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ECONOMIC REFORM PROGRAMME

OF

NORTH MACEDONIA
(2020-2022)

COMMISSION ASSESSMENT

The Economic Reform Programmes (ERP) were submitted around end-January 2020 and the present Commission assessment was finalised shortly thereafter in February 2020, supported by a fact-finding mission in mid-February.

The Covid-19-related economic crisis has in the meantime rendered the macro-fiscal scenarios presented in the ERP and in the Commission assessment largely obsolete. The Commission will publish its updated macroeconomic and fiscal projections for candidate countries, reflecting the expected impact of the Covid-19 crisis, in its spring economic forecast in early May 2020.

While the short-term macro-fiscal outlook has profoundly changed, the present Commission assessment also identifies structural reform challenges and priorities, including in the area of fiscal governance, which remain largely valid. Addressing these structural issues will be essential to ensure a sustained economic recovery after the crisis. The Joint Conclusions to be adopted at the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey will accordingly focus this year on the short-term priorities to mitigate the socio-economic consequences of the Covid-19 crisis and on the medium-term priorities to strengthen the foundations of a sustained recovery thereafter. While the Commission assessment does not address weaknesses in the public health system and issues in the social protection system are assessed only as far as they are linked to the key structural challenges, these two areas will feature more prominently among the issues identified in the policy guidance.

Contents

1. EXECUTIVE SUMMARY

Economic growth strengthened in North Macedonia in 2019 and the Economic Reform Programme (ERP) expects the outlook to remain positive. Driven by firming domestic demand and supported by expansionary policies, annual GDP growth accelerated to 3.6% in 2019. Investment rebounded, while the external balance detracted from growth amid slowing export growth. Based on expectations that household and investment spending would be further strengthened, the ERP projects growth to increase from 3.8% in 2020 to 4.3% in 2022. This scenario seems too optimistic because of sizeable domestic and external risks. These concern, on the external side, a greater than expected slowdown in major trading partners, increasing the negative contribution to growth from the external balance, and on the domestic side, lower than projected investment, resulting from weaknesses in public investment management and from a fading reform momentum.

Fiscal consolidation needs to be more ambitious to create buffers while safeguarding the sustainability of public finances. The general government deficit remained below target in 2019, as capital expenditure was again heavily under-executed. The ERP expects the primary deficit to only gradually decrease. However, this seems to be mainly based on the projected rise in economic growth, while policies underpinning consolidation are not clearly identified. Current expenditure is boosted by ad hoc pension increases, the continuation of employer subsidies supporting ongoing wage rises, and a new round of public sector wage increases. Revenue collection suffers from an inefficient tax administration, sizeable tax evasion, and a large number of tax exemptions narrowing the revenue base. Projections for the stabilisation of public debt are subject to marked risks. Creating fiscal buffers would allow the government to be better prepared for the risks that materialise, without having to jeopardise consolidation, while safeguarding growth-enhancing investment spending, which in the past often bore the brunt of fiscal adjustment. Fiscal consolidation and debt stabilisation would also benefit from an enhanced fiscal governance framework.

The main related challenges include:

- **Stabilising the public debt ratio and creating fiscal buffers by moving towards a primary balance through more ambitious fiscal consolidation.** Public debt has doubled since 2008, propelled by the general government's deteriorating primary balance, and off-budget borrowing, in particular from abroad, by public companies carrying out significant infrastructure investment. Measures to lower the fiscal deficit should aim to (i) enhance revenue mobilisation, by raising the efficiency of tax collection and reducing tax exemptions; (ii) raise the transparency, and cost-efficiency of firm-level support schemes; (iii) further reform the pension system and adhere to regular, indexation–linked pension increases; and (iv) strengthen the fiscal governance framework, in particular by putting in place well-designed fiscal rules and setting up an independent fiscal council to monitor the application of the new rules.

- **Boosting growth-enhancing public investment spending and improving investment management to reduce implementation obstacles.** Due to large infrastructure gaps and the low productivity of domestic companies, the country needs to increase public investment spending in transport, energy and education, introduce appropriate measures to ensure projects are smoothly planned and carried out.

- **Domestic companies show low and slowly growing productivity which hinders their competitiveness and integration in global value chains.** This denies them lucrative opportunities and hampers the economy's productivity and growth in competitiveness. Raising competitiveness of local firms will require improvements to human and physical capital and to the business environment, including better enforcement of business regulation and corporate governance, as well as better services including trade and transport logistics. More investment in research and innovation, as well as further regional integration could further support the competitiveness.

- **The size of the informal sector continues to be a challenge for the business environment as it creates unfair competition from unregistered companies.** Undeclared revenues and work also harm public revenue collection and reduce formal employment and its associated benefits, including job security and safety at work. Due to its complex character, reducing this sector will require a well coordinated approach from across the whole of government with high level political steer to include all the stakeholders and measures relevant for reducing informality.

- **Increasing the quality of education at all levels is crucial to improve the performance of the labour market.** The education system is outdated and does not sufficiently equip people with the key competences they need to actively participate in the society and in the economy, thus exposing young people to lengthy transitions from school to work. The implementation of the Youth Guarantee is a strong response for the youth not in employment, education or training. Reforms in the education area and in particular VET area are underway to address the difficult transition from school to work.

The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2019 has been partially implemented. The government suspended the 2019 personal income tax reform and amended the Pensions Law to allow for ad hoc pension increases beyond CPI-indexation. A tax strategy was prepared, but needs to be followed up with decisive policy steps, such as a review of existing tax exemptions to broaden the tax base. The general government debt ratio narrowed somewhat in 2019, largely as a result of under-implemented capital expenditure. The government further enhanced fiscal transparency, but measures to strengthen fiscal frameworks have been delayed. On structural reforms, the government has started to implement the 2018-2020 action plan for the formalisation of informal economy, but most of the activities are still at the initial stage. There is a need to assess the impact of the implemented measures, to widen the scope of the 2020-2022 action plan and to ensure continuous high-level political commitment. A new Law on Inspections was adopted. Further steps are needed to create a register of parafiscal charges and to reduce the time and cost of commercial disputes. In response to high youth unemployment the Youth Guarantee was introduced throughout the country with a particular emphasis on underdeveloped regions. In view of modernizing the education system, the 2018-2025 education strategy and action plan covering the six pillars of the education system is being implemented. However, more budgetary resources and capacities are required. The Law on Social Protection was adopted in May 2019 in order to strengthen the coverage and rights of people at-risk-of-poverty.

The ERP sets out reform plans that are broadly in line with the priorities identified by the Commission. The macro-fiscal framework targets a gradual reduction in the primary deficit, and a marked rise in public investment expenditure, but the concrete policy measures underpinning these goals remain vague. In particular, large-scale support to the private sector and the sizeable financing needs of public companies, coupled with the risk of lower than projected growth, pose a challenge to fiscal consolidation and debt stabilisation. Not all of the planned structural reform measures sufficiently address more fundamental policy reforms that would improve market conditions and address the underlying causes of obstacles to productivity and growth. The impact assessment of the measures could be further enhanced. The reform of the social protection system is contributing to the social inclusion of the beneficiaries at risk-of-poverty.

2. ECONOMIC OUTLOOK AND RISKS

The economic recovery gained speed in 2019, driven by investment and private consumption. After the onset of the economic rebound in 2018, driven by exports, growth drivers shifted in 2019 from external to domestic demand. After 2 weak years, investment recovered, supported by fiscal incentives and solid credit growth. Household spending was fuelled by rising income through higher wages, pensions and social transfers, solid remittances from abroad and stronger credit growth. Export growth decelerated, against a more difficult external environment as well as capacity bottlenecks of established foreign companies, while imports continued to rise at a stable rate.

The ERP expects economic growth to accelerate significantly between 2020 and 2022. GDP growth is projected to increase to 3.8% in 2020,which is 0.2 percentage points (pps) lower than projected in last year's ERP), to 4.1% in 2021 (-0.9 pps), and to 4.3% in 2022. The authorities expect the output gap to turn positive in 2020 and to continue widening in the remaining 2 years of the programme. The main growth driver would continue to be domestic demand, while the external balance would contribute negatively, albeit diminishingly so. Gross investment is projected to increase by 7.8% year-on-year (yoy) on average during this period. This is based on expectations of government capital expenditure strengthening significantly over the programme's horizon, as well as rising private investment, bolstered by different firm-level support schemes, and strong FDI inflows (to average about 3.5% of GDP between 2020-2022), as the country progresses on its Euro-Atlantic path.

Downside risks to the programme's growth scenario prevail. The expected pace of the growth acceleration in 2020-2022, even if revised downwards from the previous year, appears optimistic. The economy is expected to be bolstered by accommodative monetary policy and abundant bank liquidity, which feed credit growth, as well as increases in wages and pensions. Yet, challenges to the scenario include the growth slowdown in major trading partners and key export industries, such as the German car industry, and component supply shortfalls from China, in particular in the automotive supply industry. Some uncertainty also arises from constraints on existing production capacity by established foreign exporters. The authorities expect export capacity to expand through new FDI, but remain rather vague on the nature of this expansion. Moreover, the performance of public and private investment might be less buoyant than projected. Uncertainty during the election period might stall public investment, and induce domestic and foreign companies to postpone their investment. The latter situation may also result from current policy fluctuations, in particular uncertainty over future tax policy, and from weaker reform momentum.

The programme presents two alternative macroeconomic scenarios. The first scenario presumes lower-than-expected growth in the main trade partner economies. This would dampen export growth, by 2.2 pps on average annually compared to the baseline assumption of 6.7%. It would also reduce FDI, lowering the expected growth rate of overall investment (-2 pps on average). Real GDP growth would average 3.1% under this scenario over the ERP's three-year horizon. The second scenario assumes weaker domestic demand, taking into account lower than projected public capital expenditure, as well as a lower impact from public support on private investments, resulting in lower investment growth by 3.8 pps, compared to the baseline. This would be offset only partially by weaker import growth. Real GDP growth would average 3.4% y-o-y under this scenario. This scenario is quite probable, as public investment spending is likely to remain hampered by substantial planning and implementation obstacles. Support for investment at firm level has had only limited uptake under the current schemes, which need to be adjusted to more transparent, efficient and cost-effective.

Consumer prices are expected to rise on account of higher core inflation. Despite an accommodative monetary policy stance and the cut in the policy rate to a record low of 2% in

January, average annual inflation, at 0.8%, remained below official projections in 2019. Food and tobacco prices (due to higher tobacco excise duties) drove the CPI increase, while energy prices dropped slightly. Core inflation amounted to 0.6%. The programme expects consumer prices to rise to 2% in 2021 and to remain at that level in 2022, against the background of strengthening domestic demand and hence a bigger contribution from core inflation, as well as further rises in food prices. It underlines the risk of uncertain commodity price dynamics, in particular of oil. These projections seem plausible. As a small open economy, the country's price level is largely determined by international price developments. As the programme expects output growth to perform beyond potential, rising price pressures from domestic demand are a reasonable assumption. Given marked increases in nominal wages in recent years, which are out of line with productivity developments, and have pushed up unit labour cost, the programme might have further elaborated on the impact of past and expected further wage rises on the price level.

Table:

North Macedonia - Comparison of macroeconomic developments and forecasts

	2018		2019		2020		2021		2022	
	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**
Real GDP (% change)	2.7	**2.7**	3.2	**3.5**	3.2	**3.8**	3.3	**4.1**	n.a.	**4.3**
Contributions:										
- Final domestic demand	1.0	**2.3**	4.6	**5.0**	4.9	**5.2**	4.7	**4.9**	n.a.	**4.8**
- Change in inventories	-0.6	**n.a.**	0.0	**n.a.**	0.0	**0.0**	0.0	**n.a.**	n.a.	**n.a.**
- External balance of goods and services	2.2	**0.5**	-1.5	**-1.5**	-1.7	**-1.4**	-1.4	**-0.9**	n.a.	**-0.5**
Employment (% change)	2.5	**2.5**	4.4	**5.0**	2.2	**2.1**	2.5	**2.3**	n.a.	**2.4**
Unemployment rate (%)	20.7	**20.7**	17.5	**17.1**	16.5	**16.1**	15.5	**15.1**	n.a.	**14.2**
GDP deflator (% change)	4.3	**3.6**	2.1	**2.4**	1.7	**2.2**	2.3	**2.2**	n.a.	**2.1**
CPI inflation (%)	1.5	**1.5**	1.4	**1.0**	1.9	**1.5**	2.0	**2.0**	n.a.	**2.0**
Current account balance (% of GDP)	-0.1	**-0.1**	-1.4	**-1.3**	-2.0	**-1.3**	-2.1	**-1.5**	n.a.	**-1.7**
General government balance (% of GDP)	-1.1	**-1.1**	-2.5	**-3.0**	-2.4	**-2.3**	-2.3	**-2.0**	n.a.	**-2.0**
Government gross debt (% of GDP)	40.6	**40.6**	41.9	**40.4**	42.5	**40.9**	42.7	**40.3**	n.a.	**40.0**

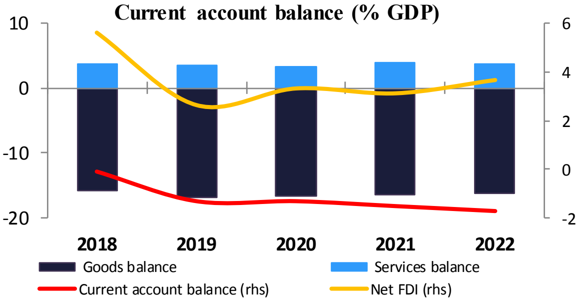
Sources: Economic Reform Programme (ERP) 2020, Commission Autumn 2019 forecast (COM).

