PUBLIC DEBT MANAGEMENT IN NORTH MACEDONIA: CHALLENGES AND OPPORTUNITIES IN THE CONTEXT OF EU ACCESSION

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Abstract: *The public debt represents an issue that is constantly discussed at different levels in society and, herein, as a phenomenon provokes greater interest and captures considerable attention. Whereas the governments continuously adopt different strategies and pursue various trends in the management of the public debt. The purpose of this research paper is to comprehensively analyse the alignment of the public debt management strategy of North Macedonia with the fiscal convergence criteria for EU accession and its impact on fiscal discipline. Likewise, conduct a thorough review and assessment of the country's latest strategies in debt management and see what reforms are further needed to ensure full compliance with EU fiscal rules. The analysis of the fiscal indicators, the public debt, and the budget deficit provides an outlook on the country's historical and current performance in public financial management. For this purpose, secondary data from the respective institution and reviewed reports from different international bodies. Later, several conclusions and recommendations are drawn in the direction of ensuring better public debt management in North Macedonia towards accession into the European Union.*

Keywords: *public debt, budget deficit, debt management, fiscal convergence, EU integration*
JEL Codes: *H61, H62, H63, P43.*

1. Introduction

Government consumption plays an important role in the stability of the national economy, especially in periods of economic crisis (Dudzeviciute, Simelyte & Liucvaitiene, 2018). Consequently, a considerable increase in government expenditure is witnessed in the period of the COVID-19 pandemic and afterwards, in the energy crisis at majority of the countries in the world, as one of the policies pursued to stifle the negative effects and shocks, stabilize the markets and the national economies. However, the increase of the government spending resulted with mounting higher levels of public debt at the countries for a short period of time. Based on Mencinger et al. (2014) a rapidly growing public debt is a concerning issue nowadays since it might jeopardize economic growth perspectives. On the other hand, dozens of studies based on the economic theory have suggested that public debt has non-linear impact on economic growth in a form of inverted U-shape (Liu & Lyu, 2021). In this direction, a growing trend and considerable high public debt is seen also, in our country, North Macedonia, as a result of the continuous expansionary fiscal policy adopted by the government of North Macedonia commenced since the onset of the respective crisis. Even though this expansionary fiscal policy has been often justified by boosting economic growth, the real GDP growth rate did not follow the same track (Kjosev et al., 2023). Hence, the accumulation of record high levels of public debt initiated a widened debate on the sustainability and management of the public debt from the national governments. Thereby, rose the interest of research and analysis of the public debt management strategies and the effectiveness of the developed public policies. In a nutshell, the main focus of this research paper is to analyse the development of the public debt in North Macedonia, in particular, the country's public debt management strategies and provide an assessment on the alignment of these strategies with the fiscal convergence criteria for EU accession. Meanwhile, we will provide an outlook on the opportunities and challenges in the area of public debt management of North Macedonia in the context of EU accession, being a candidate country. In a nutshell, the aim of this research paper is to comprehensively analyze the alignment of the public debt management strategy of North Macedonia with the fiscal convergence criteria for EU accession and its impact on fiscal discipline. Thereby, our study will attempt to provide accurate answer to the following research questions stated below:

- How do North Macedonia's debt management frameworks align with EU standards?
- What risks does the current debt portfolio impose in the context of EU accession?
- How does the public debt management strategies support the required fiscal reforms for EU accession?
- What kind of reforms are further needed by North Macedonia in order to achieve full compliance with the EU fiscal rules?
- What is the current performance of the country on public debt management in terms of sustainability and transparency?

Likewise, for accomplishing the already stated aim of this paper will be used secondary data from relevant domestic and international institutions, along with thorough review of the recent public debt management strategies of North Macedonia, reports from EU commission and relevant international organizations, and assessment of the existing literature on this respective topic.

