

IMPROVING ECONOMIC GOVERNANCE IN FYR MACEDONIA:

ACHIEVEMENTS AND CHALLENGES

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Ladies and gentlemen,

1. It is a great pleasure to participate in this important and timely conference. In my remarks today, I would like to briefly address three issues. First, what is the role of the IMF in promoting governance and reducing corruption? Second, to what extent has today's host country, Macedonia, been successful in creating an environment that is conducive to good governance and reduced corruption? And third, what remains to be done?

The Role of the Fund in Promoting Good Governance

2. **As you know, the IMF is first and foremost about promoting global macroeconomic stability.** Traditionally, the Fund has had a much stronger focus on macroeconomic variables—inflation rates, exchange rates, fiscal and external balances, or monetary aggregates—than on governance issues that are less easy to quantify. Over time, however, the Fund has increasingly come to recognize that good governance is a crucial

contributor to financial stability. The term governance generally encompasses all aspects of the way a country is governed, including its economic policies and regulatory framework. Corruption is a narrower concept, which is often defined as the abuse of public authority or trust for private benefit.

3. The Fund's role in governance issues can be summarized as follows:

(1) First, **the goal**: IMF works with members to promote transparency and accountability and reduce opportunities for corruption in areas where the Fund has a mandate and expertise (public resource management, financial sector issues).

(2) Second, the **broad principles** for doing so: by 'creating systems that limit the scope for ad hoc decision making, for rent seeking, and for undesirable preferential treatment for individuals or organizations', and by 'supporting a stable economic and regulatory environment conducive to efficient private sector activities'.

An **example** may serve to make these goals and principles more concrete. Multiple exchange rate regimes, high trade tariffs and price controls all provide fertile breeding grounds for corrupt activities. By helping members liberalize exchange, trade and price systems, opportunities for corruption are reduced. In the 1990s, much of the IMF's work in transition economies was focused on such issues.

4. The IMF also promotes good governance through specific initiatives:

- The IMF encourages member countries to improve accountability by enhancing transparency in policies, in line with internationally recognized standards and codes.
- For fiscal and monetary policies, the IMF has developed codes that set out transparency principles. The *Code of Good Practices on Fiscal Policy* aims to encourage a better-informed public debate about the design and results of fiscal policy. The *Code of Good Practice on Transparency in Monetary and Financial Policies* serves a similar purpose in the area of monetary and financial policies.
- To improve the transparency, quality and timeliness of data, the IMF encourages its members to subscribe to the Special Data Dissemination Standard (SDDS) or participate in the General Data Dissemination Standard (GDDS).
- The example of the 1994-95 financial crisis in Mexico shows the direct link between transparency and macroeconomic stability (and led the IMF to develop the SDDS). The Mexican authorities kept levels of international reserves secret from the public, allowing them to delay adjustment policies—but in the end leading to a painful collapse in the exchange rate. Today, partly as a result of the IMF's efforts, most members publish reserve data in a timely manner.

Macedonia's Achievements in Improving Economic Governance

5. **After turbulent period in the early 1990s, Macedonia has come in long way in improving and maintaining macroeconomic stability.** For many years, inflation has been low, fiscal deficits small, and the exchange rate stable. Of course, the ongoing international financial and economic crisis poses challenges—in the case of Macedonia, the main concern is the high current account deficit, of around 13 percent of GDP last year, with a

similar deficit projected for this year. To reduce external pressures, Macedonia will need tighter monetary policy, tighter fiscal policy, or higher external financing—or a combination of these.

6. Key steps to liberalize prices and the foreign trade regime were taken in the 1990s. Macedonia became a member of the World Trade Organization in 2003. **Privatization** of state owned enterprises was also largely achieved in the 1990s—with a few notable exceptions (see below). The government that took office in August 2006 focused on deregulation of the economy, with the so-called ‘**regulatory guillotine**’, thereby further reducing opportunities for corruption. An important step that has been taken more recently is the January 2009 **harmonization of bases for social contributions, and concentration of revenue collection functions in the Public Revenue Office**. The early results of this reform look good: contributions are up (even when overall tax revenue is down). The reform makes it much more difficult to evade labor taxes, and thereby contributes to the reduction of the grey economy.

7. Finally, in present circumstances of global financial crisis, it is important to point out that banking supervision in Macedonia has been solid for many years. The new Banking Law enacted in May 2007 was a major improvement—its provisions helped in closing a small bank with governance issues in 2007 (Makedonska Banka).

On the To-Do List

8. **Building on this success, there are a number of measures that Macedonia could take to further improve economic governance.** Let me list a few key suggestions below:

(1) Passage by parliament of the new **central bank law**. This law strengthens the NBRM's governance and accountability, including by providing a clearer division of responsibilities between the Governor and the NBRM Council.

(2) **Insurance sector supervision: the global financial crisis has shown that this can be a major gap (AIG).** In Macedonia, while the insurance sector is still small, now is the time to establish a sound regulatory framework, by setting up the planned insurance supervision agency.

(3) Third, the IMF's 2008 Article 4 report identified the **electricity sector** as a source of quasi fiscal losses, stemming from the difference between domestic and external prices. More rational **electricity pricing** is needed (there are now incentives for SMEs to try to pay household rates.) There is also a need for a mechanism that protects the poorest electricity users, in a targeted way.

(4) and fourth, create a clearer governance structure in the **telecommunications sector** by divesting the government's share in Maktel. Good and cheap telecommunication is crucial for a small, landlocked economy. While efforts to promote competition have led to lower prices, the

government remains subject to conflicting incentives, acting both as a producer and a regulator (with the telecom dividend a major source of government revenue). Sale of the government's share would also help shore up international reserves.

Thank you.