External vulnerabilities remain contained, even though the current account deficit is expected to increase. The current account deficit widened in 2019, by 2.7 pps to 2.8% of GDP, which is more than twice the ratio that the authorities expected in the current programme. This resulted from a deterioration in all components. Imports of raw material, capital goods and, in particular, energy, rose in line with exports and investment. The merchandise trade deficit widened, in annual terms, by 1.2 pps to 17.4% of GDP. Remittances from abroad dropped slightly (-0.3 pps to 16.2%). However, the deficit was covered by net inflows of FDI, which amounted to 2.9% of GDP, although this fell from 5.4% in 2018. Foreign exchange reserves were bolstered in 2019 through the disbursement of a World Bank loan and through foreign exchange purchases by the central bank in the context of favourable market conditions. According to the programme, the current account deficit is set to widen somewhat each year until 2022, due to lower private transfers from abroad, and a moderately widening primary income deficit. The goods trade balance is expected to improve slightly, resulting from an assumed decline in the oil price, as well as from expanded export capacities, which in the last decade have been propelled by increasing FDI in higher value-added production such as machinery and equipment. The projection of increased export capacities and an improved goods trade balance seems somewhat inconsistent with the assumptions of a shift in growth drivers to domestic activity, in particular as there is little possibility for import substitution in the domestic economy. In all 3 years, the current account deficit is projected to be more than covered by FDI inflows.

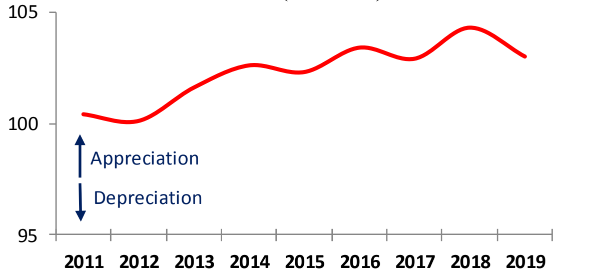
Nominal wage increases pose a growing challenge to external competitiveness. Gross wages increased by 5.1% on average in 2019, propelled by rises in minimum wages - by over 40% since 2017, with another 10% rise planned for 2020 – and in public sector wages. These developments come against the background of largely stagnant labour productivity in the past 10 years, except in the tradable sector, due to the presence of foreign companies. As a result, unit labour costs have risen (by 7.8% year-on-year in the first three quarters in 2019), although they still remain at a competitive level compared to peer countries.

External debt is likely to remain high. Foreign debt continued to rise in 2019, and stood at 72.2% of GDP at the end of the fourth quarter (-1.1 pps compared to end-2018), reflecting mainly increased private sector borrowing, as well as foreign borrowing by public companies, while general government external debt decreased. The programme contains an external debt sustainability analysis, projecting gross external debt to rise further in 2020, and to drop thereafter, to 73% of GDP by 2022, due to both lower private and public sector debt. These assumptions appear largely realistic. The following items point to a reduction in general government debt: i) upcoming repayments of external government debt; ii) the low interest rate environment; iii) favourable borrowing terms; and iv) the ongoing debt management strategy focussing increasingly on domestic issuance point to a reduction in general government external debt. However, large infrastructure investment needs and the expected borrowing of public companies after 2021 might raise external borrowing needs. In addition, inter-company borrowing between established FDI and their parent companies abroad has been rising significantly in recent years. This trend might continue as foreign firms expect to further expand in the country. At the same time, a large share of more flexible and less risky types of debt (intercompany debt and trade flows) mitigates the risks stemming from high external indebtedness.

Graph: **North Macedonia - Evolution of the Current account balance (% GDP)**



Graph: **North Macedonia - Real effective exchange rate (2010=100)**



Source: Economic Reform Programme (ERP) 2020.

The banking sector is resilient, but risks from foreign currency lending are sizeable. Despite gradual change in recent years, banks still dominate the financial sector, accounting for some 83% of sector assets. The banking sector concentration remains moderate and almost unchanged compared to previous years, with some 56.5% of assets held by the three biggest banks in 2019. Banks remained well-positioned to serve the economy's needs. Capital adequacy stood at 16.9% of risk-weighted assets, well above the Basel III requirements. The quality of banks' assets improved further[1]: the share of non-performing loans in total loans stood at 4.8% at the end of the third quarter 2019, which is 0.4 pps lower than 1 year earlier. Liquidity is abundant and the loan-to-deposit ratio dropped further in 2019. Annual growth in lending to the private non-financial sector remained solid, but decelerated (6.3%, down from

[1] The central bank, in 2016, requested banks to write off non-performing loans (NPL) that had been fully provisioned for 2 years.

7.7% in 2018)[2] and amounted to less than expected in the programme, while deposits increased at a slightly faster pace than 1 year earlier, yet also below the programme's projections. Credit growth to non-financial (private) companies increased largely due to increases in long-term lending, which can be taken as a proxy for investment lending, while short-term (working capital loans) declined in 2019. Both, deposit and lending growth are projected to accelerate over the duration of the programme. The authorities are preparing further steps to enhance financial stability in line with the 2018 joint IMF-World Bank Financial Sector Assessment Programme recommendations, including improvement in the macroprudential and supervisory policy framework. The high, though declining share of loans in foreign currency remains a challenge, in the case of a depreciation of the local currency. Following a gradual decrease over recent years, private sector loans in foreign currency still amounted to some 41% of total. A large share of these outstanding loans is with unhedged borrowers sensitive to exchange rate fluctuations, notwithstanding the de facto peg to the euro.

Table:

North Macedonia - Financial sector indicators

	2015	2016	2017	2018	2019
Total assets of the banking system (EUR million)	6 878	7 233	7 513	8 187	8 595
Foreign ownership of banking system (%)	74.8	75.0	70.1	71.4	72.9
Credit growth	9.6	6.5	5.9	7.7	6.3
Deposit growth	6.4	6.1	4.8	8.7	8.9
Loan-to-deposit ratio	90.6	87.0	87.7	86.2	83.8
Financial soundness indicators					
- non-performing loans	10.3	6.3*	6.4*	5.2*	4.8**
- net capital to risk-weighted assets	15.5	15.2	14.2	15.0	14.8**
- liquid assets to total assets	28.2	28.9	29.8	30.6	31.9**
- return on equity	10.4	13.6	13.5	16.0	12.2**
- forex loans to total loans (%)	46.5	44.9	42.5	41.4	42.3**

* including the impact of write-offs.

** September 2019.

Sources: National Central Bank, IMF, Macrobond.

3. PUBLIC FINANCE

In 2019, the fiscal deficit remained much below target as capital expenditure was again under-executed. At 2.1% of GDP, the general government deficit was higher than in 2018 (-1.1%), but much lower than projected in the programme (3%). Revenue collection remained below projections, which was due mainly to lower than expected income from direct taxes, and persistent inefficiencies in collection. According to the government, the introduction of progressive income taxation in January 2019 resulted in lower than expected additional revenue (the government projected an additional 0.2% of GDP), due to increased tax avoidance. Therefore, the reform was suspended for a period of 36 months with a return to a flat tax rate of 10% as of January 2020. The shortfall in tax revenue could not be offset by higher than projected income from social contributions, propelled by a rise in contribution rates effective from January 2019. Current expenditure, too, was carried out at a rate below

[2] A part of this deceleration is due to the extension of the programme mentioned in Footnote 1.

the revised target, mainly on account of lower than projected spending on goods and services. In October 2019, the government adopted a supplementary budget, which raised the funding available for social transfers, including pensions, and for subsidies, at the expense of capital expenditure, while keeping revenue, expenditure and deficit targets unchanged. This reallocation helped finance a 5% public wage increase, as well as a new scheme to subsidise employers for raising net wages, both effective from October 2019. Both of these measures contributed to social transfers and subsidies exceeding their original targets. On the other hand, capital expenditure was again under-executed, even compared to the revised target (with an execution rate of 78%). It amounted to only 3.4% of GDP[3], which is significantly below the rate projected in last year's programme (4.9%), but higher than the 2018 outcome.[4]

Table:

North Macedonia - Composition of the budgetary adjustment (% of GDP)

	2018	2019	2020	2021	2022	Change: 2019-22
Revenues	30.5	32.3	32.0	31.5	30.8	-1.5
- Taxes and social security contributions	27.3	27.7	28.0	27.6	27.1	-0.6
- Other (residual)	3.2	4.5	4.0	3.9	3.7	-0.8
Expenditure	31.6	35.3	34.4	33.6	32.8	-2.5
- Primary expenditure	30.4	34.1	33.3	32.5	31.6	-2.5
of which:						
Gross fixed capital formation	2.1	4.3	4.0	4.3	4.6	0.3
Consumption	9.7	10.8	10.7	10.1	9.5	-1.3
Transfers & subsidies	18.7	19.1	18.6	18.1	17.5	-1.6
Other (residual)	0.0	0.0	0.0	0.0	0.0	0.0
- Interest payments	1.2	1.2	1.1	1.1	1.2	0.0
Budget balance	-1.1	-3.0	-2.3	-2.0	-2.0	1.0
- Cyclically adjusted	-1.4	-2.4	-2.7	-3.0	-3.4	-1.0
Primary balance	0.1	-1.9	-1.2	-0.9	-0.8	1.1
- Cyclically adjusted	-0.2	-1.2	-1.6	-1.9	-2.3	-1.1
Gross debt level	40.6	40.4	40.9	40.3	40.0	-0.4

Sources: Economic Reform Programme (ERP) 2020.

The stated goal of the fiscal strategy is to enhance fiscal sustainability by reducing the deficit. Fiscal consolidation is set to rely on expenditure restraint with the public spending-to-GDP ratio falling by 2.5 pps, equally distributed over 2020-2022. The fall in the spending ratio is mainly driven by lower transfers and subsidies and government consumption, while the share of capital spending is projected to moderately increase[5]. Total revenues as a share of GDP are expected to fall by 1.5 pps, due to a decline in the revenue ratio for both direct and indirect taxes. The general government budget deficit is projected to drop from 2.3% in 2020 to 2% in 2021, and to remain there in 2022. The targets for the fiscal balance in 2020 and 2021 have not changed from the previous year's programme, even though GDP growth assumptions have been lowered substantially. The primary deficit would gradually improve

[3] This figure does not include the capital expenditure by public companies, in particular by the Public Enterprise for State Roads, which is carrying out the biggest share of the government's public road infrastructure works.

[4] In the current programme, the share of government gross fixed capital formation targeted for 2019 is still higher (4.3%) than the realised share.

[5] Compared to the initially targeted capital spending in 2019. When compared with the actual outcome, the increase is much more substantial.

from -1.2% in 2020 to -0.8% of GDP in 2022.[6] In the context of an estimated widening positive output gap, the cyclically adjusted primary deficit gradually increases over the programme period, suggesting a pro-cyclical fiscal loosening. However, the underlying output gap estimate (rising to +4.6% in 2022) is questionable.

The 2020 budget sets out a large rise in capital spending. Compared to the 2019 outcome, the programme projects the general government revenue ratio to increase by 0.9 pps in 2020, and the expenditure ratio to increase by 1.1 pps. The general government deficit is hence projected to rise, by 0.2 pps to 2.3% of projected GDP[7]. This increase is due to the lower than projected deficit in 2019, resulting from the large under-execution of capital spending, which is expected to rise substantially, to 4% of GDP in 2020 from 3.4% in 2019, hence accounting for almost half of of the increase in the spending ratio. The share of social transfers in GDP would remain almost unchanged, while the share of subsidies is projected to drop markedly, from 5.1%[8] to 2.9%, compared to the 2019 outcome. In light of the main measures incorporated in the 2020 budget (see box) nominal expenditure would rise more strongly in 2020 than revenue. Some of these measures raise concerns regarding their impact on the economy. In particular, employer subsidies to incentivise wage rises, as well as increasing public sector wages boost the already strong salary growth of recent years, which is increasingly out of line with productivity developments and might further dampen the outlook on the external balance given rising unit labour cost. On the revenue side, the government has raised social contribution rates by 0.5 pps, which it expects to lead to a substantial increase in this revenue category. At the same time, it has backtracked on the revenue-enhancing progressive income taxation introduced in January 2019.

Box: The 2020 budget

The parliament enacted the 2020 general government budget on 22 December 2019. It targets a deficit of 2.3% of projected GDP, which is 0.2 pps higher than the 2019 deficit. The revenue ratio would rise by 0.9 pps, and the expenditure ratio by 1.1 pps. The main policy measures with a significant fiscal impact are i) the increase in social contributions rates; ii) the suspension of the higher marginal tax rate for high incomes; iii) employers' subsidies to support wage increases; iv) ad hoc increase in pension benefits beyond indexation; and v) increases in public sector wages.