2. Literature Review

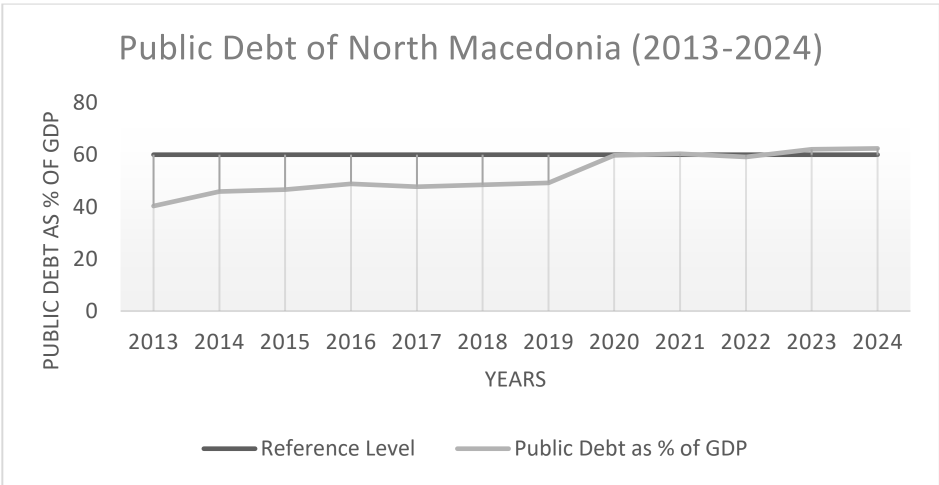
There exist considerable amount of literature published and research conducted on the topic of public debt management in the candidate or member countries in the context of alignment with fiscal convergence criteria of European Union, prescribed in the Maastricht Treaty. Based on the treaty, there are determined clear fiscal convergence rules that every EU member states need to adhere. Hence, the main two criteria are: the public debt level to GDP must not exceed 60% and the budget deficit ratio to GDP must not be higher than 3%. This trend has been following by our country, North Macedonia and all the other Western Balkan countries by gradually introducing core reforms to limit budget deficits and public debt, striving towards complete alignment with the European fiscal sustainability standards (Petreski et al., 2024). The government debt varies among the accession countries, but is low compared to those of the euro area member states, whereas, the low level of government debt is mainly as a result of relatively modest indebtedness prior to the transition to market economy, considerable privatization revenue, high growth and in some countries small government budget deficits (Hahnemann & Larsen, 2003). In projecting the public debt and budget deficit, the Ministry of Finance of North Macedonia does not include the unpaid obligations of public institutions, even though inclusion of such obligations is a standard determined by the European System of Accounts (ESA 2010). For instance, Tashevska and Trenovski (2017) as a result of the country debt level call for the need of immediate measures for fiscal consolidation. The continuous policy of fiscal expansion with optimistic growth scenarios is seen as a significant vulnerability for the debt-to-GDP ratios according to Gavranlieva – Andonova and Nikolov (2019). In this line, Kjosev et al. (2023) in their recent study on public debt of North Macedonia stress the concern of the country registering high and growing debt, especially in the period of the COVID-19 pandemic, exceeding the Maastricht criteria of 60% debt-to-GDP ratio in 2020, mainly, as a result of the continuous expansionary fiscal policy implemented by the government. Consequently, Petreski et al. (2024) analysed the compliance of North Macedonia with the fiscal criteria in the last two decades and sprout with a conclusion that the country faces serious difficulties in meeting them, pointing out in particular the exceeding of the fiscal target of 3% of the budget deficit in approximately in half of the analyzed years. Durkalic & Curcic (2019) undertook a comparative study and examined the debt sustainability of EU members and EU candidate countries, where they found that the EU and EMU candidate countries put more efforts to fulfill the debt criteria than the EU member countries. While Danijela Bobeva (2020) in her research noted that the economies of EU candidate countries converge to the EU fiscal standards at different speeds and that the real convergence of the candidate countries ought to be more unsustainable in relation to the new EU Member States. Concretely, for North Macedonia, found that the country has the best performance in nominal and institutional convergence criteria, but lags behind in real and structural convergence criteria. In general, the literature suggests that the continuously rising debt is mainly a result of expansionary fiscal policy pursued by the countries, including North Macedonia.

