PUBLIC DEBT OF THE REPUBLIC OF NORTH MACEDONIA-SPECIFICS AND TRENDS

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INTRODUCTION

This chapter aims to examine the trend and unique characteristics of the public debt in the Republic of Macedonia (now North Macedonia), in the period 1992 - 2023 year.

Public debt is a crucial component of a country's fiscal and development policy, which directly affects economic stability and growth. Thus, in a globalized economy, countries are often compared on their fiscal health and debt levels.

Due to the recent COVID - 19 pandemic and energy crisis, public debt has emerged as a critical economic issue on the global stage, reflecting the complex interplay between government spending, economic growth, and fiscal sustainability. As countries faced various financial challenges, public debt levels have dramatically increased, driven by economic downturns, increased public spending, and governments' efforts to stimulate growth.

The scale of global public debt has reached unprecedented levels, raising concerns about its long-term implications for economic stability and development. Namely, according to the International Monetary Fund (2004), global public debt surpassed 100% of global GDP, reflecting widespread fiscal challenges across both developed and developing countries.

The theory highlights numerous benefits that properly managed public debt, might have on the economy, becoming an efficient tool to mitigate the impacts of recessions, stimulating economic growth through long-term investments, and avoiding immediate tax hikes, thus enabling the government fiscal flexibility in the crisis times.

However, excessive and especially poorly managed public debt can lead to negative outcomes which overpass the mentioned benefits. Namely, high and growing public debt can lead to changes in the levels of nominal and real interest rates. Also, an increase in public debt might lead to an increase in the costs of servicing the debt, primarily the interest costs, for which additional funds must be allocated that could have been used for other purposes, much more conducive to stimulating economic growth. Besides the opportunity cost to the government and the crowding-out effect on the private sector, high public debt can also contribute to the creation of a "snowball effect". This assumes an increase in public debt caused by a rise in interest costs on that debt, which in turn is financed through additional public borrowing, leading to a negative spiral that can jeopardize the sustainability of public finances and the overall sustainability of the economy.

So, it is of particular importance to ensure the effective use of borrowed funds for productive and developmental purposes, which will enable "self-repayment" of the future public debt instalments, ensuring a solid credit rating for the country, as well as the possibility for future borrowing at acceptable interest rates.

Therefore, the analysis which is presented in this chapter is not only valuable for the policy makers in North Macedonia but as well as for all small and emerging countries with a similar backgrounds or public debt histories.

The chapter is organized into several sections, emphasizing the following key areas: the specifics of public debt in North Macedonia, a historical overview of factors influencing the country's public debt, including significant events and policy changes from independence to the present, as well as an outline of the evolution of debt management practices over time, and an analysis of public debt trends and structure. Additionally, a comparison of domestic and external debt is presented, with a particular emphasis on the specifics and trends of government debt components.

SPECIFICS OF THE PUBLIC DEBT IN REPUBLIC OF NORTH MACEDONIA

Since gaining independence in 1991, the Republic of North Macedonia has experienced significant changes in the public debt definition and scope, as well as fluctuations in the debt levels and management practices, driven by economic reforms, external influences, and global financial conditions.

Definition and Scope of the Public Debt in the Republic North Macedonia

The public debt of the Republic of North Macedonia is legally regulated by the Public Debt Law adopted in 2005, and it has been amended five times: in 2008, 2011, 2014, 2019, and 2021. The Law regulates the management of public debt, the procedures and methods of borrowing, and the process of issuing, servicing, and terminating state guarantees, as well as the information regarding public debt. (Public Debt Law, 2005)

Historically, the definition of public debt in the Republic of North Macedonia has undergone certain changes.

According to the first version of the Public Debt Law of 2005, (Official Gazette 62/2005): the public debt represents all financial liabilities created through borrowing by the Republic of Macedonia, the municipalities, and the city of Skopje, as well as by public enterprises and trade companies being fully or predominantly owned by the state. (Public Debt Law, 2005)

With the amendments to the Law on Public Debt in 2014, (Official Gazette 139/2014), the definition of public debt was narrowed, excluding the debt of the National Bank of the Republic of Macedonia and the debt of public enterprises for which the state has not issued a state guarantee. (Public Debt Law, 2014) This new method of calculating public debt makes it impossible to compare with countries whose public debts are calculated according to the definitions of the IMF and the World Bank.

Therefore, based on the amendments to the Public Debt Law made in May 2019 (Official Gazette 98/2019), the non-guaranteed debt of public enterprises and trade companies established by the state or municipalities is included in the public debt calculation. So, the latest definition and scope of the public debt is that it "represents the sum of financial obligations created through borrowing by the Republic North Macedonia, its public institutions, the municipalities, and the city of Skopje, as well as the guaranteed and non-guaranteed debt of the public enterprises and trade companies that are wholly or predominantly owned by the state or municipalities".(Public Debt Law, 2019) Yet, the debt created by the National Bank of the Republic North Macedonia is not included in the scope of the public debt.

Furthermore, the Public Debt Law distinguishes two main components, which define the scope of the public debt:

a. Government debt at the central and local level, as well as

b. Debt of the public enterprises and trade companies, wholly or predominantly owned by the state or municipalities (including the City of Skopje).

a. Government Debt at central and local levels, encompasses all financial obligations undertaken by the central government, public funds, and municipalities. It includes both internal and external debt and is used to finance public spending, infrastructure projects, and social programs.

External government debt consists of obligations of the state at central and local level to foreign creditors, which include international institutions and organizations (such as the International Bank for Reconstruction and Development, International Monetary Fund, International Development Association etc), foreign governments and private foreign investors. It includes various types of financial instruments such as multilateral loans, bilateral loans, and bonds issued at international markets.

Domestic (or internal) government debt refers to the debt that the government (central and local) owes to domestic creditors in form of issued structural bonds, treasury bills, government bonds, and municipal bonds. Although the Public Debt Law includes "loans from domestic banks and financial institutions" as a source of internal debt, it is not a common practice for government institutions in North Macedonia to borrow from these sources, resulting in no or minimal participation of such loans in the government's internal debt portfolio. Internal debt is generally considered less risky since it is denominated in the local currency, reducing exposure to exchange rate fluctuations.

b. Debt of the public enterprises and state-owned companies contains all external and internal financial obligations undertaken by public enterprises and trade companies wholly or predominantly owned by the state or municipalities (including the City of Skopje). As mentioned above, this debt is also categorized as:

- *Guaranteed debt* refers to the public enterprises' borrowing which is backed by government guarantees and in case of default, the government will cover the obligations and
- *Non-guaranteed debt* referring the financial obligations of the public enterprises and state-owned companies that are not backed by government guarantees.

Accountability, Responsible Authority and Public Debt Management Practices

With the adoption of the Public Debt Law in 2005, the Ministry of Finance assumed all responsibilities related to public debt management. Specifically, all loan agreements on behalf of the Republic of North Macedonia are negotiated and signed by the Minister of Finance. Additionally, any borrowing procedures for public institutions established by the state or municipalities require approval from the Ministry of Finance. The Ministry also issues government securities on behalf of the Republic of North Macedonia in both domestic and international financial markets.

Before 2005, the National Bank of the Republic of Macedonia managed and reported on external debt only, while the internal debt (due to its limited scope and level), was not observed, nor managed.

It is important to note that in the Republic of North Macedonia, there is no regulation that specifies a particular limit on the level of public debt. The Public Debt Law merely provides the framework for calculating the state's public debt limit, which is determined by the ratio of public debt to gross domestic product.

In fact, in 2014, an initiative for an Amendment of the Constitution was submitted, requiring the establishment of fiscal rules, through which the limit on public debt should be regulated in the Constitution itself. (Dimitrievski, 2018).

According to the rules, the public debt should not exceed a level of 60% of GDP. These fiscal rules could have been disrespected only in case of natural disasters and external shocks that would threaten national security or in case of economic crisis which would affect significant decline in gross domestic product.

