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Macedonia Economy briefing:

Expectations about Macedonia's Economy in 2018

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Expectations about Macedonia's Economy in 2018

Who is in charge of Macedonia's economic policy?

Aware of the bad economic conditions in the country, SDSM in the 2016 elections ran on a platform that literally called for "returning the [decent] life" for all Macedonian citizens. Among the SDSM supporters, there are many expectations that the Prime Minister Zaev, as a successful entrepreneur and mayor, will apply some of his practical knowledge to the policymaking process and thereby lead Macedonia to economic renewal and improvement of the livelihood of the majority of the population. He appointed the professor Dragan Tevdovski, who is fascinated by the Scandinavian model, as a Minister of Finance who is in charge of curtailing or at least tame the rising indebtedness of the state, redirect state resources towards more productive and more social measures. However, Zaev also appointed the tycoon Kocho Angjushev as a Vice Prime Minister in charge of economic affairs upon an agreement between SDSM and representatives of the big business, showing that his government, as every Macedonian government before, will be friendly to the few rich and powerful at the top. Additionally, Macedonia has a Ministry of Economy that belongs to DUI, as well as a handful of governmental agencies in charge of various economic affairs, which are often believed to pursue independent economic agendas (and perhaps, may be influenced by special interests). In total this contributes to having several actors who will shape Macedonia's economic policy in 2018, without clear idea whose approach prevails. This results with a number of uncertainties and inconsistencies in the economic policy. Unlike in the era of VMRO-DPMNE and Gruevski when everything was centralized and followed the line of the core leader, in the SDSM government there seems to be open-endedness on the economic vision and strategy. The different actors have different approaches and take measures that are disparate from each other, and sometimes seem as if they come from different realities. It is likely that these contradictions will come to the forefront in 2018.

Is the optimism about 2018 realistic?

In 2017, Macedonia had the worse economic performance in the last few years; at the same time performing worse than its neighbors and Europe as a whole. However, in 2017 it also concluded the most serious political crisis since its foundation, and it has entered 2018 in a state of relative stability. The major opposition party, VMRO-DPMNE, after a leadership change, has demonstrated cooperative attitude. The EU has expressed its support for the Macedonian government. All of this has led the Macedonian government, as well as the People's Bank of Macedonia, the IMF and the World Bank to believe that in 2018 Macedonia, despite the bad record of 2017, will be able to get back on the path of economic growth. It is estimated that Macedonia's GDP in 2018 will grow by 3.2% (in 2017 it only grew 0.5%). The main expectation is that the improved political stability will contribute to rise in the confidence in the market, and increased foreign and domestic private investment. Another reason behind the optimism of the government is the expectation that some of the measures of the government done in 2017, such as the raise of the minimal wage, will lead to more private spending. Finally, the gradual restoration of the economic robustness of the regional and European economies is another reason for having higher expectations.

Yet, there is ample room for cautiousness as well. The relative political stability (which at the same time is fragile, but this is beyond the scope of this report) is necessary but not sufficient explanation why Macedonia has regained the trust of investors. In 2017, Macedonia did stabilize, but the economic results did not arrive. In practice, much of the renewed confidence of investors is based on the belief that the SDSM government that in 2018 it will accelerate the accession of Macedonia in the EU and NATO. The double-accession is considered to be the sole most important measure of progress and therefore impacts economic sentiments. Yet, Macedonia's accession to the EU and NATO is an area where the input of the Macedonian government has limited effect – in practice this is a process that is contingent on a compromise with Greece, which in itself is rather uncertain. While both the governments in Skopje and Athens have demonstrated the necessary political will to reach an agreement, nationalist mobilizations in Greece and the rather extensive demands for constitutional change render the possibility for prolonging the status quo or even worsening the relations. Hence, in just a few months, it is possible that the optimism about Macedonia's future will be toned down, which would lead to somewhat bounded and restrained approach by investors. In this sense, stability, without a progress on the name issue, may make it difficult for Macedonia to meet the 3.2% growth projections.

At the same time, one must take in account that even though some welfare measures (such as the minimal wage) were undertaken by SDSM, there have been other measures that have increased life costs. In this sense, while this may still improve the GDP numbers, it does not mean that the life standard of the citizens has improved. As argued before, the people in charge of running economic affairs in the SDSM government are a rather awkward combination of entrepreneurs, neoliberals and Keynesians, which leads to many inconsistencies and uncertainties in their approach. This is a serious sign for concern, as in fact, in order to convert the much lauded political stability into an economic outcome, a resolute and apt political leadership is needed. The political stability, in this sense, needs to lead to comprehensive economic reforms (something that is pointed out by all domestic and international actors, regardless of belonging and ideology – and even by the government itself).

