ANALYSIS of PUBLIC DEBT

REPUBLIC OF MACEDONIA

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analytica

BALKAN MONITORING PUBLIC FINANCES

AUTHOR OF THE STUDY:

Bojana M.Hristovska, Analytica think tank
Tamara M. Spasova, Analytica think tank

EDITOR OF THE STUDY:

Kire Naumov, former technical Deputy Minister of Finance

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Introduction

Fiscal policy is designed to achieve reasonable balance between the two strategic goals of the Government of the Republic of Macedonia, those being maintaining macroeconomic stability and encouraging economic activity by increasing the quality of public finances, above all, through increasing capital expenditures related to improving the infrastructure and strengthening private sector capacities for growth and job creation. Given the high global economic and financial uncertainty, assessing a country's external and fiscal sustainability is of great significance. The need for this type of assessment is all the more crucial, when it refers to a small and open economy, with a fixed exchange rate regime, such as Macedonia. A sustainable debt level does not solely depend on the debt in nominal terms, but on successful implementation of policies boosting economic growth and sound debt management, as well. In this broad context, the fiscal policies are of great importance, because sound debt management can only be achieved through prudent fiscal framework. At the same time, implementing more efficient macro-policies and structural reforms will result in improved investment climate and acceleration of growth that would be less dependent on official long term financing.

Legal framework on public debt

Republic of Macedonia's public debt is legally regulated by the Public Debt Law which stipulates the arrangements for public debt management, the purposes of the public debt and the procedure of issuance, servicing and termination of guarantees.[1] Additionally, pursuant to the Law on Public Debt, the Parliament of the Republic of Macedonia adopts the Public Debt Management Strategy of the country, which provides framework for the Government, and above all, the Ministry of Finance, to act focusing on prudent public debt management on medium term, i.e. in the next three years. Public Debt Management Policy is set for a period of three years and became part of the Fiscal Strategy, as result of the amendment of the Law on Public Debt from 2011. Following competences in managing public debt, Ministry of Finance is assigned to prepare Annual Report on Public Debt Management which, pursuant to the Law on Public Debt, is submitted to the Parliament and Government for information purposes. However, the strategy lacks solid analytical foundation.

1 Public Debt Law – Official Gazette of the Republic of Macedonia no. 165/2014

The Public Debt Law defines public debt as sum of government debt and debt of public enterprises established by the state or by the municipalities, municipalities within the City of Skopje and the City of Skopje, as well as companies being fully or predominantly owned by the state or by the municipalities, municipalities within the City of Skopje and the City of Skopje, for which the government have issued sovereign guarantee.[2]

This new definition of public debt stipulated in the Public Debt Law (amended in 2014) is significantly narrowed, not including the debt of National Bank of the Republic of Macedonia and debt of public enterprises without an issued sovereign guarantee. Therefore, the new method of calculating the public debt prevents the comparison with countries whose debts are calculated according to the definition of the IMF and World Bank.

The Fiscal Strategy as a significant strategic document of the country provides allocation of the available funds in compliance with the strategic priorities, identifies the most significant goals and action policies, as well as sets out the policy for public debt management. Analyzing the fiscal strategies of the Ministry of Finance over the years, it can be noticed that there is inconsistency in terms of the projections and the limits of government and public debt. The main risk to economic projections in the strategy is how this document will be respected and implemented consistently by the authorities. Considering that the previous fiscal strategy 2016-2018 was largely failed, there is still a perception that the risk connected with the optimistic intentions of the economic policy makers demonstrated in the fiscal strategy 2017-2019 is the risk connected with its disobedience. Furthermore, the late submissions of the fiscal strategies contrary to Article 4 from the Law on the Budgets[3] raises a question if the fiscal strategy sets the limits and framework for the Budget (or rebalance of the Budget) or the other way around. This strategy for the period 2017-2019 does not have enough arguments about the limit for public borrowing. In this context, the identification of a sustainable level of public debt with the Maastricht criterion of 60% of GDP (Fiscal Strategy 2017-2019), is not backed up with data and argumentation in the context of local characteristics and intended use of the already generated debt. On the other hand, such a definition of the limits of public borrowing could create a perception that there is room for further borrowing, which can be harmful if such borrowing is not strictly earmarked in priority productive purposes.[4]

