

Vladimir Gligorov

Macedonia: low taxes are the key

Growth was again disappointing last year, though official figures are challenged by government officials and are somewhat doubted by the IMF as well. The latter believes that growth was perhaps above 4% in 2006, while the government suggests that it may be as high as 6%. The government also expects a speed-up in growth in the next couple of years.

If growth has been as fast as 4%, that is still rather low by the current standards of the region; if it has been lower than that, as the official data suggest, then the claim that it has again disappointed would be justified. The relatively low rate of growth of industrial production would support that feeling. There are, however, indications that consumption is increasing, both public and private. Investments have also posted some growth, though not a very convincing one. The contribution of net exports has probably been slightly positive, though the trade deficit has remained relatively high.

The surprising development in the last couple of years has been a dramatic improvement in the current account. From a deficit of close to 8% of GDP in 2004 it moved to a surplus of 2% of GDP in 2006. The turnaround was entirely due to an increase in private transfers. There is uncertainty whether the balance of payments accounting is appropriate, partly because of the lack of transparency in some of the positions, which leads to a large role played by errors and omissions. In any case, increased private transfers – remittances and perhaps what are in fact investments – seem to be a fact.

Whatever improvement in the growth performance has occurred in the past year or so, it has been somewhat helped by the more relaxed monetary policy and also by slightly increased public expenditures. On the strength of the much improved current account, the central bank saw no more need to worry about the sustainability of the exchange rate, which is in Macedonia a strict peg to the euro, and has lowered the interest rates and allowed the banks to increase their credit activity.

Also, the previous government was able to convince the IMF that a fiscal deficit of 0.6% of GDP is not going to lead to a catastrophe of one kind or another. The new government is budgeting a deficit of 1% of GDP for the year 2007. It intends to put some money into infrastructure and into human capital development. The IMF has continued to voice dissatisfaction with the speed of reforms, though not with Macedonia's fiscal policy any more.

In mid-year parliamentary elections were held, resulting in a change in government. The new government is a coalition of four parties; one Macedonian and one Albanian party are

the backbone of it. Though the coalition is rather stable, it has faced political problems immediately after coming to power. The root of its political problems is the fact that the Albanian party in the governing coalition is smaller, in terms of votes that it received in the elections, than the main rival Albanian party. The latter has requested to be included in the government instead of the smaller Albanian party. In the meantime it has decided to leave the parliament and to participate in the local government where it holds the majority, such as in city councils or other local bodies.

While the IMF has been critical of the lack of reforms, the EU has been critical of the lack of progress in institutional development. Macedonia is a candidate country, but the EU is not happy with the speed of its constitutional and reforms in the institutions of the rule of law. Thus, the date of the start of negotiations has not been determined and is unlikely to be set in the near future.

The new government seems undisturbed by the criticisms of both the IMF and the EU: it is confident that it has the right programme of reforms and expects that it will bring the economy up to a higher and sustained rate of growth. The key to reforms is a significant reduction in tax rates. Income taxes have been reduced to 12% and should be reduced to 10% in the course of 2007. Similarly, the VAT rate is planned to be brought down to 12%. In addition, and to the dissatisfaction of the IMF, the government plans to give additional tax breaks to foreign investors with the introduction of new free tax zones. The government expects a significant boost for investments and to the growth rate.

It is too early to assess the prospects of these new fiscal policy measures. It is also not altogether certain that it was the tax burden that was the main reason for the disappointing inflow of foreign and every other investment. In any case, growth of 4% to 5% per year in the medium run should not be difficult to achieve given that the growth in the region continues to be strong and Macedonia depends quite strongly on the economic growth and political stability in the region. The speed-up of EU integration, which is very important for Macedonia, will depend much more on other reforms, which are yet to be implemented, and on political stability, which depends on the resolution of the challenge to the legitimacy of the parliament and the government.