Finally, the belief that the increased activity of the European (and in particular the German economy, as German companies are key to Macedonia's export-processing sector) and regional economies will pull Macedonia upwards deserves some questioning as well. There is of course the experience of 2017, when the trickle-down effect did not happen. The drop to just 0.5% of growth cannot be only ascribed to the political instability; it certainly had to do with economic reasons too. Moreover, there is again the uncertainty with Greece. Aside from holding Macedonia's political future in its hands, Greece is Macedonia's largest economic partner. Much of the investments in Macedonia come from Greece, and much of the economic activity in southern Macedonia consists of services provided for Greek customers who come to Macedonia because of the lower prices. While anything comparable to what happened in the 1990s is not possible (a full scale economic embargo that decimated Macedonia's economy) due to the fact that the Greek government is more cooperative and simply because such measure would not be possible in today's circumstances, a rise in nationalist sentiments may impede many of the economic relations between the two sides. More even so, given the nationalist backlash against the Greek government, one may argue that even there is no worsening of the political relations between the two governments, people-to-people relations may sour, and conversely economic cooperation may suffer.

Finally, even if Macedonia meets – or even if it exceeds – the 3.2% mark, that would still make it hard to meet the target of 5% GD growth average mark for the period 2017-2020, which was the main promise of SDSM during the 2016 electoral campaign. This is a serious sign for concern on the long run, as SDSM is already beyond 1/4 deep into their 4-year term (admittedly they were unable to form a government for half of the first year). However, the 0.5% growth in 2017, and the 3.2% growth (if it happens) in 2018 would mean an average annual growth of 1.75% half way into their term, which is quite a sobering fact.

Public Finances

In 2018, Macedonia will have the highest budget in its history – 3.44 billion EUR. Despite the criticism of VMRO-DPMNE's financial policy and the promises to tame the lavishness and the wasteful spending, SDSM has in many ways kept many of the practices of VMRO-DPMNE, and is likely to continue in a similar direction in 2018. While SDSM has initiated a process of financial consolidation and reduction of the budget deficit, in order to meet the spending targets, for instance, in 2018 SDSM will borrow up to 10% of the projected public spending funds, while also making new loans at a more favorable rate targeted for repaying some of the existing deficits at less favorable rate, which would total about 850 million EUR. The SDSM government also considers issuing Eurobonds in 2018, a measure that when it was proposed by VMRO-DPMNE it harshly criticized. Should all of these moves at the financial market proceed as planned, Macedonia will surpass the threshold of 50% of debt-to-GDP ratio.

At the same time, the SDSM government has kept and even increased the public revenue measures set by VMRO-DPMNE. VMRO-DPMNE was considered a highly extractive political actor, who has sucked out the life out of the economy through various forms (and malpractice) of revenue collection. One of the notable measures that SDSM has introduced in early 2018, setting the tone for the year ahead was the introduction of a VAT obligation for freelancers who earn above 1 million MKD per year, a measure that was not properly communicated and who is believed to have a number of shortcomings, and to hit hard Macedonians who work online for foreign companies, predominantly in the IT sector (one of the few bright spots of the Macedonian economy).

When it comes to the allocation of public spending, SDSM has argued that it has significantly increased the allocation of funds for strategic investments. However, as argued in previous reports, from a quick glance it is clear that many of the items considered to be strategic investments are in fact investments in non-productive sectors (such as the civil society and NGOs).

Income

The Ministry of Finance expects a 4% rise of the average income; however the real growth is believed to be half of the projection when adjusted to inflation. Should this be fulfilled, the average income in the country (after tax) will be around 380 EUR (the target set by SDSM for 2020 is to reach 500 EUR, which is still a long shot). The increase in the income is claimed to be a direct consequences of the policy measures undertaken by the government in 2017, such as the raising of the minimal wage to 12.000 MKD, as well as the announced raise of the salaries in the public institutions (5% for the employees in healthcare and education and 10% for the armed forces). The government has even pledged funds from the budget for some private companies to help them cover the difference in costs.

The minimal wage regulation has gained a lot of attention in the public discourse. The government and its supporters consider it an infallible measure that already has positively affected more than 130 thousand workers in the private sector. Skeptics however warn of several adverse effects. First, even though all employers now follow the regulation and pay the new minimal wage according to the regulation, many of them coerce the workers into returning the difference of their previous wage and the new minimal wage in cash. This is a result of the lack of proper enforcement of labor regulations as well as the lack of any voice of the workers in the society. Second, the minimal wage regulation has now allowed employers to arbitrarily determine the output norm that the workers have to fulfill, meaning that many workers now can face much higher performance expectations at the workplace (i.e. they will not get paid by the hour, but rather by the output measure that the employer sets – in the same industry, different employers may set different norms).