3. An overview of the trend of public debt and budget deficit of North Macedonia

Undoubtedly, as one serious concern for both policymakers and research analysts in recent years, is the rising public debt in North Macedonia. This matter rose and continuously attracts the interest of the whole opinion in the country, since, as generally heard, the citizens are those who should return the respective public debt in the future. Thus, a constant rise of public debt is noted throughout the analysed period 2013-2024. For instance, North Macedonia have registered a public debt ranging from 40 to 50 per cent of GDP from 2013 until 2019, even though it followed an upward trend, the public debt never exceeded 50%, but most importantly, the rise was quite modest, with an average of 1 pp in a year. However, between the years of 2019-2020, the country experienced the biggest rise of its public debt, more than 10 pp, a double-digit increase. Respectively, from 49.2% in 2019, the public debt rose to 59.7% in 2020, amounting to EUR 6,483 million, being very close to the limit of total public level of 60% of GDP. This upsurge mainly is attributed to the economic crisis caused by the pandemic Covid-19 and the need of the North Macedonian government to secure funds for managing the pandemic, as a lot of other countries did. Additionally, the experienced increase was fueled due to the fact that from 2019, the government brought decision to include in the definition of public debt the non-guaranteed debt of public enterprises and joint stock companies established by the state or the municipalities, the municipalities in the City of Skopje and the City of Skopje. Nonetheless, for the first time in 2020, the country exceeded the limit on public debt, registering 60.3% public debt as % of GDP, amounting to EUR 7,135 million. Afterwards, in the following year (2021) the public debt level experienced a slight decrease and stood at approximately 59% of GDP. But again in 2023, the public debt went above the set limit, being in the level of 62.1%

or EUR 8,477 million, while the rising trend was noted in 2024 too. Respectively, the total public debt of North Macedonia reached 62.4 per cent, amounting to EUR 9,619 million. Thus, the public debt level of the country in the last two years exceeded the set limit and the fiscal rules of the EU. As a candidate country, the government didn't manage to maintain the public debt level not more than 60 per cent of GDP. Mostly, the respective rise of the public debt was as a result of high realisation level of capital expenditures in 2023, respectively, the government pre-paid EUR 230 million to the contracting company for the construction of Corridor 8 & 10D and EUR 80 million in the form of subsidies to the domestic electricity producers in order to stifle the effects of the energy crisis. However, despite several claims and projections that the public debt will decrease in 2025 for several reasons, the latest borrowings of the current government and other agreements that should be executed in the upcoming period prove the opposite. Based on these facts, the public debt of North Macedonia for sure will continue the upward trend and eventually rise, reaching historically record levels. Thus, it considerably exceeds the set limit from 60% of total public debt and endangers the capacity to comply with one of the EU fiscal criteria, as a candidate country striving to join the union.

Fig. 1. Total public debt of North Macedonia as % of GDP



Source: Ministry of Finance of North Macedonia

Concerning the structure of the total public debt of North Macedonia, several developments and trends can be noted in the analysed period. For example, guaranteed debt during the whole observed period have experienced upward trend. From EUR 509.8 million in 2013, guaranteed debt reached the amount of EUR 1,264 million. Whereas, the non-guaranteed debt level since the decision for their inclusion in the calculation of the total public debt, initially have experienced a considerable increase, from EUR 41.9 million reaching an amount of EUR 69.7 million in 2023, but in the last year, 2024, non-guaranteed debt experienced a decline, accounting for EUR 57 million. Related to the debt source, both external and domestic debt have followed an upward trend during the whole analysed period. For instance, the external debt of North Macedonia from 2013, in the amount of EUR 2,078 million, reached to account for EUR 5,825 million in 2024. On the other hand, domestic debt accounted for EUR 1,202 million in 2013 and reached the amount of 3,794 million in 2024. Currently, the total public debt of North Macedonia is composed mainly by external debt, accounting for over 60% and domestic debt for approximately 40%. Shortly put, the domestic debt has experienced quite a considerable increase, mainly as a result of the public debt management strategy of the country, which has set as an objective the development of the domestic government securities market.

