



REPUBLIC OF NORTH MACEDONIA
GOVERNMENT OF REPUBLIC OF NORTH MACEDONIA

**2021-2023 REVISED FISCAL
STRATEGY OF THE REPUBLIC
OF NORTH MACEDONIA
(with prospects until 2025)**

Skopje, December 2020

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Pursuant to paragraph 2, Article 16 of the Budget Law ("Official Gazette of the Republic of North Macedonia" No. 64/2005, 04/2008, 103/2008, 156/2009, 95/2010, 180/2011, 171/2012, 192 / 2015 and 167/2016) Government of the Republic of North Macedonia, at its session held on , adopted the 2021-2023 Revised Fiscal Strategy of the Republic of North Macedonia (with prospects until 2025).

Introduction

The fiscal strategy provides the medium-term projections and in accordance with the Budget Law, is adopted for a period of three years and it proposes the guidelines and goals of the fiscal policy, the basic macroeconomic projections and indicators, it determines the amounts for the main categories of estimated revenues and appropriations for that period, as well as projections for the budget deficit and the public debt. In the interest of improved fiscal predictability, this Fiscal Strategy covers medium-term planning over the next five years.

Fiscal strategy is the crucial instrument for medium-term budget planning and in creating the medium-term fiscal framework, the existence of credible medium-term budget planning is of great importance.

The revision of the Fiscal Strategy of the Republic of Macedonia for 2021-2025 is in line with the practice of developed countries and is necessary due to the changes that occurred during 2020 in terms of macroeconomic and fiscal parameters.

Improving public finance management, and thus the Fiscal Strategy as one of the most important strategic documents of a government is set among the key priorities of the Government, and is also a priority on the road to EU accession.

In this regard, the medium-term fiscal projections are based on a medium-term baseline scenario, which implies that the determination of fiscal projections arises from the performance of "usual competencies" of budget users defined in the current legislation, existing obligations and tasks, which are the result of already approved obligations, contracts and ongoing projects, as well as the inclusion of new financing initiatives, which basically refer to new projects and new financial obligations, significant changes in the time and financial framework of projects, as well as changes in legislation that have fiscal implications for the budget.

The medium-term fiscal strategy is in line with the medium-term fiscal goals and strategic priorities of the Government of the Republic of North Macedonia and it provides for monitoring of the dynamics of revenues and expenditures in relation to fiscal goals.

In accordance with the Decision on determining strategic priorities for 2021, the Government of the Republic of North Macedonia remains committed to achieving the most important strategic priorities, as follows:

- Ensuring accelerated and sustainable economic growth, improved living standards and quality of life of the citizens;
- Dealing with the global coronavirus pandemic COVID 19;
- successful accession negotiations with the European Union;
- rule of law, independence of the judiciary, consistent and non-selective fight against crime and corruption
- with broad and binding transparency;
- quality education available to all according to the demand on the labor market;
- modern and efficient public administration based on digitalization that provides quality and fast services to citizens and businesses;
- full implementation of the Ohrid Framework Agreement and building a civil state with ethnic and social cohesion based on the principles of mutual tolerance and respect; and
- Environmental protection, green development, reduction of air pollution and the impact of climate change.

Several priority goals have been determined to realize the strategic priorities of the Government, among which the following:

- maintaining financial and macroeconomic stability, increasing the competitiveness of the economy and employment;
- fiscal sustainability and support to the economy with investments in infrastructure projects;
- predictable, efficient and fair tax system, reducing the gray economy, encouraging private initiative and investment;
- Public finance reforms, improvement of the fiscal framework, strengthening of the planning process and execution of the Budget of the Republic of North Macedonia, improvement of the revenue collection, strengthening of the public procurement system, internal and external control and transparent reporting;
- increasing the investments through direct support of investment activities of companies, promotion and facilitation of the investment climate and the internationalization of businesses;
- support and development of sustainable and competitive micro, small and medium companies, improving of crafts, full use of entrepreneurial spirit and knowledge of domestic human resources;
- quality management and coordination of the accession process to the European Union and consistent fulfillment of the obligation from the Stabilization and Association Agreement and other legal rules that regulate the bilateral relations with the European Union;
- efficient use of EU accession assistance and strengthening of the established system for financial management and control of IPA funds in order to adjust the system for managing the structural funds;
- strengthening the position of the Republic of North Macedonia at the international level, development of bilateral, regional and multilateral relations with the members of NATO and the European Union and other countries in the European and non-European space;
- developing quality education accessible to all in function of persons who will respect and nurture civil rights, tolerance, diversity, education in the spirit of multiculturalism and training for the needs of the labor market;
- available health services at all levels, quality health care and establishment of a system for monitoring the health status of the population;
- Improving the social security system and establishing decentralized mechanisms of social services, as well as improving the quality of life of the elderly and ensuring a dignified old age, etc.

Key elements of medium-term fiscal policy are the redesign of budget policy and fiscal consolidation, which are aimed at supporting macroeconomic stability, accelerating economic growth, and thus strengthening the potential of the domestic economy growth.

The redesign of the budget policy is closely related to the strategy for economic recovery and accelerated growth, which consists of four pillars: (i) economic recovery from Covid-19, (ii) accelerated, inclusive and sustainable economic growth, (iii) strengthening private sector competitiveness and (iv) human resource development and equal opportunities.

The first pillar, Economic Recovery from Covid-19 covers the following two priorities: 1 / protection of citizens' health and social protection of the most vulnerable categories of society and 2 / support of the economy, the private sector and protection of jobs.

The second pillar, Accelerated, inclusive and sustainable economic growth focuses on the following priority areas: 1 / good governance (rule of law, fight against corruption and raising the institutions capacity), 2 / fiscal sustainability, macroeconomic and financial stability, 3 / local and balanced regional development, 4 / sustainable and healthy environment and 5 / digitalization of the economy and public services, within which various measures and activities are envisaged.

Regarding the third pillar, Strengthening the competitiveness of the private sector, the focus is on the following: 1 / strengthening trade links and integration into global value chains creation, 2 / improving the business environment and combating the gray economy,

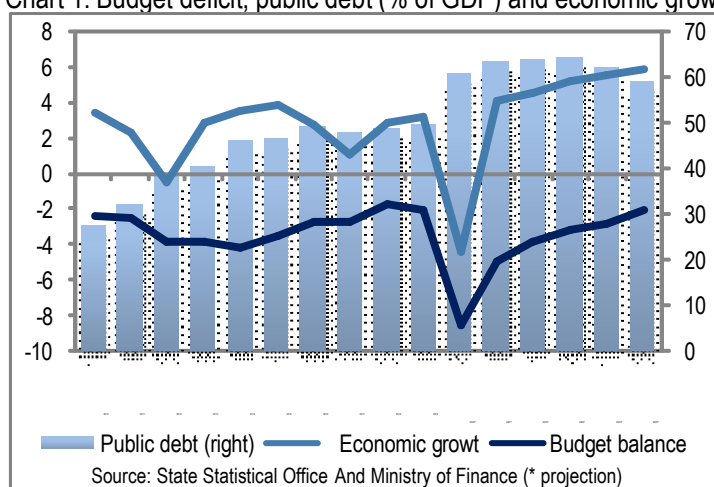
3 / improving access to finance and technology adaptation and 4 / modernization of agriculture.

The fourth pillar, Human Resources Development and Equal Opportunities covers the following three priority areas: 1 / human resources development (education, science and health), 2 / greater activity of the working population and 3 / social protection and social insurance, within which various measures and activities are envisaged.

Planned fiscal consolidation covers three main aspects:

- Improving the collection of budget revenues, through measures to reduce the gray economy and measures to prevent and combat corruption;
- reduction and restructuring of budget expenditures, by cutting non-priority and non-essential expenditures, greater support to the private sector and innovation in order to strengthen competitiveness, social component to support the most vulnerable categories of the population and revision of methodologies for transfers and subsidies;
- changes in the sources of financing the budget deficit, greater diversification of the sources of financing the deficit, financing and realization of certain projects through public-private partnerships and establishment of a Development Fund for strategic investments.

Chart 1. Budget deficit, public debt (% of GDP) and economic growth (%)



1. Macroeconomic projections

1.1 International economic trends and forecasts¹

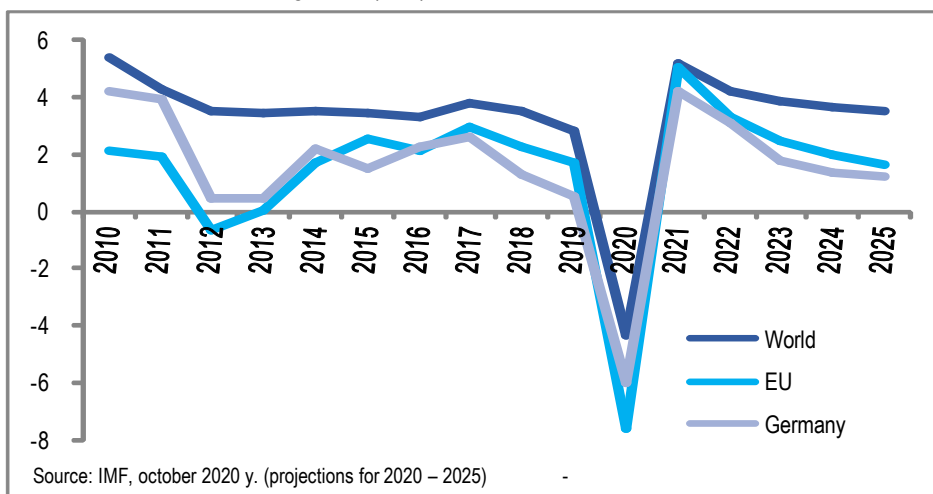
The global economy in 2020 is strongly influenced by the adverse effects of the coronavirus pandemic that disrupt global demand and contribute to significantly reduced economic activity. The economic recovery that began in the second half of the year is strongly influenced by the uncertainty about the length of the pandemic and could be severely affected by the recent increase of infected people. Social distancing measures are expected to continue in 2021, but will be gradually lifted.

Global economic activity is expected to decline by 4.4% in 2020, while in 2021 it is expected to grow by 5.2%. In the period 2022-2025, global economic growth of 3.8% on average per year is projected. The crisis caused by the pandemic with similar negative consequences also affected the EU economy, which in 2020 is projected to decline by 7.6%, while in 2021 a projected growth rate of 5%. In the period 2022-2025, the average economic growth in the EU is projected at 2.3% per year. In Germany, as the largest economy within the EU and our most important trading partner, a decline in economic activity of 6% in 2020 is projected. The German economy in 2021 is expected to record economic growth of 4.2%, and in

1.The analysis in this section is based on the report of the International Monetary Fund "World Economic Outlook", published in October 2019.

the medium term, i.e. in the period 2022-2025, an average annual growth of 1.8% is projected (Chart 2). Namely, the fund for managing with the consequences of the pandemic in the amount of 750 billion EUR within the EU is expected to stimulate the economic recovery. In countries where there is sufficient fiscal space, it is recommended to focus fiscal resources on public investment, but also social transfers; while in countries where inflation expectations are well anchored, monetary policy could help control borrowing costs. The limiting factor for economic growth in the EU is the rising level of debt in many countries as a result of the growing need for funds to support economies.

Chart 2. Global economic growth (in%)

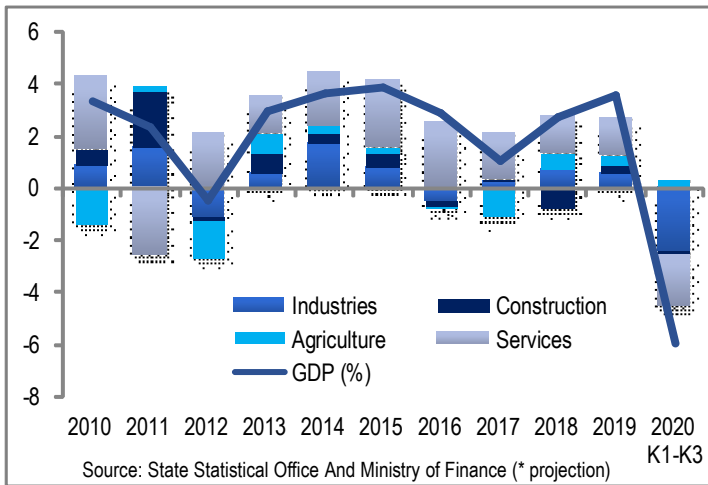


The projection risks mainly arise from the great uncertainty about the pandemic. The projections are based on both public health and economic factors that are quite difficult to predict. The first group of factors is related to the path of pandemic development, the required public health responsiveness and the associated disturbances in the affected industries. The second group of factors refers to the volume of global overflows from weak demand, reduced tourism and reduced remittances. The third group of factors includes the prospects of financial markets and their impact on global capital flows. There is also uncertainty about the damage done to the offer potential, which will depend on the duration of pandemic shocks, the magnitude and effectiveness of policies implemented, and the extent to which there is an inadequate resource allocation.

1.2 Economic developments in the Republic of North Macedonia

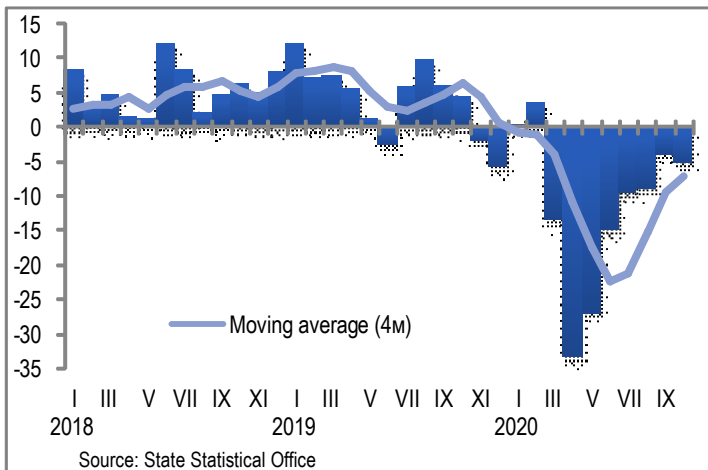
In the first nine months of 2020, there was a decline in domestic economic activity of 5.9%, which is mainly a reflection of the adverse developments in the second quarter, when economic activity decreased by almost 15% on an annual basis, as a result of restrictive measures for preventing the spread of coronavirus in the country and the aggravated international economic environment, of which the most severely affected were industrial production, construction, trade, transport and catering industry. In the third quarter, the decline in economic activity slowed down significantly, i.e. a decline of 3.3% was registered, in conditions of slower pace of decline in activity in the industrial and service sector, and growth in the construction and agricultural sector.

Chart 3. Structure of economic growth by production method (contribution to growth, p.p.)