In this respect, several areas have been identified by European Commission among the main priorities for development of public finances in the country. One of the targeted policy guidelines adopted at the Economic and Financial Dialogue of May 2016 was to improve fiscal transparency and budget planning capacity by the swift introduction of a medium-term expenditure framework; by providing multi-annual projections of detailed revenue and expenditure components in the medium-term strategy as well as by comprehensive reporting of extra-budgetary expenditure in the consolidated fiscal reports. This would be aided by better targeted public expenditure and strengthened efforts at fiscal consolidation and debt stabilization. The external borrowing of public sector bodies needs close monitoring so as to avoid challenges to monetary policy through its impact on domestic liquidity.[5] According to EC Progress Report for Macedonia 2016, budget transparency is still not ensured, because clear, comprehensive, timely and reliable budgetary and statistical information is not publicly available. Parliament has limited capacity to exercise control on use of public funds and there is no efficient mechanism to monitor the budgetary impact of government proposals. Additionally, public debt levels have been rising fast. An increasing amount of public capital expenditure has been shifted off-budget in recent years to state-owned enterprises (SOE), financed

2 Ibid

3 Law on Budgets (cleared version) – available at: *http://www.finance.gov.mk/files/u6/5.pdf*

4 Will the fiscal strategy be respected and implemented consistently, available at: *http://utrinski.mk/?ItemID=78E31959888D5E47877A9D749381FD2B* [accessed, February 10, 2017]

5 *https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/pdf/key_documents/2016/20161109_report_the_former_yugoslav_republic_of_macedonia.pdf [accessed, March 15, 2017]*

almost entirely by government-guaranteed credit. This, in addition to the rising primary fiscal deficits, has led to accelerating increases in public debt between 2008 and 2015. There is little transparency about the fiscal risks linked to the execution of sizeable public infrastructure works through state enterprises.[6]

Characteristics of the public debt – current situation in the Republic of Macedonia

The 2000-2008 period in Macedonia is characterized by continuous decline of public debt from 47.9% of GDP to the lowest level of 23% of GDP in 2008, while the 2008 general government debt was 20.5% of GDP (graph 1). Strong domestic demand, as well as favorable lending conditions, helped the acceleration of economic activity. In this period, correlation of the economic growth rates and public debt interest rates were sufficient, while a policy of fiscal discipline and primary balance (small surplus) was also carried out. In 2007 the debt to the Paris and the London Club was paid, as well as parts of the debt to multilateral creditors, and two structural bonds. However, from 2008 onwards the debt began to rise as a result of worsened economic conditions and the Government's expansive fiscal policy. The country's borrowing, especially from abroad, became an important source of assets to cover public expenditures. In August 2014, Macedonia took out a 36.4-million-euro loan for competition development policies, financed by the World Bank. In 2014 public debt reached 45.9% because the Government issued a 500-million-euro bond under very favorable conditions (3.975%, 7 years) and thus completely, early financed the 15-million-euro bond, and carried out payments to the IMF in 2015 (154 million EUR).

Public debt was reduced in the first half of 2015 to 43.7% of GDP. Nevertheless, the issuing of a new Eurobond of 270 million Euros and increased borrowing at home of 94 million Euros caused the general government debt to be 38.1% of GDP at the end of 2015, while the total public debt was 46.5% of GDP, which is an increase of 23.5pp compared to 2008 (23% of GDP).[7] In July 2016, Republic of Macedonia issued the fifth Eurobond on the international capital market, intended for financing the budget needs and refinancing the liabilities falling due in 2016 and 2017 on the basis of previously issued public debt. The Eurobond was issued in the amount of EUR 450 million, with a coupon interest rate of 5.625% annually and 7-year maturity and it is traded on the Irish Stock Exchange. The ownership structure of the Eurobond is mainly distributed between hedge and asset funds, insurance companies and banks from the USA and Continental Europe. According to a recent official data released by the Ministry of Finance, as of the end of 2016, the public debt reached 4.71 billion Euros, or 47.6% of GDP. But according to the projections for the budget deficit for 2017 by the end of this year, the public debt will exceed 5 billion Euros.[8] [9]

