic of Macedonia) national action plans, as described in the 2007 Progress Report, have to be pursued and Action Plan objectives achieved according to the actions lined up.

- Structural indicators: availability, coverage and timeliness of the indicators should be enhanced.

Ministers recalled that regarding *monetary and financial statistics* compiled by the ECB (mainly via central banks), the national central banks of the candidate countries are not required to transmit national statistical data to the ECB, and that they will be legally obliged to undertake harmonisation work to bring their statistics in line with ECB legal requirements only upon their entry into the EU. Ministers considered that an early preparation for eventual membership in the European System of Central Banks is desirable, and welcomed the ECB plans to consider a limited data collection of monetary statistics from the candidate countries.

Overall conclusions for the three candidate countries

On the whole, the programmes describe a credible medium-term macroeconomic and fiscal framework conducive to strong and sustainable economic growth. Ministers emphasized that continued and sustainable high growth is necessary for further catching up in income levels. Ministers concluded that it was crucial for all candidate countries to continue the process of reforming their economies with determination, in particular by pursuing macroeconomic stabilisation and fiscal consolidation supported by appropriate structural reforms.

Against the background of the current financial turmoil, the weakening global growth outlook and inflationary pressures stemming inter alia from rising raw material and food prices, the candidate countries are invited to remain vigilant with a view to securing the achievements with respect to macroeconomic stabilisation and fiscal consolidation. Ministers also note that in some candidate countries credit growth and current account deficits remain high and might pose a challenge over the medium-term. Besides pressures on the external balance, creating supervisory capacities to mitigate risks in the financial sector is a challenge.

On the structural side, maintaining the reform momentum is highly important to foster external competitiveness and to ensure sustainable high growth level. Challenges persist in particular in accomplishing privatisation, further improving the business environment to stimulate investment, strengthening the administrative capacity, reforming labour markets and intensifying efforts to integrate the informal economy into the formal sector. Also longer-term challenges related to the sustainability of public finances stemming from pensions and health care systems need to be addressed. The relatively high unemployment rates point to the urgent need for further structural adjustments. Ministers repeated the great importance attached to the monitoring foreseen under the Copenhagen process and to respect the commitments made by the candidate countries.

Ministers invited the Economic Policy Committee to update its work on the structural policies in the candidate countries and to present a report on this for the next year's joint ministerial meeting.

Ministers noted that further progress has been made regarding the implementation of the Action Plan on Economic, Monetary and Financial statistics for candidate countries adopted in May 2003 which identified six priority areas where countries have to concentrate their efforts. They emphasize that the Action Plan continues to be a top priority for the statistical authorities in the candidate countries. Substantial efforts are in particular required in the areas of government debt and deficit where all candidate countries should improve compliance with ESA95 accounting rules. It is important that the candidate countries ensure that their statistical authorities have the necessary resources to be able to meet the requirements of the action plan. The EFC was invited to prepare for 2009 an updated report on the implementation of the Action Plan on statistics, including by assessing progress made in the specific areas identifies in the 2008 report.

Ministers underlined their commitment to carry on monitoring with the support of the Economic and Financial Committee, the Economic Policy Committee and the Commission the progress achieved with respect to macroeconomic, budgetary and structural policies in the candidate countries to ensure continued anchoring of their medium-term economic programmes. Ministers will meet again in the course of 2009 to continue their dialogue. Likewise, the dialogue at the level of the Economic and Financial Committee and its counterparts will continue in 2009.