In the first nine months, the activity in the service sector decreased by 3.5%, as a result of the unfavorable movements in the Trade, transport and catering industry, where a decline of 10.8% was registered, which was partially neutralized by the favorable trends in information-communication industry, where there is a growth of activity of 4%. The construction sector dropped by 2.5% on real terms, which according to the high frequency data was due to the unfavorable trends in the construction sector, while the construction works in the civil engineering sector registered an increase. The agricultural sector in this period registered real growth of 4.1%.

Chart 4. Annual growth of industrial production (in%)

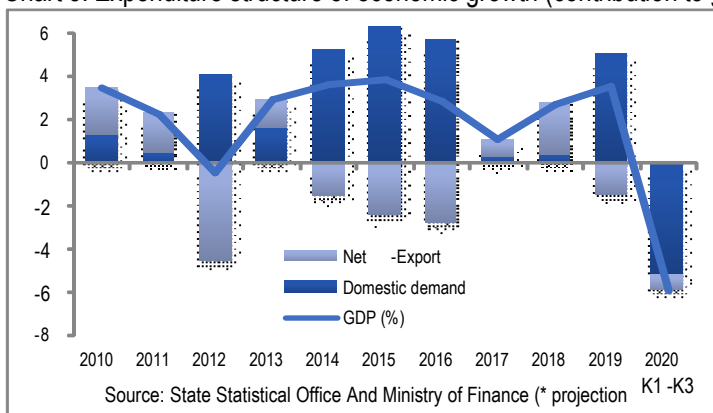


In the first nine months, the activity in the industrial sector decreased by 13.2%. According to the monthly data, the industry suffered the greatest consequences in April and May, when it registered an average decline in production of 30.2%, followed by a significant mitigation of the decline, namely industrial production in July and August decreased by 9.3% on average, and in September and October by 4.7% on average (Chart 4). Within the industrial sector, the largest decline in the period January-October was registered in the Manufacturing, mainly due to the reduced production of machinery, devices, motor vehicles and electrical equipment, i.e. the activities related to the industries in free economic zones which are integrated into global production chains as well as the decline in production of clothing and textiles. The average capacity utilization in the manufacturing industry is gradually increasing and in October it reached 68.1%, which is slowly approaching the level before the health and economic crisis (71.4% in February).

The decomposition of GDP by expenditure side shows that private consumption, investment and net exports have a negative contribution to economic activity in the first nine months, while the contribution of public consumption is positive.

Private consumption noted decline of 6% on a real terms, in conditions of significant reduction of remittances, which adversely affected households income and consequently consumption. Thereby, a more significant decline in consumption was prevented through the measure for financial support of the companies for payment of salaries, the measure for payment cards for the citizens for higher consumption, as well as the credit support of the banks. Additionally, the reduced total consumption was mitigated by the high growth of public consumption of 11.3%, due to the expenditures related to the health crisis. Gross investments decreased by 8.8% on a real terms, as a result of the decline in investments in the second quarter, which according to high frequency data corresponds to the decline in investments in construction works and machinery and equipment.

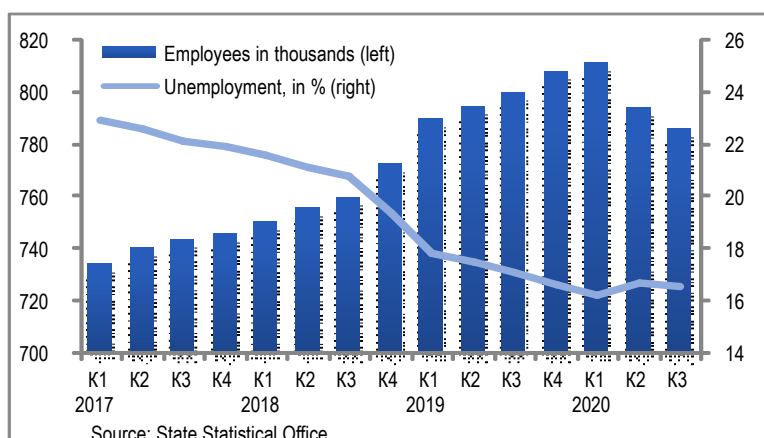
Chart 5. Expenditure structure of economic growth (contribution to growth, p.p.)



Exports of goods and services in the first nine months dropped by 15.1% on a real terms, which is mainly a reflection of the aggravated international economic environment and resulted mainly in a decline in exports of machinery, transport equipment and chemical products. Imports of goods and services dropped by 11.8%, mainly due to the reduced imports of intermediate goods. Monthly data on foreign trade exchange shows a slower pace of decline in exports and imports of goods in the period July-August, with exports in September and October recording average nominal growth of 4.8% and imports of 1.7% per year basis.

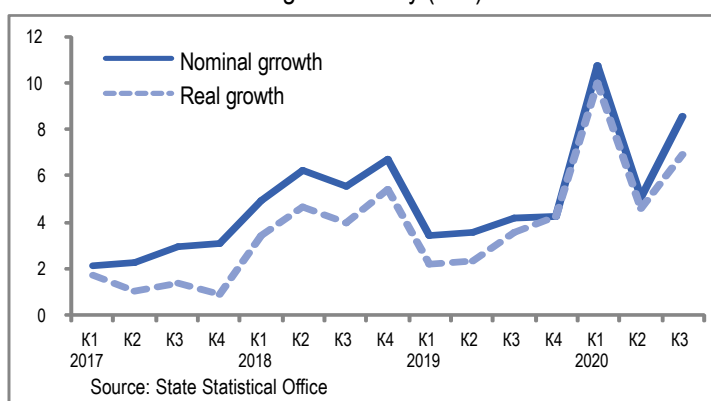
According to the Labor Force Survey, the unemployment rate in the third quarter decreased to 16.5%, after increasing to 16.7% in the second quarter (Chart 6). Thereby, the number of employees in the third quarter dropped by 1.7% on annual basis and was limited by the undertaken economic measures for retaining jobs in conditions of significant consequences of the pandemic on economic activity.

Chart 6. Number of employees and unemployment rate



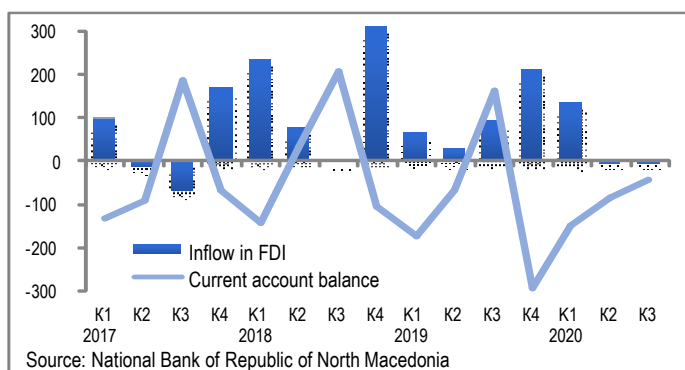
The average monthly net salary in the period January-September 2020 was higher by 8.1% on nominal basis and 7.2% on real terms. After the strong wage growth in the first quarter, in the second quarter there was a greater slowdown in wage growth, reflecting the negative impact of the pandemic on the domestic economy, after which wage growth gained intensity (Chart 7). The increase in wages in this period is due to the increase in the level of the minimum wage, the government measure for financial support of employers who will increase wages to a certain amount, the effect of increased wages of public sector employees in September last year, as well as additional increase in salaries in education and health this year, while the fiscal measure for financial support to employers affected by the health crisis for payment of wages had a mitigation of the downward trend of wage growth in the second quarter. On nominal basis, salaries in education increased by 12.1%, in information and communication by 11%, in trade by 9.2%, in health and social protection and construction by 9.1%, in the manufacturing industry by 8,7% etc. On the other hand, salaries in catering industry decreased by 2.4%, which is a reflection of the reduced workload in this activity.

Chart 7. Growth of average net salary (in%)



The current account of the balance of payments in the period January-September 2020 recorded a deficit of 277 million EUR, which represents 2.6% of projected GDP. Compared to the previous year, the current account deteriorated, mainly due to private transfers from abroad, which decreased by 28.8% in this period, primarily in the second and third quarters, as a result of the global economic crisis caused by the pandemic. There is a deterioration of the balance in the exchange of services, where the surplus is reduced by 4%, while the trade deficit narrows, as well as the deficit in primary income.

Chart 8. Current account balance and FDI inflow (in millions of euros)

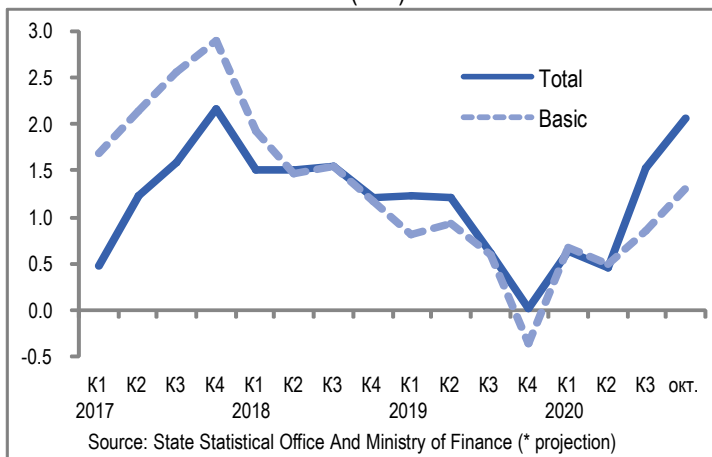


In the first nine months of the year, FDI in the country amounted to 120 million EUR, as a result of the strong inflow of FDI in the first quarter, while in the second and third quarters, in conditions of

deteriorating international environment and increased uncertainty, FDI inflows stopped (Chart 8). FDI in this period is based on equity and reinvestment of profits of companies with foreign capital, on the basis of which an inflow of approximately 140 million EUR was realized, while debt instruments (intercompany lending) had a negative contribution to FDI. Foreign exchange reserves at the end of October 2020 amounted to 3.5 billion EUR and increased by 8.4% compared to October the previous year.

The inflation rate in the period January-October 2020 is 1%. The growth of consumer prices in this period is due to the growth of food prices of 2.4% and core inflation which is 0.7%, driven by tobacco prices which are higher by 6.2%, while oil prices derivatives dropped by about 11%, in line with the fall in oil prices on world stock exchanges.

Chart 9. Total and core inflation (in%)



In the first half of 2020, in terms of high levels of foreign reserves and low inflationary pressures, the National Bank continued to loosen monetary policy by reducing the key interest rate three times, in January, March and May for a total of 0, 75 percentage points, i.e. 1.5%, but also through other additional measures, in order to mitigate the effects of the pandemic on the domestic economy, by further supporting the borrowing activity of banks. Credit activity in October 2020 increased by 6.7% on annual basis, driven by increased borrowing to households by 9%, and corporate borrowing had a positive contribution with growth of 4.4%. Total deposits in the banking system in October 2020 were higher by 5.5% on annual basis, due to which deposits in domestic currency increased by 4.5% and those in foreign currency by 7.1%.

1.3 Medium-term macroeconomic projections

In 2020, in times of a significant deterioration in the international economic environment and a significant decline in external demand caused by the health crisis, as well as negative economic implications from the implementation of measures to prevent the spread of coronavirus in the country, economic activity is expected to decline from 4.4%, according to the base scenario (Chart 10).

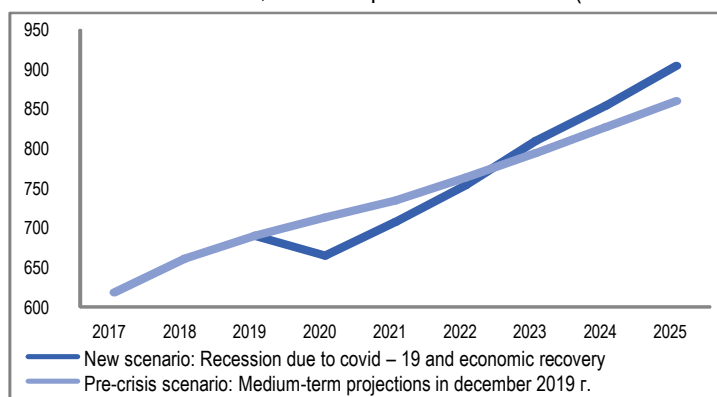
The response to the pandemic fiscal policy in the country was rapid and significant in supporting companies and employees in the most affected industries and vulnerable populations. State aid through various measures that will support domestic demand and export activity will continue in 2021, in order to accelerate the recovery of the domestic economy and create a basis for accelerated economic growth in the long term.

In 2021, the economic growth in the country is expected to move to the positive zone, in conditions of expected recovery of investments, consumption and external demand, with a projected growth of 4.1% according to the base scenario, which assumes a weakening of the health crisis and stage improvement of the epidemiological picture, higher utilization of

production and service capacities, favorable effects of economic measures, as well as increased confidence among consumers and investors.

The redesign of the budget policy and the policies aimed at economic recovery and accelerated growth (SmartER Growth) are a solid basis for accelerating economic growth in the coming period, returning the economy to the pre-crisis growth path in the second half of 2022 and ensuring faster economic dynamics growth afterwards. Thus, according to the basic medium-term scenario, the average annual growth in the period 2022-2025 is 5.3%, i.e. economic growth in 2025 is expected to reach 5.9%.

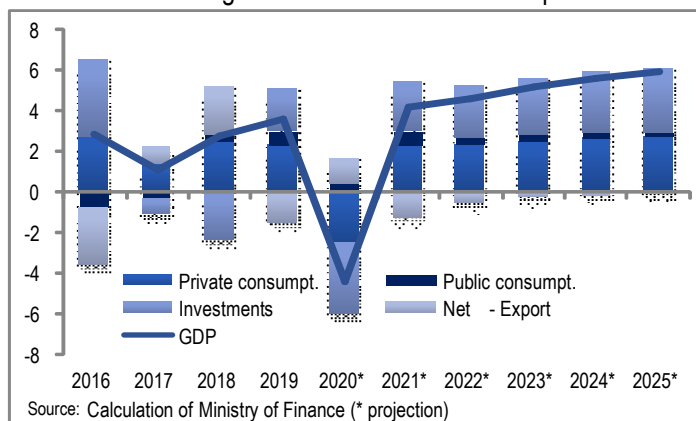
Chart 10. Nominal GDP, new and pre-crisis scenario (in billions of denars)



Export activity, with the exhaustion of the unfavorable economic effects of the pandemic and higher utilization of the production capacities of domestic companies, as well as due to the low comparison base, is projected to grow by 14% in 2021. The projected growth of external demand is expected to contribute to this in conditions of positive outlook for economic activity in the EU and other trade partners of the country. In the medium term, in conditions of expected stabilization of the growth of the external demand and increase of the export potential in the country through FDI inflow, the export is expected to have a solid contribution to the economic growth, ie it is projected to register an average annual growth of 9.1% in real terms in the period 2022-2025.

