INTERVIEW: BERT VAN SELM, IMF RESIDENT REPRESENTATIVE IN MACEDONIA

Real growth of 5.5 percent for 2009 is not realistic

VEST: Macedonia currently has no arrangement with the Fund. What is the current status of the IMF in Macedonia?

van Selm: The IMF remains engaged, via other channels: surveillance (a meeting of the Executive Board took place last week), and technical assistance (in particular in tax administration).

VEST: What are your current contacts with Macedonian government like?

van Selm: Very good, I frequently meet with top government officials, and we have good discussions.

VEST: In its latest report the IMF advises the Macedonian authorities not to expand public spending. The government responded that it intends to go ahead with its plans, as investment stimulates growth. The Finance Minister wondered why the cure that IMF recommends to other countries would not apply to Macedonia.

van Selm: Given that the economy is expected to slow down in 2009, at first sight it would appear that there is a case for more expansionary policies. The problem is that for a small open economy like Macedonia, expansionary policies are not very effective—much will spill into imports. Moreover, the government is constrained by a widening current account deficit. So, while these policies may be appropriate for larger economies, with flexible exchange rates and access to international financing, for Macedonia they may not be the best way to go.

VEST: The opposition agrees with the IMF position that this is not the right time to increase indebtedness. However, it seems the government is planning to take on new loans. What is the risk for the country? The Finance Minister recently said Macedonian indebtedness is around 25 percent of the GDP.

van Selm: For an emerging economy such as Macedonia, borrowing from the rest of the world to finance growth is normal and desirable. However, it is important that indicators of vulnerability (both liquidity—international reserves—and overall debt) remain at prudent levels. We have some concerns here—we project international reserves to remain under 3 months of imports over the next few years, and debt to exceed the level considered prudent for emerging markets (40 percent of GDP). I believe the Finance Minister was talking about *public* external debt, whereas I refer here to the *overall* external debt of Macedonia.

VEST: The Finance Minister said he does not understand why the IMF encourages the central bank to further increase interest rates at a time when all countries in the world

are reducing rates. The government obviously wants the central bank to cut its interest rates, so that commercial banks can reduce their rates, resulting in credit growth, thereby increasing private consumption.

van Selm: On monetary policy, if you read the press release carefully, you will see that the IMF does not call upon the NBRM to further increase interest rates, it says 'other actions as necessary'. That could be, for example, additional measures in the prudential sphere, along the lines that the NBRM explored in 2008. In Macedonia, given the fixed exchange rate regime, monetary policy is not very powerful. Fiscal policy is the most powerful tool of economic policy.

VEST: Obviously there is a conflict of two concepts. Why does the IMF continue to insist on a policy of a slow growth that caused stagnation in Macedonia over last 17 years? The government sees the Fund's proposals as an attempt to slow down the economy.

van Selm: I think we share the goal of achieving growth rates that are as high as possible, to reduce unemployment and improve living standards. Perhaps a more cautious approach could indeed lead to a slightly lower growth rate in 2009—but over the longer term, continued macroeconomic stability is a key condition for sustained growth.

VEST: What is the IMF's view on certain inconsistencies related to budget projections and spending? The Macedonian public has reacted to the government's practice of engaging in self-promotion using budget funds. What is the Fund's experience in this with other countries?

van Selm: The IMF is interested in macroeconomic stability—what matters for that is the overall fiscal stance, not whether spending takes place on A or on B. We do have some concerns about the assumptions underlying the budget for next year though—in particular, the 5.5 percent real growth rate. In the current international environment, that seems very high.

VEST: The Government has proposed the largest ever budget for 2009. Is there a room for cutting taxes—in particular a VAT rate cut?

van Selm: The draft 2009 budget includes tax cuts in a very important area—labor taxation. Pension contributions are reduced from 21 percent to 19 percent, and health contributions from 9 percent to 7.5 percent. Given the high unemployment rate, it is very important to reduce the labor tax wedge—but in our view, it is also important to identify measures that pay for the fiscal costs, so that these cuts do not lead to a sharp increase in the overall fiscal deficit. Let me also note that the VAT cuts in the UK have proven controversial in continental Europe. Here in Macedonia, I think the government's focus on cutting labor taxes is good, because the labor tax wedge is clearly too high, contributing to high unemployment. And as I noted, in our view this is not the time for a fiscal stimulus—a prudent fiscal policy is called for.

VEST: Some economists have claimed that the world no longer needs the IMF and the World Bank. What is your view?

van Selm: The ongoing financial turmoil has made it abundantly clear that there is an important role for the IMF in helping to provide stability for the world economy—via analysis, lending, and other services to its members. I believe that the same is true for the World Bank.

VEST: Should Macedonia request a new loan from the IMF, in order to overcome the crisis? Is there a major difference in the speed of Fund's reaction to countries with or without an arrangement?

van Selm: On a new program with the IMF, it is important to recognize that there are no deadlines. Any IMF member, including Macedonia, can request a new program at any point in time. As the Fund has shown recently in cases of Iceland, Ukraine, Hungary and Pakistan, we can put together a new program quite quickly. At the same time, the Serbian approach—to put in place a precautionary program, on which the country can draw when necessary—seems prudent. This could be a good model for Macedonia. In any case, this is up to the government; we continue to stand ready to support the government in the form that it considers most appropriate.