

Fiscal and monetary policy in republic of macedonia assignment



Expert: Blagoja Nanevski, PhD 1. Fiscal and Monetary Policy 1. 1. Planned and implemented activities of the Government of RM in the reporting period

1. 1. 1. Fiscal Policy In the reporting period, the fiscal policy was directed towards realization of several previously planned activities, as well as undertaking measures which should have acted in the direction of gradual drawing of the national economy out of the recession phase. They are mainly based on the following: a) Further liberalization of the fiscal policy, i. e. increasing the fiscal freedom of the entrepreneur with the purpose of stimulating the development of the country. That characteristic is determined by many previously undertaken measures and several additional ones that were noticed and highly evaluated in the annual report of the “The Heritage Foundation” and “The Wall Street Journal” which will be detailed elaborated in the following chapter of this Report; b) Continuing the cut in the social contributions rates. As of 1 January, 2010, the contribution rate for pension insurance was cut from 19 to 16. percent, the contribution rate for health insurance was cut from 7. 5 to 7. 0 percent, and the contribution rate for employment was cut from 1. 4 to 1. 2 percent. The aim of these measures is cutting down the financial burden of the business subjects and creating the possibility for giving financial means which will be used for stimulating production, thus increasing the number of the employees (decreasing the number of unemployed); c) Realization of the planned dynamics for approving subsidies for certain agricultural products.

With the budget of RM for 2010, they are planned to reach the amount of 100 millions of euros. Their realization in the period of 2010 would mean completing the program-planned amount for granting subsidies in agriculture

and thus its adaptation to the corresponding system of agricultural financing determined in the European Union.

The bulk of the subsidies is planned to be granted for support of the agricultural production; d) Immediately related to the previous one is also the realization of the program determination of the Government of RM for stimulating the tourism as an export branch. In the Budget of RM for 2010, subsidies of 100 euros in denar equivalent value are planned for the tourist agencies that will bring a group of at least ten tourists from the neighbouring countries into the country and who will realize at least three overnight stays with breakfast in a categorized object; e) According to the dynamics of harmonization of the national customs policy with that of the World Trade Organization, as of 1 January 2010, the Government of RM adopted lower customs duties that are calculated when importing 426 products (tariff rates); f) In the function of enhancing the business climate in the country, as one of the substantial conditions for attracting national and foreign investments, the establishment of the real-estate cadastre continued in the reporting period. In the end of 2009, that cadastre was established for the 96 percent of the real-estates in RM;) Similarly as the previously mentioned measure, the Real Estate Cadastre Agency cut down the prices of its services in a range from 10 to 72 percent depending on the type of the service. In addition, the prices for the physical and legal entities have been made equal, as well as the prices for entering the family apartment house (a flat) and office space into the cadastre registry and registering a mortgage. In the end, a system of premarking has been established which includes entering

an apartment building in the cadastre while still in the construction phase, which prevents multiple sale of a same apartment.

Besides these (program) activities, in the analyzed period the Government of RM undertook other activities as well, which arose from the need for stimulation of the economy for drawing out of the recession and reinforcing the process of decentralization of the fiscal authority: a) Towards the end of 2009 and in the beginning of 2010, the Government of RM for several times incurred with the commercial banks and the private sector by selling state bonds. That was a way to cover part of the budget deficit, but also more of a source of financial means for payment of the previously sold bonds together with the corresponding interest.

Due to that, the dynamics and level of sold state bonds were considerably lower than before. Besides that, the Government of RM realizing that it could have a great influence on the level of interest rates in the economy has started to gradually decrease the interest rate for the bonds it is selling. At the end of January 2010, the interest rate of the state bonds was 5 percent a year. Those activities should have double positive effect: Increasing the level of lending that banks approve for private entities and decreasing the corresponding interest rates that are calculated for the lending; b) For the year 2010, the Government decided to increase the financial means for redistribution among municipalities, thus the lowest amount that a given municipality would receive from the redistribution of the means from the collected VAT during 2010 to equal 3 instead of 2 millions of denars that had been given until now. This was done by changing the methodology for

redistribution of the determined 3 percent from the VAT incomes among the municipalities.