The contribution of domestic demand to economic growth is expected to move into the positive zone in 2021, amid a recovery in investment activity and private consumption. Real gross investment growth is projected at 7.7% in 2021, and in the period 2022-2025 gross investment is expected to record an average annual growth of 8.5%, with a significant impact on investment is expected to have the planned public sector investments, the increased support for the development of the private sector and strengthening of the competitiveness, the restoration of the confidence of the business entities and the more intense inflow of FDI, stimulated by the country's membership in NATO and the decision of the European Commission to start membership negotiations in the EU.

Chart 11. Real GDP growth and contributions to expenditure components (in p.p.)



Private consumption is projected to grow by 3.5% in 2021, as a result of the expectations for improvement of the labor market situation, increased inflow of private transfers from abroad, but also greater credit support from banks. Favorable developments in private consumption are expected to continue in the period 2022-2025, when an average annual growth of 4% is projected.

The growth of public consumption is projected at 4.3% in 2021, with the expected fiscal impulse being channeled through increased public capital expenditures. In the coming years, public consumption is expected to grow at a slower pace, i.e. an average annual growth of 1.5% is projected in the period 2022-2025, due to the efforts to reduce non-essential expenditures and their rationalization and implementation of a fiscal process consolidation.

The recovery of domestic demand and the growth of export activity in 2021 conditioned increased import of intermediate, investment and consumer goods, with the real growth of imports of goods and services projected at 13.2%, which implies a negative contribution of net exports to economic growth. In the next period, some stabilization of the import demand is envisaged, i.e. average annual growth of the import of goods and services of 7.9% on a real terms in the period 2022-2025, but also gradual narrowing of the negative contribution of the net export to the economic growth. (Chart 11).

Table 1. Basic macroeconomic indicators for North Macedonia

	2019	2020*	2021*	2022*	2023*	2024*	2025*
GDP, real growth rate (%)	3,2	-4,4	4,1	4,6	5,2	5,6	5,9
Inflation rate (average)	0,8	1,0	1,5	1,8	2,0	2,0	2,2
Exports of goods (nominal growth, %)	9,4	-18,5	15,1	9,8	10,6	11,2	11,7
Imports of goods (nominal growth, %)	9,9	-17,1	14,3	9,0	9,4	9,8	10,3
Current account balance (% from GDP)	-3,3	-3,5	-2,9	-2,5	-2,0	-1,6	-1,3
Net-wage – (nominal growth, %)	3,9	7,0	3,0	3,5	3,9	4,1	4,4
Unemployment rate (average)	17,3	16,6	15,8	15,0	14,1	13,2	12,4
Employee rate (average)	47,3	47,5	48,3	49,1	50,1	51,1	52,1

Source: State Statistical Office And Ministry of Finance (* projection)

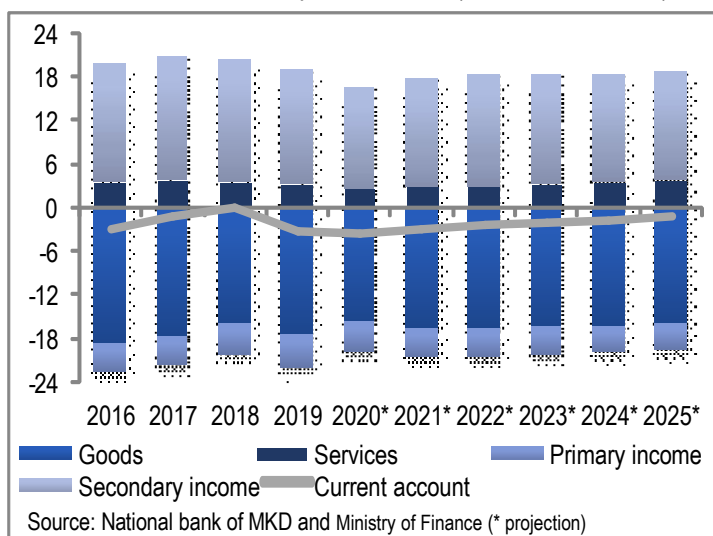
Inflation in 2021 is projected at 1.5%, amid the expected upward movement of foreign effective inflation and world prices of some primary products, which is a moderate intensification of inflation compared to 2020. In the period 2022-2025, the inflation rate is expected to remain low and stable, amounting to 2% per year on average, amid moderate growth in world prices, and partly under the influence of economic activity in the domestic economy.

The effects of the pandemic on the labor market were limited in 2020, as government measures to mitigate its effects on jobs. In the forthcoming period, in conditions of improving the expectations of business entities, increased investments and economic activity, it is projected employment growth, encouraged through active employment measures and programs and the support of domestic and foreign companies to create new jobs.

According to the projections, in the period 2021-2025, an average annual growth of the number of employees of 2.2% is expected. The growth of demand in this period is expected to be reflected on the labor supply, which is projected to increase by 1.2% on average per year. Such trends in the labor market will contribute to the average unemployment rate in 2025 to decrease to 12.4%, while the average employment rate to increase to 52.1%. The growth of the average net salary in this period is expected to be 3.8% per year on a nominal basis (Table 1).

In the next medium-term period, the current account deficit is expected to narrow, which in 2021 is projected at 2.9% of GDP and in 2025 is expected to reach 1.3% of GDP (Chart 12). This improvement results from the projected gradual narrowing of the trade deficit and the increase of the trade surplus, in conditions of stabilization of the level of private transfers from abroad. FDI inflows are expected to overcome the current account deficit in this period, which will have a favorable impact on keeping foreign reserves at an adequate level. The stable exchange rate of the Denar against the Euro will be maintained in this period, in order to maintain price stability, as the ultimate goal of monetary policy.

Chart 12. Current account by components (balance,% of GDP)



The base macroeconomic scenario is accompanied by risks, which are mainly related to the durability and consequences of the health crisis, the intensity of the effects on the economy and the results of economic measures to mitigate it. Namely, further prolongation of coronavirus infection, both domestically and internationally, may result in more strictly restrictive measures, repercussions on global supply chains and external demand, aggravated expectations of businesses and households, reduced inflow of investments and remittances from abroad and negative consequences on the overall domestic economic activity. On the other hand, NATO membership and the European Commission's decision to start EU membership negotiations could have a significant impact on investment activity and the implementation of structural reforms, the pace of which, if intensified, will boost long-term economic growth, while delays in resolving structural deficiencies could set obstacles to the country's rapid and convergent economic growth. Maintaining the political stability in the country is a key precondition for achieving the projected economic growth. The risks related to the projected inflation dynamics are mainly related to the high uncertainty regarding the price trends of the primary products on the world stock exchanges.

2. Fiscal projections

2.1 Central Government Budget (Budget of the Republic of North Macedonia)

2.1.1 Revenues and expenditures in the period January - November 2020

The health and economic crisis caused by the corona virus in the past period of the year had a strong impact on the realization of the Budget. The measures taken by the Government to prevent the spread of COVID-19 had a strong impact on economic activity, which was reflected in the realization of revenues and expenditures. In order to deal with the epidemic, in the past period, comprehensive measures were implemented to protect jobs, ensure budget liquidity, service the highest priority liabilities, and minimize all less productive spending from the budget. In the past period, the Government, through a Decision on redistribution of funds between the budget users of the central government and between the funds and through Amendments to the Budget for 2020, implemented four sets of measures aimed at amortizing the impact on the economy and stimulating consumption.

In the period January - November 2020, the total revenues of the Budget of the Republic of North Macedonia² (Table 2) were realized in the amount of 170,221 million MKD or about 86.7% of the Budget for 2020, i.e. they are lower by 7.1% in ratio of the collected for the same period of the previous year. Out of this amount, 95,688 million MKD are tax revenues and they decreased by 9.6% compared to last year. VAT revenues were realized at the level of 42,371 million MKD and they dominate in the structure of tax revenues with 44.3%. Revenues from Personal income tax were realized in the amount of 15,949 million MKD, income tax revenues were collected in the amount of 9,569 million MKD, while excises reached the level of 20,394 million MKD. All types of tax revenues decreased compared to the analyzed period last year, except import tax revenues, which increased by 11.1%. In the past period, the collection of tax revenues compared to the analyzed period last year decreased, as a result of the KOVID crisis and the restrictive measures taken by the government, which slowed down the economic activity.

Revenues from social contributions amounted to 59,756 million MKD, amounting to 4,049 million MKD, or 7.3% more than the corresponding period in 2019. On the basis of pension insurance, 40,430 million MKD were realized, while on the basis of health insurance, 16,851 million MKD were collected.

In the period January - November 2020, non-tax revenues amounted to 10,476 million MKD. Within this, the non-tax revenues of the budget users on their own accounts are dominant, which were realized at the level of 5,656 million MKD. Capital revenues amount to 1,625 million MKD, while budget users realized 2,676 million MKD on the basis of donations from international multilateral and bilateral cooperation.

The total expenditures of the Budget of the Republic of North Macedonia in the period January - November 2020 were realized in the amount of 210,266 million MKD or about 83.2% of the Budget for 2020, i.e. by 10.3% more compared to the same period last year. During this period, the obligations of the budget users, the legal rights of the citizens and the due obligations to the domestic and foreign creditors were settled in a timely and uninterrupted manner. The expenditure side of the Budget is growing on an annual basis, mostly as a result of the measures taken in the fight against the crisis caused by KOVID-19.

Within this, the current expenditures amounted to 199,363 million MKD. In this period, 27,249 million MKD were paid for salaries and allowances for the employees in the institutions that are budget users, while the expenditures for goods and services were realized in the amount of 13,226 million MKD.

The largest share in the structure of current expenditures have transfers, for which 151,163 million MKD were paid in this period. The obligations of the state on the basis of fulfillment of the rights for guaranteed social protection of the population (monetary compensations for the vulnerable categories of citizens, as well as compensations on the basis of child and parental allowance) were regularly serviced, for the purpose of which 10,541 million MKD were realized. 55,095 million MKD was earmarked for regular payment of pensions. 30,588 million MKD was paid for financing health services and allowances, while 2,419 million MKD was allocated for payment of monetary compensation in case of unemployment through the Employment Agency. 17,444 million MKD was transferred from the Budget of the Republic of North Macedonia to the municipalities as block grants for financing the transferred competencies, as well as earmarked grants for financing the material costs in the local public institutions. Also, 2,147 million MKD were transferred from the income realized from the value added tax. During the analyzed period, subsidies in the field of agriculture were paid continuously and on time, in order to improve the quality and competitiveness of this sector. Until this period, as support for companies and citizens affected by the crisis caused by KOVID-19, subsidies in the amount of about 8,200 million MKD were paid.

7,725 million MKD was allocated for regular servicing of interest-bearing liabilities in accordance with the amortization plans for domestic and foreign borrowing. Out of this amount, 5,163 million MKD were intended for payment of interest on external borrowing. Funds in the amount of 31,832 million MKD were paid for regular servicing of liabilities on the basis of principal repayment. Capital expenditures in the period January - November 2020 were realized in the amount of 10,903 million MKD, being the same by 229 million MKD or 2.1% lower compared to last year. In this period, there was a deficit of the Budget of the Republic of Macedonia in the amount of 40,045 million MKD or 6% in relation to the projected GDP for 2020.

2. According to the Amendments to the Budget of RNM for 2020 (Official Gazette No. 262/20)

Table 2. Budget of the Republic of North Macedonia for 2020 and realization January - November 2020

	Rebalance 2 2020	Realization Jan.-Noe. 2020	Realization Jan.-Noe. 2019	Realization Jan.-Noe. 2020 Rebalance 2 2020 (%)	Realization Jan.-Noe. 2020 Realization Jan.-Noe. 2019 (%)
					?? %
Total Revenues	196,343	170,221	183,137	86.7%	-7.1%
Tax revenues and Contributions	174,271	155,444	161,612	89.2%	-3.8%
Tax Revenue	109,218	95,688	105,905	87.6%	-9.6%
Personal Tax revenues	18,700	15,949	16,398	85.3%	-2.7%
Profit Tax	10,600	9,569	10,657	90.3%	-10.2%
VAT (Net)	48,000	42,371	47,215	88.3%	-10.3%
Excise Tax	23,350	20,394	24,077	87.3%	-15.3%
Import Duties	5,500	6,065	5,458	110.3%	11.1%
Other Taxes	3,068	1,340	2,100	43.7%	-36.2%
Contributions	65,053	59,756	55,707	91.9%	7.3%
Non-tax revenue	15,123	10,476	16,386	69.3%	-36.1%
Capital revenue	2,139	1,625	1,652	76.0%	-1.6%
Donations	4,810	2,676	3,487	55.6%	-23.3%
Total expenditures	252,838	210,266	190,590	83.2%	10.3%
Current expenses	233,774	199,363	179,458	85.3%	11.1%
Salaries and allowances	30,143	27,249	25,306	90.4%	7.7%
Goods and services	17,997	13,226	13,657	73.5%	-3.2%
Transfers to ELS	21,440	19,591	17,444	91.4%	12.3%
Subsidies and transfers	32,059	20,644	15,264	64.4%	35.2%
Social transfers	123,836	110,928	99,968	89.6%	11.0%
Interest	8,299	7,725	7,819	93.1%	-1.2%
Capital expenditures	19,063	10,903	11,132	57.2%	-2.1%
Deficit	-56,495	-40,045	-7,453	70.9%	437.3%
Deficit (% from GDP)	-8.5%	-6.0%	-1.1%		
Primary deficit. (% from GDP)	-7.2	-4.9	0.1		
Deficit financing	56,495	40,045	7,453		
Tides	98,602	71,877	22,466		
Domestic sources	36,287	23,361	17,206		
Foreign sources	65,052	63,330	9,315		
Deposits (cumulation of account)	-2,737	-14,814	-4,055		
Outflows	42,107	31,832	15,013		
Home Debt Repayment	15,252	6,336	10,294		
Foreign Debt Repayment	26,855	25,496	4,719		

Source: Ministry of Finance

2.1.2 Medium-term framework for the Budget of the Republic of North Macedonia 2021-2025

Despite the still present unpredictability and risks associated with the duration and intensity of the global health pandemic, its implications for the budget and the whole economy, and taking into account the four packages of economic measures implemented so far, the medium-term projections for 2021-2025 are expected to ensure fiscal sustainability, redesign of the structure of public expenditures, fiscal consolidation through phased reduction of the budget deficit, as well as continuation of the positive trends of the Macedonian economy. (Table 3).