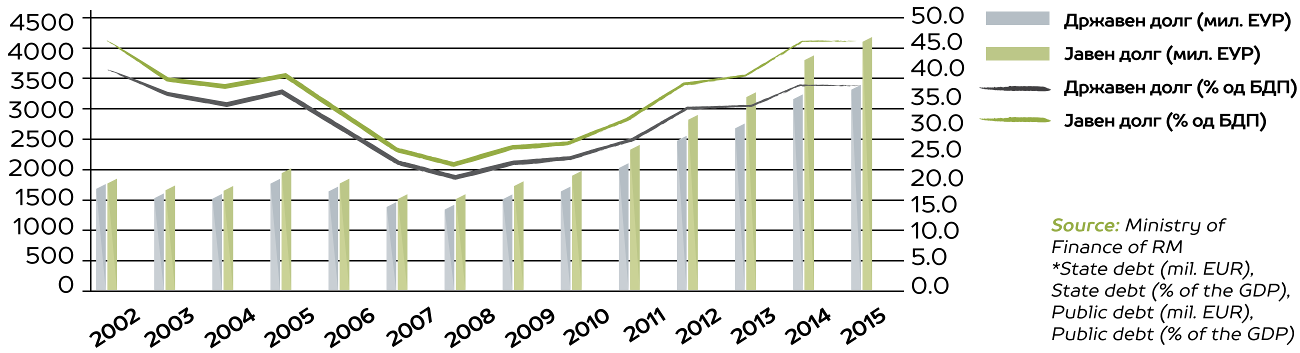
6 Progress Report FYROM 2016

7 Fiscal Sustainability of Macedonia on its path towards the EU, Faculty of Economics- University of "Ss. Cyril and Methodius"- Skopje, prepared by Borce Trenovski and Biljana Tashevska, 2016

8 Macedonian public debt is at an alarming level of 5 billion euros, available at: *http://www.dw.com/mk/македонскиот-јавен-долг-на-алармантни-5-милијарди-евра/а-37364678* [accessed on March 20, 2017]

9 According to the announcement of the Ministry of Finance on March 24, 2017, it is reported that after publishing the data on GDP (revised by the State Statistical Office), the Ministry published on its website the revised data for public and state debt according to the data of the SSO. Accordingly, it is necessary to take into account that small variations in the data for 2016 in this study are possible, compared with those published by the MoF, due to the aforementioned adjustments with the SSO in relation to GDP.

Graph 1. State debt and total public debt of the Republic of Macedonia



Source: *Ministry of Finance of RM*
**State debt (mil. EUR), State debt (% of the GDP), Public debt (mil. EUR), Public debt (% of the GDP)*

As classified by the World Bank, countries with public debt of 40% of GDP are considered low indebted, those with debt of 40% - 60% of GDP are considered moderately indebted and those with debt above 60% of GDP are considered highly indebted countries. According to this, it can be concluded that Macedonia is still moderately indebted country. Our debt is low even when compared with countries in the region. Chart 1 shows the general government debt (i.e. public debt, not including the debt of public enterprises) of the countries in the region in 2015. We can see that in the region only Kosovo and Bulgaria have lower debt from Macedonia. However, Macedonia is also one of the least developed countries in Europe and in economic science is well known that less developed countries cannot tolerate levels of debt as developed countries can. There are numerous examples of countries that have gone bankrupt bearing debt as today Macedonian debt. The most famous is that of Argentina, since 2001, when Argentina went bankrupt, although there was a public debt of "only" 50% of GDP.[10]

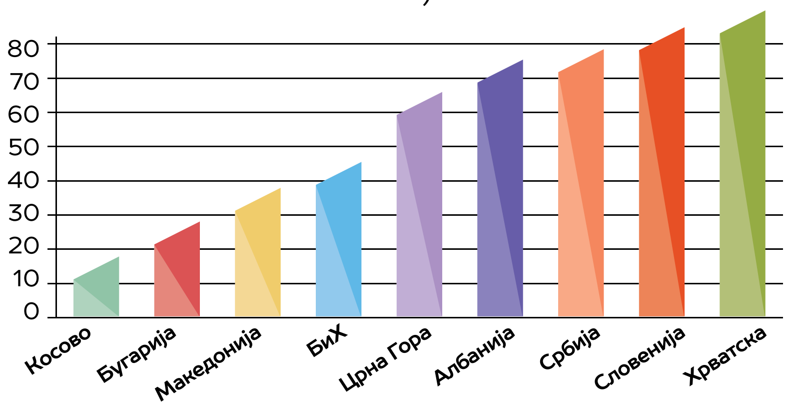
But the real problem with our public debt is not its level. The real problem is that it is growing too fast and funds from borrowing are spent unproductively and irresponsibly for funding short-term political interests, or spent on useless white elephant projects that do not yield the return needed to maintain debt service. Accordingly, there are considerations that most of the money the government borrows are misused, while the effect of credits on economic growth is weak. On the long-run, this behavior calls into question the ability of the state to stay out of default. The consequence is that many loans create illegitimate debts. Irresponsible lending and borrowing and the illegitimate debts it creates constitute a major risks for debt crises. In this sense, borrowing is justified in cases where funds are used for capital expenditures (investments) whose contribution exceeds the cost of financing.