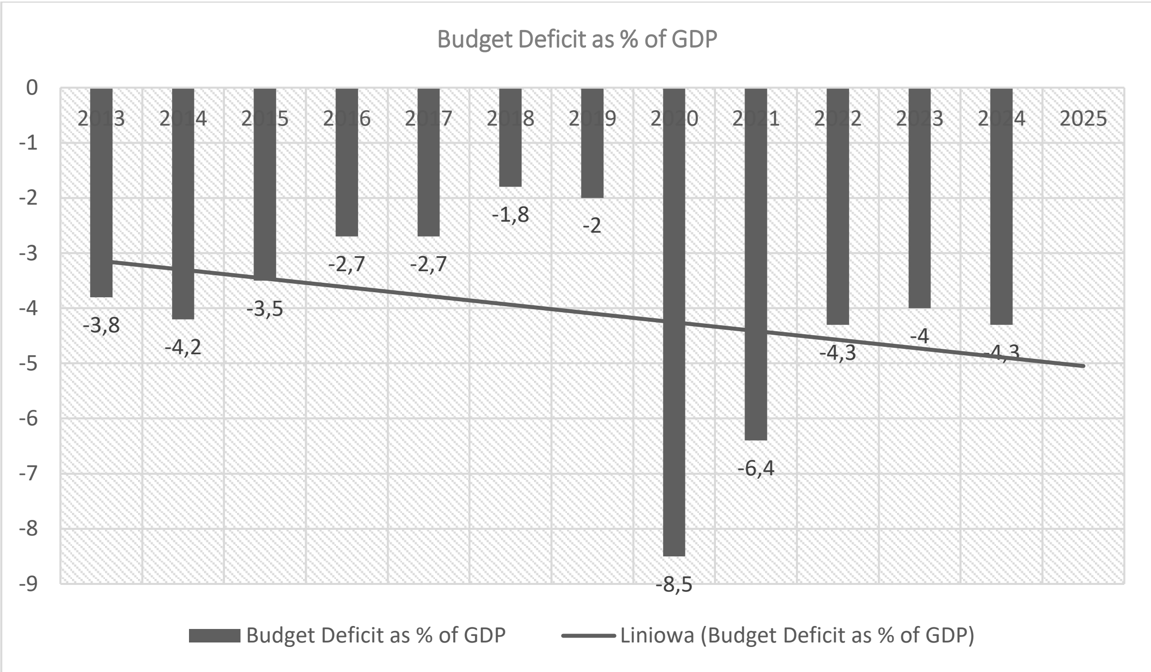
Tab. 1. The structure of the public debt of North Macedonia (2013-2024)

Years	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Government debt in EUR millions	2.772	3.262	3.453	3.85	3.958	4.344	4.557	5.514	6.080	6.581	7.256	8.298
Government debt as % of GDP	34.0	38.1	38.1	39.9	39.4	40.4	40.5	50.8	51.4	49.7	49.8	53.8
Guaranteed debt	509.8	658.9	774.0	859.9	828.4	857.7	942.2	929.5	1,007	1,053	1,151	1,264
Non-guaranteed debt	N/A	N/A	N/A	N/A	N/A	N/A	41.9	37.8	47.7	68.2	69.7	57.0
Total public debt	3.281	3.921	4.277	4.711	4.787	5.202	5.541	6.483	7.135	7.703	8.477	9.619
External public debt	2,078	2,725	2,847.5	3,286	3,187	3,537	3,709	4,323	4,668	5,055	5,345	5,825
Domestic public debt	1,202	1,196	1,379	1,425	1,599	1,664	1,831	2,159	2,466	2,647	3,131	3,794
Total public as % of GDP	40.3	45.8	46.6	48.8	47.7	48.4	49.2	59.7	60.3	59.1	62.1	62.4