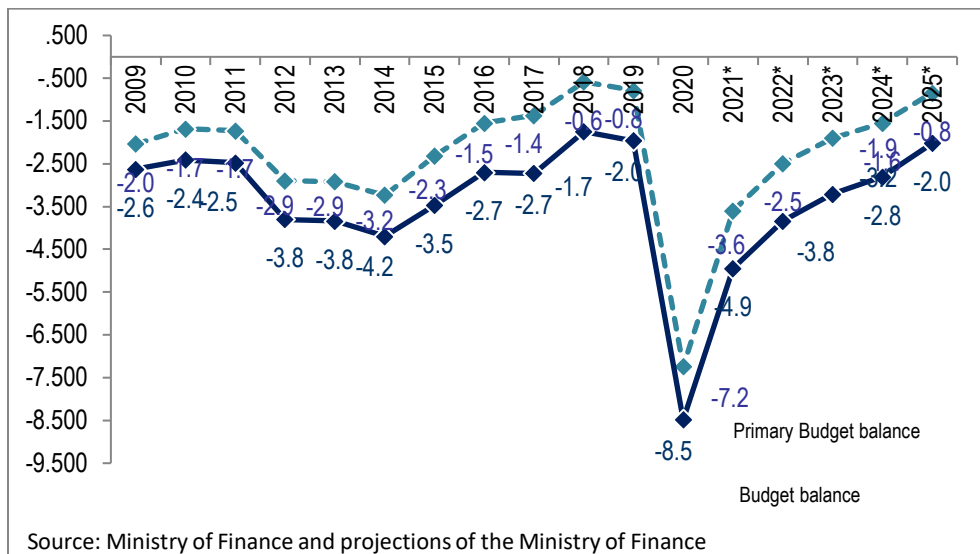
Table 3. Budget of the Republic of North Macedonia 2019-2025 (in millions of denars)

	Realization 2019	Rebalance 2020*	2021*	2022*	2023*	2024*	2025*
Total Revenues	203,946	196,343	212,630	223,532	239,216	257,033	278,142
Tax revenues and contributions	178,894	174,271	186,282	197,707	212,316	229,433	249,542
Tax Revenues	116,728	109,218	117,982	126,001	137,032	150,392	166,558
Contributions	62,166	65,053	68,300	71,706	75,284	79,040	82,984
Non-tax revenue	18,800	15,123	16,954	16,317	17,246	17,746	18,246
Capital revenue	2,369	2,139	3,187	3,188	3,334	3,534	4,034
Donations	3,883	4,810	6,207	6,320	6,320	6,320	6,320
Total expenditures	217,447	252,838	247,567	252,483	265,172	281,515	297,251
Current expenses	199,634	233,775	223,512	226,593	233,344	245,878	259,270
Salaries and allowances	27,754	30,143	31,394	31,562	31,662	33,062	34,062
Goods and Services	16,265	17,997	21,322	22,068	23,418	25,418	27,718
Transfers to ELS	19,097	21,440	21,315	21,453	22,617	23,744	26,018
Subsidies and transfers	20,285	37,311	19,351	17,234	18,234	21,734	24,590
Social transfers	108,131	118,584	120,653	124,104	126,855	130,981	135,742
Interest payments	8,102	8,299	9,478	10,172	10,558	10,939	11,140
Domestic	2,534	2,740	3,069	3,580	3,938	3,939	3,940
Foreign	5,568	5,559	6,409	6,592	6,620	7,000	7,200
Capital expenditures	17,813	19,063	24,055	25,890	31,828	35,637	37,981
Budget balance	-13,501	-56,495	-34,937	-28,951	-25,956	-24,482	-19,109
Primary budget balance	-5,399	-48,196	-25,459	-18,779	-15,398	-13,543	-7,969
Total Revenue % from GDP**	29.6	29.5	30.1	29.7	29.6	29.5	29.5
Total expenditures % from GDP **	31.5	38.0	35.0	33.5	32.8	32.3	31.5
Budget balance % from GDP **	-2.0	-8.5	-4.9	-3.8	-3.2	-2.8	-2.0
Primary Budget Balance % from GDP	-0.8	-7.2	-3.6	-2.5	-1.9	-1.6	-0.8

Source: Ministry of Finance and Ministry of Finance projections

In this regard, a gradual reduction of the budget deficit from 4.9% of GDP in 2021 to 2% of GDP in 2025 is envisaged, accordingly, the primary budget deficit will move downwards of 3.6% of GDP in 2021 at the level of 0.8% in 2025 (Chart 13).

Chart 13. Overall and Primary Budget balance (in% of GDP)



The total genuine revenues of the Budget of MKD (central government budget and funds) for the period 2021-2025 are projected to around 29.6% of GDP. Revenue projections in the coming medium-term period are based upon the revenues collected from previous years and the effects from the tax and pension reforms.

The main objective of the tax policy is to ensure sustainable economic growth and development, thereby providing for legal safety of taxpayers and regular collection of public revenues. The main priorities are:

- greater fair taxation, in order to ensure that everyone fulfills their social obligation and pays their fair share of the tax,
- greater efficiency and productivity of the tax system for better collection of revenues, through more efficient fight against unregistered activities and tax evasion and strengthened institutional capacity, as well as reduction of arrears of tax liabilities,
- Increased tax transparency, which includes improving the exchange of information between tax authorities and other entities, which will be primarily based on electronic services, which will lead to increased fiscal literacy and greater voluntary compliance,
- Better quality of services, in a way that simplifies and speeds up procedures and reduces administrative burden, through more digital services, better management of import-export licenses, elimination of unnecessary non-tariff barriers and better internal and tax control.
- Introduction of green taxation, in order to stimulate taxpayers through taxes to contribute to less pollution, i.e. to discourage them from polluting the environment.

By slightly relaxing the tax policy with simultaneous correction of certain tax rates, it is expected to achieve a multiple effect, it is intended to provide greater tax coverage, fair and facilitated administrative processes, as well as support to the private sector, which would result in reduction of tax evasion.

From the aspect of tax reforms, it is important to emphasize the reform for the return of part of the value added tax (VAT) to individuals. Namely, the natural persons by collecting their fiscal accounts and reporting to the tax authority will have the right to a refund of part of the VAT, i.e. 15% of the tax expressed in the fiscal accounts, i.e. during 2020 a change in “Moj DDV” was made, 20% instead of 15% return for Macedonian products and services. This measure

provides additional income to each family, strengthens purchasing power and a positive impact on increasing consumption and VAT collection, as well as reducing tax evasion and the gray economy.

In order to increase flexibility and lower burden and administration for small companies, the threshold for mandatory registration for value added tax purposes

has been realized from 1,000,000 MKD to 2,000,000 MKD, as well as additional harmonization of the VAT Law with EU directives.

Simultaneously, in terms of value added tax and in order to improve the environment, the VAT rate for thermal energy was reduced from 18% to 5%.

The Excises Law simplifies and improves the manner of reporting excise for small producers of alcohol, as well as the introduction of the system for electronic monitoring of excise goods improves the capacity for excise administration.

The taxation of motor vehicles is done through a new law on motor vehicle tax where in addition to the basic parameter for taxation, an indicator of environmental pollution is introduced, which contributes to improving the quality of the environment.

Pursuant to the amendments to the Personal Income Tax Law, which are applicable from January 1, 2020, it is foreseen to freeze the progressive rates of the personal income tax as well as to return the flat tax rate of 10% for all types of income, except for the income earned from games of chance.

Regarding the direct taxes, certain changes have been made relating to fair calculation of the tax base in the profit tax and with it the harmonization with the international tax practices has been achieved.

In parallel with the process of legal changes, the process of strengthening the capacities of the Public Revenue Office and the Customs Administration for implementation of the above-mentioned legal provisions is taking place.

In the structure of planned revenues, tax revenues participate with 57.5%, revenues on the basis of social contributions with 31.3%, non-tax and capital revenues with 8.6%, while the rest of the revenues are expected to be realized from IPA funds and other donations. Within the tax revenues, the most significant amount of revenues will be realized on the basis of VAT, personal income tax and excise.

The projections of the social contributions that represent the source income of the pension, health insurance and employment funds in the next medium-term period are based on the calculated increase of the mandatory rates for pension and health insurance in 2020 (increase of the contribution rate for pension and disability insurance by 0,4 percentage points and increase of the contribution for health insurance by 0.1 percentage points), as well as the expected positive economic developments, which will adequately reflect on the appropriate parameters - employment growth and wages.

Non-tax revenues in the next medium-term period participate with about 7.2% in the total revenues, and in them the most significant is the share of revenues based on administrative fees and other non-tax revenues generated by budget users on their own accounts.

In the projection of the revenues of the Budget of the Republic of North Macedonia in the part of foreign donations, in the next period are planned the donations that the budget users will realize for specific projects, as well as the withdrawals from the pre-accession funds of the EU.

The expenditure side of the Budget of the Republic of North Macedonia in the coming period is fully created in order to achieve strategic priorities, accelerate economic growth and EU and NATO integration processes. The average share of the total expenditures of the Budget of the Republic of North Macedonia in the period 2021-2025 is about 33% of GDP. The budget expenditure projections for the next medium-term period are prepared upon three key bases:

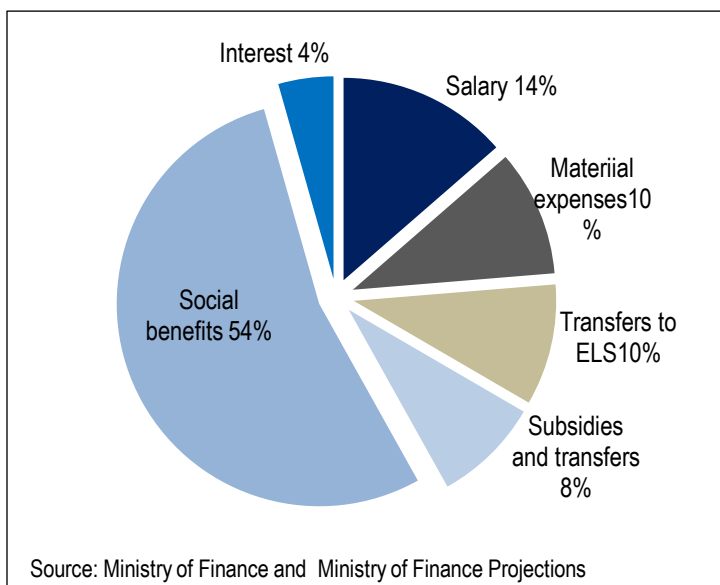
- compliance of the revenue projection with the planned economic activities;
- the projection of the total expenditures of the Budget provides continuous fiscal consolidation and
- The planned amounts of expenditures ensure regular, without obstacles execution of all legal obligations.

In the projection of the amount and structure of current expenditures for the next period, intended for regular payment of salaries to public sector employees, timely and regular payment of pensions, guaranteed minimum income

and other social benefits, payment of subsidies in agriculture, support for small and medium enterprises, as well as subsidizing innovative activities, the following assumptions are taken into account:

- In the area of expenditures for salaries and allowances, in the medium-term projections, the determination for the strict control of the new employments continues;
- timely payment of pension income, timely payment of social benefits, the reformed social protection system (guaranteed minimum income) in order to ensure a secure financial situation of the beneficiaries of these rights.
- The health care that is realized through the Health Insurance Fund, mostly refers to the financing of health services and the measures taken in this area such as increasing the capitation, availability of medicines etc.
- Implement active employment policies and measures, which will be aimed at creating employment programs, measures and services to be implemented to improve the functioning of the labor market, to support the creation of new jobs, as well as employment of young people - youth guarantee.
- Providing funds for payment of subsidies in agriculture, in order to strengthen and support this sector, increase the export of Macedonian agricultural products and conquer new markets.
- Encouraging economic growth and development in the Republic of North Macedonia by increasing the competitiveness of the private sector, with measures for new investments, measures to support exports and conquer new markets, support for the creation of new jobs, support for small and medium enterprises, innovative activity, technological development and research, as well as encouraging foreign and domestic investments.

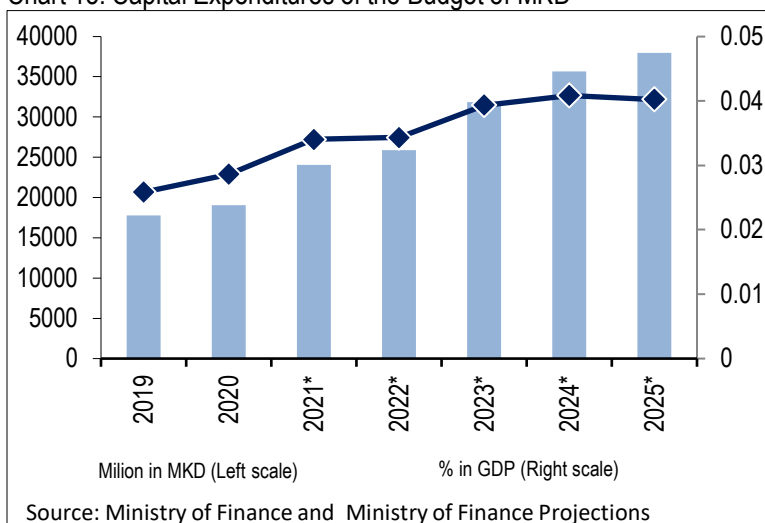
Chart 14. Average structure of current expenditures 2021-2025 (in%)



In the medium term, the focus of fiscal policy remains on providing a significant level of public investment, which is a prerequisite for improving economic prospects, as well as a better life for citizens. In this regard, a significant amount of capital investments is planned (Chart 15) through the use of funds from the Budget, including funds secured by borrowings from international financial institutions and bilateral creditors. The planned amounts indicate intensification of infrastructure projects, i.e. investments for road and railway infrastructure, energy and communal

infrastructure, as well as capital investments to improve the conditions in the health, education and social system, agriculture, culture, sports, environment and environmental protection and the judiciary.

Chart 15. Capital Expenditures of the Budget of MKD



Public investment plan 2021-2025

In order to ensure sustainable and inclusive growth, in accordance with the priorities of the Program of the Government of the Republic of North Macedonia, in the period from 2021 to 2025, the Government will focus on the implementation of capital infrastructure projects in road and railway infrastructure, energy and communal infrastructure, as well as capital investments to improve the conditions in the health, education and social system, agriculture, environmental protection. Specifically, in the period from 2021 to 2025, capital projects are planned in the total amount of 3.2 billion EUR, of which 1.28 billion EUR would be financed with budget funds, from donations (through IPA funds) 112.8 million EUR, and with funds from international financial institutions / bilateral creditors (including investment grant funds from the Western Balkans Investment Framework – WBIF) capital investments would be financed in the amount of 1.84 billion EUR.

In the period 2021-2025, within the financial perspective of the Instrument for Pre-Accession Assistance - IPA 2 for the period 2014-2020, it is planned to finance capital projects in the total value of 142.1 million EUR, of which 112.8 million EUR are IPA funds, 29.3 million EUR will be provided as national co-financing from the Budget of the Republic of North Macedonia and 124 million EUR which will be provided through borrowings from international financial institutions (this amount of 124 million EUR is intended for Corridor 8 Railways phase 3 and is already included in the amount of 1.84 billion EUR).

Additionally, in the following period, in addition to large capital projects, within the above stated areas, significant projects will be implemented, including the implementation of reform measures aimed at improving social and educational conditions for citizens, as well as measures to deal with the consequences of the COVID crisis.