According to some economists, economic growth in relation to borrowing is not sustainable and current growth rates do not actually contribute for improving the standard of living of the average citizen. They have also pointed out that the public debt and the deficit should not be seen only as an economic category, but as a social category in terms of intergenerational problem of generations, especially long-term public debt. It is necessary to have in mind that in the future, according to the maturities of public debt, the funds to repay the debt have to be provided from the budget, which basically means cutting some public expenditures (probably capital expenditures) or raising taxes, or creating new borrowings. All alternatives seem constraining the economic development of the country in the future, which means that the burden of today's borrowings will be borne by future generations. This burden is acceptable and justified if the current and future generations would benefit (for the construction of roads, power plants, hospitals, etc.).[11]

10 Public debt officially exceeded 50% of GDP, available at: *http://prizma.mk/kolumni/polovina-bdp-javen-dolg/* [accessed on April 12, 2017]

11 DEBATE: Does the limit of public debt and deficit guarantee responsible spending of the state?, available at: *http://faktor.mk/debata-dali-ogranichuvanjeto-na-javniot-dolg-i-deficitot-garantira-domakjinsko-troshenje/*, (accessed November, 15, 2016)

Chart 2: General Government Debt, total, % GDP, 2015, Western Balkan (SEE non-EU member states and SEE EU member) countries



Source: International Monetary Fund

When it comes to publication of fiscal data and fiscal transparency, the Ministry of Finance published public debt data for the first time in 2005. Between 2006 and March 2010, it published public debt information every quarter. This was interrupted in March 2010, when the MoF started to publish information on central government debt and publicly guaranteed debt in two different documents. Public debt as of end September was published once a year in the context of the EU pre-accession economic program. This was not in line with international best practice. In October 2014, the Ministry resumed the publication of public debt statistics, including of all the external and domestic debt of the central government, the state owned enterprises (SOEs) and the municipalities, on a quarterly basis. The Ministry also prepares comprehensive annual reports on public debt management which are discussed in the Cabinet and presented to Parliament. The Law states that the annual report should also be published on the MoF website. No requirement currently exists to publish public debt data as an integral part of the annual budget execution report.[12] The last Annual Report on Public Debt Management is prepared for the year 2016 and it is published on the MoF website. At the same time, in terms of transparency, the MoF publishes quarterly data about government and public debt, as well as adjustments to macroeconomic indicators. Following the publication of the data on GDP, the Ministry on its website publishes the revised public and government debt according to the State Statistical Office.

However, there are some methodological challenges regarding calculation and assessment of public debt data. The world's most common systems of reporting of budgetary transactions are those of accrual and cash basis. Macedonian budget accounting is build upon a cash basis, that shows only performed cash income and expenses. In such a case, the debts held by the state and arising from unpaid and overdue obligations are not shown; and if these obligations calculated as public debt, it may significantly increase. The IMF has recommended these international accounting standards since 2001, but Macedonia has not yet accepted them.

Transparency of public finance is one of the key areas as regards the reforms, which should be implemented. Bearing in mind the current situation, the new government has already commenced to implement a number of measures, being indicated in the International Financial Institutions' strategic documents. According to this, transparency in the public finance reporting has been improved. Ministry of Finance changed the structure of its website. In order to increase both transparency and accountability of public finances, special section "Statistics" is added on the official internet site, wherein, all important information is easily available such as: budget execution, public debt and state debt, macroeconomic indicators and statistical data. Monthly and quarterly data on the Budget execution by budget users and municipalities can now be found on this website. The semi-annual report on the Budget execution has been revised. There is also information on overdue liabilities.

12 Report No. 93913- MK FYR Macedonia Public Expenditure Review Fiscal Policy for Growth, World Bank Group, July 2015

These data was not being previously available to the public and it is worth to mention that all these information are published in an open Excel format (instead of previous PDF format) which is suitable for further analysis. At the same time, with aim for the state budget to be more available and transparent for the citizens, MoF prepared a so-called Citizens' Budget, presenting, in an understandable manner, the key information from the state budget to the broader public. This is one of the tools by which MoF creates transparency and accountability of public finances and for the purpose of increasing public awareness, as well as intensifying citizens' inclusion in the creation of governmental documents.[13]