Even though the Assembly adopted the decision to proceed with the amendment of the Constitution, the proposed amendments were not passed.

However, the limits necessary for prudent management of public debt are outlined in the country's Fiscal Strategy and the Public Debt Management Strategy, which are adopted every three years and established:

- the amount (limit) of public debt in the medium term;
- the maximum amount of net borrowing in the first year to which the strategy applies;
- the maximum amount of newly issued state guarantees in the first year; and
- the structure of public debt.

Although the limits for public debt are revised every three years, the Public Debt Management Strategy for the period (2023-2025) generally has set similar medium and long-term limits with ones from the previous years, aiming to keep the level of public debt within sustainable bounds:

- The level of total public debt in the medium and long term should not exceed 60% of GDP.
- Wear of the guaranteed public debt should not exceed a level of 15% of GDP.
- The minimum threshold for the euro debt in the foreign currency debt portfolio should be 80%.
- The minimum threshold for fixed interest rate debt should be 60%. (2023–2025 Public Debt Management Strategy of the Republic of North Macedonia, 2022).

PUBLIC DEBT TRENDS IN NORTH MACEDONIA: A HISTORICAL OVERVIEW

The Republic of North Macedonia has experienced its unique challenges regarding public debt. Namely, over these three decades, North Macedonia's public debt dynamics have been shaped by a series of economic, political, and structural factors, reflecting the country's transition from a post-socialist economy to a market-oriented state.

To gain a better understanding of the changes in public debt structure and trends, the historical analysis of public debt in North Macedonia should be divided into two distinct periods:

- Macedonian external public debt in the period 1992-2001[1] and
- Macedonian public debt in the period 2002-2023.

This segmentation is essential for understanding the significant regulatory changes and management structures that emerged, particularly with the adoption of the Public Debt Law in 2005. Namely, the adoption of this law marked a significant shift in how public debt was managed, transferring all debt management responsibilities from the National Bank of the Republic of Macedonia to the Ministry of Finance. This change established a formal framework for public debt management that continues to influence practices today.

1 The period since Republic of Macedonia's independence in September 1991till the end of the year , is not considered in this analysis , due to the lack of consistent official data related to international debt level and structure.

Before 2005, the focus was primarily on external debt, which was managed and reported by the National Bank. The internal debt was largely ignored due to its limited scope, leading to a fragmented understanding of the overall public debt situation. However, when the Ministry of Finance assumed responsibility for managing and reporting public debt, additional analyses of the debt structure as of the 2002 year were conducted, ensuring comprehensive transparency of both external and internal public debt from the 2002 year onward.

After currency independence in 1992, the Macedonian economy has undergone many economic and monetary fluctuations, including the devaluation of the Macedonian denar in 1997, which affected the value and management of external debt. The external debt was continuously reported in US dollars until the introduction of the euro in 2002. Thus, the differences in reporting of external debt, expressed in US $ in the period from 1992 to 2001 was also the reason for such period segmentation.

From 2002 onward, the scope of public debt expanded significantly, changing its structure, especially after the issuance of the first treasury bill (in 2004) on the domestic financial market and the first Eurobond (in 2005) on international markets. The introduction of the euro and subsequent regulatory changes led to a more comprehensive approach to public debt analysis, including. This evolution requires a separate analysis to understand the implications of the changes on fiscal policy and economic stability.

North Macedonia's External Public Debt Trend in the Period (1992-2001)

In the first decade of its independence, the Republic of Macedonia, (now North Macedonia), has faced a complex and challenging process in determining and servicing its debt obligations to international creditors, influenced by several historical, economic, and structural factors.

Challenges in Determining and Servicing The Public Debt

The main challenges for the Macedonian government related to public debt servicing and maintaining stability can be understood by analyzing the historical, economic, and structural aspects that defined the economic environment of the newly independent country.

a) Historical Context

Having declared independence from the Socialist Federal Republic of Yugoslavia (SFRY) in 1991, the Republic of Macedonia, faced significant financial and administrative problems in its early years. The Agreement on Succession Issues of the Former SFRY" (so-called "Succession agreement") signed in Vienna on June 29, 2001, and ratified on June 2, 2004, was a critical step in defining how the debts of the former Yugoslavia would be divided among the successor states. For a decade after independence, Macedonia struggled with the allocation of its portion of the Yugoslav debt, which stood at 5.4%. (State Archives of the Republic of North Macedonia, n.d.) This delay left Macedonia without a clear understanding of its debt obligations for a significant period.

b) Economic and Financial Challenges

- Lack of Foreign Currency Inflow

During the early years of its independence, the Republic of Macedonia faced a significant lack of foreign currency inflows, which severely decreased its ability to service external debt. The period from 1991 to 1992 was particularly challenging, as Macedonia had not yet established a fully functioning currency system or financial infrastructure. The introduction of the Macedonian denar on April 26, 1992, marked the start of monetary independence, but the currency was issued in the form of coupons and was not backed by gold or foreign exchange reserves. Following the breakup of former Yugoslavia, international reserves remained with the Central Bank of Yugoslavia, leaving Macedonia without the foreign exchange reserves necessary to meet its external debt obligations (NBRM, 1992).

- International Recognition and Financial Integration

Republic of Macedonia's international legal subjectivity was not fully recognized until the 8th of April, 1993, when it became the 181st member state of the United Nations, under the provisional name of FYROM (Former Yugoslav Republic of Macedonia). (Parliamentary Assembly of the Council of Europe, 1995). This delay in recognition also postponed the country's membership in numerous international financial organizations and therefore prevented its ability to borrow new loans and refinance existing ones.

- Banking System Collapse

The collapse of the banking system following the breakup of Yugoslavia left the Republic of Macedonia with significant challenges. Banks with headquarters in other former Yugoslav republics, withdrew their deposits from Macedonian branches, leaving citizens without access to their savings. This crisis led the Macedonian government to decide to issue bonds to repay these debts, but the issue of foreign debt to currency savers remained unresolved till September 2000 year, when the bonds for "old foreign currency savings "were finally issued (National Bank of the Republic of Macedonia, 2001).

- *Currency and Exchange Rate Policy*:

After the monetary independence of the Republic of Macedonia, the National Bank of Macedonia fully redrew the Yugoslav denars from circulation and returned them to the National Bank of Yugoslavia, thereby acquiring a receivable in the amount of 13.5 billion Yu denars or 41 million US dollars (according to the exchange rate valid in the 1992 year). (National Bank of the Republic of Macedonia, 1992) To stabilize the economy, Macedonia maintained a fixed exchange rate policy against the German mark and a basket of convertible currencies, which contributed to the formation of foreign exchange reserves. However, this policy also created additional pressure on the country's financial system, which struggled to balance reserve accumulation with debt servicing. So, in 1997, the Macedonian denar experienced 30% devaluation against the German mark, which impacted not only public debt dynamics but also shaped future economic policies and strategies aimed at ensuring the stability of the economy (National Bank of the Republic of Macedonia, 1997).

c) Institutional and Structural Issues

- Dominance of Foreign Creditors:

Macedonia's public debt was heavily influenced by foreign creditors, making the country highly vulnerable to external financial pressures. The dominance of foreign creditors in Macedonia's public debt portfolio posed challenges in debt management and negotiations.

- Banking Sector Rehabilitation:

The banking sector, severely impacted by the crisis, faced a process of rehabilitation. Bank Rehabilitation Agency was established to manage the collection of foreign debts and oversee the restructuring of the banking sector. This process was essential for restoring stability but added another layer of complexity to debt servicing.

- Development of Financial Regulations

The absence of well-defined regulations and prudent practices for managing public debt further complicated Macedonia's financial situation. The lack of a robust legal and regulatory framework for debt management hindered the country's ability to effectively address its debt obligations.

