



## COMMENT



### On the Fiscal Strategy of Republic of Macedonia (2018-2020)

17 November 2017

The Ministry of finance published the [Fiscal Strategy of Republic of Macedonia \(2018-2020\)](#). Finance Think assesses that the document is prepared on **solid macroeconomic basis** and offers an analytical framework which has been **significantly improved** in relation to the fiscal strategies in previous years. **The main area for improvement** in the document exists in two segments: *first*, the Strategy does not elaborate on how to ensure its respect and consistent practical implementation; and *secondly*, there is a lack of scenario ('if if') analysis of all aspects involved in budget planning of the Strategy's time horizon of the Strategy. This approach is particularly important to address **all external risks** in the implementation of budget and public projections, but also the **reforms** that the Government wants to implement and which may have significant budgetary implications.

Finance Think provides the following detailed comments on the aspects of the Strategy that are in the domain of our work:

- **The objectives of public debt management** are correctly presented, but not clear and complete. Firstly, the primary purpose of public debt management should be specified as "public debt management in a way that it would be sustainable,"

which implies a pace of borrowing according to the level and speed of the development of the economy. In doing so, the calculation of the sustainable level of the public debt should be based on solid economic analysis and clear medium-term projections for macroeconomic aggregates. Secondly, the current first and second goals are prescribed to sustainability, and they need to be clarified in more detail. Thirdly, the key objectives of public finance management are to **increase both the efficiency of public spending and the improvement of the credibility of public finance management**. The latter two should be added as objectives of the Fiscal Strategy if the Government shares the view that they are part of the objectives of the overall public finance management.

- **Projections for the movement of macroeconomic aggregates** are correct and in line with the projections and considerations of the domestic expert public as well as with the international financial institutions. The fiscal strategy will also benefit if it contains an overview and elaboration of the economic model and methodology for the macroeconomic design, i.e. the expert public should

have insight into the method and assumptions through which the projected indicators are estimated.

- **The approach of period-based fiscal consolidation is a positive step**, which in the medium term will contribute to a solid consolidation of fiscal finances both in terms of the amount and the structure of spending. Taking into account that the fiscal consolidation started recently, it is useful for the Fiscal Strategy to contain elaboration on the fiscal consolidation current phase in order to provide greater predictability in the economy. In doing so, the Strategy itself should make a clear distinction between gradual and slight tightening and budget restructuring, and a situation in which excessive fiscal savings can put an end to the economy. In this context, **the projected reduction of the budget deficit below 2.5% of GDP can be overemphasized and have more damage than benefit at this stage of the development of the economy.**
- The projection of budget revenues and expenditures (page 16), although based on solid macroeconomic assumptions, is assuming that nothing in the system will change. Hence, **the revenues and expenditures projected in the Fiscal Strategy are intended to move by inertia, that is, as a consequence of previous economic policies.** More specifically, they do not include assumptions for larger system reforms, especially those announced by the Government, such as progressive taxation, minimum guaranteed income, VAT refunds, pension system reform, and so on. **Currently, this is the weakest point of the Fiscal Strategy 2018-2020.** This aspect is also related to the absence of a mid-term vision and adequate planning for the movement of fiscal policy in case of larger and more significant reforms in the fiscal and social system.
- In a similar context, **the mid-term component of the Fiscal Strategy is completely undermined** in the area of debt management. More specifically, on page 22

it says: "The choice of a specific source for external financing will be based on the current and expected conditions in the international capital markets." Hence, Finance Think points out that it is useful for the Ministry of Finance to engage in a more in-depth analysis of the expected movements in the international financial markets and, consequently, to develop a robust framework that would include scenarios due to (un)expected variations, to manage future borrowings. This kind of analysis is particularly important for the purpose of a more precise assessment of the turning point after which the excess amount of withdrawn funds from the domestic financial system can be adversely affected by the lending to companies.

- The Ministry of Finance's efforts in the area of disclosure and management of past **due but unsettled obligations** are fair-minded and Finance Think strongly supports it. Incorporating elaboration for them in the Fiscal Strategy is appropriate and should become a common practice.
- The public debt management part should pay more attention to the **sustainable limit of the debt** and the limit should be based as a result of an in-depth economic analysis, which will take into account in particular the structural characteristics of the Macedonian economy and its degree of development. In that sense, equating the sustainable level with the Maastricht criterion of 60% of GDP looks hasty and naive for such a serious document.
- The short-term limits of the net public and state debt for 2018 should be harmonized with budgetary needs and clearly linked to the investment needs of the country. In that sense, **the new net state borrowing of 550m euros in 2018** (implying a net public debt of more than 550m euros) **may seem high** in the context of the high public sensitivity on the issue.