Table MK

Macedonia: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 ¹⁾	2007	2008
Population, th pers., mid-year ²⁾	2026.4	2034.9	2020.2	2026.8	2032.5	2035	2038	.	.
Gross domestic product, MKD mn, nom.	236389	233841	243970	251486	265257	284226	303305	325000	348000
annual change in % (real)	4.5	-4.5	0.9	2.8	4.1	3.8	3.5	4	4
GDP/capita (EUR at exchange rate)	1921	1887	1981	2025	2128	2279	2432	.	.
GDP/capita (EUR at PPP - wiiw)	5140	4990	5200	5330	5660	6110	6400	.	.
Gross industrial production									
annual change in % (real) ³⁾	3.0	-2.9	-4.8	4.1	-2.2	7.0	3.4	5	5
Gross agricultural production									
annual change in % (real)	1.0	-10.2	-2.3	4.5	6.8	2.2	.	.	.
Construction output, value added									
annual change in % (real)	-1.1	-14.4	0.6	13.3	7.4	-6.8	.	.	.
Consumption of households, MKD mn, nom.	175965	163788	188179	191873	209075	222890	.	.	.
annual change in % (real)	11.2	-11.6	12.5	-1.5	8.0	.	.	.	.
Gross fixed capital form., MKD mn, nom.	38332	34716	40448	42110	47286	48868	.	.	.
annual change in % (real)	-1.5	-8.6	17.6	1.1	10.9	.	.	.	.
LFS - employed persons, th. avg.	549.8	599.3	561.3	545.1	523.0	545.3	570	.	.
annual change in %	0.8	9.0	-6.3	-2.9	-4.1	4.3	4.5	.	.
Reg. employees in industry, th pers., avg.	114.4	122.5	110.9	106.7	101.5	97.6	94.6 ^x	.	.
annual change in %	-4.5	-4.8	-9.5	-3.8	-4.9	-3.9	-3.7 ^x	.	.
LFS - unemployed, th pers., average	261.7	263.2	263.5	315.9	309.3	323.9	320	.	.
LFS - unemployment rate in %, average	32.3	30.5	31.9	36.7	37.2	37.3	36	35	35
Reg. unemployment rate in %, end of period	.	.	.	.	.	.	.	.	.
Average gross monthly wages, MKD	17958	17886	19025	19950	20771	21330	22950	.	.
real growth rate, % (net wages)	-0.3	-1.9	5.0	3.6	4.4	2.2	4.2	.	.
Consumer prices, % p.a.	5.8	5.5	1.8	1.2	-0.4	0.5	3.2	3	3
Producer prices in industry, % p.a.	10.7	2.0	-0.9	-0.3	0.9	3.2	4.5	4	4
Central governm. budget, nat.def., % GDP ⁴⁾									
Revenues	43.9	34.4	34.9	33.4	33.2	32.7	.	.	.
Expenditures	41.5	40.8	40.0	34.5	33.2	32.4	.	.	.
Deficit (-) / surplus (+), % GDP	2.3	-6.3	-5.0	-1.1	0.0	0.2	-0.6	-1	-1
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	7.9	10.7	10.7	6.5	6.5	6.5	6.5	.	.
Current account, EUR mn ⁵⁾⁶⁾	-78.5	-272.1	-379.9	-132.1	-334.2	-65.5	100	-100	-100
Current account in % of GDP	-2.0	-7.1	-9.5	-3.2	-7.7	-1.4	2.0	-1.9	-1.8
Gross reserves of NB, excl. gold, EUR mn	461.5	845.5	692.8	718.4	665.2	1041.4	1377.9 ^x	.	.
Gross external debt, EUR mn ⁷⁾	1606.8	1621.4	1513.2	1439.4	1475.7	1849.1	1758.4	.	.
Gross external debt in % of GDP	41.3	42.2	37.8	35.1	34.1	39.9	35.5	.	.
FDI inflow, EUR mn ⁶⁾	189.4	493.2	82.6	85.4	126.5	80.3	280	.	.
FDI outflow, EUR mn ⁶⁾	-0.7	1.0	0.1	0.3	0.9	2.2	-0.1	.	.
Exports of goods, BOP, EUR mn ⁶⁾	1433	1291	1181	1208	1347	1640	1900	2100	2300
annual growth rate in %	28.3	-9.9	-8.5	2.3	11.5	21.7	16	10	10
Imports of goods, BOP, EUR mn ⁶⁾	2182	1879	2035	1959	2243	2491	2870	3300	3800
annual growth rate in %	37.9	-13.9	8.3	-3.7	14.5	11.0	15	15	15
Exports of services, BOP, EUR mn ⁶⁾	344	273	269	290	329	379	370	.	.
annual growth rate in %	34.2	-20.5	-1.6	7.8	13.4	15.4	-2	.	.
Imports of services, BOP, EUR mn ⁶⁾	291	295	292	299	372	407	450	.	.
annual growth rate in %	34.2	1.3	-0.8	2.2	24.7	9.2	11	.	.
Average exchange rate MKD/USD	65.89	68.04	64.74	54.30	49.41	49.29	48.79	.	.
Average exchange rate MKD/EUR (ECU)	60.73	60.91	60.98	61.26	61.34	61.30	61.19	62	62
Purchasing power parity MKD/USD	19.94	20.07	20.03	19.69	19.46	19.19	19.29	.	.
Purchasing power parity MKD/EUR	22.69	23.02	23.23	23.27	23.08	22.87	23.27	.	.

Note: The term 'industry' refers to NACE classification C+D+E.

1) Preliminary. - 2) From 2002 according to census November 2002; 2005, 2006 wiiw estimate. - 3) Enterprises with more than 10 employees, from 2004 new methodology. - 4) Revenues excluding privatization incomes, expenditures excluding financing items. 2005 data projected. - 5) Including grants. - 6) Converted from USD. - 7) Medium- and long-term debt.

Source: wiiw Database incorporating national statistics; wiiw forecasts.