- Limited Financial Market and Internal Debt

Due to the underdevelopment of the financial market, Macedonia faced constraints in accessing certain debt instruments. The internal debt was largely limited to bonds issued for bank rehabilitation and recapitalization of Stopanska Banka AD Skopje, as well as bonds on selective loans from the National Bank of the Republic of Macedonia (NBRM). The secondary market was still in its infancy stage as the official trading at the newly established Macedonian Exchange took place in 1996, but transactions during this period were modest, primarily involving stocks traded in a continuous auction format on the exchange floor. (Macedonian Stock Exchange, n.d.) The trading model relied on an "order-driven market," which was not robust enough to encourage significant activity. The situation slightly improved with the introduction of a new Securities Law and mandatory trading on the Stock Exchange in 1998, and especially in 2001, when electronic trading was implemented, and the complete dematerialization of securities occurred. The establishment of the Central Depository further enhanced trading capabilities, but before these developments, the domestic financial market struggled to gain significance. This limited financial market capacity in the first decade following independence restricted the country's options for managing and restructuring its debt.

Despite the challenges in identifying and managing public debt, the Macedonian authorities began establishing relationships and negotiating solutions for accumulated debt.

Namely, recognizing that debt owed to foreign commercial banks was the most significant, but carrying the highest interest rates, the authorities redeemed part of their debt to commercial banks, amounting to $10.6 million. (National Bank of the Republic of Macedonia, 1992), thus capitalizing on the low prices at which these loans were trading in the international secondary financial markets.

In the same year (1992), the Macedonian authorities also initiated discussions with representatives from the World Bank and the International Monetary Fund to create the ground for further debt resolution efforts.

Consequently, Macedonia became a member of the World Bank in March 1993 and joined the International Monetary Fund in April 1993. These memberships enabled the country to be eligible for cooperation and assistance from international multilateral financial institutions. However, high political risks and an unfavourable environment effectively blocked the inflow of private capital into the country (Petkovski & Bishev, 2004).

The cooperation with the International Monetary Fund and World Bank during the transition period was ongoing. From 1994 to 2002, Macedonia accessed IMF funds in total amount of USD 129.3 million through six arrangements. The World Bank Group contributed USD 341.6 million for structural reforms, (among which USD 67 million came from the International Bank for Reconstruction and

Development, and USD 274.6 million was utilized under IDA terms. The country ceased to be eligible for IDA assistance in July 2001 (Petkovski & Bishev, 2004).

Trend and Structure of the External Public Debt of the Republic of North Macedonia (1992 -2001)

In the first decade following Macedonia's independence, there was limited data available on public debt and its structure, primarily due to undefined inherited debt from ex-Yugoslavia and the minimal and poorly defined domestic debt. Therefore, the focus was primarily centred on monitoring and servicing of external public debt, a responsibility assigned to the National Bank of Macedonia.

According to the National Bank report from 1992, the identified external debt at the end of 1992 was 842,1 million US $ with the dominant participation of the foreign commercial banks as main creditors, followed by International Financial organizations and loans from foreign governments and governmental organizations (National Bank of the Republic of Macedonia, 1992).

As presented in Figure 1, the trend of the external public debt evolved through the years reaching its nominal pic in 2000, as well as its debt-to-GDP ratio pick at the end of the observed period (2000 and 2001 year respectively).

Graph 1. The trend of the External Public Debt of the Republic of Macedonia (1992-2001)

Source: collected data from the reports of the National Bank of the Republic of Macedonia (1992, 1993, 1994, 1995, 1996, 1997, 1998, 1998, 2000, 2001) and Macrotrends website.

In the first years till 1996, Macedonian Government gradually recognized the inherited external debt and started the initiatives for settling the debt with all creditors. Although the portion of the succession debt was fully confirmed in 2004 with the ratification of the “Agreement on Succession Issues of the Former SFRY”, even since 1995, Macedonian authorities accepted the 5,4% portion of the external debt of the SFRY, recognizing $397 million of the debt to the Paris Club of creditors, while the debt to the London Club of creditors of $229 million was reprogrammed in March 1997. In 1994 the Government also regulated the inherited debt with the World Bank, while in 1996 year, the obligations to the European Investment Bank (EIB), EUROFIMA, and the European Resettlement Fund were settled (Ministry of Finance of the Republic of North Macedonia, 2005).

The period 1995-1997 was marked as the period of recognition and restructuring of the debt and borrowing additional funds for stimulating the economic growth of the country. In this context, the long-term Paris Club agreement was reprogrammed twice, (once in 1995 and again in 2000). The long-term loan from the London Club of Creditors was refinanced under the New Financial Agreement (NFA) from 1998, which granted the Republic of Macedonia the right to redeem the bonds at any time, according to the conditions of the securities market, in case of fulfilling all outstanding obligations on the principal and interest.

The trend of nominal external debt in North Macedonia from 1992 to 2001 reflects a complex dynamic of economic and political factors. Starting at $842.1 million in 1992, the external debt declined to $702.9 million in 1993, due to the economic instability following independence and reduced access to international financing but rose again in 1994, reaching almost the same amount of $876.98 million (National Bank of the Republic of Macedonia, 1992, 1993).

The most significant moment occurred in 1995, when external debt escalated sharply to $1,235.97 million, due to the new arrangement with the International Monetary Fund, as well as to the first governments’ structural bond issuance within the process of banks’ rehabilitation. This was followed by a slight correction in 1996, with debt decreasing to $1,172.40 million, mostly due to the restructured debt from the Paris Club of creditors.

The devaluation of the Macedonian denar in 1997 led to another spike in debt, reaching $1,293.40 million, as the costs of servicing existing liabilities increased. The trend showed some stabilization in 1998, with debt decreasing to $1,235 million, but it rose again to $1,283 million in 1999, reflecting renewed borrowing to respond to ongoing economic recovery efforts and regional tensions.

The peak came in 2000 and 2001, when external debt reached $1,488 million, and $1,451 million, respectively, indicating the government's efforts to manage rising liabilities while addressing pressing fiscal demands, set against a backdrop of ethnic conflict and economic challenges.

The trend of the External Debt to GDP ratio has followed a similar pattern to the nominal debt trend, but the structure of the debt has changed over the observed period.

The data in Graph 1 indicates that North Macedonia's external debt-to-GDP ratio experienced certain fluctuations between 1992 and 2001. Starting at 34.50% in 1992, the ratio peaked at 42.40% in 1995, before ending the decade at 41% in 2001.

This period reflects significant economic challenges and adjustments as the country navigated its transition and integration processes. Yet, despite the fluctuations in the external debt-to-GDP ratio, the overall debt level in North Macedonia remained moderate compared to other former Yugoslav countries.

Trend Of The External Public Debt Components

The structure of external debt also evolved during the first decade of the observed period, significantly changing the sources of debt financing at the beginning of the 2000s compared to those in 1992.

While in 1992 the dominant creditors were foreign commercial banks (with 42%), followed by International Financial organizations (30%) and loans from foreign governments and governmental organizations (19%), in 2001, half of the Macedonian external public debt portfolio was to international organizations, bilateral creditors participated with 20,4%, while commercial banks contribute with only 19 %. (National Bank of the Republic of Macedonia, 2001).

During the observed decade, there was a significant e shift in the percentage contribution of specific international organizations to the external debt.

Namely in 1992, almost 60% of the international organizations' debt portfolio belongs to International Bank for Reconstruction and Development (IBRD), 20% belongs to European Investment Bank (EIB), 10% to the European Company for the Financing of Railroad Rolling Stock (EUROFIMA) and 4% each to International Finance Corporation (IFC) and International Monetary Fund (IMF), (National Bank of the Republic of Macedonia, 1992).