Main measures in the 2020 budget*

Revenue measures		**Expenditure measures**	
• rise in social contributions (+0.15% of GDP)		• employers' subsidies (+0.3%)	
• return to flat taxation in PIT (-0.2% of GDP)		• rise in pension benefits in addition to CPI-indexation (+0.4%)	
		• rise in public sector wages (+0.15%)	
		• VAT reimbursement scheme (+0.4%)	
Total revenue effect	**(-0.05% of GDP)**	**Total expenditure effect**	**(+1.25% of GDP)**

[6] The Fiscal Strategy 2020-2022, adopted in May 2019, projected the primary deficit to drop to 0.8% in 2021, i.e. 1 year earlier than projected in the 2020 ERP. The ERP does not explain the reasons for this revision.

[7] According to the programme, the general government deficit would have narrowed by 0.7ppts in 2020, compared to 2019. Yet, the actual realised deficit in 2019 (2.1%) turned out to be even lower than the target for 2020 (2.3%). This came on the back of a reallocation of budgeted capital expenditure in the supplementary budget, and its under-execution compared to the revised target.

[8] In the programme, the share of subsidies targeted for 2019 was lower (3.5%) than the realised share. The over-execution results from the newly introduced employers' subsidies on the one hand, and from higher than anticipated payments of agricultural subsidies on the other.

* Estimated impact on general government revenue and expenditure.
Source: ERP 2020, MoF information, ECFIN calculations

Public debt is expected to decline after 2021. Driven by high primary deficits, the general government debt ratio increased by some 20 pps in the past decade, but it dropped slightly in 2019. The programme expects it to increase again in 2020, to 40.9% of GDP, and to start decreasing thereafter. The main debt-increasing driver would be the primary deficit, yet gradually less so over the duration of the programme, and, as of 2021, it will be overtaken by a debt-reducing real growth effect. The projections are lower than in the previous year's programme for 2020 and 2021, which the authorities plausibly explain result from lower than anticipated external financing inflows in 2019, and reduced financing needs in 2020. The authorities expect public debt – which includes the debt of public companies - to rise from 48.6% of GDP in 2019 to 50.9% in 2021, and to drop thereafter, as disbursements of loans for public infrastructure works come to an end. These assumptions are also below those in last year's programme, largely due to the lower trajectory of general government debt, but the projected rise in publicly guaranteed debt of public companies has also been revised downwards.

The debt structure has improved, but gross financing needs remain substantial. The government's annual gross financing needs are estimated at around 12% of GDP on average between 2020 and 2022, driven by the rollover of maturing debt. The government plans to meet these requirements by use of domestic and foreign sources, including another Eurobond over the summer. Financing conditions benefit from an improved structure of government debt. The maturities of domestic issues have increased in recent years as the share of 30-yr bonds in the portfolio has been growing. Average time to maturity has risen to 7 years for domestic debt, and to 5.4 years for total debt. The government increased the share of domestic currency debt and is planning to restrict foreign currency borrowing to euro only. Yet, the debt portfolio remains exposed to considerable risk from interest rate developments, given the still high share of domestic currency debt at variable rates. In addition, the share of foreign currency-denominated public debt (over three quarters of the total) remains elevated and creates vulnerabilities in the case of exchange rate depreciation, mitigated by the de facto currency peg, as most of the foreign currency-denominated debt is in euro. The programme takes these risks into account by providing a sensitivity analysis of public debt as regards interest and exchange rate risk. Given the recently lengthened maturities of domestic issues, the government has boosted its potential for domestic refinancing of the maturing external debt.

Debt dynamics

After declining in 2019, the general government debt ratio is expected to rise again in 2020, and to drop gradually thereafter until 2022, to below its 2019 level. In 2020, the debt-increasing stock-flow-adjustment would account for the whole of the change in the ratio. In line with the authorities' expectations for fiscal consolidation, the debt-raising effect of the primary balance would gradually decline over the horizon. The share of interest expenditure in the debt dynamics would remain largely stable for the programme's duration. The contribution of stock-flow adjustments (SFAs) would detract from the debt rise in 2021 and be positive again in 2022. SFAs reflect in large part the expected build-up and drawdown of government deposits at the central bank, related to anticipated borrowing and debt repayments.

Table: **North Macedonia**

Composition of changes in the debt ratio (% of GDP)

	2018	2019	2020	2021	2022
Gross debt ratio [1]	**40.6**	**40.4**	**40.9**	**40.3**	**40.0**
Change in the ratio	1.1	-0.2	0.5	-0.6	-0.3
Contributions [2]:					
1. Primary balance	**-0.1**	**1.9**	**1.2**	**0.9**	**0.8**
2. "Snowball" effect	**-1.4**	**-1.1**	**-1.2**	**-1.4**	**-1.3**
Of which:					
Interest expenditure	1.2	1.2	1.1	1.1	1.2
Growth effect	-1.0	-1.4	-1.5	-1.6	-1.7
Inflation effect	-1.5	-0.9	-0.9	-0.9	-0.8
3. Stock-flow adjustment	**2.6**	**-0.9**	**0.5**	**-0.2**	**0.2**

[1] End of period.

[2] The snowball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator).

The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other effects.

Source: Economic Reform Programme (ERP) 2020, ECFIN calculations.

Achieving the fiscal targets is subject to sizeable risks. The planned fiscal deficit is highly sensitive to lower than projected economic growth, which is a plausible risk given the ERP's optimistic assumptions. Moreover, the deficit would widen if current expenditure was higher than projected, due to further ad hoc increases in social transfers and subsidies, as in 2019 or election-related spending. In the medium and long-term, sizeable fiscal risks arise from the sustainability of pensions, which requires further reforms to the system. Reaching the projected level of government capital investment also poses challenges: in the past, budgeted capital expenditure was regularly reallocated in mid-year to cover unexpected revenue shortfalls or additional expenditure. Moreover, raising the share of government gross fixed capital formation in a cost-effective way requires prior improvements to planning and management. Corporate subsidy schemes, also, need adjustments with regard to improving their targeting and cost-effectiveness, so they can better incentivise growth-enhancing private investment while minimising the costs to the budget. Consolidation of public finances should also be bolstered through further steps to improve revenue mobilisation, such as revising tax deductions and preferential rates, improving capacities to collect revenue, and reducing tax evasion, as discussed in the government's January 2020 Tax Strategy Paper.

Fiscal consolidation needs to be more ambitious to create buffers and protect growth-enhancing capital spending. Due to these challenges, the government should take advantage of the current beneficial macroeconomic climate to step up consolidation efforts, and target a primary balance in the medium-term. This would create buffers to protect against adverse macro-fiscal shocks. It would also enable the government to avoid cutting growth-enhancing capital expenditure in mid-year to deal with pressures from revenue shortfalls or higher than anticipated current spending, without jeopardising fiscal sustainability. Moreover, the combined primary deficit of the general government and public companies, which is exacerbating public debt levels, is considerably higher than the general government primary deficit alone, and would probably require more ambitious consolidation to reach a debt-stabilising level. While general government debt is on a stable trajectory, the development of public debt is subject to uncertainties, in particular the future financing needs of public companies carrying out infrastructure investment.

The quality of public expenditure is projected to improve, but realisation is subject to risks. The 2020 budget and government plans for 2021 and 2022 are strongly focused on fostering social inclusion and equality by means of (i) a reformed and better targeted social assistance framework, (ii) rising pension benefits and wage increases, (iii) developing human capital, and (iv) tackling the informal economy, while at the same time supporting corporate activity. Education and social expenditure has been increased, as a share of GDP, in 2019. This share is expected to remain the same in 2020. Health expenditure has been further stepped up. The government projects a decline in the share of public consumption after 2020, including the compensation of public sector employees, and in social transfers and subsidies. On the other hand, government capital expenditure is expected to increase from 4% of projected GDP in 2020 to 4.6% in 2022. These dynamics would improve the quality of public spending, but realisation is subject to the aforementioned risks.

Sensitivity analysis

The programme includes a sensitivity analysis of the fiscal deficit based on three parameters. If average annual real GDP growth is lower than projected, by 1 percentage point (pp) in 2020-2022, the budget deficit would increase by an average of 0.6 pps per year (or 0.1 pp more than assumed in the previous year's programme for 2019-2021). Lower capital expenditure (70% realisation) would imply a reduction in GDP growth by 0.7 pps per year and an increase in the deficit by 0.4 pps; reduced tax collection by 5% per year would imply a budget deficit of 3% on average in 2020-2022 (compared to 2.1% in the baseline scenario). The programme also assesses the potential impact on public debt developments from higher interest rates and a 10%-appreciation vis-à-vis the euro of other currencies in the portfolio.

While the transparency of public finances has further improved, fiscal governance frameworks need to be strengthened. The government took steps in 2019 to increase the information on the finances of public enterprises. It has set up a new web platform on public debt and has amended the Public Debt Law of May 2019 to also include the non-guaranteed debt of public companies into the definition of public debt. However, the government has not yet finalised its review of which extra-budgetary units need to be included in general government fiscal documentation where required by international statistical standards. The transparency of the new State aid regime also needs to be improved, in particular by creating a central State aid registry. Furthermore, significant improvements to the fiscal framework are still pending. The new organic budget law, which provides for fiscal rules and a fiscal council was expected to be subject to public consultation in March 2020, but the government expects a lengthy implementation period due to complex technical and procedural requirements. However, some parts of the new law, in particular those relating to fiscal rules could be adopted and implemented under a faster procedure, such as an amendment to the current budget law. North Macedonia is the only country in the region that does not yet have a set of fiscal rules. In order for future fiscal rules to fully deliver the intended benefits, a proper medium-term budget framework, more realistic macroeconomic forecasts, and better control of expenditure commitments need to be put in place.

4. Key Structural Challenges and Reform Priorities

This chapter provides the Commission's independent analysis of North Macedonia's economy and identifies the main structural challenges. Each of these challenges influences the overall competitiveness in its own way. However, as the challenges are very often mutually reinforcing, it will be essential to address them in the medium-term to boost productivity and inclusive growth. The three most important challenges identified are: (i) improving the quality and relevance of education system, (ii) increasing the competitiveness of domestic companies and their integration into global value chains and (iii) formalisation of the economy.

The education outcomes are not sufficiently linked with the needs of the labour market which prolongs the transition from school-to-work, feeding the informal economy and poverty. The informal economy distorts competition, decreases the quality of the business environment, leads to a shortfall in public revenue and leaves some workers without social protection or with limited rights. By failing to address the underlying obstacles which drag down the competitiveness of domestic companies, firms are missing lucrative opportunities to integrate into global value chains, which would enable them to further increase their productivity and positively influence the country's trade balance and growth prospects.

North Macedonia also needs to tackle corruption, improve the rule of law and strengthen institutions in order to promote competitiveness. Addressing these fundamental concerns is a prerequisite for successfully transforming the economy. The Commission is closely following the issues concerning the strengthening the rule of law and the fighting of corruption in the annual North Macedonia report.

Key challenge #1: Improving the quality and relevance of the education system

In 2019 North Macedonia recorded its lowest unemployment rate of the decade, but unemployment remains a prominent issue in the country. The overall unemployment rate (15-64) decreased from 32.3% in 2009 to 17.4% in 2019, but it still remains high compared to the EU-28 average (6.3%). People with lower level qualifications and less represented ethnic groups are prominently affected, notably in underdeveloped regions and rural areas. A strong regional disparity is illustrated by the unemployment rate of 35.9% in the Northeast region compared to 10.9% in the Southeast region in 2018. The labour force participation rate and employment rate remain low. The activity rate is rather solid by men (67.8%) compared to women (46.6%) but increasing by 2 pps for this group year on year. While the labour force participation rate (15-64 year-olds) increased only slightly between 2018 (65.4%) and 2019 (66.3%), the employment rate (15-64 years-olds) increased more substantially from 51,7 % by 3.0 pps to 54,7% over the same period. The increase 2018-2019 benefiting more to the 15-24 cohort (+3.7 pps)

People with at least 3 years of secondary or vocational education have higher chances of being employed. Youth unemployment (15-24 year-olds) decreased sharply from 45.4% in 2018 to 35.6% in 2019 while the drop was limited to 2.6 pps for the 25-49 age group in the same period. However, most of those who benefited had at least 3 years of secondary education. The 2018-2025 Education Strategy mentions that around 53% of new jobs are related to the secondary vocational education and 34% to lower levels of education, which illustrating the importance of the education level for the school-to work transition. According to the strategy, it is expected that 62% of jobs to be created will be suitable for those with a secondary or vocational education while 10 % will be suitable for those with a higher-level education.

The education system in North Macedonia is outdated and does not sufficiently equip people with the key competencies they need to actively participate in the society and in the economy. It does not respond to the labour market needs which contributes to lengthy transitions from school to work. In the 2018 PISA study, the country improved by 7 places compared to the 2015 PISA results. However it still ranks 11th from the bottom out of 78 countries that participated in the assessment. The assessment confirms the very low quality of the country's basic education and is symptomatic of a weak education system which contributes to persistent youth unemployment and the underuse of the young people's potential. The preparedness and the evaluation of teachers is perceived as a concern by schools principals (OECD, 2018). The initial and continuous training of teachers is key to improving the overall quality of the education system. In practice, there is no common system to evaluate teachers and their competences and to incentivise good teaching methods. The OECD also signals the suppression of the growth mindset, resulting from the years of promotion based on clientelism rather than merit as a problem in North Macedonia. Young people rarely see positive examples and role models that highlight how investing in education benefits people. Even those investing in their education plan would prefer to benefit from it outside the country.

