

North Macedonia rolls back progressive taxation

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During November 2019, the Government announced that it will roll back the implementation of the progressive income taxation, introduced in January 2019. As indicated in a press conference by the Minister of Finance, this is a temporary measure, until this policy is further redefined. The arguments provided are based on indicative rather than representative harmonised data.



Description

The Government introduced progressive taxation with the adoption of the new Law on Personal Income Tax (December 2018), implemented as of January 2019. This policy and the Law itself were part of a larger social reform package, along with other texts: the New Law on Social Protection, which introduced guaranteed minimum assistance; the new Law on Social Security for Older Persons, which introduced social pensions; and the Amendments to the Law on Child Protection, which introduced educational allowances. According to government estimates, the progressive taxation was to affect 1% of the wealthier citizens, and the expected revenues from this measure were estimated at 1,558 million MKD (€25 million). The policy plan, as publicly announced by the Government (November 2018), aimed to direct the increased revenues towards financing the new social protection rights.

The latest Government decision to roll back the progressive taxation is explained in a 20-page policy document (Ministry of Finance, 2019a). The findings are based on administrative data from the Public Revenue Office, for the period January 2019 to June 2019. The main arguments include:

- A minor improvement in inequality of income distribution: <1% reduction in inequality; and
- “Tax avoidance” affecting about 50% of the lost tax revenue that could have been collected.

Regarding the first finding, the analysis focused on the disaggregated impact of various sources of income, such as

wages, other salaries, contractual services, and authors’ contracts. Wages contributed towards 0.9 percentage point (p.p.) of the reduction in income inequality. Other salaries, contractual services and authors’ contracts had a higher impact on income inequality: 3.68 p.p., 2.76 p.p. and 2.27 p.p., respectively. However, the analysis warns that this better income distribution was not accompanied by higher incomes, and that these were significantly lower than they could potentially have been, given the better redistribution.

The second finding is a presumptive explanation of why the better income distribution was not accompanied by higher incomes. The analysis claims that “the taxpayers have probably decided to transfer their income to other tax systems or transfer it to other persons who have not yet exceeded or know that they will not exceed the threshold for progressive taxation” (Ministry of Finance, 2019a:13). Due to this, the analysis finds that “the amount of income generated only by the progressive and higher rate of personal income for the first 6 months of 2019 is 7,817 million MKD (€12.7 million). The potential income, if there were no ‘tax evasion’, would be 11,818 million MKD (€19.2 million). Hence, the total lost revenue that could have been collected was estimated at 4,001 million MKD (€6.5 million), representing 51.2% of the progressive and higher income tax revenue collected” (Ministry of Finance, 2019a:16).

In relation to the personal income tax, the policy document makes the following recommendations: the progressive and higher personal income tax should be put on hold until 1 January 2023; its

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design should be improved; there should be broader consultations with all stakeholders; mechanisms for the elimination of the informal economy should be improved (in line with the Strategy for the Formalization of the Informal Economy 2018-2022); the trust in institutions should be enhanced; and efficient and effective processes should be put in place to harness the potential of technology to reduce administrative burdens.

Outlook and commentary

The unexpected Government move to change its own policy decision introducing progressive taxation, 11 months after its implementation, received mixed reactions. The business community, which initially opposed the progressive taxation, welcomed the move, while supporters of the social reform introduced alongside the tax reform were unpleasantly surprised.

The arguments put forward in the policy document can be disputed from a number of angles. First, the income inequality estimations based on administrative data are only indicative. The official statistical data based on EU-SILC are available only for 2018, and they show a 0.6 p.p. decline in the Gini coefficient. More importantly, a decline in the Gini coefficient of less than 1% is neither negligible, nor a reason to abandon the progressive taxation. Second, as rightly pointed out by Jovanovic (former advisor and member of the cabinet team of the previous Minister of Finance, who introduced the progressive taxation), the publicly available

Ministry of Finance data on budget implementation show that the income from personal income tax in the first 9 months of 2019 increased by 1,664 million MKD (€27 million) compared to the same period in 2018; this reduced the projected revenues, estimated at 1,558 million MKD (€25 million) (Jovanovic, 2019). In addition, a period of 6 months is too short for a comprehensive assessment of the overall effect of the tax reform, let alone for such a decisive and contradictory policy move.

In a recent statement, the IMF has also criticised this government move indicating that: “The proposed rollback of the progressive personal income tax rate and capital gains tax will slow down revenue growth” (IMF, 2019).

The context in which this decision has been taken, i.e. the period following the Government’s announcement of early parliamentary elections in 2020, sparked debates about its “populist” character and possible intention to buffer the angry sentiments of the business community. Also, it remains unclear how the social reform undertaken will be financially supported in the future. Finally, if the Government wanted to correct any burden on certain income groups, then it would have been more appropriate to increase the progressive personal income tax thresholds.

With the suggested rollback of its own tax-policy reform, the Government has lost substantial policy credibility and made it less likely that the reform will be reintroduced.

Further reading

International Monetary Fund (2019), Republic of North Macedonia: Staff Concluding Statement of the 2019 Article IV Mission.

Jovanovic, B. (2019), “Where the Minister Got it Wrong”, (in Macedonian). Available at: <https://prizma.mk/kolumni/kade-zgreshi-ministerkata/>

Ministry of Finance (2019a), “How to achieve comprehensive, fair and efficient tax in the Republic of North Macedonia” (in Macedonian). Available at: <https://finance.gov.mk/mk/node/8323>

Ministry of Finance (2019b), Budget Execution Reports. Available at: <https://finance.gov.mk/en/node/699>

Nova TV News Release (2018), “PM Statement – Progressive taxation will contribute toward fair society (in Macedonian). Available at: <https://novatv.mk/zaev-progresivniot-danok-ke-bridonese-za-pravedno-opshtestvo/>

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