At the end of 2001 however, the largest individual creditor within the group of multilateral creditors was the International Development Association (IDA), with a participation of 37.0%, followed by the International Bank for Reconstruction and Development (which participated with 18.1%), while European Investment Bank (EIB) and internationally Monetary Fund (IMF) contributed with 10.9% and 10,3% respectively. (National Bank of the Republic of Macedonia, 2001). In the group of bilateral credits, 82.5% represented restructured debt towards the Paris Club of Creditors, while London Club of Creditors participated with 64.1% in the group of commercial banks.

Generally, despite some improvements in the public debt portfolio structure, at the end of the 2001 year, the overall situation remained unfavourable, due for several reasons:

- Domination of the external debt in total debt portfolio at the end of 2001, meant that almost the whole public debt was denominated in foreign currencies, exposing the economy to exchange rate fluctuations.
- There was limited activity in the newly established capital market, with issued financial instruments not being actively traded.
- The lack of liquidity restricted the government's ability to manage its debt effectively, including refinancing or rolling over existing obligations.
- The combination of heavy reliance on external debt and stagnant local markets also decreased both domestic and foreign investment which an adverse impact on GDP growth and budget revenues, creating further pressure on public debt.

In 1995, alongside its external debt, the North Macedonian government began to accumulate internal public debt through the issuance of structural bonds. This added a burden to the economy and the overall public debt portfolio. However, by the end of 2000, this internal debt had not been fully analyzed or effectively managed, highlighting a need for more robust fiscal strategies to address the growing financial obligations.

Specifics, Trends and Structure of the Public Debt in the Period 2002-2023

As of January 2002, with the official introduction of the new European currency, the euro, the National Bank adjusted its foreign exchange strategy from targeting the denar's exchange rate against the German mark to targeting it against the euro. Consequently, all public debt data from 2002 onward are officially reported in euros. The initial exchange rate was established at 60.95 denars per euro. (National Bank of the Republic of Macedonia, 2001). Since domestic debt began to play a more significant role in the structure of the public debt portfolio, in 2002 year, it has been included in all official public debt data.

Over the past two decades, external factors— including global economic conditions, regional stability, and domestic policy decisions— have influenced the course of public debt in North Macedonia. The country's decreased, but still significant reliance on external borrowing, particularly during economic crises, has created vulnerabilities, highlighting the importance of prudent fiscal management and strategic economic policies for the future. The following section outlines the key events that have impacted the development of public debt in the period 2002-2023 year.

Key Milestones Affecting the Public Debt of North Macedonia (2002- 2023)

In the early years following the introduction of the euro in 2002, the National Bank of the Republic of North Macedonia (NBRNM) adjusted its exchange rate targeting, which not only stabilized economic expectation, but also fostered a more favourable environment for foreign investment. This transition positively influenced public debt management strategies, setting the stage for future developments.

Namely, to improve the structure of the debt portfolio, in 2005 the Ministry of Finance, issued the first 10-year maturity Eurobond on the international capital market for 150 million euros. (Ministry of Finance of the Republic of North Macedonia, 2005) The idea was to use the funds received from the Eurobond's sale to replace the existing debt against the London Club of Creditors (with high variable interest rate) with a low fixed debt rate. This financial "manoeuvre "contributed to significant improvement of the interest structure of the public debt and the realization of a high level of savings in the Budget.

Despite the global economic downturn, in 2008, North Macedonia's macroeconomic performance remained relatively strong, contributing to a resilient economic environment. Furthermore, the Macedonian banking sector hasn't experienced the direct negative effects of the Global Financial Crisis, allowing for greater stability during this tumultuous period. As a result, the country experienced a significant achievement in terms of its debt levels, reaching a historically lowest "Debt-to-GDP" ratio of 23% per year.

The consequences of the Eurozone Sovereign Debt Crisis from 2010 to 2012 further affected public debt levels. The crisis in the Eurozone had spillover effects, influencing North Macedonia's borrowing strategy and leading to increased external debt as the government aimed to maintain fiscal stability.

Between 2013 and 2015, the government focused on fiscal consolidation efforts, implementing various measures to stabilize the economy. Yet, public debt continued to climb due to ongoing structural challenges and ambitious luxury infrastructure projects to cope with the fluctuating economic environment.

In the wake of the 2016 political crisis and subsequent changes in government, North Macedonia faced a significant increase in public debt. The social reforms and reforms in public administration caused the increase in public expenditures in terms of increased costs for social transfers, salaries, and capital expenditures which created a complex fiscal environment. On one hand, these expenditures were essential for addressing immediate social needs and promoting economic development. On the other hand, they contributed to a growing fiscal deficit and increasing public debt.

The economic impact of the COVID-19 pandemic further complicated the situation, as increased spending on healthcare and economic support measures led to additional borrowing. Thus, the high levels of debt in 2020 and 2021 can be primarily attributed to the issuance of Eurobonds as a key source of funding, while striving to maintain long-term fiscal stability. In fact, 2020 and 2021 are the years of the largest public borrowing through the issuance of Eurobonds in total amount of 1,4 billion euros.

As North Macedonia began to recover from the pandemic between 2021 and 2023, government borrowing persisted to fund economic stimulus packages and infrastructure projects. However, the emergence of an energy crisis significantly impacted public finances, increasing the expenditures for subsidies and social programs. These factors ultimately pushed the debt-to-GDP ratio beyond the critical threshold of 60%, emphasizing further challenges to maintain the country's fiscal stability.

After the parliamentary and presidential election in the spring 2024, the new Government has been struggling to enable sustainable growth, with limited and exhausted budget expenditures and using additional borrowing a "last resort" option.

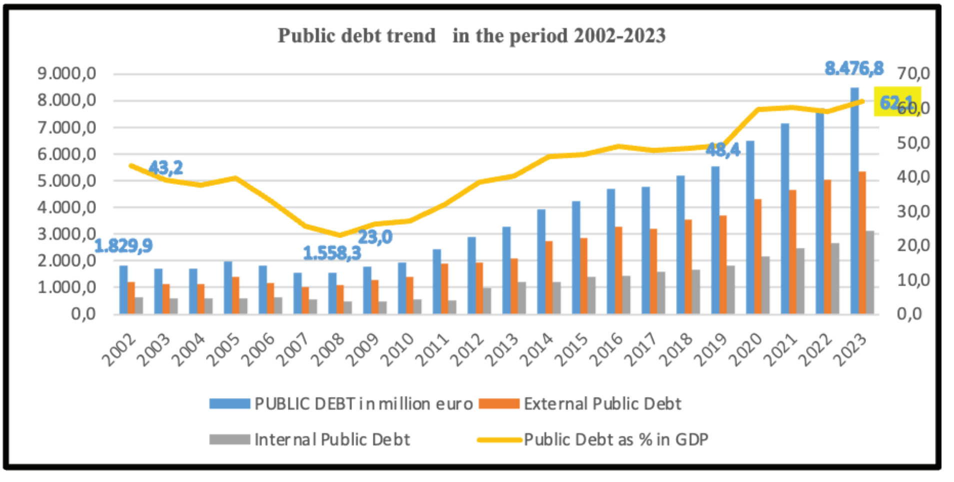
Public Debt Trends of North Macedonia in the Period 2002-2023 Year

Public debt has undergone significant developments and structural transformations over the past two decades. *Figure 2* illustrates the trend of North Macedonia's total public debt from 2002 to 2023, including both external and internal debt figures in million euros, as well as the total public debt to GDP ratio, expressed as a percentage. According to the data from Graph 2, the trend of the North Macedonia's public debt from 2002 to 2023 exhibits several key patterns:

a) Nominal Public Debt Growth

The trend of public debt in North Macedonia from 2002 to 2023 reveals distinct phases characterized by initial stability, a significant rise, and subsequent fluctuations. Specifically, public debt grew steadily from 1,829.9 million in 2002 to 8,476.8 million in 2023. This 4.5-fold rise in public debt highlights the growing financial obligations of the government over the years.