This measure is expected to reach higher level of equation of the incomes of the municipalities, which shall be mostly beneficial for the smaller and less developed municipalities in RM; c) In order to decrease the number of unproductive expenses, the Government of RM has decided in the course of 2010 not to realize the planned increase in the salaries of the public administration. That measure is in function of the efforts to overcome the problems that the national economy is facing because of the still present world economic crisis. 1. 1. 2.

Monetary Policy The monetary policy in the reporting period was orientated towards keeping the stability of the exchange rate of the denar. That kind of monetary policy had to ensure keeping prices stability as its basic, legally determined objective. Thus, NBRM kept restrictive monetary policy. Its main instruments were used in that function (operations on the open market, interest rate and compulsory reserve). By their use, NBRM kept the stability of the exchange rate of the denar. Moreover, in the function of protecting the exchange rate of the denar, the condition of the foreign xchange reserves of the country was significantly enhanced. On 31. 12. 2009 they equaled 1. 597, 5 million of euros, which is for 102, 5 million of euros more than their previous condition at the end of the previous year. However, the over-restrictiveness of the monetary policy caused the consumer prices (through which the inflation rate can be measured) to notice falling (negative) dimensions. This means that the economy entered in a destructive zone of

deflation. That condition was present in the period of June-December 2009. The rate of deflation equaled 0.8 percent for the whole 2010.

The longer presence of deflation can be worse for the economy with an inflation rate of, for example, 8-10 percent. Realizing that, in December 2009 and in the beginning of January 2010, NBRM decreased the referent interest rate from 9 to 8.5 percent at the beginning, and then to 8 percent a year. However, NBRM did not decrease the amount of central bank bills that banks could place with the NBRM. It can be noticed that with the decreased referent interest rate, the amount of entered treasury bills of NBRM in the reporting period noticed record dimensions exceeding the amount of 290 millions of euros.

That had a great restrictive effect on the solvency of the banks, on the level of granted landings to the companies and the population, thus placing a negative effect on the level of interest rates when granting lendings to private entities. c) The granting of lendings to small and medium-sized enterprises from the credit line which in 2009 was given to the Government of RM from the European Investment Bank (100 mill. of euros) enforced in the analyzed period. Within the end of January 2010, 12.4 million of euros were granted for the support of development through Macedonian Bank.

They were additionally supported by credit financial means from commercial banks authorized to grant and serve those credits. 1. 2. What remains to be implemented (not implemented yet or not yet finished) in the analyzed period During the analyzed period a substantial part of the planned activities of the Government of RM were realized. Besides them, the Government of

RM undertook other activities that arose from the newly created recession conditions as a result of the effect of the world economic crisis. However, some of the planned program activities are still left to be (fully) realized.

They are particularly about continuing and completing the processes of denationalization of the property and the fiscal decentralization. The dynamics of decentralization is done in a slower pace than before, which is a serious problem for the realization of the planned increase of investments (national and foreign) in the country, as well as the already started process of privatization of the land parcels used by a substantial part of the enterprises and the citizens. In the mean time, the process of fiscal decentralization is slowly completing.

On the basis of a previous evaluation of the fulfillment of the appropriate conditions, during the analyzed period only one municipality was given permission by the Government of RM to go to the second phase of the process of fiscal decentralization. There are still 16 units of self-government left (USG) that have not passed the threshold of the second phase of the fiscal decentralization (there are 69 USG in that phase). The incompleteness of that process delays further reform activities on that plan, noticed in the realization of the regional economic development of USG, the fiscal equivalency of USG, the gradual exchange of block-subsidies from the central budget with new ways of financing the corresponding competencies of USG, etc.

1. 3. Evaluation of the potential risks from (non)implementation or from (non) quality implementation of activities

The greatest risk that the Government of RM was facing in the realization of its program activities in the reporting period, and those that it will face during 2010, are the

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continuing effects of the economic crisis and the tempo with which the country is going to draw out of the recession phase.