The educational system of North Macedonia lacks sufficient funding to effectively respond to its growing challenges. The Public Finance Review (2019) indicates that between 2011 and 2016, public spending on education as a share of GDP slipped down from 4.62% to 3.77% of GDP. Even if North Macedonia spends slightly more on education than most Western Balkans countries, the country lags behind the EU-28 average by 0.8 pps. The lack of finance in the education system contributes to the lack of innovative and updated methods of teaching and study environment, limited professional development opportunities and incentives for teachers and school leaders, at all levels of the education. In addition, the financing of the primary and secondary schools is shared between the state level and municipalities, contributing to a lack of controls by the state level and allowing political interferences at the local levels including in the recruitment of teachers.

Although North Macedonia made efforts to create and improve early childhood education and care infrastructure, there is still a lot to do to reach the EU benchmark of 95% of children participating in early childhood education. Pre-school enrolment for children aged 4 until compulsory primary passed from 22% in 2012 to 40.6% in 2018 which is a positive improvement although the number of preschool facilities is insufficient particularly in rural areas. Traditionally, a significant number of parents believes that it is better for children to be at home than at preschool. Investing in early childhood education and care is of high importance not only for reducing inequalities at a young age, but also for preventing the risk of poverty and exclusion in adulthood. Therefore, it is recommended to adopt integrated and child-centred approaches targeting all aspects of child development and well-being and further strengthen the coordination and interaction between the health, education, social and child protection systems as well as integrated and coordinated delivery of services delivery at local level

Weaknesses in the education system leave young people subject to lengthy transitions from school to work. According to the 2017 Labour Force Survey (LFS), out of a population of 74 792 young people aged 20-29, 45% stay unemployed for 4 years and longer after finishing school while only 7.3% will stay unemployed for less than 1 year. The transition to the working environment is even more difficult given the composition of companies in the country where 79% are SMEs. In addition at the end of 2018, the LFS indicates that nearly 1 young person out of four (24.14%) is not in education, employment or training compared to 1 out of 10 in the EU. The manufacturing industry confirms the shortage of a skilled labour force as the main factor that limits the production volume ahead of insufficient demand and uncertainty over the economic environment (State Statistical Office, 2020).

To tackle the lack of employment prospects young people develop various strategies. Facing unemployment, young people stay unoccupied or continue their studies in branches with lower employment prospects such as social sciences or humanities. In addition, these students are more likely to feed the informal market to finance their precarious life. Another option for them is to leave the country. The Skopje-based Institute for Strategic Research and Education mentions (2018) that 69% of university professors are willing to leave the country for better jobs, even those that are below their level of qualifications. The Association of

Private Doctors of North Macedonia confirm this statement by underlining that while 220 doctors graduate annually from the Faculty of Medicine, 173 apply for work abroad.

The reform measure 15 (Youth Guarantee) in this year's ERP is rolled over from the previous year. North Macedonia was the first non-EU country to introduce an adjusted form of the Youth Guarantee. The authorities identified its implementation in 2018 as a high priority by the authorities to tackle the high level of youth unemployment and in particular those not in education, employment or training. The creation of a specific unit for youth employment in the Employment Agency is welcome for coordinating and monitoring of activities related to the transition from school to work, particularly since the enactment of the new Law on Social Protection unexpectedly increased the number of registrations well over the numbers estimated. As well as unemployed young people, the Employment Agency and Centres for Social Work need to help those in society who are most vulnerable with integrated services and measures for inclusion in the labour market. Therefore the use of well-functioning IT programmes should accompany the further recruitment and the training of staff to manage the flow of new entrants and to ensure the monitoring and a proper evaluation (data collection) of the activities. It is also recommended to use the EU Youth Guarantee's indicator framework and the EU Youth Guarantee methodological manual.

The importance of non-formal education and informal learning is particularly high in North Macedonia, indicating that the formal education system is not providing individuals with the necessary skills to enter the labour market. According to the Adult Education Survey (2016), 18.2% of people aged 25 to 64 participated in formal and non-formal education and training. But it indicates also that a very large majority participates mainly in non-formal education and informal learning. The highest share in this informal learning process was registered among people aged 25 to 34. There are also important regional disparities: someone living in an urban area has almost three times more opportunities to participate in formal and non-formal education and training than someone living in a rural area (State Statistical Office, 2016). The prerequisites to attend adult education, the cost, the schedule, the distance and the difficulty in accessing to a computer or internet represent major obstacles. Although adult education is promoted by the authorities, less educated and socially disadvantaged adults are practically excluded from opportunities to upgrade their skills and knowledge through adult education and training programmes.

Reforming the education system is a matter of priority to ensure economic growth and people's well-being, but this reform needs to be properly funded. The quality education and training system in North Macedonia could contribute to a more productive economy and help domestic companies become more competitive, allowing them to make the most of the potential offered by digital technologies and link with the regional and European global value chains. The country's budget could translate in practice the political will to invest in real improvement of the human capital. Education spending for 2020 shows that, while the sector will receive €11 million more than last year, over 60% of the budget will be spent on wages, including the planned wage increase, leaving limited funds for structural improvements.

Fundamental and serious reforms have already been introduced under the 2018-2025 education strategy and related action plan. The document covers all areas of the education system where improvements are needed, in particular quality controls, increasing of the pre-school coverage and use of new technology. The implementation of the strategy also aims to ensure a better link between labour market demand and better career guidance for students. Together with authorities, public and private education providers should commit to supporting the employability of students and young people by closely involving the employers and the business sector. The adult education and training offer needs to be aligned with key priorities of the economy (for instance in terms of digital skills, entrepreneurship and innovation). The government has undertaken the overall review of the whole legislative framework of the education sector. The pace of this review is a crucial step for the integration of ongoing reforms at system level. However, there is a lack of monitoring and reporting mechanisms in place.

The reform measure 14 (further developing the qualification system) in this year's ERP is rolled over from last year and is relevant for improving educational outcomes and the skills mismatch. The adoption of the 2018-2025 education strategy and the related action plan, laws and by-laws clearly signals that education is the top priority for the authorities, which are well aware of the challenges. The measure clearly justifies the need for developing a modern qualification system throughout the whole country to address issues such as (i) the high youth unemployment rate, (ii) long transitions from school-to-work, (iii) inadequate teaching method, (iv) obsolete learning conditions and (v) limited exposure of students and teachers to the world of work. However, it is clear that strong leadership and coordination will be required to carry out the measures envisaged with the action plan. The modernisation of three regional VET centres is key but further development of such 'centres of excellence' is needed throughout the whole country. The financial resources indicated in the ERP's measure (around €8 million) look modest compared to the challenges identified.

Key challenge #2: Improving the competitiveness of domestic companies and integration in global value chains

Domestic companies' low and slowly growing productivity hinder their competitiveness. Local businesses suffer from unsophisticated technology, limited capacities of production and innovation, inconsistent quality of goods and services, deficient managerial skills and competition from a large informal sector. Further constraints result from the skills mismatch in the labour market and a complex application of business regulations. Raising the competitiveness of local firms will require improvements to human and physical capital and to the business environment, including better enforcement of business regulations and corporate governance, as well as better services including trade and transport logistics. More investment in research and innovation, as well as further regional integration could further increase productivity.

North Macedonia still only participates to a relatively low extent in global value chains (GVCs) which represent 80% of global trade (IMF, 2019). Measured with the GVCs participation index as a percentage of GDP, North Macedonia scores lower than its aspirational peers but similar to Serbia as the leaders in the Western Balkans (IMF, 2019)[9]. The country's links to GVCs are still predominantly concentrated in services and low- to medium-value manufacturing products, bringing only limited benefits to the rest of the economy (IMF, 2019). Stronger integration of North Macedonia's companies into these networks could further enhance productivity and income, and the sharing of knowledge and technology, as well as facilitate finer cross-border division of labour and better availability of inputs. However, there is a need for targeted public policies in order to reduce the underlying structural obstacles dragging down the growth of domestic companies' competitiveness and their integration in these networks.

The potential for linkages between domestic and foreign companies established in the country is not sufficiently used as a vehicle for productivity growth. Multinationals operating in the country perceive insufficient technological development, weak adherence to

[9] Global Value Chain participation index (in % of GDP) is 31% for North Macedonia, 32% for Serbia, 29% for Montenegro, while the same indicator is 51% for Bulgaria, 66% for Estonia, 80% for Slovakia, and 49% for Hungary.

quality requirements, lack of compliance with international standards and certificates as well as limited production capacity of domestic partners as the main weaknesses constraining their integration with domestic industry (Finance Think, 2019). The authorities should facilitate technological upgrading and investment in reliability and quality of production, and support companies in developing their technological capacity. North Macedonia is currently preparing its smart specialisation strategy which will be based on the mapping of economic, innovative and scientific potential in the country. The strategy should be used to further develop policy strategies in different fields such as skills, research and innovation, and attracting FDI.

Rather than tackling the underlying structural challenges and business environment issues, the government's flagship policy to attract FDI and improve domestic firms' competitiveness relies on providing various forms of State-aid to businesses. Rather than improving business performance, those State aid schemes have a distortive effect on the market. Based on the Law on Financial Support of Investments, support is provided to companies without a clear policy objective. Furthermore, the law has certain features that are problematic in view of the EU *acquis* on State aid. The recently adopted Law on Strategic Investments, aims to support so-called strategic projects, lacks policy elaboration and implementing regulations. There is an urgent need to develop a comprehensive and transparent registry of State aid and to create a more effective State aid notification system. More action is needed to monitor these schemes' cost-effectiveness and their impact on competitiveness, to ensure coordination of different programmes, and to strengthen the capacity of the Competition Agency and of the institutions providing State aid.

The regulatory framework's lack of transparency and predictability negatively affects the business environment and the competitiveness of domestic companies, in particular that of SMEs. Increasing the efficiency and transparency of public administration, reducing the time and costs of commercial disputes and promoting alternative dispute resolutions mechanisms would address some of the factors limiting the competitiveness of domestic companies. Increasing the transparency of parafiscal charges by creating a register of such charges at central and local level would also help companies to do business. Further efforts to simplify the access to public services and ease enforcement procedures to be more business friendly could increase productivity, in particular that of SMEs. The law on inspection supervision adopted in 2019 aimed to streamline the inspection procedure. Among others, it envisages warnings for minor infractions and grace periods for corrective actions. However, 'risk based assessment' inspections will only begin in 2021 and rulebooks for their implementation are still lacking. Fully implementing the law and establishing transparent and consistent procedures for inspections would increase the ease of doing business. Swiftly setting up a fully operational on-line 'one-stop-shop' system for all business-related permits and licences could have an additional positive impact on the business environment.

Further developing sectors for certain services can be an opportunity for domestic companies. Services such as logistics, transportation and information and communication technologies are fairly unsophisticated at present, which forces foreign companies to use alternatives outside the country. According to multinationals operating in the country, 91% of services can be found in North Macedonia. However, 30% of the companies surveyed found these services not to be of the required quality standards (Finance Think, 2019), which is also reflected in the relatively small export share of service industries. A shift to policies in support of upgrading services closely linked to creative industries could allow the country to increase the significance of services for productivity and value creation.

The education system of North Macedonia is not sufficiently coping with the needs of the labour market and technological progress. There is a significant mismatch between the skills that can be acquired through education and the needs of the labour market. This continues to obstruct companies' competitiveness and their stronger integration into the global economy. Further focus should be put on improving the quality and relevance of VET. Developing systems for work-based learning would help increase the relevance of training and provide an interface between firms and the education system and students. Furthermore, promoting life-long learning and the strengthening of informal education should help to improve workforce technical and managerial skills needed to raise productivity in companies and in industries of higher productivity.

Implementing the Regional Economic Area multi-annual action plan (REA MAP) has the potential to enable competitiveness to grow. The REA MAP is based on EU standards and will help the country to integrate in regional and European value chains and will also help increase the attractiveness of the economy for FDI in tradable sectors, notably by extending the market size. Further connectivity with neighbouring countries in transport and energy will strengthen the access to, and integration into, the regional market. The new Additional Protocol 6 of the Central European Free Trade Agreement (CEFTA) agreement to liberalise trade in services also opens new opportunities in the dynamic service sectors, and therefore should be implemented swiftly. Regulatory and investment moves towards creating a regional digital space and more integrated labour markets with neighbouring economies will offer new possibilities for the country's young people, which is also important in light of the high youth unemployment.

Key challenge #3: Formalisation of the economy

The informal economy remains high both in the share of total output and in the number of people employed. While the State Statistical Office estimates that the informal economy amounts to 17% of output and 18% of total employment, other estimates suggest that the share could also be as high as 37.6% of GDP (IMF, 2019). The country's informal sector takes various forms of which the most prominent are unregistered labour, partially undeclared wages and other irregularities in the enforcement of the Labour Relations Act. Other practices common to the informal economy include not issuing tax receipts or invoices or reporting lower turnover. The growing freelance work and personal services provided at homes or via the internet often go unregistered.