Graph 2. Public Debt Trend of the Republic North Macedonia in the Period 2002-2023



Source: Ministry of Finance of the Republic of North Macedonia. (n.d.-a) (graph created by the author).

In fact, in the early years, particularly from 2002 to 2004, public debt remained relatively steady and low (between €1,829.9 million in 2002 and €1,722.4 million in 2004). This stability reflects the government's cautious approach to borrowing during a period of economic transition and efforts to maintain fiscal discipline.

However, in 2005, public debt saw a notable increase, rising sharply to €1,992.2 million. This surge was attributed to the government's strategic shift towards financing essential projects and initiatives, as well as the introduction of domestic treasury bills and Eurobonds, which expanded funding sources and facilitated more aggressive borrowing.

Following this peak in 2005, public debt experienced a decline in 2006, dropping to €1,818.3 million, and continued to decrease slightly to €1,558,3 million in 2008. This period of reduced debt levels indicates improved fiscal management and a focus on stabilizing the economy. Although in 2009, public debt began to increase again, it was still a low and acceptable level, especially keeping in mind the negative impact of the global financial and economic crisis. Since the 2009 year the public debt has marked a continuous upward trend, but the most substantial increase is observed between 2019 and 2023, indicating ongoing pressures, from economic recovery efforts created by COVID-19 and the energy crisis, reaching the level of almost 8,5 million euros in the 2023 year.

b) Public Debt to GDP Ratio Fluctuation

Public debt as a percentage of GDP shows obvious increase during the two decades of the observed period, starting with 43.2% in 2002 and reaching the peak of 62.1% in 2023, but with even more evident fluctuation over the time. Namely, in the early years, the ratio marked a continuous decline, reaching its lowest level of 23.0% by 2008. The global financial crisis and European sovereign debt crisis prompted an increase in government borrowing to stimulate the economy and support public services, resulting in a rise in the debt-to-GDP ratio to 26.2% in 2009 and 27.2% in 2010.

As the economy struggled to recover, the ratio continued to increase, reaching 32.0% in 2011 and further climbing to 38.3% by 2012.

From 2013 to 2019, the debt ratio showed a steady upward trend, reaching a ratio of 49.2% in 2019. This period was marked by ongoing fiscal consolidation efforts and infrastructure investments, which, despite increasing public debt, aimed to foster long-term economic growth.

The onset of the COVID-19 pandemic in 2020 caused a significant increase in the debt-to-GDP ratio, reaching the level of to 59.7%, as the government borrowed extensively to implement relief measures and support affected sectors. This trend continued, with the ratio reaching 60.3% in 2021 and eventually peaking at 62.1% in 2023 due to ongoing economic challenges, the energy crisis, and presidential and parliamentary pre-election activities.

Generally, this rising ratio indicates that while the debt amount is increasing, the growth of the economy hasn't been keeping pace, leading to concerns about the fiscal sustainability of North Macedonia's economy.

C) Continuous Domination of the External Versus Domestic Debt in Total Public Debt

In general, the share of external debt in the overall public debt has been continuously significant, typically accounting for around 65-70% of the total debt. It peaked in 2012, reaching 78% of the total debt, and decreased to its lowest level of 63% by the end of 2023.

The external public debt amounted to about €1,203.0 million in 2002, contributing 65% to the total debt, while in 2009, this amount had decreased to €1,092 million and its share of total debt rose to 70%.

From 2010 onwards, external debt steadily increased, reaching €5,345.4 million in 2023, although its percentage contribution to total debt fell to 63%. This ongoing reliance on foreign borrowing introduces risks related to exchange rate fluctuations and global economic conditions, potentially creating vulnerabilities for the economy in the long run.

During the observed period, internal public debt experienced a fivefold increase, although with certain fluctuations over time. It began at €626.9 million in 2002, followed by a decline to €466 million in 2009 and subsequently increasing the level, both nominally and structurally, reaching €3,131.4 million by 2023, which accounts for 37% of the total debt.

Although the improvements in the public debt structure are very modest, the growth of internal debt as a share of total public debt highlights the North Macedonian government's efforts to develop domestic financial markets and reduce reliance on external funding sources.

Further Analysis of the Public Debt in North Macedonia in the Period 2002-2023

Besides the division of the public debt into external and internal one, the composition of public debt in North Macedonia encompasses the following main structural categories:

- Government debt - presenting both external and internal obligations created by the Central government, Municipalities and Public Funds and
- Debt of Public enterprises and trade companies fully or dominantly owned by the central or local government (which can be guaranteed and non-guaranteed). (Public Debt Law, 2019)

However, based on the Ministry of Finance official data, the contribution of government debt within total public debt shows that it is the main component, accounting for between 85% (at the end of observed period) to nearly 94% in 2002. In contrast, the contribution of guaranteed and non-guaranteed debt from public enterprises and trade companies owned by central and local government remains insignificant but with increasing trend over the years, which highlights the need for a more in-depth analysis and consideration in future assessments. The trend of guaranteed and non-guaranteed debt of public enterprises and trade companies with dominant state ownership.

As already mentioned, the structure of public debt in North Macedonia includes both guaranteed and non-guaranteed debt related to public enterprises and trade companies fully or predominantly owned by the government. Understanding these components is essential for assessing the financial health and risk exposure of the country.

Namely, Guaranteed debt facilitates investment in critical infrastructure and services, contributing to economic growth. However, a heavy reliance on guarantees may lead to complacency in financial management among public companies. The growth of guaranteed public debt represents a potential risk to government finances, as the state is obligated to cover these debts in case of a public company's default. This can strain fiscal resources, particularly during economic downturns (Economic Institute-Skopje, 2017).

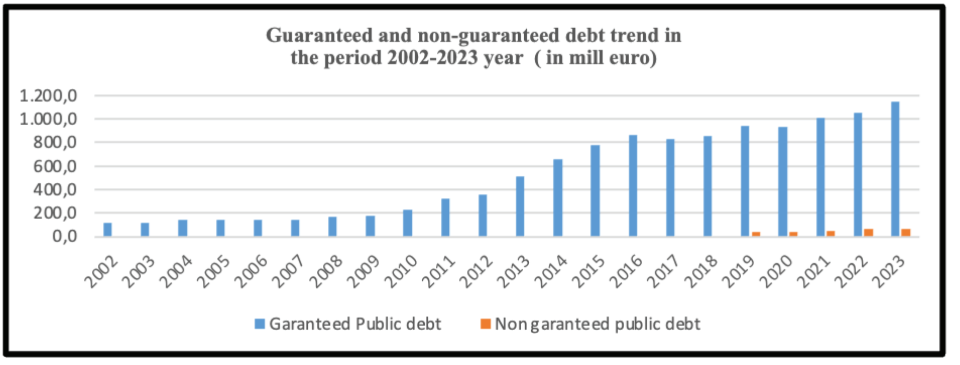
The increase in non-guaranteed debt also reflects a trend towards greater autonomy for public companies. However, it also raises concerns about their financial sustainability and risk management practices, as these companies must generate sufficient revenue to meet their obligations without government support.

Generally, the distinction between guaranteed and non-guaranteed public debt in North Macedonia highlights the complexities of financing public enterprises. While guaranteed debt has steadily increased, reflecting government support for key sectors, the emergence of non-guaranteed debt indicates a shift towards greater financial independence for public companies. Ongoing monitoring and management of these debt levels will be crucial to ensure fiscal sustainability and economic stability in the years to come.

Analysing the Guaranteed Public Debt Trend presented in Figure 3, it can be noticed that it has steadily risen, from 114.0 million euros in 2002, to 1,151.0 million euros in 2023. This consistent increase reflects the government's ongoing commitment to supporting public companies, especially in critical sectors like energy, infrastructure, and utilities. Especially, notable spike was observed after 2010, with guaranteed debt rising sharply from 225.5 million euros in 2010 to 354.3 million euros in 2011, and continuing its upward trajectory to reach over 1 billion euros in the following years.