International Monetary Fund has demanded from the government in Macedonia to take urgent measures in order to cut expenses, to start a fiscal consolidation without delay and suggests that public debt should be below 50% of GDP. According to IMF predictions, this year will mark a 2.2% economic growth. Public debt this year will be 47.9%, while in five years it will go up to 54.7% of GDP. [14]

In line with 2015 Article IV consultation, IMF staff recommended keeping public debt below 50 percent of GDP for the following reasons: a) Recent analysis by IMF staff (Modernizing the Framework for Fiscal Policy and Public Debt Sustainability Analysis) that looks at long-run debt thresholds for emerging market economies points to 49-58 percent of GDP as the safe threshold. For Macedonia, which is a small open economy with limited policy space and significant vulnerabilities, a prudent public debt ratio is likely to be at the lower bound of this range rather than the upper bound. A growing body of empirical literature also shows lesser effectiveness of fiscal policy when debt-to-GDP ratio is high. More specifically, for a group of European countries, studies show responses of real GDP and private investment to fiscal stimulus becoming negative when public debt level exceeds 50-60 percent of GDP; b) Macedonia faces significant future spending pressures not just from ageing population, but also from infrastructure investment needs beyond what is planned in the medium term. For a land-locked economy, improving connectivity is key to competitiveness and growth. Choosing a prudent debt limit in the medium term will enhance its ability to accommodate longer-term spending pressures.[15]

Independent regulatory and oversight bodies/ accountability

Democratic government requires that public debt and its medium and long term effects be made transparent. This is only possible if public debt is regularly audited by independent audit body which operates autonomously.

The State Audit Office (SAO) is a supreme audit institution in Macedonia, which aims to promptly and objectively inform the Parliament (Assembly), the Government, other public officials and the general public about the findings from the performed audits. The SAO provides support to the Parliament for execution of its jurisdiction, through identification and presentation of irregularities and illegal operations of audited entities, uncovered with the performed audits. The continuous cooperation between SAO and the Parliament is carried out in several directions as prescribed by the State Audit Law.[16] In line with the Rules of Procedure of the Government, the Audit Committee submits written reports to the Government with opinions and suggestions for measures undertaken upon recommendations in audit reports, and the General Secretary of the

13 Ministry of Finance, *http://finance.gov.mk/*, accessed on September 6, 2017

14 IMF: Public debt higher than 50% is a risk for FYROM available from *http://www.balkaneu.com/imf-public-debt-higher-50-risk-fyrom/ [accessed on March 17, 2017]*

15 IMF Country Report No. 16/356 FYROM, 2016 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT, November 2016

16 State Audit Law, "Official Gazette of the Republic of Macedonia" no. 66/10, 145/10, 12/14, 43/14, 154/15, 192/15 and 27/16

Government informs the SAO on the conclusions of the Government regarding the measures undertaken by the auditees.[17] The SAO is obliged to immediately inform the authorities when there are findings of misdemeanor or criminal act made by some of the audited entities.

One of the main prerequisites for Macedonia's accession to the European Union is the independence and autonomy of SAO. The work of this institution is essential for accountability and responsibility for public spending, which is why the independent functioning of the SAO should be determined by the Constitution. The Government proposed amendments concerning SAO's constitutional independence, but this process has not been resolved yet. Having this said, although according to the Law SAO has certain operational independence for conducting audits, the body adheres the same regulations as any other budget user, and in practice its independence and autonomy are limited from legal and financial aspects.

According to the last PEFA Report 2015[18], SAO does not have the resources needed to carry out a full financial and compliance audit of all its auditees every year, and therefore aims to cover most of them in detail over a period of several years.

Also in the Progress report of the European Commission for Macedonia (2015) was noted that audit coverage has been limited, leaving a majority of public funds unaudited, so improved transparency and accountability could be achieved by developing the capacity of this body. Another particular problem is that the Law does not give jurisdiction to SAO to impose penalties (sanctions) to entities that do not implement the recommendations of the authorized state auditor or has failed to provide feedback for SAO regarding the status of the recommendation. Meaning, the Law does not provide executive provisions for SAO. Also, the authorized organs (State Commission for Prevention of Corruption, the Public Prosecution Office and the Ministry of Interior) have no clear legal obligation to take action upon the notification of the authorized state auditor on reasonable suspicion for a misdemeanor or a felony, and to inform the SAO on regular basis about the measures taken until a final decision is reached by the authorities on a previous SAO notification. Additionally, in the Progress Report 2015 was noted that SAO's annual audit report is discussed in parliament but its recommendations and findings are still not followed up systematically to guarantee that public recourses are used more transparently and have a legal justification.[19]