As regards road infrastructure with credit funds it is planned construction of the highway section Skopje-Blace, construction of the highway section Kichevo-Gostivar, improvement of the road infrastructure of the municipalities in the Republic of North Macedonia through the Local Roads Project - Rankovce, Rankovce-Kriva Palanka, Kriva Palanka to the border with Bulgaria, financing of the section Kichevo-Ohrid, Shtip-Radovish, widening of the highway Tetovo - Gostivar, the National Roads Programme, the Western Balkan Trade and Transport Facilitation Project, and the Skopje Bus Rapid Transit Project on the territory of the City of Skopje.

As of the railway infrastructure, it is planned to finance the three phases of construction and rehabilitation of the eastern part of the railway - Corridor VIII section to Bulgaria, therefore 130 million EU grant funds are provided for the second and third phase, as well as to start the project construction of the railway Kicevo – Albanian border. Also, in this area it is planned to build a railway border crossing with accompanying facilities "Tabanovce" between the Republic of North Macedonia and the Republic of Serbia, which will be financed with a grant from the Western Balkans Investment Framework and a loan from the European Bank for Reconstruction and Development (EBRD).

In the field of gasification, is planned the construction of magistral gas pipelines section Skopje-Tetovo, Gostivar - Kicevo and section Sveti Nikole - Veles, construction of an interconnection gas pipeline between the Republic of North Macedonia and the Republic of Kosovo, as well as construction of an interconnection gas pipeline between the Republic of North Macedonia and the Republic Greece.

As significant projects that are planned to be implemented in this period in the field of communal infrastructure are the first and second phase of the Project for water supply and wastewater in the municipalities in the Republic of North Macedonia.

Major capital projects in the field of agriculture are the Irrigation Program of North Macedonia and the Agricultural Modernization Project. In this area, construction of irrigation systems is also planned in the Valandovo region, which is financed with a loan and grant funds from KfW through the implementation of the second phase of the Irrigation Project in the southern valley of the river Vardar.

As regards environment, a significant capital project is the construction of the Wastewater Treatment Plant Skopje, as well as solid waste stations in the Southwest, Vardar, Pelagonija region, Southeast region and the Skopje region.

As regards health, capital projects are the construction of the University Clinical Center in Skopje and the reconstruction and extension of the Regional Clinical Hospital Stip.

Having in consideration the need to support the healthcare system in dealing with the COVID 19 situation, a World Bank loan has been provided to finance the Emergency COVID-19 Response Project.

In relation to education, it is planned to finance the reconstruction of student dormitories in the Republic of North Macedonia, and the implementation of the Project for construction of sports halls in secondary schools and the Project for construction of sports halls in primary schools and rehabilitation of primary and secondary schools in the Republic of North Macedonia, financed with a loan from CEB and national co-financing for promotion of physical education, as well as improving the overall learning conditions of students in primary and secondary schools. To improve the conditions for learning in primary education in the country, the Primary Education Improvement Project will be launched with a loan from the World Bank.

The Skills Innovation and Development Support Project, financed by a World Bank loan, which, among other things, supported the work of the Fund for Innovations and Technology Development.

In order to improve access to social rights and services, as well as expand the capacity for preschool care and education through the construction of new facilities and conversion/upgrade of the existing infrastructure of preschool institutions, in 2021 the implementation of the Social Services Improvement Project continues financed by a World Bank loan. Also, with a loan from the World Bank, the Social Insurance Administration Project will continue to be implemented. In order to improve the conditions for socially vulnerable groups, in the upcoming period the implementation of the Project for the Housing of Vulnerable Groups will continue, financed by a loan from the Council of Europe Development Bank.

As regarding justice, the Prisons Reconstruction Project, financed by a loan from the Council of Europe Development Bank, will be implemented.

In the field of municipal infrastructure, two major capital projects are being funded: the Municipal Services Improvement Project and the Public Sector Energy Efficiency Project. The Municipal Services Improvement Project, funded by the World Bank, will enable municipalities and public communal enterprises to finance investment projects in accordance with their priorities in the field of water supply and wastewater, solid waste management and other investments in municipal services which have the potential to generate revenue, i.e. achieve savings or which are of high priority for municipalities. The Public Sector Energy Efficiency Project will finance energy efficient projects in the municipalities, as well as public health institutions of the central authorities.

In the energy infrastructure, projects that are planned to be financed are the projects implemented by AD ESM and AD MEPSO, as follows: Bogdanci Wind Park phase 2, Bitola heating system, 400 kV interconnection Macedonia (Bitola) - Albania (Elbasan), Photovoltaic power plant

Oslomej, Miravci Wind Park, Lindane Cleaning Project (OHIS), Oslomej 2 Photovoltaic Power Plants Project and Bitola Photovoltaic Power Plants Project.

In relation with the public finance reforms, improvement of the fiscal framework, strengthening of the planning process and execution of the Budget of the Republic of North Macedonia, improvement of revenue collection, strengthening of the public procurement system, internal and external control and transparent reporting, it is envisaged to implement the Project for introduction of an integrated financial management information system and integrated tax information system.

In order to support the private sector, the Project for financing small and medium enterprises and other priority projects 6 phase will be implemented.

2.1.3 Central Government Budget deficit and its financing

The financing of the projected deficit, as well as the debt repayments, will be provided through foreign and domestic borrowing (Table 4). At the beginning of 2020, the state borrowed a short-term loan from domestic banks in the amount of 132.9 million EUR, which was intended for repayment/refinancing of part of the long-term loan in the amount of 155 million EUR. Furthermore, as a result of the new situation with the Covid-19 virus, the financing of the increased needs was carried out through borrowing from the IMF, World Bank, EU and Eurobond, as well as through borrowing on the domestic government securities market. Through this financial structure, the state will be able to finance the budget deficit without obstacles as well as to repay liabilities based on debt due during the year. In the period 2021-2025, borrowing abroad can be realized by issuing a Eurobond on the international capital market and by withdrawing funds from favorable loans from foreign financial institutions and credit lines intended for financing certain projects. The selection of a specific source of external financing will be based on the current and expected conditions on the international capital markets. Furthermore, borrowing on the domestic market will be realized through the issuance of government securities, which will provide additional financing under favorable conditions, using low interest rates and investor interest. In order to optimize payments and reduce the risk of refinancing, the Ministry of Finance will continue to issue government bonds with longer maturities, thus reducing the risk of refinancing the debt. In order to effectively manage the public debt, the Ministry of Finance will monitor the possibility for early repayment of part of the debt, i.e. achieving a more favorable maturity, currency and interest structure of the debt.

Table 4. Deficit and Sources for its financing (MKD Milion)

	Realization 2019	2020	2021 *	2022*	2023 *	2024*	2025*
Budget balance	-13,501	-56,495	-34,937	-28,951	-25,956	-24,482	-19,109
Deficit financing	13,501	56,495	34,973	28,951	25,956	24,482	19,109
Inflows	29,569	98,602	78,290	39,920	74,468	54,905	74,204
Domestic sources	19,058	26,287	23,437	25,808	30,155	38,925	27,276
Foreign sources	9,243	65,052	53,542	8,890	50,666	12,500	47,325
Deposits ("e account accumulating)	1,268	-2,737	1,311	5,222	-6,353	3,480	-354
Outflows	16,068	42,107	43,353	10,969	48,512	30,423	55,138
Domestic debt repayment	10,314	15,252	6,119	4,677	12,092	17,746	12,197
Foreign debt repayment	5,754	26,855	37,234	6,292	36,420	12,677	42,941
Memorandum:							
Net domestic borrowing	8,744	21,035	17,318	21,131	18,063	21,179	15,079
Net foreign borrowing	3,489	38,197	16,308	2,598	14,246	-177	4,384

Source: Ministry of finance and planning of the Ministry of finance (*)

2.2 Local government budget

Decentralization of competencies to local government and strengthening its capacity is one of the priorities arising from the Accession Partnership of the Republic of North Macedonia with the EU and the Framework Agreement. All municipalities (except for Plasnica) have been financing the transferred competencies since 2012 with block grants, thus completing the phased approach for transferring and managing the operating and financial resources for the transferred competencies in education, culture, child and social protection.

The competencies in several sectors assumed by the municipalities increased both the administrative and the discal capacities and strengthened the capacities for managing larger amount of funds.

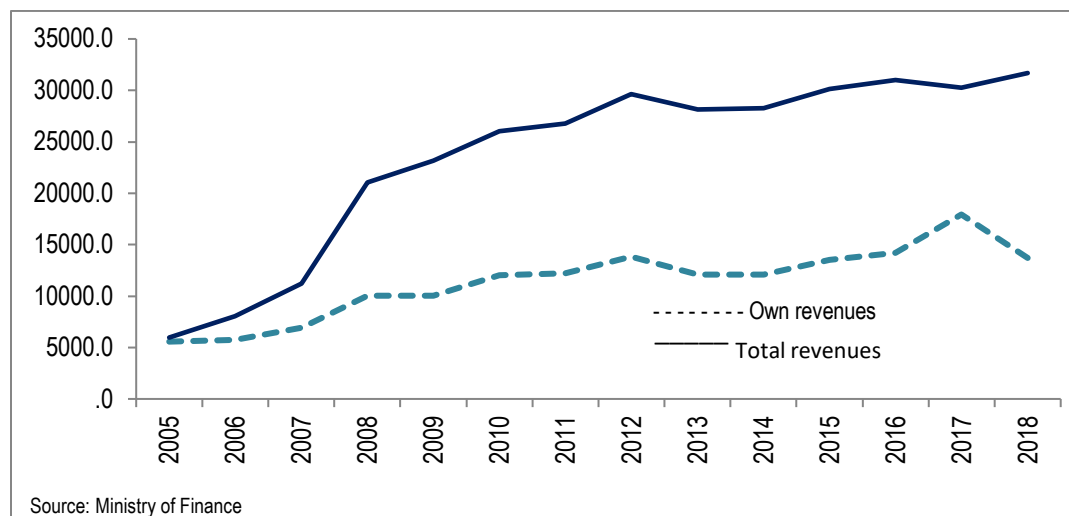
With the successful administration and collection of own revenues, the process of increasing the own revenues of the municipalities and the capacity for managing the funds, the execution of the transferred competencies and the management of the funds and other resources necessary for their execution continues. Additionally, the municipalities successfully administer new competencies of construction land management, dealing with illegally constructed buildings with adequate revenue provision. The successful implementation of fiscal decentralization with a fully established legal and institutional framework of local self-government, provides developed, responsible and functional units of local self-government and a level of local democracy that brings citizens closer to local self-government institutions. The progress in achieving the goals of decentralization has been assessed as successful by several international institutions with the help of which within several projects improvements have been made in the system of management, control, transparency and coordination of the management of local self-government reforms.

Simultaneously, access to the capital market has become more accessible on the basis of more liberal and more transparent borrowing requirements, which has increased the interest of municipalities in financing investment projects through borrowing. In this regard, the Government has provided credit lines from international financial institutions (World Bank, EIB, KfW and EBRD) which have provided for substantial investments, especially in: reconstruction and rehabilitation of local streets, roads and bridges, construction and reconstruction of water supply and atmospheric water networks, improvement of public hygiene and increasing of energy efficiency in the municipal public facilities and local spatial landscaping.

The Republic of North Macedonia, regarding the level of decentralization according to the data on 2019 expenditures execution (participation of about 5.2% in GDP), belongs to the group of countries with medium decentralization. Furthermore, compared to 2005 when the process of transfer of competencies and fiscal decentralization commenced, the revenues of the municipalities have increased more than six times (of 5.9 billion MKD

in 2005, more than 37 billion MKD in 2019). In the same period, tax revenues, which the municipality are authorized to collect have increased by more than twice (Chart 16).

Chart 16. Own and total revenues in the period 2005-2019 (MKD Million)



The municipalities in the Republic of North Macedonia are financed from their own sources of income, grants from the Budget of RNM for the transferred competencies in education, culture, social protection and fire fighting, revenues determined in separate laws, tax revenues that are collected at the central level, transfers from the Budget of the Republic of North Macedonia and other institutions, revenues from donations and loans and other revenues.

Municipal own revenues are local taxes (property tax, inheritance and gift tax, real estate sales tax), local fees determined by law (utility fees, administrative fees and other fees determined by law), local fees (fee for landscaping of construction land, fees for utility activities, fees for spatial and urban plans), revenues on the basis of ownership and other revenues determined by law. Municipalities receive revenues in the amount of 3% of the collected personal income tax from the salaries of natural persons with permanent residence in the respective municipality and 100% of the personal income tax from natural persons engaged in craftsmanship activity, registered in the area of the municipality.

Additional revenues are provided through grants from the Budget of the Republic of North Macedonia, such as: revenues from VAT grants (in the amount of 4.5% of the collected VAT in the previous fiscal year), capital transfers, earmarked and block grants for the transferred competencies in education, culture, social protection and fire fighting. The funds from these grants are distributed according to criteria set out in decrees adopted by the Government of the Republic of North Macedonia.

Unreal projecting of the budgets of the local self-government units, i.e. the over-optimistic revenue planning is one of the reasons why the local self-government units accrued unpaid obligations in the previous years. In order to overcome this situation, with the amendments to the Law on Financing of Local Self-Government Units from November 2018, a fiscal rule was established for planning own revenues of the core budget of local self-government units, i.e. planning own revenues of the core budget of the municipality is limited with the performance of the collected revenues. With the amendments to the Law, the own revenues of the core budget of the municipalities in the future will be projected with an increase of maximum 10% of the average revenues in the last three years, according to the data from the treasury records. At the same time, exceptions have been envisaged only if the municipality has provided a confirmation for transfer of funds from a respective institution. During 2019, another amendment to the Law on Financing of Local Self-Government Units was adopted, which at the request of the municipalities, with the aim of

greater flexibility in planning the Municipal Budgets and thus improving the fiscal position of the municipalities, previously determined growth rate of planned revenues from 10% has been increased to 30%.

2.2.1 Revenues and expenditures in the period January – November 2020

Revenue collection and inflows in the budgets of the local self-government units for this period is within the expectations, i.e. in the period January - November 2020, the total revenues were collected in the amount of 30,574 million MKD and compared to the same period last year slight increase of 0.5%. Out of this amount, 6,962 million MKD are tax revenues, being lower by 9.5% compared to the previous year. In this period from 2020, the collection of revenues from property taxes amounted to 2,628 million MKD and a decline of 9.3% was noted. Income taxes increased by 31.9%, revenues from taxes on specific services decreased by 12.2%, while fees for usage or licenses for performing an activity decreased by 37.2%.

In the analyzed period this year, non-tax revenues amounted to 914 million denars, which compared to the same period in 2019 are significantly lower by 43.1%, or about 693 million MKD. Within the non-tax revenues, the inflows from fees and commissions dominate in the amount of 559 million MKD and decreased by 40.2% compared to the realized revenues in the same period of the previous year. Other non-tax revenues that have a high share in non-tax revenues amount to 276 million MKD, with a significant decline of 51.6%.

In the period January - November 2020, capital revenues were collected in the amount of 906 million MKD and there was a significant decrease of 55.7% compared to the previous year. Capital income consists almost entirely of income from the sale of land and intangible investments.

