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КОМЕНТАР

COMMENT

On the Draft Budget of the Republic of Macedonia for 2018

16 ноември 2017

The Government adopted the Draft Budget of the Republic of Macedonia for 2018 and submitted it for consideration and adoption to the Parliament of Republic of Macedonia. The draft budget for 2018 is prepared on a **realistic assumption** of economic growth of 3.2% and price increase of 1.7%. From the perspective of macroeconomic design, a positive step forward is that the government’s projection is in line with the projections of the domestic expert public and the international financial institutions, which provides solid basis for the reasonable design of budget revenues and expenditures.

Regarding the amounts and structure of the Draft Budget, Finance Think gives the following comments:

- **Budget revenues** are correctly projected according to the growth of the economy and in line with the anticipated change in the increase of the excise tax on oil and some of the oil derivatives, which is followed by an increase in the VAT revenues. However, the effects of an increase in the excise on the budget, and especially on the prices and living standards of the population, are only sporadically mentioned in the draft budget document, although the public debate has raised concerns as to how this measure will affect the standard of living. Finance Think's view is that the increase in excise duties on oil and some of the oil derivatives will affect the price of transport, but the effect will not be significant and there is no danger of accelerating the rise in prices. If the Government shares this view, it should be expressed in the draft budget document in an unambiguous manner.
- **Budget expenditures** are designed to reflect the intentions for fiscal consolidation, a move that is supported by the domestic expert community and international financial institutions. In particular, the shortening of the goods and services budget item is a positive step forward in this direction, which should not be a one-time thing, but a continuous commitment of the Government. However, the **significant increase in the 'subsidies and transfers'** budget item creates a zone of incompetence from an economic point of view, and prevents the Budget from being viewed in a different way compared to the period before.
- **The wage increase in the sphere of education and health of 5%** is a positive move. But the draft budget document will benefit, and thus the public debate, from a more detailed elaboration of why these two

sectors have been selected for salary increase. The argument that they are the bearers of long-term economic growth is correct, but the government must have a more in-depth and more analytical approach in making such decisions, and at the very least to link them with the productivity of the sectors at the moment, and to how wage increases will affect productivity and quality of operations in these sectors in the short to medium term. Such analysis should be followed with a detailed picture of the structure of employees in these sectors, i.e. whether there are shortages and surpluses of employees in certain segments of these sectors, in which case the salary increase should be followed by appropriate restructuring. Otherwise, wage increases will not give the desired effects. In addition, it is necessary to consider also the differentiation of wage growth within those sectors. For example, a greater increase in salaries of directly involved persons in the delivery of the services (teachers and doctors), and lower in the administration in those sectors.

- The amount that the Government will transfer to the pension fund remains high, which leaves the issue of sanation of the pension deficit still very burning. The budget document should give an appropriate overview of this issue, especially to begin to clarify the directions in which the government plans to move in solving this problem. Otherwise, the pension deficit will continue to exceed the central budget deficit and is will have a growing trend.
- The draft budget should elaborate, in the context of the structure and predicted amounts, the costs associated with the **anticipated major reforms in the system**, such as the guaranteed minimum income and the refund of part of the collected VAT. Bearing in mind that in the proposed budget this is missing, it is perceived that it is only a continuation/replication of the budgets from previous years.
- **Capital expenditures** are projected at the correct level, but with a significant risk of not fully realising the estimated level. When analysing the capital projects that should be financed during 2018, and presented in the Draft Budget, the impression is that the Government moves by inertia, that is, that it will mainly finish the already started projects. Although this approach is correct, especially with regard to the large launched infrastructure projects, a more ambitious approach to medium-term planning of large-scale infrastructural projects is needed, which will give a new impetus to the economy and will accelerate the improvement of its competitiveness. At the same time, it is necessary to consider introducing mechanisms that will ensure the realization of the projected capital expenditures.
- In relation to capital expenditures, **the approach to their planning** requires a complete change, and as soon as possible. Namely, the underutilization of the estimated amounts of capital expenditures that was present in the previous years was a consequence of the inadequate planning, especially in the medium to long term, of the capital investments of the state. It is expected from the Ministry of Finance in 2018 to open a wide debate on the need and effects of potential capital investments and offer a **study that will calculate fiscal multipliers and the wider effects of those investments.** This would also achieve a social consensus on what the priority capital projects the state should finance.
- **The budget deficit,** as well as the budget expenditures, reflects the intentions for fiscal consolidation. Expressed through the budget deficit, the pace of fiscal consolidation is correct and should be sustained, that is, neither to accelerate nor to slow down. Designing budget deficits below

2.5% of GDP at this stage of the development of the economy would have more harmful than beneficial consequences, and may result in the phenomenon "there is no money in the economy". Hence, Finance Think recommends maintaining the pace of fiscal consolidation.

- The draft budget envisions financing of the deficit both on the domestic and foreign markets. In addition, a higher amount of borrowing on the foreign market is predicted, out of which part will be kept on the government deposit account for future years. Moreover, the Government's argument is that the conditions of the international financial market are favourable and now more access to greater borrowing is needed. **Finance Think expresses concern about this argument.** Namely, this argument cannot be advocated without the public having information and consensus on **what the national money will be spent on.** High borrowing, regardless of the funds being potentially kept in the National Bank of Republic of Macedonia (NBRM), will raise the public debt to **over 50% of GDP,** in conditions when the public is still highly sensitive to such moves. Therefore, Finance Think believes that the amount of borrowing should be moderate and in line with the projected budget deficit, i.e. **up to 500m euros.** This view will be further elaborated during 2018.