Source: Ministry of Finance of North Macedonia

Based on the article 10 of the Budget Law of 2022 of the country and the EU fiscal criteria, budget deficit must not exceed 3% of nominal GDP. As observed through the whole period of our research, North Macedonia dominantly have experienced a fiscal deficit higher than 3% of the GDP. In particular, from 2013-2015, the country registered on average a 3.8% budget deficit, while later, in the following years (2016-2019), the deficit underwent a decline and has been continuously lower than the set limit of 3%. The country did quite well, maintaining an average deficit of 2.3%. However, mainly, as a result of the economic crisis caused by the pandemic and the imposed support measures from the government to protect living standards and jobs, the deficit in 2020 reached high record levels, accounting for 8.5% of the GDP. Within a year, in 2021, the deficit is expected to face a decline, even though it stood at a still high level for the country, accounting for 6.4%. Despite the downward trend followed in the last three years (2022-2024), the budget deficit of the country continued to be higher than the fiscal limit of 3%, and continued to stay at 4% on average.

Fig. 2. Budget Deficit of North Macedonia (2013-2024)



Source: Ministry of Finance of North Macedonia

4. Analysis and discussion on North Macedonia's public debt management in the context of EU accession

Based on the Law on Public Debt, the government of North Macedonia adopts a Public Debt Management Strategy, which sets out the amount of public debt in the medium term, the maximum amount of net borrowing in the first year covered by the strategy, the maximum amount of newly issued sovereign guarantees in the first year covered by the strategy, as well as the debt structure.

Another important document and vital tool in public debt management is the Fiscal Strategy prepared by the government and adopted by the Parliament of North Macedonia. It presents the macroeconomic assumptions and medium-term priorities of the Government, outlines the framework and directions of fiscal policy, and details the alignment of fiscal policy with the fiscal rules prescribed by the Law on Budgets (Fiscal Council of North Macedonia, 2024). Nonetheless, as a serious weakness is detected in the annual revision of the Fiscal Strategy, even though it is projected to be a medium – term plan with fixed objectives in the long run. In

Article 10 of the Budget Law of 2022 in North Macedonia are prescribed fiscal rules that clearly set limit on public debt and budget deficit of the government as stated below:

- The budget deficit must not exceed 3% of GDP;
- Total public debt must not exceed 60% of GDP and guaranteed debt must not exceed 15% of GDP;
- Budget compliance with the fiscal strategy;