Revenues from grants in the analyzed period from 2020 amounted to 17,443 million MKD, increasing by 13.3%. Revenues from transfers in the period January - November 2020 were collected in the amount of 2,971 million MKD, which is by 16.1% higher compare to the colleted revenues in the analyzed period last year.

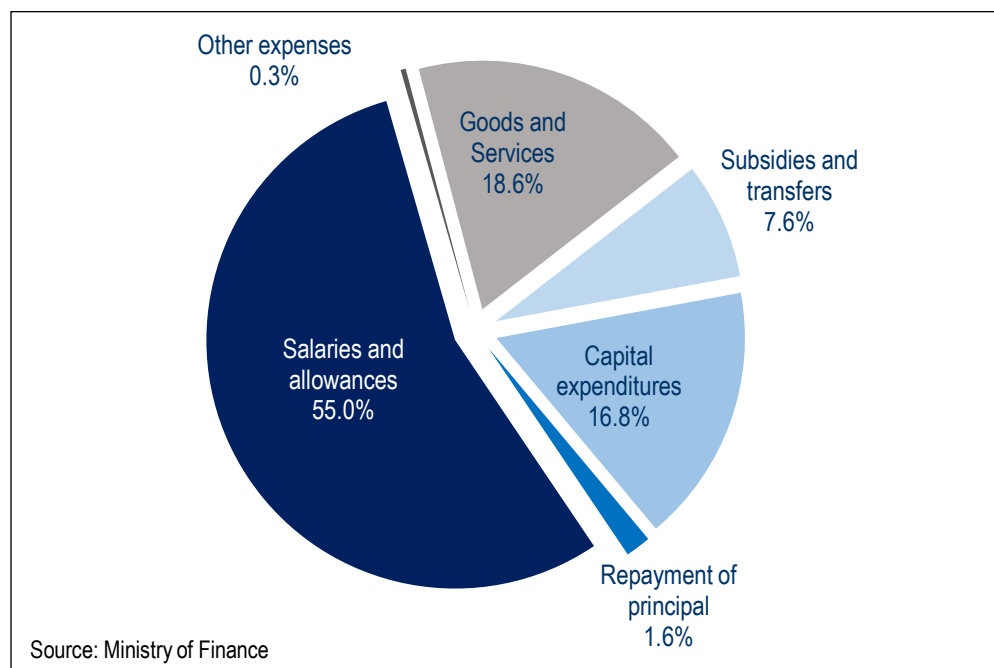
In the period January - November 2020, revenues from donations in the amount of 623 million MKD were collected, i.e. they slightly decreased by 1.4% compared to last year.

In the period January - November 2020, loan revenues were collected in the amount of 754 million MKD and compared to the same period last year, they increased significantly by 60.4%.

Realized expenditures in the period January - November 2020 amounted to 30,493 million MKD and compared to the same period last year were lower by 4%. With these expenditures, the liabilities undertaken in accordance with the transferred competencies of the municipalities needed for current operations, implementation of capital projects and repayment of principal for previously taken loans were regularly settled.

In the structure of expenditures, the largest participation with 55%, i.e. 16,767 million MKD is occupied by expenditures for salaries and allowances. Most of the salaries, i.e. 85.7% or 14,367 million MKD are intended for employees in institutions at the local level of primary and secondary education, culture, kindergartens and nursing homes and fire protection, which with about 99.2% are financed by block grants. Expenditures for goods and services amount to 5,678 million MKD and participate with 18.6% in the total expenditures. Capital expenditures participate with 16.8% and amount to 5,131 million MKD, which in the largest percentage, ie 76.9%, are financed with own funds of the municipality, 5.8% are funds received from donations and 13.5% from loans. Expenditures for subsidies and transfers amount to 2,313 million MKD and participate with 7.6%, and the repayment of principal amounts to 502 million MKD or 1.6% of the total expenditures. Expenditures realized from the reserves, for social benefits and interest payments participated with about 0.3%.

Chart 17 Expenditure structure for the period January-November 2020



2.2.2 Medium-term framework for the Local government budget

In the course of 2021 and in the medium term, the municipalities are expected to continue the trend of improved collection of their own revenues, strengthening the capacities for developing policies for financing the municipalities and strengthening the capacities for financial management. For the purpose of realizing the strategic commitments in the next period will continue the strong commitment to encouraging sustainable local development, good local governance and creating conditions for more active, more effective and more innovative role of local governments in implementing national objectives for growth and development.

In the next medium-term period, the decentralization process will continue, with special attention to fiscal decentralization. This will ensure the improvement of democracy in society, more efficient and economical delivery of services, but also enhanced local development. The transfer of competencies to the local government ensures the most effective management of the funds from the government that is closest to the citizens and increased participation of the citizens in the creation of policies at the local level. In parallel with improving the fiscal capacity of the municipalities and ensuring better local and regional development, there will be an increase in accountability and transparency in the operation of municipalities.

The Budget of the Republic of North Macedonia provides stable revenues for the municipalities from the VAT grant (general grant) which is paid in the amount of 4.5% of the collected VAT in the previous year. In the coming period, more attention will be paid to the introduction of a system for equalization of revenues, by introducing a criterion in the existing distribution of VAT grants, but taking into account the fiscal effort that each municipality makes. On the one hand, this will try to ensure a more equitable distribution of the VAT grant, but at the same time to encourage the municipalities to take measures and activities to collect the statutory revenues.

Regarding the grants for the transferred competencies, the criteria for distribution of the allocated funds for the transferred competencies in the field of primary and secondary education, culture, child protection and protection of the elderly and fire fighting will be determined in the next period. Based on the prepared detailed analysis of the

situation in these areas in which block and earmarked grants are awarded, the competent ministries in the coming period need to consider the possibilities for redefining the manner and determining criteria for allocation of block and earmarked grants. At the same time, the amount of grants will be in accordance with the needs of the municipalities, respecting the legal provisions, and it is necessary to reorganize the institutions at the local level and to ensure equal access of all citizens to the services offered by the municipality. At the same time, improving quality of local services for the transferred competencies will be realized.

As a result of the adopted legal solutions in the past years, the municipalities have been provided with stable revenues from the lease of agricultural land owned by the Republic of North Macedonia to the municipalities in a ratio of 50% for the Budget of the Republic of North Macedonia and 50% for the municipalities and municipalities in the City of Skopje, which are distributed from 2018, depending on the location of the agricultural land that is subject to leasing, provided that the collection of the real estate tax revenues is realized over 80% compared to the planned previous year. Increase of the own revenues of the municipalities is realized from the fee charged from issuing a concession for use of water resources for electricity production in a ratio of 50% for the central budget and 50% for the local authorities, depending on the area in which the concession activity is performed.

The growth of the own revenues of the municipalities, especially the revenues from real estate taxes with better coverage of the tax base of natural persons and legal entities and reassessment of the value of real estate will continue during the next medium-term period. At the same time, some of the municipalities collect higher revenues from property taxes as a result of the higher rate for calculation and collection of property tax within the determined range in accordance with the Law on Property Taxes. Increase is also expected with the application of the improved elements of calculation in the Methodology for determining the market value of real estate, as well as better quality assessment of real estate with the legal possibility to hire a professional appraiser in the municipalities or to use the services of licensed appraisers.

In the next period, it is expected to achieve higher revenues by determining the real market value of real estate after the completion of the procedure for illegally constructed buildings on construction and agricultural land. Furthermore, the municipalities will continue with the execution in the part of the transferred competencies for construction land management and treatment of the illegally constructed buildings on construction and agricultural land, for which appropriate sources of revenues of the municipal budget have been determined.

Increasing the property tax rate on high-value properties could be an additional source of revenue, as once the rate is increased, it is essential to provide assessment and auditing capacities in order to avoid declaring property at a lower value.

In the next medium-term period, implementation of a new Law on Balanced Regional Development and adoption of a new Strategy for Balanced Regional Development for the period 2020-2030 is expected. The Government of the Republic of North Macedonia will continue in the next period with the activities for balanced regional development and promotion of all regions in the country. Implementation of the Strategy for balanced regional development of the Republic of North Macedonia 2020-2030 in the eight planning regions (Vardar, East, Southwest, Southeast, Pelagonija, Polog, Northeast and Skopje) with better vertical and horizontal coordination of national and local political and integrated development projects adjusted to local needs and conditions will provide a more balanced and territorially oriented local development. The Council for Balanced Regional Development will continue to play an important role as a promoter of the partnership between the regions/municipalities and the Government and will coordinate the use of funds from all sectoral programs intended for the planning regions and municipalities. Special efforts will be made to support the municipalities, by encouraging local development by supporting local projects and aligning them with national ones.

Each unit of local self-government that will use funds from the state budget will have to accept clear rules for transparency in its operations and make available to the public all financial expenses, through the Open Finance system. The Ministry of Finance publishes quarterly data on the website on the realized revenues and expenditures of the municipalities, but also on the amount of unpaid and due liabilities. In the coming period, the attention will be focused on increasing the transparency of the municipalities and publishing the data from the financial operations on their websites, as well as publishing the unpaid liabilities to the creditors.

The new Program for Sustainable Local Development and Decentralization, which is currently being prepared for the period 2021 - 2026, includes the preparation of a new Methodology that will respond to the circumstances in which the country finds itself and the prospects for EU membership.

A new approach to the new Methodology for preparation of the new Decentralization Program is that in addition to the conducted research and documented findings, recommendations and proposals for the implementation of the participatory process in the second half of 2020, processed topics for consultation or discussion are proposed. It was prepared by the competent Ministry of Local Self-Government and submitted for adoption by the Government of the Republic of North Macedonia.

Simultaneously, the Sectoral Working Group on Regional and Local Development is responsible for carrying out expert-level tasks related to the formulation and implementation of national sectoral policies, including those related to EU integration and donor assistance in general, and the IPA program. In the forthcoming period, a wide consultation and verification of the strategic responses for IPA III will be conducted and better coordination of the donor support and national activities in these sectors.

The implementation of a series of infrastructure projects related to improving the quality of life will accordingly affect the improvement of regional development and active integration into the economy. In that direction, projects will be implemented to improve the overall road infrastructure, bridges, local streets and roads, utility infrastructure (water supply, sewerage systems, collectors for treatment plants, pedestrian crossings, horticultural arrangement, public hygiene), as well as infrastructure improvement of villages through urbanization, connecting inhabited areas and construction of local roads, pedestrian crossings and lighting, development and support of rural tourism and recreational centers.

The implementation of the Municipal Services Improvement Project, financially supported by the World Bank, as well as the Water Supply and Wastewater Project, financed by a loan from the European Investment Bank (EIB), will continue in the coming period. At the same time, according to the legislation, the municipalities that meet the legal criteria for borrowing,

in the coming period will be able to finance their projects by borrowing by concluding a loan agreement with domestic or foreign creditors or by issuing municipal bonds.

Table 5 Medium term projection of the local government budget

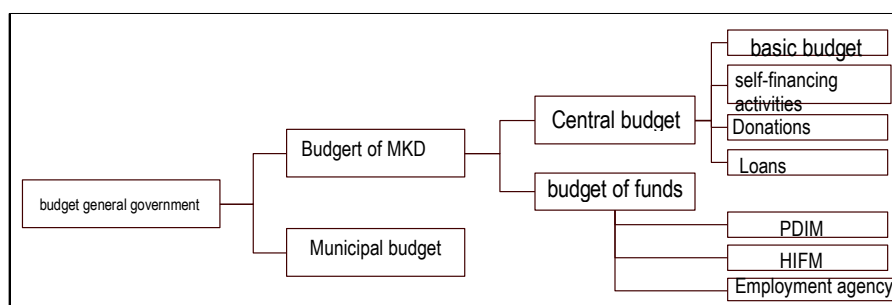
	2020	2021*	2022*	2023*	2024*	2025*
Total revenue	44,586	44,176	44,314	45,478	46,605	48,879
Tax revenues	9,873	10,835	10,835	10,835	10,835	10,835
Non-tax revenues	2,466	1,924	1,924	1,924	1,924	1,924
Capital revenues	2,593	2,763	2,763	2,763	2,763	2,763
Transfers	27,606	26,604	26,742	27,906	29,033	31,307
Other transfers	5,866	4,989	4,989	4,989	4,989	4,989
Donations	2,048	2,050	2,050	2,050	2,050	2,050
Total expenditures	44,051	44,176	44,314	45,478	46,605	48,879
Salaries and allowances	18,895	19,084	19,084	19,084	19,084	19,084
Goods and services	10,540	10,050	10,050	10,350	10,850	11,450
Interest payments	43	59	59	59	59	59
Subsidies and transfers	3,642	3,681	3,681	3,681	3,681	3,681
Social transfers	61	61	61	61	61	61
Capital expenditures	10,870	11,241	11,379	12,244	12,871	14,544
Balance	535	0	0	0	0	0

Source: Ministry of Finance Projections

2.3 General Government Budget (consolidated central and local government budget)

The General Government Budget includes consolidated data of the Budget of the Republic of North Macedonia and the local government budget (budgets of the municipalities). The budget of the Republic of North Macedonia is composed of the central budget (core budget, budget of self-financing activities, funds from donations and loan funds) and from the budgets of the pension insurance funds, health insurance and the Employment Agency (Chart 18).

Chart 18. Structure of the General Government Budget



The projected revenues of the General Government Budget in the next three years show a relative decrease as a share in GDP, from 32.6% in 2021 to 29.7% in 2025 (Table 6). As a result of the continuity in the implementation of disciplined budget policy and strengthened control of public spending, the total expenditures of the consolidated budget in the period 2021-2025 will also decrease from 37.6% in 2021 to 31.8% in 2025. Consequently, and in line with gradual fiscal consolidation, the general government budget deficit will be reduced from 4.9% of GDP in 2021 to 2.0% of GDP in 2025.