Non-guaranteed debt data is only available starting from 2019, with figures of 41.9 million euros that year. This marks a critical phase where public companies began to rely on debt financing without government backing, possibly indicating a shift towards greater independence in managing their finances.

Graph 3. Guaranteed and non-guaranteed public debt trend of the North Macedonia (2002-2023)



Source: Ministry of Finance of the Republic of North Macedonia. (n.d.-a) (graph created by the author).

The non-guaranteed debt has seen fluctuations, rising to 69.7 million euros in 2023 after reaching a peak of 68.2 million euros in 2021. This variability suggests that while companies are exploring alternative financing sources, they may face challenges in maintaining stable debt levels without government support.

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Due to the complex structure of government debt and its significant share of North Macedonia's public debt, it is essential to analyze and present the trends of government debt and its components in a separate section of this chapter. This focused analysis aims to offer clearer insights into the dynamics of government debt, enabling a more comprehensive understanding of its impact on overall public debt and the broader economic context.

ANALYSIS OF THE GOVERNMENT DEBT TREND AND STRUCTURE IN THE PERIOD 2002-2023

Government debt represents the overall financial liabilities of the Government at the Central and local levels (including the State Funds) and is a critical indicator of fiscal health of the country. The Government debt in the Republic of North Macedonia is additionally classified as external and domestic government debt, with further sub-classification (Public Debt Law, 2021).

- **External Government Debt -** refers specifically to the portion of government debt (on central and local level) that is borrowed from foreign sources. It is typically denominated in foreign currencies, which can expose the country to exchange rate risks. External debt is often used to finance development projects, infrastructure, and economic stability measures.

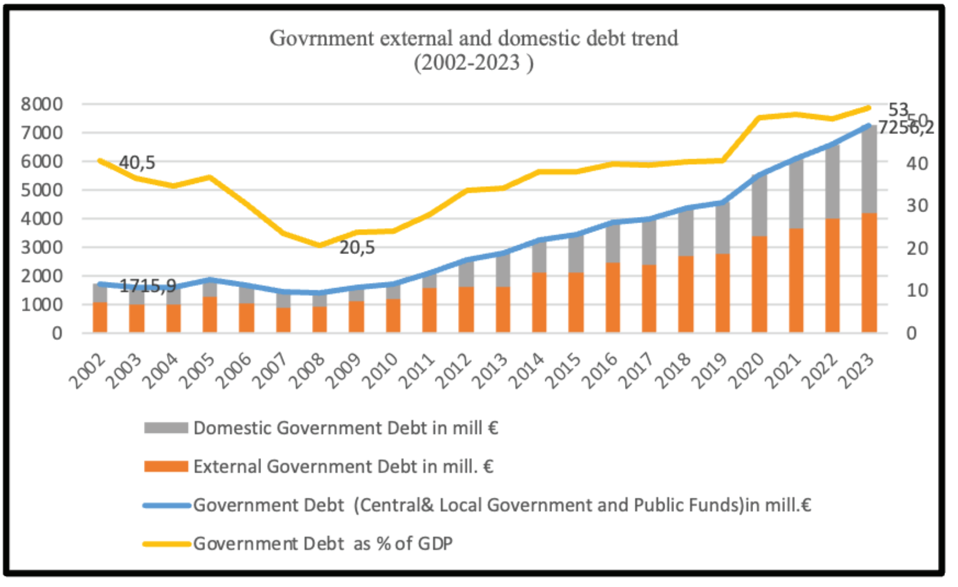
- **Domestic Government Debt** -refers to the liabilities owed to domestic creditors, which helps in managing liquidity in the domestic financial market. This includes borrowing through the issuance of government securities such as treasury bills and bonds, structural bonds as well as domestic municipal bonds.

The trend of government debt in North Macedonia from 2002 to 2023 presented in the Figure 4, shows significant fluctuations over the observed period following almost the same pattern like that of a public debt, which is understandable, having in mind that Government debt contribute one average with 90 % in total public debt (or from 93% in 2002 to 86% in 2023 year).

The government's debt as a percentage of GDP reflects the same volatility, starting with 40,5% in 2002, dropping to a low of 20.5% in 2008 and subsequently rising sharply to over 53% by 2023, highlighting increasing financial pressures and reliance on borrowing during economic challenges. Although decrease in the contribution, the increase of the Government debt from €1,715.9 million in 2002 to €7,256.2 million in 2023, clearly shows that the government still keeps the main role in borrowing activities to respond to economic challenges and stimulate growth.

The relationship between external and domestic government debt in North Macedonia reveals contrasting trends over the years. From 2002 to 2008, external debt declined significantly, while domestic debt decreased to its lowest point in 2009. However, starting in 2010, external debt began a steady upward trajectory, peaking at approximately €4.17 billion by 2023.

Graph 4. Government (external and domestic) debt trend in mill. Euro and as % in GDP



Source: Ministry of Finance of the Republic of North Macedonia. (n.d.-a) (graph created by the author)

In contrast, domestic debt showed a consistent increase after 2009, reaching over €3 billion in the same year, highlighting a shift towards greater reliance on domestic borrowing as the government navigated fiscal challenges and economic recovery.

Government External Debt Trend and Structure

As already mentioned, the External Government debt is composed by:

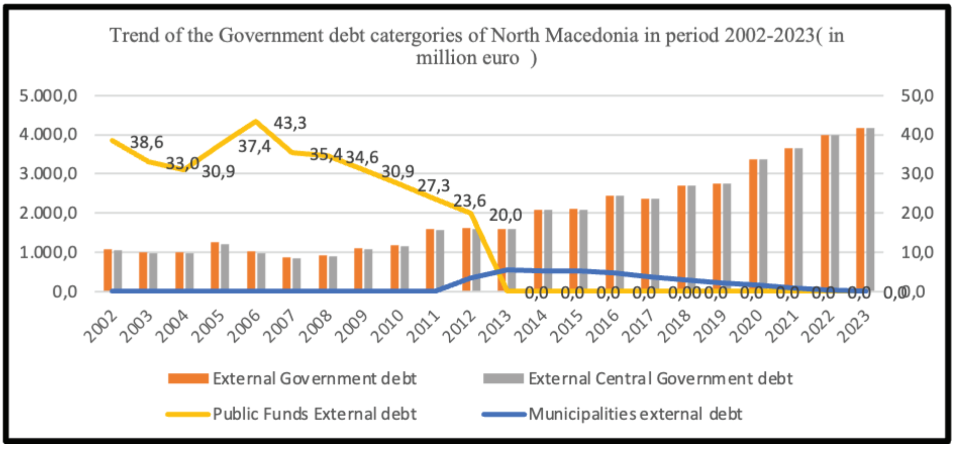
- Central Government external debt (Central government institutions and bodies)
- Debt of the Public Funds (Health insurance Fund, Pension and Disability fund) and
- Municipal external debt (80 local self-government units and City of Skopje)

Analysing the structure of the External Government debt (as presented in Figure 5) it is more than evident that the External Central government consistently holds the bulk of the overall government external debt. For instance, in 2002, the central government's external debt was €1,050.4 million, while total external government debt was €1,089.0 million.

This trend continued over the years, with central government debt reaching €4,171.0 million by 2023, closely aligning with the overall external government debt figure of €4,171.0 million. This indicates that central government borrowing is the primary driver of external debt, reflecting its significant role in funding national initiatives and infrastructure projects.

In contrast, the external debt of the state public funds as well as municipal external debt represent a minimal portion of total government external debt. Namely, public funds external debt, started from 38 million euros in 2002 year, fluctuated slightly over the next years, and after reaching its pick with €43.3 million in 2006, continued to decline ultimately reaching "zero" by 2023.

Graph 5. Trend of the External Government Debt Categories in the Period 2002-2023 (in mill. Euro)



Source: Ministry of Finance of the Republic of North Macedonia. (n.d.-a) (graph created by the author).