Public Debt Management

Main principles of public debt management pursuant to Public Debt Law are: financing the needs of the state at the lowest cost, in both medium- and long-term, and sustainable level of risk; identifying, monitoring and managing the risks which public debt portfolio is susceptible to and developing and maintaining efficient domestic financial markets. Public debt management policy is set for a period of three years and it is part of the Fiscal Strategy of the Ministry of Finance. Public debt management policy includes the following: determining the level of the amount (limit) of public debt in medium term; determining the maximum amount of new borrowing in the first year which the Fiscal Strategy refers to; and determining the maximum amount of newly issued sovereign guarantees in the first year which the Fiscal Strategy refers to.[20]

17 State Audit Office of Republic of Macedonia *http://www.dzr.mk*

18 PEFA Assessment on the FYR Macedonia, prepared by John Wiggins, Jean-Marc Philip, Bojan Pogačar and Anto Bajo

19 Progress Report FYROM 2015, available at: *https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/pdf/key_documents/2015/20151110_report_the_former_yugoslav_republic_of_macedonia.pdf*, [accessed on February, 12 2016]

20 Public Debt Law – cleared version – "Official Gazette of the Republic of Macedonia" no. 165/2014

The first thing to do for effective public debt management is to set up fiscal rules. These fiscal rules will be constraints for the politicians in power and will prevent them from funding their own short-term interest and at the same time will enable realization of long-term state interest. For example, one of those rules may be that the targeted budget deficit in the medium term should be 1% of GDP, while the current budget deficit will depend on the realized and potential growth rate of the economy in order to provide an anticyclical fiscal policy. Another rule may be that the growth of the current budget expenditures must not exceed the long-term nominal growth of the economy, in order not to allow the reduction of investments while increasing the current expenditures.[21]

Preparations for the introduction of the fiscal rule, planed for the beginning of 2017, are still on hold. The legal framework for the fiscal rule should include independent monitoring and oversight, as well as other enforcement mechanisms, such as corrective measures to restore deviations over a certain period of time.[22] Almost all EU member states have given their support to introduction of the new fiscal rules legally reinforcing the existing fiscal rule on maximum debt to GDP ratio as was implementation of the "public debt brake" in the form of a rule on low level structural fiscal deficit. Some EU countries even went a step further by imposing additional direct restrictions on national public debt at the level considerably lower than that required by the Maastricht rules.[23][24]

According to World Bank report (2015), debt management and debt reporting have evolved over the past years. All debt management functions were transferred to the Ministry of Finance and there is a new system that is comprehensive and covers all front, middle and back-office functions. Debt is being monitored at the central and local government level by institutions, by stock, flow, interest, and currency. It includes all debt (loans and guarantee) instruments. Currently, NBRM only publishes external debt, while the MoF publishes consolidated general public debt on its website. Recently, the MoF included explicit targets for refinancing needs, interest payments and currency risks in the debt management strategy that accompanies the medium-term fiscal strategy. In an effort to further strengthen debt management and reduce risks, the authorities could consider to strengthen the strategy by including information on the debt of SOEs as well as contingent liabilities, particularly to manage currency risk.[25] However,

21
Public Debt Rules, column by Dragan Tevdovski, Chairman of the SDSM Economy Committee for Utrinski vesnik, 19.07.2016, available at: *http://www.sdsm.org.mk/News.aspx?idNews=2189&lng=1,* [accessed on: August 15, 2016]

22
https://www.imf.org/external/pubs/ft/scr/2016/cr16356.pdf [accessed, April 10, 2017]