The above limits are set to serve for the purpose of keeping the level of the public debt and budget deficit sustainable, without damaging the overall fiscal sustainability. In addition, the respective fiscal rules are fully aligned with the fiscal convergence criteria set up under the Maastricht Treaty. Furthermore, in the country's fiscal strategy is projected that in case the public debt exceeds the set limit, the government must prepare a strategy for the reduction of the public debt levels within 5 years, except in case of state emergency as a result of various crises. This is in line with the recent reforms made in the EU fiscal rules (adopted in April, 2024), where the fiscal targets remained unchanged, but in case they are exceeded above the set limit, the EU Commission puts a reference trajectory. Hence, this mechanism is set to ensure fiscal consolidation within all the member countries that did not meet the fiscal targets, by providing them with a fiscal adjustment period of at least 4 years up to a maximum of 7 years, in order to bring both the deficit and debt ratios to prudent levels. Whereas, Debt Sustainability Analysis (DSA) is used by the EU Commission for the assessment of the public debt trajectory and to see whether it will decline in a respective period. North Macedonia has in place a legal framework for debt management, which is primarily governed by the Public Debt Law, the Law on financing LSGs Units and the new Organic Budget Law (OBL), adopted in 2022. The OBL regulates the registry of public entities, fiscal rules and principles, the fiscal council, budget and financial plans, budget classifications, medium-term budget planning, the budget process, the budget circular, the fiscal strategy, the Integrated Financial Management System (IFMIS) and transparency (EU Commission, 2023). Other significant parts of the legal framework of the PFM system are the Law on Public Enterprises, on Financing Local Self - Government Units, on Financial Discipline and the law on Reporting Liabilities. The country established a new Public Investment Management Department (PIM) within the Ministry of Finance, and on the other hand, strengthened budget credibility by setting up and functionalizing the Fiscal Council. However, both the Ministry of Finance and the EU Commission have reviewed and concluded in their assessment reports that Public Financial Management Reform Program (PFMRP) implementation has been slow and considerably poor. For this purpose, the Ministry of Finance prepared a new reform program for the period 2024-2027. Whereas, the EU Commission (2024), in its last report, besides other remarks, noted that substantial delays occurred in the implementation of the legislation along the OBL and the setting of the Integrated Financial Management Information System (IFMIS). In a nutshell, the strategic and legal framework for Public Financial Management (PFM) of North Macedonia, EU Commission in the screening report of 2023 have evaluated as moderately prepared. Afterwards, in the report by the end of 2024, the commission has assessed it as broadly in place, but needs to be further improved (EU Commission, 2024). In terms of transparency and public access to the country budget resources, North Macedonia still lags behind, registering a score of 35 out of 100 as noted on the 2023 Open Budget Survey, being ranked in the 80th place among 120 countries. Hence, the country needs to ensure disclosure and accessibility of all relevant fiscal information for increasing the transparency of the budget and the overall public finances. Additionally, North Macedonia is behind all the EU candidate countries from the region, except Bosnia & Herzegovina. Likewise, the same concern is noted in the recent reports of the EU Commission, where important weaknesses are detected in terms of the transparency of public finances. However, improvements in this area are expected under the OBL, which mandates the Ministry of Finance to prepare a report on the impact of tax expenditures on budget revenues. Additionally, the incorporation of a separate module E-debt under the new Integrated Financial Management Information System on the MoF website in 2025 is expected to give results and increase transparency & accessibility of public finances. Another weak area in public debt management is the management of assets and liabilities. As noted in the screening report of the EU Commission (2023), North Macedonia’s capacity to monitor and manage fiscal risks is at an early stage of development. In this regard, the adoption of a functional public investment management (PIM) is seen as necessary for better management of the public capital investments. In terms of budget reliability, the country needs to minimize the significant deviations at the functional classifications and sectoral levels. Mainly, these weaknesses are a result of the delays in the adoption of the secondary legislation to implement the OBL, which includes key implementing acts on introducing a budget classification (EU Commission, 2024). After a thorough review of the last two public debt management strategies, the previous for the period 2022-2024 and the existing strategy 2025-2027 of the government of North Macedonia, the following answers were achieved in the context of the current debt portfolio of the country, the set public debt limits and the sustainability of the public debt, in the context of EU accession. Both strategies set limits on the debt amount and structure for the purpose of compilation of the public debt movement in the upcoming period, as part of the country's fiscal policy to ensure fiscal sustainability. As regard to the PDMS (2025-2027), limit on total public debt level for medium and long term is set to not exceed 60% of GDP, while a threshold of 15% of GDP is the limit set for the level of guaranteed debt. At the end of 2024, the public debt accounted for 62.4% exceeding the set limit and based on the projections in the respective strategy the public debt will continue to be higher than the threshold of 60% in the upcoming period. Nonetheless, the expected downward trend in the strategy projected to take place in the beginning of 2025 and continuing in the period 2026-2028, hardly will be obtained. Mainly, as a result of the ongoing fiscal expansionary policies of the current government and the decision for additional external borrowing that will considerably increase the level of the public debt. Thus, based on the recent developments in this area, the public debt will follow an upward trend, reaching record high public debt levels for North Macedonia. However, as we may see the limits on the public debt set in the PDMS of the country are fully aligned with the fiscal criteria set and required from the European Union too. Nevertheless, we are witnessing that the government of North Macedonia do not achieve to secure adherence to the set limit of 60% of the public debt level. On the other hand, the level of the guaranteed debt is expected to continue to be below the set limit of 15% of GDP in the upcoming period 2025-2029. In general, North Macedonia to ensure public debt sustainability requires a reduction in public debt relative to GDP by at least 0.5 pp, based on the current public debt level (Petreski et. al, 2024). While, concerning the public debt risk management, the exposure of the current debt portfolio to refinancing risk is measured through "the average time to maturity" indicator (PDMS, 2024). Based on the projections in the respective strategy the average time to maturity of government debt is expected to slightly decrease, and the public debt of North Macedonia will bear less re-financing risk in the period 2025-2029.