Undeclared labour remains an issue which persists despite some improvements in the labour market. The sectors with particularly high labour informality are agriculture, construction and various types of household services. A large proportion of the population continues to declare as inactive while likely being engaged in some undeclared activity. In 2019, 42.8% of the population was classified as inactive, almost 16 pps higher than the average EU rate. This figure remains largely stable despite the growing employment (47.4% in 2019), the lowest unemployment rate historically (16.6% in 2019) and an increase of net wages in nominal terms.

Partially unregistered labour and undeclared wages are also prominent with income being partially or completely undeclared by almost 44% of employees. According to the estimates 27.6% of employees' social security contributions are paid at a level lower than that which would correspond to the actual salary received (Centre for Research and Policy Making, 2019). Almost 74% of individuals engaging in additional work to their primary source of employment do so without a formal contract (CRPM, 2019). These workers' social and health benefits are not paid in full, nor are their rights as workers protected.

The widespread acceptance of this phenomenon contributes to the persistence of informality. A recent population survey indicates that only 1.6% of individuals in the country highlight the informal economy as one of the three basic problems in the country (CRPM, 2019). Furthermore, 21.1% of individuals are willing to participate in undeclared work in order to get a higher wage (CRPM, 2016). Both employees and employers benefit from the arrangement: the employer makes savings by not paying contributions for the actual amount exceeding the fictitious wage being reported, and the employee gets a higher net salary. The perception of insufficiently high quality public services such as healthcare and education also discourages voluntary tax compliance. As the system designed to protect their rights is not perceived as efficient and just, many employees are likely to willingly forgo institutional protection of their legal labour rights.

The high proportion of cash transactions and the related practice of not issuing tax receipts remain an issue. Based on the 2018 anti-money laundry and fighting terrorism law, the maximum amount allowed for cash payments had been gradually reduced to €500. However, the government abruptly changed the law in 2019 and increased the maximum cash payment to €3,000. Promoting electronic payments and limiting the use of cash, in particular for higher value purchases, would likely help reduce activities in the shadow economy.

The high level of informality contributes to lower productivity and competitiveness as well as to increased inequality. The high level of informality reduces the amount of tax revenue received by the government. Production in the informal sector is often inefficient, either because firms remain small enough to avoid being detected or because they use outdated production technologies. Firms operating in the informal sector also have more limited access to finance, which constrains investment, and access to qualified labour. Even though they do have some access to social security, informal employees are more vulnerable in case of work-related injury, when they lose their job or retire. High levels of informality also affect the overall level of human capital in the economy as informal workers have less access to training, exacerbating skills shortages. This ultimately generates greater inequalities.

Competition from the informal economy remains one of the main obstacles for doing business as perceived by registered businesses in North Macedonia. According to the latest Business Environment and Enterprise Performance Survey (BEEPS, 2016), the practices of competitors in the informal sector are seen as the main obstacle for businesses in the country: 56% of companies cite competing against companies in the informal sector as a main challenge, exceeding the average for Southeast Europe by 7 p.p.

Reducing the informal economy requires appropriate institutional set up. Strengthening the skills, expertise and powers of tax officials, improving judicial efficiency and ensuring inspectors have greater independence are key in the fight against the informal economy. Ensuring adequate and timely enforcement of contracts and increasing the transparency of legal changes will increase predictability in the business environment and decrease the incentives to participate in informal activities. Clarifying the mandates of various inspections, increasing their skills and further digitising processes, notably on labour law and occupational safety, would also help to reduce informality.

North Macedonia has recently introduced a number of fiscal measures that could have a significant impact on the informal economy. Notably, limited refunds of VAT to citizens under the ‘my VAT’ project were introduced and the measure is expected to increase trader’s tax compliance. In an attempt to transfer some benefits of the positive economic environment to citizens, the country has also increased the statutory minimum wage and introduced subsidies for employers’ social security contributions to mitigate the impact of wage increases. The increase in formal wages propelled by the government’s policies could lead to incentives for informal employment. The impact these measures could have on the informal economy needs to be considered, monitored and regularly assessed. Furthermore, frequent and sudden policy changes related to taxation, such as suspending the application of progressive taxation, as well as the high level of tax exemptions, create distrust among taxpayers over whether they will receive equitable treatment, and have an adverse effect on voluntary tax compliance. Further simplifying the tax and social benefits system to reduce the number of exceptions, and not necessarily the tax rate, could reduce tax compliance costs and reduce informality.

In an effort to address the informal economy, North Macedonia developed a 2018-2022 medium-term strategy and an action plan. The strategy was developed using a participatory approach and reflects the latest OECD recommendations. It recognises that deterrent measures alone are not enough to effectively reduce the informal economy and that its underlying causes such as weaknesses in the labour market and business environment need to be removed. However, in 2019, only partial progress was made in implementing the measures set out in the action plan. The impact of the measures undertaken needs to be regularly assessed and measures adjusted accordingly. In order to ensure that the wide set of measures in the strategy are implemented and to address the underlying causes of informality, they need to be further integrated in other sectors' policies and action plans. A positive example is the inclusion of the measures to combat the informal economy directly in the new 2018-2023 SME strategy.

A fully coordinated government approach with high-level political steer is needed to successfully review and implement the action plan in 2020-2022. The updated action plan should be wider in scope and should consider all the relevant areas and stakeholders when it comes to tackling the informal economy. The new action plan would benefit from further measures targeting overall societal acceptance of informality given that 52.4% of population considers it as an inevitable part of their life. All fiscal initiatives relevant for informal sector, such as changes in minimum wages and taxation should be taken into account. Furthermore, measures related to digitalisation of processes in public administration as well as the introduction of risk based audits should be considered as they would reduce bureaucracy and the opportunity for corruption. Considering that e-commerce is a growing industry with a high propensity to informality, the subsequent plan could also benefit from actions in this field.

The reform measure 10 (reducing the informal economy) in the ERP is rolled out from last year and is in line with the Commission's assessment. The measure aims to implement the 2018-2022 strategy for formalising of the informal economy. The strategy identifies three salient motives for engaging in informal business activities, but these are not properly addressed by the measure's activities. The measure focuses mainly on employment policies while ignoring other important aspects contributing to the informal economy, such as the overall business environment or taxation. For the area of taxation, the Ministry of Finance is drafting an ad hoc action plan to address the fiscal aspects of informality, but this should be integrated in the overall revised 2020-2022 action plan. Most of the activities included are based on more stringent monitoring and inspection. The measure also suggests implementing awareness-rising activities on the benefits of transition to the formal economy, and introducing a voucher-based system to promote better working conditions. However, it remains unclear how these will be put in place or implemented. The expected positive impact of the measure on competitiveness is not sufficiently quantified and the impact on employment and gender is not sufficiently considered.

Box: **Monitoring performance in light of the European Pillar of Social Rights**

The European Pillar of Social Rights, proclaimed on 17 November 2017 by the European Parliament, the Council and the European Commission, sets out 20 key principles and rights on equal opportunities and access to the labour market, fair working conditions, and social protection and inclusion for the benefit of citizens in the EU. Since the 20 principles are essential for countries if they are to achieve fair and well-functioning labour markets and welfare systems, they are equally relevant for candidate countries and potential candidates. The new reinforced social dimension for the Western Balkans includes an increased focus on employment and social reforms through greater monitoring of relevant policies (EC, 2018). The Western Balkans Ministers' Declaration on improving social policy in the Western Balkans (6 November 2018) confirms that they will use the Pillar to guide the aligning of their labour markets and welfare systems with those of the EU.

North Macedonia faces challenges for a number of indicators of the Social Scoreboard[10] supporting the European Pillar of Social Rights. This is particularly the case for equal opportunities and access to the labour market. The employment rate, despite increasing in recent years, is still well behind the EU-28 average. The main reasons for such a low performance in activity and employment are the gender gap and youth unemployment. Informal and precarious work affects a large proportion of workers and one out of three young people has only a temporary work contract.

NORTH MACEDONIA		
Equal opportunities and access to the labour market	Early leavers from education and training (% of population aged 18-24)	Better than EU average, improving
	Gender employment gap	Worse than EU average, deteriorating
	Income quintile ratio (S80/S20)	Worse than EU average, improving
	At risk of poverty or social exclusion (in %)	Worse than EU average, no change
	Youth NEET (% of total population aged 15-24	Worse than EU average, no change
Dynamic labour markets and fair working conditions	Employment rate (% of population aged 20-64)	Worse than EU average, improving
	Unemployment rate (% of population aged 15-64)	Worse than EU average, improving
	GDHI per capita growth	N/A
Social protection and inclusion	Impact of social transfers (other than pensions) on poverty reduction	Worse than EU average, improving
	Children aged less than 3 years in formal childcare	Worse than EU average, improving
	Self-reported unmet need for medical care	Worse than EU average, improving
	Individuals' level of digital skills	Worse than EU average, deteriorating

The Youth Guarantee has been successfully introduced on the whole territory to tackle youth unemployment, which mainly affects the country's poorest region. Improving coordination between Public Employment Service (PES) and other services like social work centres, associations, social service providers, health sector, municipalities which have legal obligations to provide additional forms of social protection support, is another prerequisite for the success of the social reforms package and activation of the most vulnerable.

Despite the fact that large progress has been made in terms of the design and implementation of ALMPs, North Macedonia is still at an "inception" level in terms of evaluation of the measures. The Public Employment Service could make better use of its well developed IT system to track the labour market status of ALMPs participants on short and medium terms. Comprehensive impact evaluation study of the ALMPs are recommended as well as increasing the capacity of the PES.

The reform of the social protection system aims to increase coverage. The law on Social Protection adopted in May 2019 redefined the financial transfers and associated rights for households with low or no income. The Guaranteed Minimum Assistance (GMA) introduced higher amount of support, access to additional rights like child allowance, education allowance as well as strengthened emphasis on activation. Most at risk of poverty remain young people, those without education and ethnic community such as the Roma.

North Macedonia has a well-developed statistical system. The State Statistical Office is the primary producer and coordinator of the statistical system of the country. Since 2004, the Labour Force Survey (LFS) has been carried out as a continuous quarterly survey throughout the year, providing quarterly and annual statistics. The Survey on Income and Living Conditions (SILC) is conducted as a regular annual survey and has been implemented since 2010.

[10] The Social Scoreboard includes 14 headline indicators, of which 12 are currently used to compare Member States performance (https://ec.europa.eu/eurostat/web/european-pillar-of-social-rights/indicators/social-scoreboard-indicators). The 12 indicators are also compared for the Western Balkans and Turkey, with one small adjustment for the age bracket for the unemployment rate (reducing the upper age bracket to 64 instead of 74 years) due to data availability. The assessment includes the country's performance in relation to the EU-28 average (performing worse/better/around the EU-28 average, generally 2018 data are used for this comparison) and a review of the trend for the indicator based on the latest available three-year period for the country (improving/deteriorating/no change). Data from 2016-2018 are used and can be found in Annex A.

5. Overview of the Implementation of the policy guidance adopted at the Economic and Financial Dialogue in 2019

Overall: Partial implementation (46.7%)[11]	
2019 Policy Guidance	**Summary assessment**
PG 1: Stabilise the debt ratio by moving towards a balanced primary budget while implementing the budgeted capital expenditure	There was **limited implementation** of PG 1: 1) **Limited implementation**: The central government primary deficit widened from 0.6% in 2018 to 0.8% of projected GDP in 2019. This deterioration came on the back of a strong increase in current expenditure (pensions, subsidies, public sector wages), and despite solid annual revenue growth. The general government (GG) debt ratio narrowed in 2019 by 0.4 pps to 40.2% of GDP, and hence turned out lower than projected in the Fiscal Strategy (40.4%). This was largely due to the lower than projected GG deficit (under-implementation of capital expenditure at 78% of budget) and a change in external financing (instead of a EUR 350mn loan, as projected, the government took out a loan of EUR 125 mn). Public debt increased as a share of GDP in 2019, by 0.3 pps to 48.9%.
Adhere to agreed consolidation measures, in particular the new pensions indexation formula	2) **No implementation:** The government reversed fiscally important reforms it had introduced in 2019 (higher marginal personal income tax rate for high incomes; restriction of pension increases to CPI-only indexation).
Implement legal and organisational measures to improve revenue collection.	3) **Limited implementation:** The government set up some efficiency-raising measures to improve processes at the Public Revenue Office. However, no measures were taken with regard to broadening the tax base/reviewing tax exemptions; analysing new sources of income; or increasing the number of tax inspectors for improving compliance. Some of these issues are discussed in the January 2020 Tax Strategy Paper which contains a number of well-analysed measures, but its adoption and implementation is likely to be held up until a new government takes office.
PG 2: Further increase the transparency of public finances by including public enterprises in the general government fiscal reporting framework where mandated by international statistical standards.	There was **partial implementation** of PG 2: 1) **Partial implementation**: The government has set up a working group to examine on a case-by-case basis which public company and off-budget unit would need to be included in the general government reporting. So far, the Public Enterprise for State Roads, which is the biggest borrower, has not been analysed. Other measures taken to enhance fiscal transparency include: i) a web platform set up in February 2020 on the finances of public companies; ii) the widening of the definition of public debt to also include the non-guaranteed part of public enterprises' debt;and iii) a web-based tool for tracking progress on the implementation of budgeted capital expenditure.
Adopt the new organic budget law including fiscal rules and arrangements for an independent fiscal council.	2) **Limited implementation**: there is significant delay in the publication and hence adoption of the new draft budget law, in relation to the original timeline. The draft law, which contains i.a. fiscal rules, provisions for a fiscal council, and a medium-