23
Moreover, the restrictions in these countries came in a package with the legislation prescribing mandatory government measures to be triggered in case the debt to GDP ratio breaks through a certain barrier for the purpose of preventing public debt from growing in excess of the maximum 60% of GDP limit and pushing it back to a sustainable level. In addition to the rule on public debt imposed by EU which it must respect as a member state, for instance, Slovakia has introduced its own fiscal rule in an effort to prevent overstepping the Maastricht limit of 60% of GDP. Slovakian legislation (Fiscal Responsibility Act) defines public debt in exactly the same way as it is defined under the Maastricht Treaty. To prevent public debt from exceeding the 60% threshold, the country's legislation foresees additional reference values of 50, 53, 55 and 57% of GDP together with measures to be taken at each "crossing point". The aim is to halt the public debt growth before it gets a chance to reach the legally prescribed barrier of 60%. In addition, the rules on public debt are foreseen to be tightened in the coming years by constantly lowering the reference values at the rate of 1%of GDP per year, starting 2018, until each of them is reduced by a total of 10% by 2027 (in other words, the 50% reference value will be lowered to 40% of GDP, the 53% one to 43%, etc.). When public debt crosses the threshold of 50% of GDP, the Minister of Finance is required to present his explanation stating reasons for this and proposing a plan for pushing the debt down and below this value. When public debt crosses the threshold of 53% of GDP, the Government has to present its proposal of measures for decreasing public debt including mandatory pay cuts in the public sector as necessary to bring the salaries back to previous year's level, if indeed they were lower at that time. The pay cuts are triggered at the beginning of the month immediately following the day it is announced that public debt has crossed the 53% of GDP reference value and this measure remains in effect until the level of public debt drops below the 53% of GDP line. When public debt crosses the threshold of 55% of GDP, public expenditures in the following fiscal year are frozen at the same nominal level. When public debt crosses the threshold of 57% of GDP, the Government must ensure that its next year's budget is either balanced or in surplus. In case of violation of the 60% of GDP threshold, this automatically triggers the vote of confidence procedure against the Government. (Source: Highlights 1: New Fiscal Rules for Improved Public Debt Control in EU, prepared by Milojko Arsić and Milan Pejić)

24
Similarly, although Poland's Constitution imposes a limit on the public debt stock (including guarantees) not to exceed 60 percent of GDP, the Act on Public Finance (2005) sets out detailed prudential and remedial procedures if the public debt-to-GDP ratio exceeds 50, 55 and 60 percent of GDP. (Source: Government Debt Management: A Guidance Note on the Legal Framework, A guide for countries in reviewing, updating and developing their legal framework relating to government debt management, prepared by Arindam Roy and Mike Williams, October 2010)

25
Report No. 93913- MK FYR Macedonia Public Expenditure Review Fiscal Policy for Growth, World Bank Group, July 2015

the last Public debt strategy published on the MoF website is for the period 2010-2012, which calls into question the transparency of the data published by this institution. In 2011, in the Public Debt Law a change was introduced in order the Public debt strategy to be part of the Fiscal strategy of the Ministry of Finance, as Public debt policy.

Given the high global economic and financial uncertainty, assessing a country's external and fiscal sustainability is of great significance. The need for this type of assessment is crucial for Macedonia, since the country is a small and open economy, with a fixed exchange rate regime. The analysis of sustainability of debt has long-term and strategic nature and its purpose is to assess the country's ability to finance its programs and activities and repay the incurred debt without major adjustments in the budget revenues and expenditures that may impair macroeconomic stability. [26] Lately, worldwide and in our country, there is a quite popular discussion on "prudent" limits on the amount of public debt, on the amount of public debt as a percentage of GDP in order to be sustainable in the long run with no negative repercussions on the long-term economy growth. In this context, it is important to know whether they are developed countries or developing countries. For developed countries, studies show and refer to the prudential limit of 60% of GDP (this coincides with the Maastricht criteria). In less developed countries and developing countries prudent limit is estimated at 40% of GDP.

Accordingly, our country's public debt of 47.6% of GDP[27] already exceeds this limit. It should be borne in mind that each country has a different capacity of borrowing, which is why this empirically established figure of 40% of GDP should be taken only as indicative and not strictly set "red border" limit. For more accurate determination of the "red border" limit of our country, should do further analysis, including all factors affecting the sustainability of public debt. There aren't many empirical analyses that touch on the problem of Macedonia's fiscal sustainability. In the analysis of public and external debt sustainability, the National Bank of the Republic of Macedonia is actively using the IMF's DSA framework. The IMF's Debt Sustainability Analysis (DSA) framework, as in case of external sustainability, provides analysis of the factors that drive the public debt dynamics.[28]

President of the MASA (Macedonian Academy of Sciences and Arts), Professor Fiti, in his interview pointed out that the creators of economic policies should be extremely cautious about the creation of budget deficits, because they lead to accumulation and growth of public debt. Hence, to avoid further increasing of debt (with all the negative implications arising from it), it is necessary to establish clear momentum of fiscal consolidation, i.e. the reduction of budget deficits, of course, by eliminating unproductive government spending.[29] According to the available data from Ministry of Finance, in the last five years, from 2010 to the end of 2015, the public debt increased by 2.3 billion Euros (from 1.93 billion to 4.23 billion Euros), or from 27.2% to 46.5% relative to GDP. In the same period, as authorities increased the debt for an additional 2.3 billion, the economic impact, expressed through GDP growth, is an average growth rate of just 2.3%.[30] This data about public debt raise the dilemma of whether Macedonian debt is sustainable. According to economists, for sustainable debt is considered the debt whose interest is lower than the rate of economic growth of a country. In our case, as we can noticed from the data released by Research Center for Computer