Tab. 2. Average Time to Maturity (years)

	2024	2025	2026	2027	2028	2029
Central Government Debt	5.2	5.5	5.5	5.8	5.9	5.5
Domestic Debt						
External Debt	3.8	4.3	4.4	5.2	5.8	5.5

Source: Ministry of Finance of North Macedonia

On the other hand, regarding the interest rate risk of the debt portfolio as measured by the indicator Average Time to Re-fixing, in the period 2025 – 2029 it is expected a moderate level of interest rate risk – around 5.3 years. Even though the average time to re-fixing is expected to be significantly above the set limit of 3 years in 2025, the debt portfolio of North Macedonia will continue to be lower-risk portfolio. Related to the budgetary convergence, North

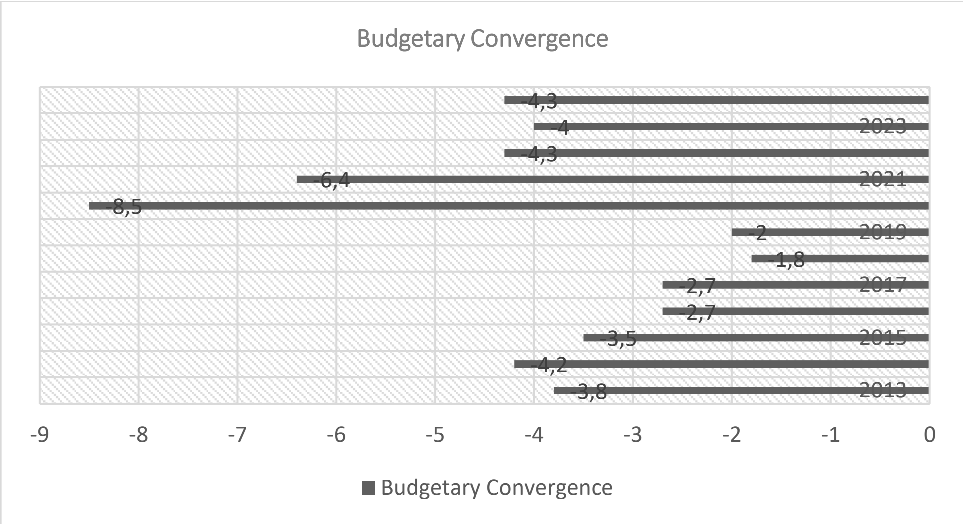
Macedonia in the majority of the analyzed years have exceeded the set limit of 3% of the budget deficit as defined by the country's Fiscal Strategy and as required by the EU fiscal standards. The budget deficit has been standing relatively high in the last 4 years, even though followed downward trend and generally, based on the developments with public debt is expected to continue being above the limit of 3% in the upcoming period. Mainly, as a result of inaccurate planning, challenges in limiting expenditures and excessive revenue projections. North Macedonia possess the highest fiscal deficit rate than the other Western Balkan and EU candidate countries. Below is presented the number of violations from North Macedonia of both convergence criteria, public debt and budget deficit during the observed period of our research.