[11] For a detailed description of the methodology used to assess policy guidance implementation, see Section 1.3 of the Commission's Overview and Country Assessments of the 2017 Economic Reform Programmes available at https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform-programmes-commissions-overview-and-country-assessments_en.

	term budget framework was expected to be put to public consultation in March 2020, and adopted by the government in June. The government expects a lengthy implementation period on account of the necessary large-scale technical system transformations.
PG 3: Operationalise the adopted denarisation and non-performing loan resolution strategies, also by prioritising key areas of reform. Continue to closely monitor the emergence of potential financial stability risks related to the consumer loan segment, deploying appropriate micro- and macroprudential policy tools if needed. Legally clarify the national bank's mandate to set macroprudential policy and establish a framework for an effective co-operation among all agencies involved in macroprudential supervision.	There was **substantial implementation** of PG 3: 1) **Substantial implementation**: Several important aspects of the strategies have advanced towards completion and the implementation of remaining measures is ongoing. 2) **Partial implementation:** A consumer credit analysis was conducted, but measures to address the build-up of potential financial stability risks in the consumer segment of the credit market are yet to be decided upon. 3) **Substantial implementation**: Considerations about the setup and operating mode of the Financial Stability Council are in their final stages, to be followed by the legal clarification of the central bank's macroprudential mandate.
PG 4: Put in place and apply transparent and consistent procedures for business inspections implemented by inspectorates with clear mandates. Create a register of parafiscal charges on central and local level. Reduce the time and costs of commercial disputes by strengthening the institutional capacity of civil courts.	There was **limited implementation** of PG 4: 1) **Partial implementation**: In 2019, the new Law on Inspections was adopted. Several by-laws, guidelines and manuals to establish the necessary ground for consistent business inspections are yet to be developed. 2) **Limited implementation:** In 2019, the Ministry of Economy started collecting data on parafiscal charges at national level, but a register has not yet been created. 3) **Limited implementation**: In 2019, the government continued to implement the judicial reform strategy and the new legal framework aiming at improving the independence of the judicial system. No specific measure was taken to reduce the time and costs of commercial disputes, and no particular efforts were made to promote the use of alternative dispute resolution mechanisms. The Supreme Court has striven to improve consistency of judgments and to harmonise court practice.
PG 5: Ensure the implementation of the action plan for Formalisation of the Informal Economy 2018-2020 in accordance with the timeline.	There was **partial implementation** of PG 4: 1) **Partial implementation.** The country started implementing the action plan. However, most of the activities are at initial stage of implementation. The authorities are developing, collecting and monitoring statistical data but no report has been published yet. The analysis of existing legislation related to the informal economy was conducted which showed no harmonisation of the provisions of separate laws; this analysis will feed into the preparation of the new law on labour relations. The authorities have also started analysing good practices of the 'voucher system' and are preparing the 'white lists' for companies complying with the rules. The 'My VAT' scheme was introduced to encourage the issuing of fiscal receipts.

PG 6 Implement the Youth Guarantee in the whole territory with an emphasis on underdeveloped regions by ensuring sufficient and qualified human resources of the Employment Agency, and the participation of relevant stakeholders.	There was **substantial implementation** of PG 6: 1) **Full implementation.** In 2019 the Youth Guarantee was implemented on the whole territory of the country, throughout the 30 employment service centres. 20,302 young people (out of which 10,501 women) were enrolled in the Youth Guarantee in 2019. 29.7% of them got employed and 5.7% were involved in active labour market measures (in line with EU Member States' Youth Guarantee statistics). Staff of the Employment Service Agency received a first round of trainings and recruitment of additional staff was approved by the government. The recruitment itself yet needs to take place.
Strengthen the governance in the education sector in order to accelerate modernisation of the education system at all levels through improving infrastructure, curricula and teachers' qualifications.	2) **Partial implementation**. In 2019, the Government has committed and begun infrastructure improvement for pre-school, primary and secondary education and VET as well as training of pre-school staff. The reform of VET secondary education curricula continued at a slow pace. In its Action Plan, reforming the primary education curricula is foreseen but this was not done in 2019. Reform to teachers' qualifications is also pending. Legislation reform in the area of primary education and teacher professional development was undertaken.
Adopt and implement the new social protection legislation for improving the impact of social transfers on poverty reduction.	3) **Substantial implementation**. Bylaws and other implementing regulations relating to Cash Transfers were adopted and applied. Around 60% of the bylaws related to the provision of services were adopted and the rest, related to the work of the institutions are in the process of finalization.

6. ASSESSMENT OF THE OTHER AREA/SECTOR AND STRUCTURAL REFORM MEASURES INCLUDED IN THE 2020-2022 ERP

Business environment

Structural weaknesses in the business environment continue to be an obstacle for domestic companies despite the country being ranked 17th out of 190 economies in the latest World Bank's Doing Business 2020 report. Still, frequent policy changes and red tape are among the top concerns reported by businesses (BEEPS V, 2016). There is a need to make the regulatory environment more predictable and user-friendly, tackle widespread informality, streamline parafiscal charges and improve the efficiency of the inspection system. An effective and independent judicial system is a prerequisite for creating an environment that is investment- and business-friendly. Effective measures to further strengthen the rule of law, ensure adequate and timely contract enforcement and decrease corruption could benefit the business environment and overall competitiveness[12]. There is also a need to further promote the skills needed to develop innovation and entrepreneurship, support women's entrepreneurship, simplify business survival and bankruptcy procedures and promote second chance among entrepreneurs. Monitoring the cost-effectiveness of business support schemes and ensuring the coordination of different programmes is required. Further digitisation in public administration in particular streamlining company registration and the provisions of licenses and permits by consolidating the services under one-stop-shop could help to ease doing business.

Measure 8: Harmonisation of the public procurement legal framework with the *acquis*

This measure is rolled over from last year. It aims to develop an e-market place for low-value procurements and to professionalise civil servants working with public procurement after the new public procurement law was enacted, in force since April 2019. The law aims to harmonise the public procurement legal framework with the 2014 EU procurement directives. It is expected that the measure will help to increase the transparency and predictability on the market by publishing public procurement plans electronically and in advance. The number of bidders per tender is also expected to rise, in particular bids by SMEs. However, the potential effects of these developments are not sufficiently elaborated upon nor quantified. The risk identified for the measure implementation is perceived as high but no mitigating measures have been suggested.

Measure 9: Development of a national e-Services portal

This measure is also rolled over from the previous year and has been implemented for several years. It is relevant for reducing the costs and time in relation to dealing with the administration and is therefore important for improving the overall business environment and the ease of doing business. Although e-services to individuals have progressed, e-services to businesses have not been sufficiently developed yet: 127 services provided by administrative bodies are accessible online in the established portal, but many business related services offered by individual institutions (central register, the agency dealing with land and property, tax authority) are not yet linked to the portal. The measure elaborates on potential risks affecting its implementation. These risks stem from the inefficient coordination and communication between state institutions, lack of IT human resources and lack of commitment at operational level. Those risks could significantly challenge the measure's implementation and should be clearly monitored and counteracted by mitigating actions. The

[12] According to the World Economic Forum's 2019 Global Competitiveness Index, North Macedonia is ranked 81st out of 144 economies on incidence of corruption, 66th out of 141 on property rights and 127th out of 141 on judicial independence.

measure does not quantify the expected impact on competitiveness, which is only described in general terms rather than with a clear focus on quantitative targets. A large-scale EU funded project for upgrading the portal with 120 new services for companies and businesses is expected to start in April/May 2020 and therefore enable the measure to be implemented.

Research, development and innovation

North Macedonia's average innovation performance remains below 50% of the EU average and the European Innovation Scoreboard 2019 assesses the country as a 'modest innovator'.This is linked to very low total R&D expenditure, which amounts to 0.44% of GDP in 2019 (compared to the EU average of 2% of GDP in 2018). The private sector provides 26% of total research and development expenditure (State Statistical Office Year Book, 2019). The government's R&D&I support increased in 2019 and it is provided mainly through State aid schemes implemented by the Fund for Innovation and Technology Development. In particular, there was increased support given to research and innovation activities in businesses with some concrete initiatives undertaken. However, the impact of this financial support on private sector R&D remains to be evaluated. It is also important to ensure that the funding provided is distributed in a more transparent manner and that it is accompanied by proper monitoring and an evaluation of the results. The country's annual participation in the Horizon 2020 framework programme is increasing (65 signed grants in February 2020). However, this should increase much further. North Macedonia's performance in the programme remains below its potential and the overall success rate of 11.1% is below the average success rate of 15.7%. An integrated research and innovation strategy covering the whole innovation value chain from basic research to business innovation was adopted in 2012, but it needs to be updated. The smart specialisation strategy, which is expected to replace an existing competitiveness strategy is still being developed.

Measure 11: Enhancing cooperation between the academy and industry

This is a new measure with two sub-measures: (i) further development of the science technology park (STP) and (ii) grants for enhancing cooperation between the academy and industry. The STP is envisaged as a complex organisation that offers professional business support and innovation services designed to increase the extent of innovation, as well as networking possibilities at national level. Such a facility was formally established within the state university in Skopje and some funding was secured for its initial operation. This measure envisages announcing and implementing calls in 2020. However, it remains unclear whether the funding is available from the state budget. A balanced public-private ownership and management structure, with initial public funding, is a preferred model for operating a life science park. However, the measure does not mention whether potential private investors were found. The measure also has not quantified the expected impact on competitiveness, while the impact on employment and gender has been insufficiently considered.

Digital economy

The digitalisation of the economy is continuing. However, it is hampered by the relatively high cost of digital services and by the low level of digital skills[13]. The proportion of households with internet access rose to 79.3% in 2018 from 65% in 2013. Mobile broadband penetration is also expanding and reached 70.5% in 2019. The aim is to provide the measures

[13] According to the Global Competitiveness Index 2019 North Macedonia scores as 106 out of 141 economies in Digital Skills among population. According to the OECD Competitiveness Outlook (2018) with regards to digitisation the country scores 2.3 out of 5.

to improve national broadband outlook and assess future public investments in area where no commercial interest exists, along with the development of 5G technology. The plan envisages the forming of the National Broadband Competency Office, which will try to ensure that all citizens have equal access to broadband. In 2019 the country adopted necessary legislation to facilitate the use of electronic identification at national level and foster the use of e-signature which is currently limited to a few institutions that provide services to businesses despite the equipment and software having been installed. The 2018-2022 National Cybersecurity Strategy that addresses the challenges in cyberspace and fosters the development of a safe, secure, reliable and resilient digital environment is in place. Digital literacy is one of the education strategy's priorities. However, a specific strategy addressing digital skills is still lacking. The campaigns have been organised to inform citizens on how to use e-services. The analysis of ICT staff across all public institutions is ongoing, focusing on their retention as well as the ICT skills needed.

Investment activity

The country continuously underperforms on gross capital expenditure which combined with low capital stock significantly slows down efforts to increase productivity and the overall competitiveness of the economy. In 2009-2017 investment contributed 1.8 pps to GDP growth and in the same period the investment-to-GDP ratio averaged 29%. In 2019, investment in the country showed an annual increase of 21.1%. Real growth of gross investment in 2020-2022 is projected to be 6.1%; however, the risk of investment not materialising remains substantial. Private investment activity is impeded by the weaknesses in the business environment, the large informal sector and insufficient managerial skills. Low realisation of public investment is linked to the weaknesses in public investment planning by budget users and cumbersome procurement procedures. Furthermore, public investments seem linked to the election cycle and budgeted capital expenditure is often subject to mid-year cuts to cover shortfalls in current expenditure. By December 2019, the budget execution rate of capital spending of the 2019 revised budget reached 78%, an increase of 47% on 2018, though the budget for capital expenditure was reduced in the supplementary budget, so inflating the final ratio.

Trade performance

The economy posts a high and growing degree of trade openness. The total value of trade in goods and services amounted to 126% of GDP in 2018. In 2019, both exports and imports grew by 10.3% and 9.6% respectively. Import coverage by export stood at 75.9% in 2019 with the merchandise trade deficit amounting to 17.4% of GDP. A decline in the trade deficit was observed over recent years, leading to a narrowing in the current account deficit and easing the pressure on the exchange rate. The EU remains the country's main trading partner. The total bilateral trade with the EU increased by a further 8.9% and has passed the €10.5 billion or 70.2% of the total trade in 2019, followed by the CEFTA parties (10.1% in 2019). Germany, the United Kingdom, Greece, Serbia and Italy are the country's biggest trading partners. 95.6% of products from North Macedonia can access to the EU market without customs duties. The export product mix has been improving in recent years. The share of iron, steel, and clothing in total exports remained stable (17.4% in 2019, the same percentage as in 2018, although this has dropped from 33.3% in 2013). However, there was a further increase in the export of chemicals, machinery and transport equipment (57.2% in 2019 compared to 32.8% in 2013). The key import products are platinum and platinum alloys, petroleum oils, other metals and alloys, and flat-rolled iron products. Exporting companies, notably SMEs, still face key obstacles to trade. These impediments are linked to non-tariff barriers, including technical standards and administrative obstacles. Insufficient quality of logistics is an impediment to further increases in exports. In 2018 the World Bank's logistics performance indicator ranked North Macedonia 81st out of 160 countries (World Bank, 2018). The country also has the highest average number of days for clearing customs in the Western Balkans; for 83% of firms it took over 5 days to complete the process (BEEPS V, 2016).