Table 6. General government budget

	Millions denars						% from GDP					
	2020	2021*	2022*	2023*	2024*	2025*	2020	2021	2022	2023	2024	2025
Central budget												
Revenue	101,933	115,876	123,234	134,176	147,109	162,001	15.3	16.4	16.3	16.6	16.9	17.2
Expenditures	156,771	150,806	152,177	160,125	171,585	181,102	23.6	21.3	20.2	19.8	19.7	19.2
Budget balance	-54,838	-34,930	-28,943	-25,949	-24,476	-19,101	-8.2	-4.9	-3.8	-3.2	-2.8	-2.0
Budget Funds												
Revenues	67,104	70,450	73,856	77,434	81,190	85,134	10.1	10.0	9.8	9.6	9.3	9.0
Expenditures	68,760	70,458	73,864	77,442	81,198	85,142	10.3	10.0	9.8	9.6	9.3	9.0
Budget balance	-1,656	-8	-8	-8	-8	-8	-0.2	0.0	0.0	0.0	0.0	0.0
Budget of MKD Central budget and funds?												
Revenues	169,037	186,326	197,090	211,610	228,299	247,135	25.4	26.4	26.1	26.1	26.2	26.2
Expenditures	225,531	221,264	226,041	237,566	252,783	266,244	33.9	31.3	30.0	29.4	29.0	28.2
Budget balance	-56,494	-34,938	-28,951	-25,956	-24,484	-19,109	-8.5	-4.9	-3.8	-3.2	-2.8	-2.0
Local government budget												
Revenues	44,586	44,176	44,314	45,478	46,605	48,879	6.7	6.2	5.9	5.6	5.3	5.2
Expenditures	44,051	44,176	44,314	45,478	46,605	48,879	6.6	6.2	5.9	5.6	5.3	5.2
Budget balance	535	0	0	0	0	0	0.1	0.0	0.0	0.0	0.0	0.0
general government budget (consolidated)												
Budget of MKD and local budget												
Revenues	213,623	230,502	241,404	257,088	274,904	296,014	32.1	32.6	32.0	31.8	31.5	31.3
Expenditures	269,582	265,439	270,355	283,044	299,387	315,123	40.5	37.6	35.8	35.0	34.3	33.4
Budget balance	-55,959	-34,937	-28,951	-25,956	-24,483	-19,109	-8.4	-4.9	-3.8	-3.2	-2.8	-2.0

Source: Ministry of Finance and projections on Ministry of Finance

3. Other Aspects and Improving Public Financial Management

3.1 Public Financial Management for the period 2018-2021

Maintaining overall fiscal discipline in the medium term is one of the priorities in the planning and budgeting process, which will result in: a) medium-term fiscal consolidation; b) allocation of resources based on the programs and the included program indicators; and, c) A medium-term budget framework that serves as a reliable guidebook to the future allocation of budget funds to each budget user. These priorities will be maintained and upgraded in the future period which will be covered by the new Public Financial Management Reform Program for the next period of the program starting from 2022, which will start being prepared in 2021.

The Ministry of Finance, in cooperation with foreign experts (from the IMF and the WB) in the past period, worked intensively on detailed and comprehensive identification of areas for further improvement of public financial management, preparation of the structure, content and scope of the new Budget Law, as well as preparation of proposals for certain areas included in the Law (medium-term fiscal strategy, structure of budget documents, organizational structure, registry of public sector entities, fiscal rules, enhancement of transparency).

The new law, which is in the final stages of preparation, is in line with improvements to the public financial management system, in order to provide a framework for implementing sound, predictable and sustainable fiscal policy and increasing the budget discipline and responsibility.

The new mechanism of the law includes:

- establishment of fiscal rules and institutionalization of the Fiscal Council;
- publishing a registry of public sector entities;
- improving the process of medium-term fiscal strategy, preparation of a baseline scenario and new initiatives; and
- enhancement of transparency (submission of data on public enterprises, local self-government units).

Also, with the draft Budget Law in the next period it is planned to introduce an Integrated Financial Management Information System (IFMIS), which will establish integration and connection with all budget users and the systems of the Public Revenue Office, the Customs Administration, and other institutions, in order to enable more efficient management of public finances.

As part of the technical assistance of the project for the new Budget Law, implemented by the World Bank in cooperation with the Ministry of Finance, a "Report on IFMIS - functional and technical requirements" was prepared, which presents details of the modules in the future IFMIS and technological architecture. This system will support public finance reforms through the implementation of the new Budget Law.

The implementation of the IFMIS system will achieve full compatibility and interoperability of public finance systems, and their application in accordance with the Public Financial Management Strategy, means ensuring the availability of systems and data exchange 24 hours a day throughout the year.

In the next period, the Ministry of Finance, in cooperation with the World Bank and the Government of the United Kingdom, as well as through sectoral budget support from the EU, will continue to work on the preparation of bylaws, guidebooks, manuals, etc., aimed at operationalizing the new Budget Law, further improvements of the system for the PFM, development of a detailed plan for all work processes in the Ministry of Finance and their mapping, as well as preparation of a detailed technical specification for the Integrated Information System for Public Finance Management.

In accordance with the Public Investment Management Assessment (PIMA) conducted by the International Monetary Fund, the Ministry of Finance, as the process coordinator, prepared an Action Plan for the implementation of the PIMA recommendations, which was adopted by the Government. The action plan envisages activities that should start with implementation in 2021 and 2022, and will be implemented by the competent national institutions in the next period 2021 - 2024 in order to improve public investment management.

In particular, the reforms that will be gradually introduced are aimed at improving the planning, allocation and implementation of public infrastructure projects, which will contribute to greater alignment of budget allocations with the Government's investment priorities, improving the comprehensiveness of budget documentation in order to include all public expenditures for capital investments and information on the financial needs of current and new projects,

introduction of inspection of the public investment portfolio at the national level, which includes monitoring and management of the overall risk in the implementation.

3.2 Report on the recorded liabilities pursuant to the Law on reporting and recording of liabilities

In order to ensure and maintain transparency and accountability and strengthen accountability in the disposal of public funds, the Law on Reporting and Recording of Liabilities regulates the reporting, recording and publication of data on reported incurred and outstanding liabilities and due and unpaid liabilities.

With this legal solution, a legal duty has been established on a monthly basis for reporting the obligations in the electronic system by the state authorities, local self-government units, institutions and institutions that perform activities in the field of culture, education, health, child, social protection, as well as in other activities of public interest determined by law, established by the Republic of North Macedonia or by the units of local self-government, public enterprises, state-owned companies and other legal entities established by the Republic of North Macedonia or local self-government units.

In order to inform the public and greater transparency, and based on the recorded data on reported liabilities, the Ministry of Finance continuously, on a quarterly basis publishes summary reports on the website.

Based on the data recorded in the Electronic System for Reporting and Recording of Liabilities, from the reported data as of September 2020, Table 7 shows the Report on reported liabilities by groups of entities.

Table 7. Report on reported liabilities by groups of entities for September 2020 (in millions of denars)

Serial Number	Group of subjects	Overdue and unpaid liabilities	Outstanding liabilities, 2020	Outstanding Liabilities, 2021	Outstanding liabilities 2022
1	Budget users first line	789	880	649	274
2	Budget users second line – institutions at the National level	111	23	23	7
3	Municipalities	3,929	437	386	295
4	Second line user units – Local institutions Financing through block grants	367	34	3	0
5	Public health institutions	2,937	1,165	9	1
6	Public enterprises / companies established by Republic North Macedonia	7,333	1,952	3,844	5,337
7	Local enterprises established by municipalities	3,342	305	124	127
8	Regulatory bodies	5	16	5	0
9	Planning regions	56	27	0	0
10	Other entities	4	543	1,221	1,480
Total (1+2+3+4+5+6+7+8+9+10)		18,873	5,382	6,264	7,522

Source: Ministry of Finance - Electronic system for reporting and recording liabilities

3.3. Public enterprises and State-owned companies

The operation of public enterprises and state-owned companies is regulated by the Law on Public Enterprises, the Company Law, as well as by sub-sector laws that define the operation in a specific area (Law on Energy, Law on Railway System, Law on Public Roads, etc.). The total revenues of public enterprises and state-owned companies for 2019, according to the data from the annual reports amount to 38.3 billion MKD, the total expenditures were executed in the amount of 36 billion MKD, with the final result in 2019 being gross profit in amount of 2.3 billion MKD (Table 8).

The financial indicators from the financial operations of the public enterprises and trade companies are presented on a calculation basis, according to the prescribed accounting methodology, which differs from the accounting methodology of the budget users where the financial data are presented on a cash basis.

The shown loss in certain public enterprises and state-owned companies is a result of the calculated depreciation of fixed assets, which is basically an accrual expense and is presented as an expense of public enterprises.

The positive result recorded in the joint operation of public enterprises and state-owned companies in 2019 will be the basis for further improvement of the financial performance of these enterprises, along with the efficient improvement of public services they provide to citizens and the economy.

Table 8. Main financial indicators for public enterprises and state-owned companies (million MKD)

Nr. Public Enterprise and State-owned company	Total Revenues	Total expenditures	Loss/Profit before tax	Plan revenues	Plan expenditures	Loss/profit before tax	2020 Invest program	K3-Revenues (2020)	K3-expenditures (2020)	Final result
	2019			2020 Plan				K3 - third quarter 2020		
1. Power plants of North Macedonia, JSC	12,752.7	12,559.4	193.3	13,484.4	13,355.6	128.8	7,563.3	2,733.2	2,741.2	-8.0
2. Electricity Transmission System Operator of the Republic of North Macedonia, JSC	5,456.5	4,976.4	480.1	3,719.4	3,719.4	0.0	2,127.0	649.3	885.8	-236.5
3. Public enterprise for State Roads	8,583.4	5,652.4	2,931.0	18,523.3	18,523.3	0.0	12,012.5	2,972.5	950.5	2,021.9
4. Railways of the Republic of North Macedonia Transport JSC	1,313.2	1,717.2	-404.0	1,307.1	1,837.5	-530.5	444.4	294.7	409.3	-114.6
5. Public enterprise for managing forests "National Forests"	1,661.8	1,633.2	28.6	2,136.3	1,897.9	238.4	24.4	488.1	423.2	64.9
6. State-owned Joint-Stock Company for postal Traffic "posts of North Macedonia"	1,197.8	1,262.9	-65.2	1,357.9	1,370.6	-12.7	0.0	243.4	306.2	-62.8

7.	Public enterprise for Railway Infrastructure Railways of Republic of North Macedonia	874.2	1,214.9	-340.6	979.1	1,311.6	-332.5	1,943.3	178.1	261.1	-83.0
8.	Public enterprise for maintenance and protection of national and regional roads	1,146.2	1,091.9	54.3	1,550.0	1,540.0	10.0	1,450.0	262.4	325.2	-62.8
9.	Public enterprise "National television" MRT	928.7	1,455.8	-527.1	966.0	966.0	0.0	6.0	227.3	209.2	18.1
10.	Joint Stock company for construction and management of residential properties and commercial properties with significance for the Republic	831.5	822.5	8.9	1,043.4	982.9	60.5	35.5	124.4	147.4	-23.0
11.	"M-Nav" Air Navigation service Provider of the Republic of North Macedonia, GOJSC	1,092.6	1,060.5	32.1	1,114.6	1,111.5	3.1	705.3	175.6	212.9	-37.3
12.	Joint Stock Company for water management of the Republic of North Macedonia	612.5	612.2	0.4	571.3	570.8	0.6	0.0	129.5	164.7	-35.3
13.	Public enterprise for water supply "Strezevo"	243.1	464.1	-221.0	238.8	471.9	-233.1	70.0	51.7	119.5	-67.8

14.	Joint Stock company "TEC Negotino"	194.6	181.9	12.6	214.2	214.2	0.0	0.0	46.9	42.4	4.5
15.	Joint stock company "State lottery of North Macedonia"	557.1	239.9	317.2	658.0	331.2	326.8	0.0	85.7	58.6	27.1
16.	Public enterprise Hydro system "Zletovica"	27.5	164.2	-136.6	26.3	26.3	0.0	65.2	5.4	40.3	-34.9
17.	Public Enterprise "National broadcasting"	291.0	173.7	117.4	229.3	229.3	0.0	397.9	65.3	59.1	6.3
18.	Joint stock company for airport services "Airports of the Republic of North Macedonia"	43.3	117.3	-74.1	15.6	127.9	-112.4	12.4	2.4	4.2	-1.8
19.	Company for construction, management and issuance of multipurpose hall "Boris Trajkovski", state owned limited liability company established by one person	76.9	114.1	-37.2	86.8	110.4	-13.7	0.0	9.3	22.8	-13.5
20.	Public enterprise for water supply "Lisice"	46.3	84.1	-37.8	18.5	18.5	0.0	10.4	16.8	20.8	-4.1
21.	Joint stock company for management of state-owned business premises	90.8	81.6	9.2	99.9	91.0	8.9	53.3	19.7	18.3	1.4
22.	Public enterprise "Official"	90.5	63.7	26.9	79.6	79.2	0.3	144.0	21.2	18.3	3.0

	gazette" of Republic of North Macedonia										
23.	Public enterprise for water supply "Zletovica"	59.4	57.2	2.2	66.1	57.8	8.3	29.9	15.5	14.7	0.8
24.	Media information Agency - Skopje, a state owned joint-stock company	69.7	57.8	11.9	69.0	67.8	1.2	4.2	11.3	14.2	-3.0
25.	Public enterprise for managing and protection of the multipurpos e area "Jasen"	60.5	59.9	0.7	48.0	43.2	4.8	0.1	10.5	11.5	-1.0
26.	Public enterprise for pastures managemen t	22.2	32.8	-10.6	41.1	34.8	6.3	6.3	25.4	23.4	2.0
27.	Joint stock company for performing energy activities "National Energy Resources" in state ownership	4,4	31.7	-31.7	41.6	41.6	0.0	3,378.4	0.0	4.3	-4.3
28.	Public enterprise "Agro-berza"	12.9	11.8	1.0	13.6	13.8	-0.3	0.0	1.8	2.0	-0.2
29.	State-owned limited liability company established by one person "Naftovod"	0.0	7.6	-7.6	7.4	7.4	0.0	0.0	0.0	1.7	-1.7
Total:		38,341	36,003	2,334	48,716	49,153	-437	30,483	8,867	7,513	1,354
Source: Annual reports and Finance plans of the public enterprises and state-owned companies											

In order to promote transparency, with the amendments to the Law on Public Enterprises, public enterprises are obliged to publish annual and quarterly reports on their websites, which will enable timely and transparent monitoring of the financial operations of these entities, which will ultimately provides an opportunity for more realistic forecasting of fiscal risk in this area and timely response and taking appropriate measures.

From this year, the Ministry of Finance publishes on its website consolidated quarterly data on executed revenues and expenditures at the level of public enterprise / state-owned company.

4. Use of EU pre-accession assistance

The Republic of North Macedonia, as a candidate country for membership in the European Union, has funds under the Instrument for Pre-Accession Assistance (IPA) of the European Union available through two financial perspectives: Financial Perspective of IPA 2007-2013 (IPA 1) and Financial Perspective of IPA 2014-2020 (IPA 2).

This section of the document presents only the part of EU pre-accession assistance which is implemented under decentralized / indirect management method. The decentralized/indirect management method of IPA is a method of management within which the European Commission (EC) entrusts tasks for implementation of certain IPA programmes to the accredited structure in the Republic of North Macedonia such as tender procedures, contracting, monitoring projects and execution of payments. On the other hand, when it is a matter of centralized management, these are responsibilities of the EC.

The funds for national co-financing intended for projects implemented under the decentralized/indirect management method, are planned within the budget of the Ministry of Finance, organizational code 09002 - State functions, with the exception of national co-financing necessary for financing IPARD projects, which is planned within the budget of the Agency for Financial Support and Rural Development, organizational code 14004, as well as the national co-financing for the payment of the financial contribution to the EC for participation in the programs of the Union which is planned in the line ministries.