Tab. 3. Number of violation of fiscal convergence criteria (2013-2024)

	Budget Deficit	Public Debt
North Macedonia	8	2

Source: Author's elaboration

Fig. 3. Budgetary Convergence of North Macedonia (2013-2024)



*Number of violations of the 3 % fiscal deficit limit

An interesting fact is that the economies of EU candidate countries, including North Macedonia converge with different speed to the European one (Bobeva, 2021). Our analysis on the compliance with fiscal rules in the context of EU accession in the period from 2013 to 2024 showed that North Macedonia faces difficulties in adhering to them. Thus, the duration of the process towards compliance with fiscal convergence criteria seems uncertain.

5. Concluding remarks and recommendations

North Macedonia has already made considerable progress in relation to the alignment with the EU framework in public financial management and compliance with the fiscal convergence criteria of the union. Even though a considerable time ago, Hahneman and Larsen (2003) clearly summarized that real convergence is achieved only through economic reforms, creating sustained high economic growth, a better trade-off between unemployment and inflation, and a reduced structural budget deficit. Likewise, macroeconomic stabilization policies along with economic reforms are vital for candidate countries in achieving convergence compliance during the accession period. In this direction, North Macedonia has successfully undertaken several set of reform packages in the area of public financial management and particularly, in public debt management. Nonetheless, there are areas for improvement and further need for implementation of reforms in the public financial management system of North Macedonia, which are noted in the assessment of international bodies, too, such as the following:

- The reforms under the Public Financial Management Reform Program (PFMRP) should continue and be completed sooner, related to such as the adoption of the second legislation to fully implement the Organic Budget Law, key acts on budget classification, modernization of the legal framework for the Public – Private Partnerships (PPPs) and related reforms to fulfill the gaps in Public Financial Management system (PFM).
- Budgeting continuous to be regarded as a regular annual process, not policy-based. Likewise, the government need to strive and achieve the budgeting and the fiscal strategy to be policy-based;
- The frequent revisions of the fiscal strategy of the country undermine the medium-term character, soaring the credibility of the set fiscal targets on budget deficit and public debt, hindering the country's capacity to achieve adherence to them.
- There is an evident need for North Macedonia to strengthen fiscal discipline and ensure better alignment with the set fiscal rules towards reaching fiscal convergence;
- The country still lags behind and important weaknesses are detected in terms of transparency of public finances and further efforts are needed in the direction of increasing accessibility and timely disclosure of all relevant information on public resources for improving budget transparency of the country.
- Fiscal reporting is another weakness of the PFM system, as noted on the latest reports of many international organizations such as the EU Commission, World Bank, etc. Hereby, better management of assets and liabilities is highly needed from the government, as a response to the continuous widening of its budget deficit, standing above the fiscal criteria of 3% in the last years.
- North Macedonia needs to include all unpaid liabilities of the public sector in the public debt projections to align with EU standards and requirements, something that is urged from the country's Fiscal Council too.
- Serious concerns for increase of the public debt are rising due to the recent external borrowing of the governments, mainly, for the purpose of re-financing public debt, capital investments in central level and across municipalities, support the domestic companies and other related expenditures not clearly disclosed still. Nevertheless, the country's public debt is necessary to be maintained in the determined fiscal target levels.

- There exist evident need for intervention in the further development of the country's public debt management strategies improving their accuracy, better management and planning of revenues and expenditures, ensuring more precise projections and risk assessments.
- North Macedonia need fiscal consolidation due to the high fiscal deficit registered in the last years and undergone low fiscal discipline in public institutions, in order to ensure sustainability of its fiscal position.

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