26
PUBLIC DEBT: CURRENT SITUATION, CHALLENGES AND POSSIBLE SOLUTIONS, prepared by Kire Naumov and Nikola Popovski

27
According to the announcement of the Ministry of Finance on March 24, 2017, it is reported that after publishing the data on GDP (revised by the State Statistical Office), the Ministry published on its website the revised data for public and state debt according to the data of the SSO. Accordingly, it is necessary to take into account that small variations in the data for 2016 in this study are possible, compared with those published by the MoF, due to the aforementioned adjustments with the SSO in relation to GDP.

28
Transmission of external shocks in assessing debt sustainability, the case of Macedonia, prepared by Danica Unevska Andonova and Dijana Janevska Stefanova, 2015

29
MASA stopped counting the public debt, but the public debt did not stop growing, available at:
https://prizma.mk/manu-prestana-da-odbrojuva-no-javniot-dolg-ne-prestanuva-da-raste/,[accessed on February 15, 2017]

30
ibid

Science and Information Technology (MASA), the average interest on debt was 3.3%, and by one percentage point higher than the average growth rate in the last five years. In other words, the capacity of the economy to repay this debt grows at a slower pace than the debt.[31]

Warning also was given by the IMF and the World Bank in a sense that dynamic of the debt growth presents a cause for concern and imposes the need for higher caution in the management of public finances in order not to endanger their sustainability.

31 ibid

Recommendations

- To provide comparability, it is necessary to make a step towards the adoption of the definition set by the IMF.
- Set stricter rules for calculating and presenting the amount and structure of public debt, it is necessary to bring back some of the old rules in the fiscal strategy including clearly defined target levels of government and public debt, as well as limits on new loans for a period of one year, and also the maximum amount of the guarantees.
- Improving fiscal transparency and predictability in Macedonia can be done by introducing the Fiscal Council that would function as an independent expert body established by the legislature, composed of experts in finance and economics. [32]
- Fiscal consolidation – one of the EU recommendations for the country is to develop a proper fiscal consolidation strategy by defining and costing concrete revenue and expenditure measures on a multi-annual basis, whilst protecting growth-enhancing spending. Measures of gradual fiscal consolidation are required, in order for a fiscal space to be created. It is recommendable that each over-performance of revenue i.e. accrual surplus, to be used to lower public debt. To ensure debt sustainability, the primary deficit should gradually decrease, in order to stabilize the debt, and then build fiscal buffers. [33]
- A careful evaluation of spending priorities and determined implementation of the proposed fiscal rule.[34]
- Key focus for policy makers should be on raising the efficiency and effectiveness of public spending.
- External debt sustainability assessments should be carried out by a body which is democratically accountable, but independent of creditors and debtors. They should ensure that lenders act responsibly, which might mean restricting lending where it would be irresponsible. Debt sustainability assessments should also be used to guide whether a government is in need of debt cancellation and help in indicating how much.
- Public debt should be regularly audited by independent audit body which operates autonomously.
- State Audit Office to stand together with civil society organizations (experts in their field) to raise awareness of state institutions for accountability to the citizens.
- The most important is the political will of the ruling majority for a social and political consensus on constitutional and legislative changes, as well as the financial support of the State Audit Office that will allow this body to work independently and efficiently and to achieve its important role for audit and control of spending of the money of taxpayers (citizens).
- The principle of transparency is universal. Taxpayers are, in the end analysis, those who are paying this debt, and it is their basic right to know to whom they are paying the debt and what the corresponding debt is.
- For any fiscal measure which is of great importance, it is necessary to have a public debate supported by empirical research and scientific claims. In this way the country can build stable policies and draft legal changes aimed at building a stable, transparent and responsible system.[35]

32 PUBLIC DEBT: CURRENT SITUATION, CHALLENGES AND POSSIBLE SOLUTIONS, prepared by Kire Naumov and Nikola Popovski

33 Fiscal Sustainability of Macedonia on its path towards the EU, Faculty of Economics- University of “Ss. Cyril and Methodius”- Skopje, prepared by Borce Trenovski and Biljana Tashevska, 2016

34 Report No. 93913- MK FYR Macedonia Public Expenditure Review Fiscal Policy for Growth, World Bank Group, July 2015

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