4.1 IPA 1 - Financial Perspective 2007-2013

Within the IPA 1 financial perspective 2007-2013, the Republic of North Macedonia through the five components of IPA had funds available in the amount of 614 million EUR (37.8 billion MKD) of which about 467 million EUR (28.7 billion MKD) or about 76% of the total allocations are employed through the decentralized management method (through structures accredited by the European Commission services to manage European funds independently). As regards IPA 1 programming period 2007-2013, the following components are accredited for decentralized management: IPA Component I - Transition Assistance and Institution Building (TAIB); IPA Component III - Regional Development; IPA Component IV - Human Resources Development and IPA Component V - Rural Development.

The implementation of most of the programs within IPA 1 finished at the end of 2018, and additionally by the end of 2020 all contracts implementations are expected to be completed.

4.2 IPA 2 - financial perspective 2014-2020

Under the IPA 2 financial perspective 2014-2020, 664 million EUR have been made available to the Republic of North Macedonia. With respect to the manner of implementation, around 50% of the total allocations for IPA 2 are planned to be implemented through an indirect management system, i.e. through accredited IPA structures.

The assistance will finance projects in the following areas: justice and home affairs, road and railway infrastructure, environmental protection, education, employment, promotion of gender equality and human resource development, and agriculture and rural development.

The IPA funds that will be employed through indirect management are the following annual and multi-annual programmes:

- 2014 action program for financing projects in the following areas: Judiciary, Disaster recovery system and ensuring business continuity, Development of capacities for on-site inspections, Entrance tickets

- for programs of the Union, Local and regional competitiveness , with a focus on tourism and Support for EU Integration (SEA).
- 2015 action Program, 2016 action Program, 2018 action Program and 2020 action Program, for financing entry tickets for EU Programmes;
- 2017 action program for financing projects in the following areas:
 - o Labor and education,
 - o Entrance tickets for Union programs;
- Multi-annual sectoral operational programme for transport 2014-2020;
- Multi-annual sectoral operational programme for environment and climate action 2014-2020;
- IPARD 2 Programme.

Within the **2014 Action Program**, the Republic of North Macedonia has been provided with around 20 million EUR of IPA funds. The more significant projects that are planned to be financed within the Program are: construction works for rehabilitation of the prisons in Bitola and Skopje, construction works for rehabilitation of the regional offices of the Public Prosecutor's Office, grant scheme for support of the non-governmental sector in the field of law, contract for services to support the reforms in the judicial system, contract for procurement of IT equipment for the Ministry of Internal Affairs - Center for data storage in case of disaster, etc. The deadline for concluding these agreements was December 23, 2018, by which time 26 agreements in the amount of 14.63 million EUR have been concluded. Some of these projects have been completed, and some are still ongoing. The deadline for completion of projects under this program is December 23, 2021.

Under the Multiannual Program for the **Sector for Environment and Climate Activities**, 114.9 million EUR were allocated to IPA funds and funding of projects for construction of treatment plants, sewerage networks and waste management and climate change is envisaged. As of November 2020, 8 agreements in the amount of 24.5 million EUR were concluded in the Environment and Climate Activities Sector. Tender procedures are underway for some of the other projects. The most significant capital projects that will be financed are the project for construction of a wastewater treatment plant and rehabilitation and expansion of the sewerage network in the municipality of Tetovo, rehabilitation and expansion of the sewerage network in the municipality of Kichevo, construction of a wastewater treatment plant and rehabilitation and expansion of the sewerage network in Bitola, project for closure of landfills in the eastern and northeastern region, construction of a central waste management facility, construction of a sorting plant, MBT plant, landfill, composting plant, green point for the eastern and northeastern region in Sveti Nikole, construction of six (6) Local waste management facilities - transfer stations, composting plants and green spots for the eastern and northeastern region, support in establishing a regional waste management system - Procurement of equipment for the Eastern region, support and preparation of the necessary documentation for procurement of water equipment for the municipalities of Radovish, Kichevo, Strumica, Bitola, Tetovo, Berovo, Kumanovo and Prilep.

Within the **Transport** sector for the period 2014-2020, 110.9 million EUR of IPA funds have been allocated. As of November 2020, 3 contracts in the amount of 31.3 million EUR were concluded in the Transport sector. Tender procedures are underway for some of the other projects. Significant capital projects are construction and rehabilitation of the eastern part of the railway - Corridor VIII part to Bulgaria third phase, construction of road section Gradsko - Drenovo as part of road corridor 10-d, rehabilitation of regional road A2, section Kumanovo - Stracin (phase 1), construction of a new expressway from Prilep - bridge over the river Lenishka and construction of a third lane on the road section from the village Belovodica - Mavrovo quarry, replacement of protective fences according to EN standards on highways 100 km on Corridor 10, procurement and installation of new signalization at the railway level crossings as well as implementation of measures for improvement of the road safety along the selected road sections.

Regarding the **2015, 2016, 2018 and 2020 Action Program** within which the entrance tickets for the programs of the Union are financed, the payment of the entrance tickets for participation in the respective programs and agencies for the financial perspective 2014-2020 will be implemented decentralized through the National Fund within the Ministry of Finance, where the planning of IPA participation is within the budget of the Ministry of Finance, while the planning of the national participation is an obligation of the competent institutions in their budget. The Union's programs cover

almost every area of the socio-economic life of European citizens: education, culture, youth, media, social affairs, SME development, environment, transport, public health, legal cooperation, fight against violence, crime, terrorism, information society, customs and taxes. All legal entities can participate in the programs, but in certain cases also natural persons (individuals) from the participating countries may also participate therein.

Within the **2017 Action Program**, projects in the field of Labor and Education are financed in order to reduce the high unemployment rate, increase the share of the labor market, especially young people and women, increasing access to quality education and training, improving results and skills, and establishing a modern and flexible social protection system. In order to achieve the general objective, several projects are envisaged in the following areas:

- Institutional strengthening of the capacities for sustainable sectoral reforms;
- Improving the quality of the education and training system;
- Promoting skills development, employment and working conditions;
- Social protection, social inclusion and equal share in the labor market and society.

As of November 2019, in the field of Labor and Education, 3 contracts were concluded in the amount of 5.35 million EUR. Tender procedures are underway for some of the other projects.

The **IPARD 2 Program** supports projects that will enable the achievement of EU standards established in the field of agricultural production, food processing and rural development. For the period 2014-2020, within this Program, a total of 60 million EUR IPA funds have been made available to the Republic of North Macedonia.

The implementation of the IPARD Program 2014-2020 begins with 4 measures (Investments in physical (tangible) assets of agricultural holdings, Investments in fixed assets for processing of agricultural and fishery products, Diversification of farms and business development and Technical assistance for the implementation of the Program) , while preparations for accreditation of one more measure (Rural Public Infrastructure Investments) is commenced.

4.3 IPA 3 - within the 2021-2027 financial perspective

The new financial package 2021-2027 is expected to have an increase of 6% compared to the previous IPA 2 package. The focus of IPA 3 will be more investment funds through grants and loans and increased convergence. Also, with IPA 3 the focus of the European Union is placed on the cooperation with the EIB and the EBRD, but also other international financial institutions, which will offer the so-called "Leverage" loans. IPA 3 will have to contribute to the implementation of the "Economic and Investment Plan for the Western Balkans" adopted at the May 2020 summit in Zagreb, to encourage a dynamic medium-term recovery, job creation and increased trade between the Western Balkans and the EU by financing major infrastructure projects in the sectors of transport, environment, digitalization and energy, which have regional importance and connectivity, as well as projects mature for implementation in the next 4 years.

The use of IPA 3 funds will be done at national and regional level. The use of funds through the Instrument for Pre-Accession Assistance IPA III for the period 2021-2027, provides for 5 key objectives, as follows:

Objective 1: Rule of Law, Fundamental Rights and Democracy

Objective 2: Good governance, legislative alignment, good neighborly relations and strategic communication

Objective 3: Green Agenda and Sustainable Connection

Objective 4: Competitiveness and Inclusive Growth

Objective 5: Territorial and cross-border cooperation

At the national level, the package of funds will be within the current 80-100 million EUR per year. Within the national package, the focus remains on the beginning of the negotiations, on adapting the administration to the accelerated pace of reforms and on the coordination mechanisms that should move the negotiation process in line with the new negotiation methodology, clustering and harmonization of negotiations with the use IPA funds for the needs of the negotiation process and structural reforms throughout society. The amount of funding at the national level will depend on the willingness of the administration to prepare relevant and mature projects arising from the needs of the EU integration process, political commitment in the implementation of these projects, because IPA 3 is a competition between beneficiary countries (Western Balkans and Turkey) within the so-called fair share.

At the regional level, a large part of the announced IPA 3 funds will be placed through regional programs, intended to support the sectors of transport, environment, energy, social support and digitalization. Therefore, it will be

important for these sectors to successfully implement their long-term strategies that define national priorities, but also the trends arising from the European agenda, such as digitalization, broadband and high speed internet, energy projects and transformation towards decarbonization, renewable energy sources, gas infrastructure, circular economy, clean environment, guarantees for private business and traffic relations, etc. Funds from the Investment Framework for the Western Balkans will continue to be available to our country on the principle of the so-called blending of grants and loans. Mature projects, ready for fast implementation, will have the advantage of financing. The new fiscal strategy will be more loosened in terms of borrowing capital from international institutions.

5. Public debt

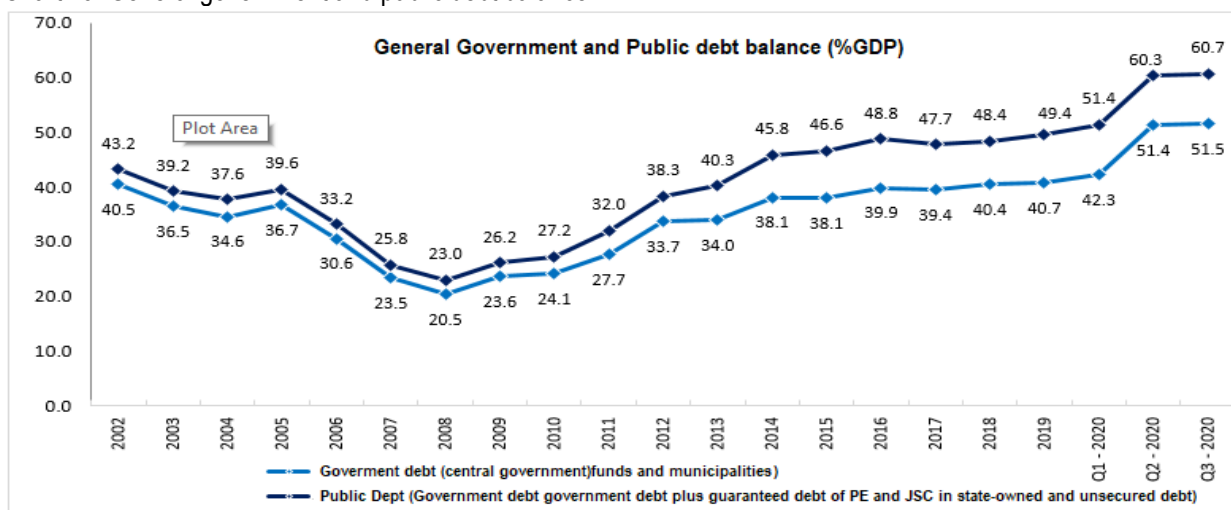
Efficient public debt management is essential and means reducing the risks in designing the structure and policy for debt management, in order to avoid the possible inability of regular and timely debt servicing. The main objective is to provide the necessary funds for financing the budget deficit and repayment of previous debts, as well as funds for project financing, without causing an unjustified increase in debt to a level that could jeopardize the stability of the economy and economic growth of the country. Quality debt management, among other things, is determined by the institutional framework and the capacity to set and implement public debt management policy. This means clearly defining the goals and measures for public debt management.

In May 2019, the Assembly of the Republic of North Macedonia adopted the Law on Amending the Law on Public Debt (published in the Official Gazette of MKD No. 98/19 of 21.05.2019). The purpose of the legal changes was to increase transparency, harmonization with international practices and greater credibility among international institutions and investors. With the legal changes, the public debt management policy is set aside in a separate Public Debt Management Strategy, which will be prepared for a medium-term period of three years, and will be adopted by the Government of the Republic of North Macedonia at the proposal of the Ministry of Finance. Prior to the legislative changes, public debt management policy was part of the Fiscal Strategy.

5.1 Public and General Government debt limits

The General Government debt of the Republic of North Macedonia on September 30, 2020 amounts to 5,573.14 million EUR, i.e. 51.5% of GDP. Within the General Government debt, the dominant share is the debt of the central government which amounts to 5,563.8 million EUR, while the debt of the municipalities amounts to 9.4 million EUR. Total public debt includes government debt and debt of public enterprises and companies in dominant or fully state ownership (guaranteed and non-guaranteed) on 30.09.2020 amounted to 6,571.54 million EUR, which is 60.7% of GDP.

Chart 19. General government and public debt balance



Central government debt represents 99.4% of total government debt at the end of the third quarter of 2020 and this debt is directly managed by the Ministry of Finance. At other levels of debt, such as municipal debt and the debt of public enterprises and state-owned companies guaranteed by the state, the Ministry of Finance participates in the borrowing process, but cannot influence the intensity of withdrawal of funds in the concluded loans.

With the Covid-19 crisis, financing needs increased, resulting in greater borrowing in the international capital market. Thereby, the increased financing needs followed by the reduced projections for economic growth, increased the public debt/GDP indicator which at the end of 2020, which due to the increased financial needs and reduced economic growth will be higher than planned in the 2020-2022 revised Fiscal Strategy. More detailed projections for the government and public debt movement will be presented in the Public Debt Management Strategy for 2021-2025.

5.2 Guaranteed debt and risk of activation of state guarantees

In order to obtain better conditions for financing by creditors, the state issues a state guarantee, after analyzes of the borrower and his ability to independently service future liabilities. The realization of new borrowings takes into account the long-term sustainability of public finances, and the process of issuing new guarantees is strictly regulated and subject to the borrowing procedure set out in the Law on Public Debt, according to which applicants for guarantees must meet certain criteria to the state can issue a guarantee. According to the latest legal changes in the Public Debt Law, the management of potential liabilities will be improved by strengthening the capacities in the area of issuing borrowing approvals. Namely, the Ministry of Finance will perform credit analysis and assessment of the creditworthiness of the holders of public debt when issuing a state guarantee, in accordance with a special prescribed methodology for assessment. This approach harmonizes with international practices in issuing state guarantees.

As of September 30, 2020, the issued state guarantees amount to 957.6 million EUR, which represents 8.72% of GDP.

Although the guaranteed debt is an integral part of the public debt and it is published in a transparent manner, the Ministry of Finance takes into account the risk associated with potential liabilities, i.e. what would be the effects on the Budget in the event of activation of government guarantees.

The revised fiscal strategy for this medium-term period fits into the concept of SMART finance, i.e. it will provide a framework for conducting sound, predictable and sustainable fiscal policy, as well as increasing budgetary discipline and accountability.