The Municipal debt, however, remained negligible until 2011, peaking at just €5.6 million in 2013. There is significant change in a structure of the Government debt in terms of the sources of funding. Namely, based on the data from the Ministry of finance annual report on public debt management, as well as NBRM Annual Reports it can be observed the following:

In 2002, the structure of external public debt in the Republic of Macedonia revealed that multilateral and bilateral creditors were the primary sources of borrowing, with 49% owed to multilateral creditors and 19% to bilateral creditors. Commercial banks and other creditors each contributed 16%. Among multilateral creditors, the largest individual creditor was the International Development Association (IDA), accounting for 39.1%, followed by the International Bank for Reconstruction and

Development (IBRD) at 19.4% and the European Investment Bank (EIB) at 13% (National Bank of the Republic of Macedonia, 2001; Public Debt Management Department, Ministry of Finance of the Republic of North Macedonia, 2023).

In 2023, however, the structure of external government debt (the amount of 4,7 billion euros) shows a significant reliance on various sources. Multilateral creditors account for 33% of the total government central external debt, with the International Bank for Reconstruction and Development (IBRD), being the largest contributor among them at €535.5 million. Bilateral creditors make up a minimal portion at 3%, while a substantial 63% of the external debt is sourced from Eurobonds issued to private creditors. This distribution highlights the government's strategic emphasis on tapping capital markets through Eurobonds, indicating a shift towards more market-based financing while still maintaining relationships with multilateral institutions for additional support.

Due to the significant role of Eurobonds in external debt funding, the following section will provide a brief overview of the Eurobond issuance by the Government of North Macedonia.

Eurobonds As A Source of External Funding of North Macedonia's Debt -Specifics and Trend

Until the 2005 year, the government of the Republic of Macedonia lacked experience in issuing government securities on international financial markets, which could have served as a source for covering the budget deficit. However, with the country's first credit rating acquired in 2004, the essential prerequisites for placing Macedonian Eurobonds issuance were fulfilled, attracting interest from foreign investors. Namely, the credit agency "Standard & Poor's" rated Macedonia through its external debt at "BB with a positive outlook", and "BB+ "for its domestic debt. This rating places Macedonia in the speculative category, but just a step away from an "investment rating", as investment ratings range from AAA to BBB (Ministry of Finance of the Republic of North Macedonia, 2005).

In this context, the issuance of Eurobonds by the Macedonian government and its successful execution served as a crucial test for evaluating the country's credit rating and future investment prospects.

According to the Annual Reports on Public Debt Management, from 2005 to 2023, (Public Debt Management Department, Ministry of Finance of the Republic of North Macedonia, 2006, 2009, 2014, 2015, 2017, 2018, 2020, 2021, 2023) the Government of the Republic of North Macedonia issued nine bonds totalling 3.945 billion euros, with following characteristics:

- The first Eurobond was issued in December 2005 for 150 million euros with a coupon interest rate of 4.625% for 10 years. Despite relatively low budget deficits in 2004 and 2005, the government decided to issue its first bond to assess its credit rating with international investors. There was high interest in these bonds, with demand reaching around 600 million euros—four times the amount offered. Given the manageable budget deficit, funds from this initial issuance were used to redeem debts owed to a group of international private creditors known as the "London Club," who had particularly unfavourable repayment terms.
- The second Eurobond, valued at 175 million euros, was issued in July 2009 during the Global financial crisis. Despite limited global funding sources, Republic of North Macedonia completed the issuance, but at a historically the highest annual interest rate of 9.875%. This bond had a maturity period of 3.5 years, expiring in January 2013.
- Due to increased spending on capital investments related to the "Skopje 2014" project and ongoing structural reforms, the Ministry of Finance issued its third Eurobond in July 2014, amounting to 500 million euros, with a maturity of 7 years and an interest rate of 3.975%. Although the bond was issued for 500 million euros, investor demand reached nearly 1.2 billion euros. This Eurobond was listed on the Irish Stock Exchange, broadening the investor base to include European and American investors.
- The following year, in November 2015, the fourth Eurobond was issued for 270 million euros at an interest rate of 4.875%. This bond matured in 2020 and attracted over 100 institutional investors from Europe and the USA. The transaction was facilitated by Citibank, Deutsche Bank, and ERSTE Bank.
- In July 2016, the fifth Eurobond was issued for 450 million euros to finance budgetary needs and refinance obligations due in 2016 and 2017. This Eurobond carried a coupon interest rate of 5.625% and a maturity of 7 years, expiring in 2023, and was traded on the Irish Stock Exchange.
- In January 2018, the Republic of Macedonia issued its sixth Eurobond on the international capital market, aimed to finance budgetary needs and refinance previous obligations. This bond was valued at 500 million euros, with a coupon interest rate of 2.75% and a maturity period of 7 years, until 2025. The interest rate was one of the lowest in the history of Macedonian Eurobonds, and demand was seven times higher than the issued amount, exceeding 3.5 billion euros. Alongside this issuance, North Macedonia executed an early redemption of one-third of the 2015 Eurobond (270 million euros) set to mature in 2020, which had a higher interest rate of 4.875%.

- In June 2020, the Republic of North Macedonia issued its seventh Eurobond for 700 million euros to support the budget for 2020 and 2021 and refinance existing state debt obligations. This bond featured a coupon interest rate of 3.675% and a maturity period of 6 years, expiring in 2026, and it was also traded on the Irish Stock Exchange. For this issuance, as well as previous ones, investor demand significantly exceeded the supply, with demand being five times greater than the amount issued.
- In March 2021, the Republic of North Macedonia issued its eighth Eurobond for 700 million euros, intended to finance the budget for 2021 and refinance the 2014 Eurobond worth 500 million euros, resulting in a net borrowing of 200 million euros. This Eurobond was issued at a historically the lowest coupon interest rate of 1.625% with a maturity period of 7 years, until 2028, and it was traded on the London Stock Exchange.
- In March 2023, North Macedonia issued its ninth Eurobond for 500 million euros, intended for financing budgetary needs for 2023 and refinancing the fifth Eurobond from 2016, which was worth 450 million euros. This bond was issued with a coupon interest rate of 6.960% and a maturity period of 4 years.

While the issuance of Eurobonds is viewed as a positive step in financing North Macedonia's budget deficit, the State Audit Office's "Report on Effective Public Debt Management " (State Audit Office of the Republic of North Macedonia, 2024) indicates that the interest costs of Eurobonds are much higher compared to other borrowing options, such as issuance of domestic government securities or loans from official international and bilateral creditors. The audit findings reveal that the interest expenses for these nine bond issues exceed 1 billion euros, representing a quarter of the nominal value of all Eurobonds issued till 2023 year.

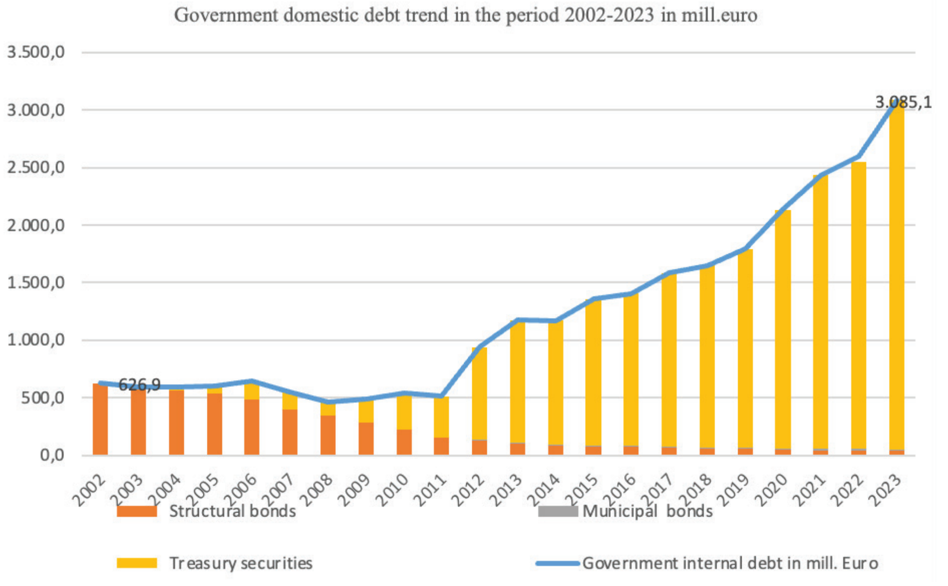
Thus, to enhance efficiency in public debt management, it is crucial to strategically plan future bond issuances and improve the country's credit rating through a stable macroeconomic environment. This approach could help facilitate a reduction in interest rates for Macedonian Eurobonds in the international capital market.