In that direction, of particular importance is whether and in what pace the greatest trade partners of RM (Germany, Italy, Russia, Greece and Serbia) are going to draw out of the recession phase. Out of them, Germany shows positive changes, while the other four countries will face serious economic problems in the course of 2010 as well. That in particular is typical for the Republic of Greece, which has a dominant participation in the ownership structure of the foreign direct investments in RM, which can transform in a great threat and risk for leading the national economy in the prosperity path of its development.

On national plan, the still present risk for realization of the planned activities will be the current insolvency of the economic subjects, which can lead to a decreased level of industrial production. That will condition for slower drawing out of the Macedonian economy from the recession phase. In addition, there is a risk for a possible increase in the number of unemployed persons which is regular in economies when they come out of the recession phase.

The realization of that phenomenon in a larger scale can inact the appearance of certain elements of social crisis, which will largely engage the budget of RM in the elimination of the consequences. That would also mean reducing the financial means used in developing activities of the economy. A serious risk for realization of the programmed and newly created activities and measures by the Government of RM could be the unsynchronized

monetary and fiscal policy. This time, a serious problem may be the excessive amount of withdrawn financial means from banks through the sale of treasury bills of NBRM which diminishes the solvency potential of the banks, restricts the level of loans for the private sector, and the interest rates are at a level which is not appropriate to the recession condition that has embraced the national economy. In addition, the still present high restrictiveness of the monetary policy could be reflected in the diminished investments in economy, decreased production and incomes, and thus decreased revenues in the budget of the country. The result of that could be the additional increase in the indebtedness of the country at home and abroad.

On the other hand, a serious risk is also the pace in which the Government of RM shall realize the planned capital investments, as an instigator of the positive changes that are expected to happen in the national economy in the upcoming period. In the end, a risk for the Macedonian economy in the upcoming period can be the (non) adoption of the decision of the European Union for specifying a date for start of the negotiations with RM for membership in that community, as well as for its membership in

NATO. The possible negative response from those international institutions could slow the income of foreign direct investments in RM which, in times of insufficient financial capacity of the country could greatly affect the successful realization of the future program activities of the Government of RM, especially in the part of restructuring and stimulating the future growth of the economy. 1. 4.

Overall evaluation by the expert on implemented activities for the reporting period, with possible recommendations In the reporting period the bulk of the planned activities of the Government of RM and the other institutions has been realized in the domain of the financial policy. Apart from them, the Government of RM undertook other measures that were conditioned by the current economic conditions and movements in the country caused by the effects of the world economic crisis and by the need to draw the national economy out of the recession phase.

The undertaken measures and activities contributed to a further enhancement of the economic climate and increase of the economic freedom in the country. That, actually, was confirmed in the report of “ The Heritage Foundation” and “ The Wall Street Journal”, in which, RM was ranked on the 56th place in the world (22 places better than in 2008) according to the level of economic freedom of the entrepreneurs. However, the enhancement of the economic environment is not manifested in more significant positive changes in the national economic plan.

The main reason for that is the further continuous effect of the economic crisis and the serious problems that the most important foreign-trade partners of RM are facing on the economic plan. In the monitored period, the absence of synchronization is evident between the fiscal and monetary policy while undertaking measures for facing the crisis. It can be noticed that the fiscal policy is standing alone in that fight. NBRM led by its strict determination keeps the fixed exchange rate of the denar, conducts/-ed especially restrictive monetary policy, which result is destructive condition of deflation in the economy which lasts for many months.

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The result of that policy is decreased solvency of the enterprises and increased inability for them to face the increasing problems caused by the recession. That kind of unsynchronized and occasional dissonance between the most important pillars of the macroeconomic policy caused general insecurity and uncertainty with the economic subjects for the future directions of the economic policy of the country and was transformed into a serious risk for realization of the future program activities of the Government of RM.

That imposed the need for their future synchronized action in order the Macedonian economy to leave the recession zone as quickly as possible. Besides that risk/threat, the Macedonian economy in the upcoming period shall face two other serious risks: Uncertainty in the pace of drawing the economies of its most important foreign-trade partners out of the current crisis, and thus helping itself do the same, as well as uncertainty in respect of receiving date for start of the negotiations with the EU for membership of RM in that community and in the view of joining RM in the NATO alliance.