Measure 12: Trade facilitation

This measure, which is carried over from last year, aims to simplify inspections and clearance procedures. It has the potential to improve competitiveness by speeding up all trade that requires veterinary and phytosanitary certificates issued through the EU Trade Control and Expert System. The measure is related to the Additional Protocol 5 on Trade Facilitation of the CEFTA agreement. The ERP provides a good quantitative assessment of the expected impact on competitiveness. However, the budgeted costs should be clarified as they are quite small and it is unclear whether they cover all of the measure's required activities.

Measure 13: Facilitating North Macedonia -Serbia cross-border crossing

The measure is rolled over from the previous year. The country followed the Commission's advice to consider the measure as relevant for the section on trade rather than that on transport. The measure provides for the construction of the new Joint Railway Border Station between North Macedonia and Serbia which would operate on a one-stop-shop principle and provide an opportunity to carry out checks while the train is moving. The measure description indicates that its application would increase the competitive advantage of rail compared to road transport; however, the effect is not quantified. Savings are expressed only in terms of time saved per train. As the amount of expected freight or passengers has not been presented, it is impossible to infer what the impact would be on the competitiveness, growth or any linked sector. Possible adverse effects on other means of transport (notably road) are not considered. In addition, the possible positive impact on the environment stemming from the reduced carbon footprint of rail transport compared to the other means of transport is not considered. Risk analysis of the implementation of the measure was considered and appropriate mitigating actions were presented.

Energy

The economy is characterised by high energy intensity, inefficiencies in the ageing energy production system, persistent high dependency on coal, and inefficient energy consumption. Domestic production is dominated by fossil fuels. According to the latest available data, 40.6% of the final energy consumption in 2018 was covered by domestic production, while 59.4% was imported. For energy consumption, oil was the highest at 51.4%, followed by electricity (27.6%), biomass (10.1%) and coal (6%). In terms of final electricity consumption, 74.5% was covered by domestic production while 25.5% was imported. Domestic electricity production relied heavily on lignite (51.6%) followed by hydro production (31.9%) gas (13.3%), wind (1.7%), biogas (1%) and solar (0.4%). Regarding investment in infrastructure, the country is continuing to construct several internal gas pipeline sections. The 2018-2040 national energy strategy was adopted and it properly reflects the main challenges in the energy sector, but it should be harmonised with the national climate strategy, by taking into account the commitments under Paris Agreement on Climate Change. The country should benefit from further regional connectivity in energy and further liberalisation of the energy market. The Law on energy that came into force in January 2019 liberalised the electricity market for micro and small companies, and households. In 2018, only 1,226 consumers were supplied under market conditions (0.16%) which points to an insufficient effort made to educate relevant partners about their obligation in the liberalised electricity market. The country has adopted the new balancing rules.

Measure 1: Increasing the competitiveness of the electricity market

This measure is rolled over from the previous year. It aims to set up a more liquid and organised electricity market to allow more competition in energy supply for the benefit of customers. It will also stimulate cross-border regional market integration and connectivity. Furthermore, the measure could be placed in the context of the EU advancing decarbonisation policies and the announced 'Green Deal'. The measure could potentially have a significant impact on the economy, though a possible initial increase of the energy price might reduce its competitiveness in the short term. However, as was the case last year, the potential impact on prices is not quantified, either on vulnerable households or on any economic sectors. The measure contains an initial attempt to prepare an environmental impact assessment that should be further strengthened. Significant potential risks related to the implementation of the measure are sufficiently elaborated upon and they should be clearly monitored. Other risks should be considered such as the capacity of the national provider (AD ESM) to cope with competitive pressure of the open market and the need to revitalise the old electricity producing infrastructure.

Measure 2: Promotion of renewable energy sources and improvement of energy efficiency

The measure is also rolled over from last year. It will help diversify energy generation and contribute to the security of energy supply, with expected positive effects for the economy. The measure includes both regulatory aspects (including adopting the energy efficiency law) and power generation capacity building. It sets out alternative methods to promote energy efficiency and renewable energy such as pollution taxes, selling products with energy-saving characteristics and a campaign to encourage the buying-off of inefficient products; these are also in line with the 'Green Deal' priorities too. However, the exact way that this will be put into practice and the expected impact have not been sufficiently developed. Furthermore, energy efficiency activities should focus more on the residential sector. As pointed out in last year's assessment, energy efficiency and renewable energy use can only be achieved by fully complying with the relevant EU laws. The measure would have benefited from a clearer link to the newly adopted energy strategy which prioritises measures related to investments and further development of distribution system network, investment in smart grid and management of system flexibility to integrate more renewable energy sources generation. The environmental impact, which could be particularly relevant for this measure, was not sufficiently presented and lacks quantifications. Impact assessments on economic and social outcomes were not well prepared.

Transport

The transport market remains concentrated on road transport with limited investment in other means of transportation and without a consistent intelligent transport traffic management and control system. The road maintenance is handled by state companies that lack full efficiency, operating with old equipment. In 2019, the transport sector's contribution to gross value added remains unchanged at 3.5%, which is lower than the EU average level of around 5%. The Integrated Road Transport System is deemed to reduce travel time by 17% and road fatalities by 16.6% benefiting the trade flows and the economy (ERP, 2020). The World Economic Forum's 2019 Global Competitiveness Report ranks the country 84th out of 138 economies for transport infrastructure. Though better than some other peers, the transport infrastructure's relatively low quality as well as the weak trade and transport logistics present barriers for foreign firms wanting to invest in the country as well as for domestic firms. Further developing Railway Corridor VIII, which is currently under construction, will directly link North Macedonia, Albania and Bulgaria and will allow the country's companies to have alternative export option via Albanian and Bulgarian ports. The country would also benefit from the opening of the rail transport market at least for domestic and regional firms. The fatality rate in traffic accidents compared to the EU averages is high: 32% above the EU average which is why the government is considering creating a lead road safety agency to ensure a coordinated and comprehensive approach to road safety.

Measure 3: Implementation of an Intelligent Transport System (ITS) along Corridor X

This measured is rolled over from the previous year. The ITS should be put in place along Road Corridor X, which is a strategic objective of the 2018-2030 national transport strategy. The ITS related measures along Corridor X are carried out without a current specific ITS strategy at country level and proper legislation. The measure will contribute to road transport safety and will ease the traffic flow along Corridor X. Unlike in the previous year, there is an attempt to quantify the measure's impact on travel times and traffic accidents based on the impact of a similar system applied in other countries. However, the full potential impact on competitiveness and growth cannot be fully determined given the insufficient analysis and the lack of estimate of savings (cost and time). The possible environmental impact has not been analysed.

Agriculture

The agricultural sector is characterised by highly fragmented, mostly privately owned (80%) agriculture land and insufficient use of modern technologies. Overall, the agricultural sector contribution to growth is declining and employment has remained static. In 2018, agriculture accounted for a share of 8.5% of GDP and 15.7% of employment, but these shares are considerably higher in some regions. According to the latest farm structure survey (2016), individual farmers cultivated on average 1.5 ha of land, which is 10 times less than the average farm in the EU–28 (16.1ha). The size of property significantly curbs productivity as it prevents farmers from benefiting from economies of scale and hampers investments in modernisation. The trade deficit in agri-food industry increased by 10.3% in 2018 compared to 2017 reflecting the week competitiveness of the sector. Agricultural subsidies per hectare (estimated at between €340 and €380) are above the EU average (estimated at below €300 for the EU-27). Although subsidies are linked to production, they involve a very complex administration scheme and there are indications that they may slow down the structural transformation of the sector. The link between agricultural policies and other sectoral policies such as those on trade, education and SMEs, needs to be increased. Investing in skills and know-how of agricultural workers as well as connecting agriculture with research and education, services, and in particular tourism could lead to the sector increasing productivity through innovation and application of modern technologies.

Measure 4: Improving the irrigation system

The measure continues to target investments in new irrigation systems with multipurpose dams and to expand the existing large hydro-melioration systems. However, very little attention is given to irrigation networks at present (only in the scope of Pre-accession Assistance (IPA) funding for small-scale irrigation systems). However, the ERP does not address issues over the use of the regulatory framework for establishing water communities as a model for strengthening the role of farmers in irrigation management, or for reviewing pricing methodologies as regards particular components of the small-scale irrigation systems. Information on the budget of the public water management company that maintains the irrigation systems as well as on the revenues collected from the irrigation users is lacking. Despite the size of the construction works and the many impacts they might have, there is no description of synergies with other sectoral policies. The impact assessment is generic and does not include sufficient quantitative information.

Measure 5: Consolidation and defragmentation of agricultural land

This measure, rolled over from last year, is still relevant as it aims to reduce the excessive agricultural land fragmentation by consolidating small parcels into larger units suitable for modern and efficient agriculture cultivation. The Commission's suggestion to incorporate abandoned and state-owned land into an amended Law on land consolidation was not followed. The ERP is missing site-specific information on the land consolidation areas which were selected to benefit from IPA support. Moreover, no actions are planned to incentivise voluntary land consolidation initiatives by groups of farmers as part of the rural development programmes. Estimates of capital investments involved in the process are not budgeted. Impact assessments lack quantitative information.

Measure 6: Agricultural cooperatives

The measure to support associations of farmers in agricultural cooperatives remains relevant as it addresses a key challenge of the agricultural sector due to the small size and fragmentation of farms. It is rolled over from previous years due to limited progress in its implementation despite the support provided through national and IPA funds. The Commission recommendation to link the measure to the alignment process with EU law on producer groups and common market organisations was considered. This measure is implemented with the support of the IPA funded project for the Common Market Organisation: a World Bank loan may also be used to support its implementation. We should note that there is progress in preparing of the relevant legal framework which is in a final stage but still needs to be adopted. The reform is consistent with other related measures in the ERP but the expectation that the involvement young farmers and woman will become involved over the next years is quite pessimistic. The expected impact on competitiveness, employment and gender needs to be more considered more, and the impact of the measure could be further quantified.

Industry

The main obstacles to competitiveness in industry include (i) low productivity and the slow growth rate of productivity, (ii) limited modernisation of the production processes and obsolete technologies caused by insufficient public and private spending on research and innovation, (iii) insufficient development of clusters of businesses and (iv) a significant skills gap. The industry sector contributed 23.6% of the economy's gross value added in 2018 and 30% of jobs in 2019. Manufacturing generates 19% of country's employment (EU average 20%) with the textile and apparel industry being the largest employer. Only small number of companies (5% in 2017) are exporters, with main export products being iron, steel and textiles. A shift towards medium value added products (such as spare parts for motor vehicles) is visible. The level of cooperation between universities and the industrial sector remains very low. Human capital inadequacies also hinder productivity: the average manufacturing and services worker is on average four times less productive than their counterpart in Europe and Central Asia (World Bank, 2018). Linkages between domestic industry and international production chains remain insufficient. However, like elsewhere in the world, the transition towards a greener economy brings about significant potential in the local market for low-emission technologies and sustainable products, offering great potential for new activities and jobs in North Macedonia. This should be considered in the next ERP. Furthermore, given the importance of manufacturing to the composition of GDP and jobs, measures in this area should be considered.

Services

According to the latest available data, the services sector accounted for 54% of total employment (2019) and 54.06% of GDP (2019). Further development and growth of services sector companies is hampered by weak entrepreneurial skills and a significant skills gap in employees, particularly soft skills, which are especially important in services. Despite the increase in service exports in 2018, services represent only around 26% of the value of the country's export basket, indicating the low competitiveness of the firms in this sector. Tourism and transport continue to constitute the largest chunk of the country's export in services (40%) followed by services provided to manufacturing companies (25%). The latter have significant potential for growth because their development is closely related to the inflow of export-oriented FDI. Telecommunications, computer and other information services, along with other business services, represent close to 25% of service exports and could also be expanded.

Measure 7: Increasing competitiveness in the tourism and hospitality sector

This measure is rolled over from the previous year and the sectoral analysis is mostly based on statistics from 2017 that need to be updated. The measure is largely inspired from the EU-financed Local and Regional Competitiveness Project (LRCP) that is prolonged until end-2020. The Commission's recommendation to embed the measure in a more strategic approach and to detail it better has been partially considered. However, as the country will be updating its tourism strategy, it is important to further consider how the measure fits in the overall tourism strategy framework. In addition, actions to mitigate the potential risks identified should be carried out. This measure convincingly highlights the expected impact in specific segments of the tourism sector, as adventure tourism or ecotourism (e.g. North Macedonia has been included by Lonely Planet among the top travel destinations for 2020). In the long run, this can have a significant impact on the broader tourism and hospitality sector. It is suggested to get information on additional impact indicators and relative values (e.g. jobs and investments in the sector) from the LRCP monitoring and evaluation framework.

