

Review of the Measures of the Macedonian Government against Global Economic Crisis

CEA

March 2009

Background of the Financial Crisis

- It started in the second half of 2007 in US with the mortgage crisis and it becomes the biggest global crisis since last big Economic Deprecation in 1929-1933
- In very short period the ongoing mortgage crisis spread into the banking sector
- The US Government undertook bail-out plan worth 700 billion \$ in order to stop the bankruptcy process started with Lehman Brother Bank
- In some of the largest investment banks started the nationalization process

Background of the Financial crisis

- Through the market channels of the globalized world the crisis started to take its course into the European and the Asian markets and economies
- The developed countries are already in recession and they are struggling with the increasing number of unemployment and decreasing public consumption
- The developing economies will have higher growth from the developed economies but they will be confronted with reduced Foreign Direct Investments (FDI), the net export of the produced goods and services will have a high decrease and the interest rates will go much higher
- The IMF predicts that the global growth will be 3%

The Situation in Macedonia

- Despite the solid structure of the banking sector the Central Bank undertook some preventive measures
- The MBI-10 (stock index) decreased by 73.3% in 2008
- The real sector was more hit by the ongoing economic crisis
 - 7.6% decline in industrial production in the last Q4 in 2008
 - 16.7% decline in the industrial production in January 2009 compared to January 2008
 - Export decline 15.7% in the last Q4 in 2008

Measures undertaken by the Macedonian Government

- In order to prevent the domestic economy from the influence of the global crisis, the governments have two options in implementation of plans.
 - One is to boost the fiscal spending and generate GDP growth and new employments
 - and the other is to liberate the monetary policy, supporting lower interest rates to help the households and the companies secure finances.
- Macedonian Government is no acceptance. In order to prevent the Macedonian economy from the ongoing crisis undertake 10 measures based on writing-off some type of liabilities

Measure 1: Writing-off the outstanding current liabilities for health insurance, if in the next four years the companies regularly and on time pay the employee's health insurance benefits

- The expected value of this measure is 50 million EUR
- Pros:
 - "cleaning" of the Balance Sheets
 - Insurance that the budget will receive the benefits inflows in the next four years
- Cons:
 - the liabilities will be written-off in 2012
 - not a direct injection of cash
 - double standard (moral hazard) punishing the regular benefit payers

Measure 2: Writing-off all accumulated interest payables on the liabilities for social care insurance benefits if the company pays the principal debt and Measure 3: Writing-off all the accumulated interest payables on the unpaid tax liabilities if the company pays the principal debt (VAT, Income tax, Property tax, PIT)

- There is no available information about the expected value of this measure
- Pros:
 - reduction of bad debt liabilities of the companies
- Cons:
 - reduce the liquidity of the companies with significant cash outflows
 - double standard (moral hazard) punishing the regular benefit payers
 - writing off revenues of the state budget

Measure 4: Opportunity for the company for postponed payment to the main tax liability if the company secures the debt with banking guarantee of 100% or if the company offers mortgage with a value of 250% of the main liability

- There is no available information about the expected value of this measure
- Pros:
 - increase the liquidity of the companies by postponing the cash payment for the liabilities
 - substitution for bank loans for liquidity and working capital
- Cons:
 - can be used only by companies with satisfactory creditworthiness

Measure 5: Relieving of the companies from the obligation of income tax payment if the total annual profit is retained within the companies

- The expected value of this measure is 100 million EUR
- Pros:
 - incentive for increased investments within the companies
 - potentially new employments or reduced layoffs
 - reduced national cash outflow outside the country
- Cons:
 - investors will be de-motivated to invest in securities
 - increased fragility of the Macedonian capital market

Measure 6: Reduction of the custom taxes (for 498 items)

- The expected value of this measure is 3 million EUR
- Pros:
 - lower input costs
 - increased price competitiveness
 - increased competitiveness if the inputs are exported as finished products
- Cons:
 - potential threat for the domestic production

Measure 7: Lower personal incomes taxation rates for the individual farmers

- There is no available information about the expected value of this measure
- Pros:
 - improved control of group so far evading tax
 - reduced tax rate for the existing registered payers
- Cons:
 - increased costs for producers not paying tax until now
 - potentially more expensive exports and reduced international competitiveness

Measure 9: Transformation of the tax receivables of the Government into a permanent share in some companies where the government is already the major shareholder/owner

- There is no available information about the expected value of this measure
- Pros:
 - the liabilities turned into capital may increase the value for future company sales
- Cons:
 - concerns 4 specific companies with already questionable future
 - the state will generate double loss (will not collect the receivables and will become owner of questionable companies)
 - the state becomes owner in low quality companies

Measures undertaken by other Governments

- The countries in the region are undertaking measures aimed at the increase of the personal spending of the population, increase the availability of the loans through subsidizing these and reduction of the budgets and the state's spending.
 - **The Croatian Government** measures were based on the antirecession models for increasing the investments in infrastructure and giving incentive for personal spending through decreased taxes;
 - The measures that were undertaken by the **Slovenian government** were aimed at increasing of the liquidity of the banking sector, reduction of the public spending and job maintenance through financing of the liquidity of companies; labor market, life-long learning and social security; infrastructure, energy, environment - for sustainable development; better drawing of cohesion funds.

Measures undertaken by other Governments

- The USA Government was the first one to take actions against the financial crisis. The first package of measures of the so called bailout program with a total cost of 700 billion dollars was with an aim to purchase bad debts, to reduce the uncertainty of the value of the remaining debts and to restore confidence in the credit markets;
- After the first bailout, Obama's administration decided to prepare another bailout program for which many economists believe that it will reach \$1 trillion or more. The new government intends to provide support through government-private sector partnership and to continue with the government purchases of stock in banks as a way to support the banks and increase the lending intended for the banks which have not received assistance so far

The confidence in the worldwide effort to fight the Global economic crisis

- First is that the IMF's call for three main measures (cleaning bank's balance sheets, boosting global trade and open economies instead of economic nationalism) are not on the agenda in the world economies
- Second, IMF's inconsistencies
- Third, we want to note that the world needs strong national financial regulations as opposed to the widely held notion of global regulation
- Fourth, we want to stress that the Global Economic nationalism is taking place possible resulting with inefficient global coordination for overcoming the crisis

Recommendations

- The 10 Measures of the GoM are not the right package for the targeted objective
- The business representatives and GoM should coordinate themselves before any new package
- Macedonian government to be prepared for the effects of the "economic nationalism" globally
- Macedonian government should go with possible Stand-by arrangement with the IMF with relaxed budget targets on the capital expenditures but with tight budget targets on the current expenditures. This should go step by step with supplementary budget with proper roll over assumptions of the PEP, fiscal strategy and strategy for managing the public debt

Recommendations

- Fiscal expansion and expansionary policies should be accompanied with fiscal transparency enhanced
- Short term policies targeting the real sector to keep jobs are needed
- Policies should be focused on securing financing and know-how for the small and medium enterprises
- GoM announcement about the arrangement with EIB for 50 million EUR with lower interest rates to SMEs in Macedonia needs a follow up immediately
- Aggressive search for the FDI should continue

CEA CONTACT DETAILS

For information:

www.cea.org.mk

www.lsg-data.org.mk

Center for Economic Analyses-CEA

Bul. Jane Sandanski 63/3

1000 Skopje

Macedonia

Phone: +389 (70) 834 636

Fax: +389 (2) 2444 766

Marjan Nikolov President

E-mail: info@org.com.mk