Education and skills

This sector and the relevant reform measure 14 are analysed above in section 4 under key challenge #1.

Employment and the labour market

This sector and the relevant reform measure 15 are analysed above in section 4 under key challenge #1.

Social Dialogue

Bipartite social dialogue in the private sector and the commitment of social partners to reinforce collective agreements remain weak. The absence of union activities results in few enterprises having collective agreements at the company or branch level. Current unionization figures are still high (approximately 22%). However, most members come from the public sector. The Economic and Social Council is actively involved in the elaboration of relevant legislation before its adoption, but limited to the Ministry of Labour and Social Policy. Last year (2019), the Government obliged all the relevant ministries to submit the materials from the economic and social area, intended for governmental discussion, to ESC for opinion. Results of this decision are yet to be seen. With regard to funding, the ESC depends on the budget of the Ministry of Labour and Social Policy for financing its activities and the secretariat. The presidency of the Economic and Social Committee is not rotating.

Social protection and inclusion

The risk of poverty rate remains high in the country affecting 21.9% of population in 2018. Social transfers, particularly pensions, are of key importance for keeping ~~the~~ individuals above the poverty rate. The new Law on Social Protection, adopted in 2019, marks the start of a series of reforms in the field of social protection. The Law aims to reinforce the rights of people at risk of poverty and social exclusion by introducing a Guaranteed Minimum Assistance (GMA) and removing the barriers to access to activation measures for beneficiaries. The Child Protection Law gives free access to public childcare facilities to children from single parent families whose income is below the guaranteed minimum wage. Another novelty of the Law on Social Protection is that it gives GMA beneficiaries with children access to child allowances. Beneficiaries with school age children are also provided with a newly introduced educational allowance. The institutional set up for social protection and inclusion needs to be continuously strengthened. Improving coordination between Public Employment Service (PES) and other services like social work centres, associations, social service providers, health sector, municipalities which have legal obligations to provide additional forms of social protection support, is another prerequisite for the success of–the social reforms package. A proper analysis of the impact of-active labour market measures is needed given their unclear cost-benefit relationship. North Macedonia is the first country in the Western Balkans implementing the Youth Guarantee. It is reported that more than 20000 "Not in Education, Employment, or Training" benefitted from the scheme from which 7213 (35%) were beneficiaries of active labour market policies or directly employed through job mediation.

Measure 16: Enhancement of financial benefits in the field of social protection

This measure is considered crucial for tackling poverty in the country and is rolled over from the previous year. The law regulating the social protection that is included in the measure was enacted. Now, additional attention should be put on implementing the Law starting with adopting the bylaws and implementing regulation. The capacity of the bodies that are responsible for implementing, monitoring and enforcement of the new Law has to be increased. The information campaign, including fieldwork targeting potential beneficiaries, particularly the most vulnerable (Roma, women with children), is relevant. The expected impact is well quantified with a poverty rate target of 16% in 2022 that given the sluggish trend of the recent years might be overambitious.

ANNEX A: OVERVIEW OF THE MAIN INDICATORS PER AREA/SECTOR OF THE ECONOMY

Area/Sector	2018	2017	2016	EU-28 Average
Energy				
Energy imports dependency (net imports / consumption, %)	N/A	56.14%	58.95%	55.1% (2017)
Energy intensity: kilograms of oil equivalent (KGOE) per thousand euro GDP	300.26	329.78	380.99	117.69
Share of renewable energy sources (RES) in final energy consumption (%)	18.12%	19.64%	N/A	17.98%
Transport				
Railway network density (metres of line per km^2 of land area)	N/A	27.4	N/A	49.9 (2016)
Motorization rate (Passenger cars per 1000 inhabitants)	N/A	195	N/A	507 (2017)
Agriculture				
Share of gross value added (agriculture, forestry and fishing)	9.8%	9.1%	10.6%	1.6%
Share of employment (agriculture, forestry and fishing)	15.7%	16.2%	N/A	4%
Utilised agricultural area (% of total land area)	N/A	49.2%	N/A	40.0% (2017)
Industry				
Share of gross value added	21.4%	20.5%	19.7%	19.1%
Contribution to employment (% of total employment)	22.6%	22.5%	23.1%	17.3%
Services				
Share of gross value added	62.6%	62.9%	61.7%	73.8%
Contribution to employment (% of total employment)	54.3%	54.1%	53.1%	71.9%
Business environment				
Rank in World Bank Doing Business (Source: World Bank)	11	10	16	N/A
Rank in Global Competitiveness Index (Source: World Economic Forum)	84	60	63	N/A
Estimated share of informal economy in GDP (as % of GDP) (Source: IMF)	N/A	N/A	Up to 37.6%	N/A
Research, development and innovation				
R&D intensity of GDP (R&D expenditure as % of GDP)	0.37%	0.35%	0.44%	2,12%
R&D expenditure – € per inhabitant	18.8€	17.20€	20.30€	656.5€
Digital economy (TBC)				
Percentage of broadband penetration (mobile and fixed) [NB: households]	78%	N/A	N/A	86%
Share of total population using	79%	75%	72%	85%

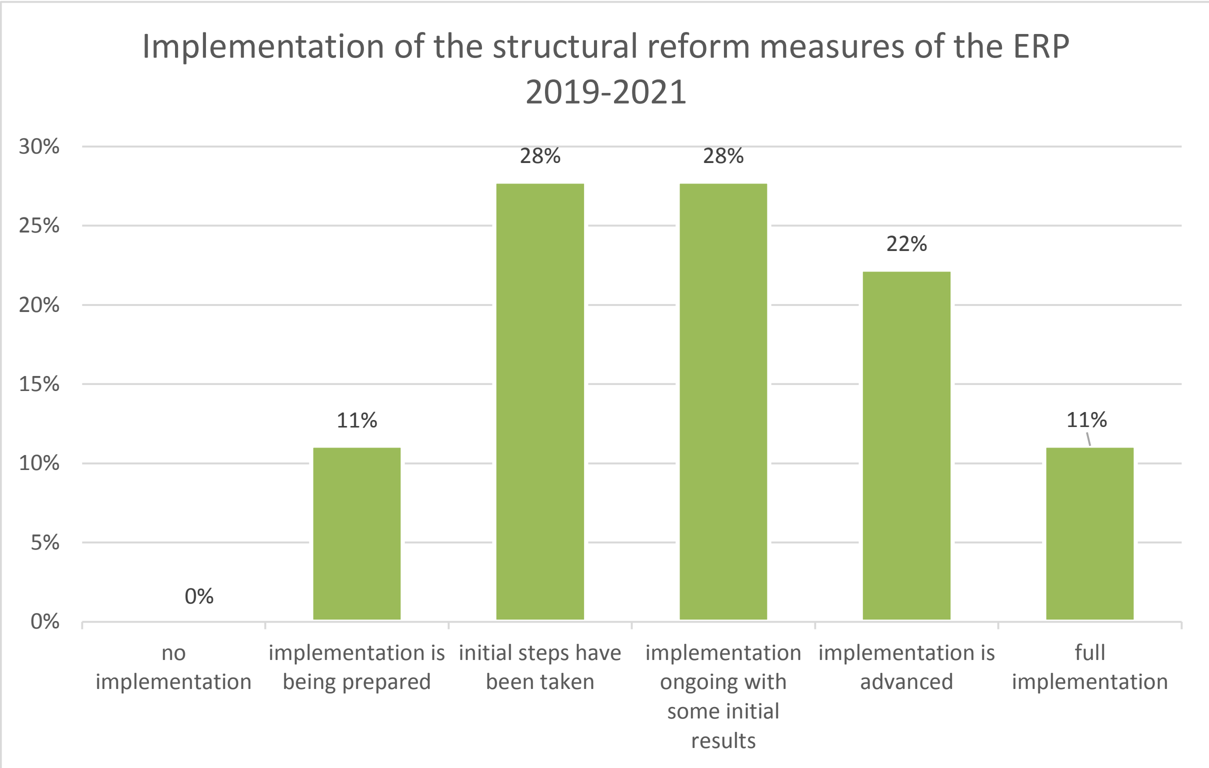
internet [NB: population 16-74]				
Trade				
Export of goods and services (as % of GDP)	60.6%	55.1%	50.7%	46.2%
Import of goods and services (as % of GDP)	73.2%	69%	65.5%	43.0%
Trade in goods balance (as % of GDP)	-16.2%	-17.8%	-19.2%	
Education and skills				
Early leavers from education and training (% of population aged 18-24)	7.1%	8.5%	9.9%	10.5%
Youth NEET (% of population aged 15-24)	24.1%	24.9%	24.3%	10.5%
Formal child care - children aged less than 3 years (% of total)	8.8%	10.3%	9.1%	35.1%
Individuals' level of digital skills (% of individuals aged 16-74 who have basic or above basic overall digital skills by sex)	N/A	32%	34%	57% (2017)
Employment				
Employment rate (% of population aged 20-64)	56.1%	54.8%	53.3%	73.2%
Unemployment rate (% of labour force aged 15-64)	21.0%	22.5%	24.0%	7.0%
Gender employment gap (Difference between the employment rates of men and women aged 20-64)	21.4%	21.9%	21.2%	11.6%
Social protection system				
% of population at risk of poverty or social exclusion	41.1%	41.6%	41.1%	21.9%
Impact of social transfers (other than pensions) on poverty reduction	14.79%	14.29%	14.79%	33.20%
Self-reported unmet need for medical care (of people over 16)	2.3%	2.5%	2.9%	2.0%
Income quintile share ratio S80/S20 for disposable income by sex and age group (Comparison ratio of total income received by the 20% with the highest income to that received by the 20% with the lowest income)	6.16	6.38	6.63	5.17

Source: EUROSTAT, unless otherwise indicated.

ANNEX B: PROGRESS WITH STRUCTURAL REFORM MEASURES FROM 2019-2021 ERP

Relatively good progress was made in implementing the measures in 2019 (average score: 3.1 out of 5). Activity reports provide a mostly accurate description of the level of implementation. The scoring is slightly imprecise for the measures related to agricultural development.

Implementation is stronger for some measures, such as measure 16 on further developing of the qualification system, and measures 8 and 9 which are linked with financial support for investments and micro, small and medium-sized enterprises. In contrast, implementation is weaker for other measures, such as measure 13 on reducing the informal economy and measure 15 on trade facilitation.



ANNEX C: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The government of North Macedonia submitted the 2020-2022 ERP was submitted by the government of North Macedonia on 3 February 2020. None of its components are missing.

Inter-ministerial coordination

The Ministry of Finance of North Macedonia coordinated the preparation of the ERP and an inter-ministerial working group comprised of several ministries, agencies and other offices were involved in this work. Upon completion, the government formally endorsed the ERP. The coordination process worked well and the attendance to technical meetings was good.

Stakeholder consultation

The draft of the 2020-2022 ERP's structural reforms was posted on the Ministry of Finance's website for 2 weeks. Interested parties were also invited to send written contributions. The Economic and Social Council discussed it and its contribution is included as an annex to the ERP.

Macroeconomic framework

The macroeconomic framework is coherent and consistent, while somewhat optimistic. The ERP presents two alternative scenarios compared to the baseline: (i) assuming lower growth in trade partner countries; and (ii) assuming lower investment. However, but it does not include a low-growth scenario combining both domestic and external risks. The ERP's sensitivity analysis would have benefited from a more comprehensive impact assessment, including on employment, deficit and debt. The external sector outlook is described in detail and an analysis of external debt sustainability is provided in the annex. The latter could have been improved by providing more detail on parameters and on the results of the stress test.

Fiscal framework

The ERP is based on the latest budget projections following its revision and on the fiscal data available at the end of Q3 2019. Despite the revised economic growth assumptions, the ERP sticks to the fiscal targets of previous years. It includes: (i) information on the expected budgetary impact of new policy measures; (ii) an analysis of the budget balance's sensitivity to lower GDP, lower revenue, and higher expenditure growth; (iii) an analysis of public debt's sensitivity to changes in interest rates and exchange rates; and (iv) a short assessment of the long-term sustainability of public finances based on a number of assumptions, including population ageing. The external debt analysis refers to stress tests for shocks to the primary current account and to economic growth. These stress tests would have benefited from more detail on the impact of individual debt-creating flows and from alternative scenarios.

Structural reforms

The chapter on structural reforms follows the guidance note. A slight improvement in the impact assessment is noted, though more effort is needed to quantify the impact for each measure and make the ERP the most relevant policy document to guide economic reforms. The ERP includes 16 measures and largely complies with the set page limit. The government has not included any measure on the industry sector though it is a very relevant component in terms of share of GDP and employment. The measures in the energy sector are in line with the recent prioritisation of green growth strategies by the Commission. However, activities in the area of the circular economy and environmental business are missing. Tables 9-11 in the annex are properly completed. The implementation reports of the 2019-2021 ERP's policy guidance and Table 11 in annex are sufficiently well prepared. The scores attributed properly reflect the implementation level. Separate annexes to provide information on the results, the organisation of the consultation process with external stakeholders and a list of the institutions that were directly consulted have not been added.

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