Government Internal Debt Trend and Structure

The government domestic debt of North Macedonia has shown notable trends over the period from 2002 to 2023, rising from approximately €626.9 million in 2002 to about €3,085.1 million in 2023. (Fig 6).

This upward trajectory indicates a growing reliance on domestic borrowing as the government aims to finance budget deficits and fulfill fiscal obligations through diversified funding sources.

Graph 6. North Macedonia's Government Domestic Debt Trend and Structure (2002-2023 year)



Source: Ministry of Finance of the Republic of North Macedonia. (n.d.-a) (graph created by the author).

The structure of the Government's domestic debt has also gradually changed. At the beginning of the observed period, the government's domestic debt comprised various types of structural bonds. However, the value of structural bonds decreased substantially from €626.9 million in 2002 to €37.3 million in 2023. This decline indicates that the government has been moving away from structural bonds, due to the diminishing need to compensate for transition-related losses as the economy stabilized.

Although still a minor component, municipal bonds demonstrate growth potential, reflecting local governments' increasing engagement in the capital market. Introduced in 2005, their value remained below €0.5 million until 2011. Since then, municipal bonds have gradually risen, peaking at €17.5 million in 2021 before slightly declining to €13.7 million in 2023.

The modest rise of municipal bonds suggests a growing interest in local financing solutions, though the amounts remain relatively small compared to other components.

While structural bonds have seen a marked decline, and municipal bonds have an insignificant portion in government domestic debt, treasury securities have emerged as a dominant form of financing.

Namely, with the issuance of the first treasury bills and Government bond in 2004 and 2005 respectively, the share of domestic debt based on treasury securities steadily increased, starting with €32 million in 2004 and reaching over €3 billion in 2023, accounting for nearly 98% of total Government domestic debt.

This substantial increase and dominance in of government securities in the total domestic debt, illustrate the government's shift towards more standardized and potentially lower-cost financing options. Also, the rise in treasury securities indicates a stronger institutional framework for debt management and a greater reliance on the domestic capital and money market.

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Given the unique features and significance of structural bonds and government continuous securities, a comprehensive analysis of the specifics, structure, and historical trends of these two categories will be provided in the following sections.

Structural Bonds in the Republic of North Macedonia -Specifics, Composition and Trends

Although structural bonds have become a minor component of internal government debt in recent years, they historically represented a significant part of North Macedonia's internal public debt. These bonds illustrated the government's financing strategy for various developmental projects and initiatives, playing a crucial role in effective public debt management. Each of these structural bonds plays a unique role in the financial landscape of North Macedonia, serving different purposes and catering to various economic needs.

So, before analyzing the trend of their development over the observed years, it is advisable to briefly explain each of them.

Here's a breakdown of the characteristics of various structural bonds in North Macedonia:

i. Bonds for rehabilitation of Stopanska Banka AD Skopje

These bonds represented the first form of a significant portion of internal public debt, issued in 1995 year, by the newly founded Bank Rehabilitation Agency, as part of the bank's rehabilitation process, regulated by the Law on the Rehabilitation and Reconstruction of Part of the Banking System of the Republic of Macedonia (Official Gazette 14/95).

Based on this Law, on behalf of the Government, the Agency, issued to Stopanska Banka -Skopje, 20-year maturity bond for 6,000,000,000.00 denars for its rehabilitation and reconstruction. The payment due on this bond was on April 1 of each year, starting from April 1, 1996. This bond existed in the internal debt portfolio structure till 2006, indicating the completion of the rehabilitation process and a shift in the government's fiscal strategy.

Also, as part of the rehabilitation process of the whole banking system, the Government issued additional 5 years maturity semi-annual bond in the amount of up to 3,300.00 million denars, which started to be re-paid from 1997 year till 2001 year. This bond was issued to meet the demands of the banks from the Government, based on remaining deposited foreign currency (savings deposits) that are recorded in the banks' balances.

ii. Bonds on Selective Loans

Loans and bonds are usually designed to provide targeted financing to specific sectors or projects, often aimed at stimulating economic growth or addressing particular needs within the economy. In the case of the Republic of Macedonia, this bond was issued based on the same Law on Banks' Rehabilitation and Reconstruction (Official Gazette of the RM No. 14/95, as a replacement of selective loans given from the National Bank of Macedonia to support agricultural sector through commercial banks. The bond was of a zero-coupon type in amount of 1,039 million denars, and was paid in a lump sum on April 1, 2020. (Ministry of Finance of the Republic of North Macedonia, n.d.-b)

iii. Bond for Privatization of Stopanska Banka -Skopje

This bond was issued as part of the government's privatization strategy for Stopanska Banka -Skopje. Namely, on December 31, 1999, the Government rehabilitated Stopanska Banka- Skopje for the second time, by taking over loans from several companies, totalling 235 million German marks, and transferring them to the Bank Rehabilitation Agency. As part of the bank's privatization to foreign investors, including the National Bank of Greece, EBRD, and IFC, the government issued bond for the same amount. They also committed to cover any potential legal disputes related to this sale. The bond issuance declined significantly from its peak, indicating a successful transition away from government ownership.

iv. Old Foreign Exchange Savings Bonds

These bonds were issued to enable the government to meet its obligations by compensating citizens for foreign exchange savings held in ex-Yugoslav banks following the breakup in 1991. Namely, in 2000 the old foreign currency savings bonds were issued amounting to 546.5 million euros, to repay the foreign currency deposits of citizens made in the ex-Yugoslav banks' branches in the Republic of Macedonia following the breakup of the former Yugoslav federation. First installment of this bond was paid on 1st April 2002. Repayment period for the bond was 10 years, i.e. it was paid in 20 semi-annual instalments, on 1st April and 1st October. Interest of 2% was calculated on the nominal value of the bonds and paid annually. By regular redemption of the bond's tranches, their value decreased over time, and by October 2011, these bonds were no longer in circulation, reflecting the resolution of these historical liabilities. (Public Debt Management Department, Ministry of Finance of the Republic of Macedonia, 2010, 2011, 2012, 2013, 2014, 2015, 2016, 2017)

v. Denationalization Bonds (I-XXII Issue)

Denationalization bonds were issued to compensate individuals whose property was nationalized during previous political regimes, allowing the Government to facilitate the process of denationalization. Issued for the first time in 2002 year in multiple series (I-XXII till the end of 2023 year), these bonds varied in terms and conditions, reflecting different phases of the denationalization process. They offered fixed interest rates and were designed to restore property rights, supporting the overall economic reform agenda. These are the only type of structural bonds issued to compensate individuals for transition-related losses that remain in the internal public debt portfolio at the end of 2023. Obligations for further emissions of these bonds will continue until 2027 By the end of 2023, 12 issues of denationalization bonds totalling EUR 314 million have been issued. (Public Debt Management Department, Ministry of Finance of the Republic of Macedonia, 2018, 2019, 2020, 2021, 2022)

vi. Municipal Structural Bonds

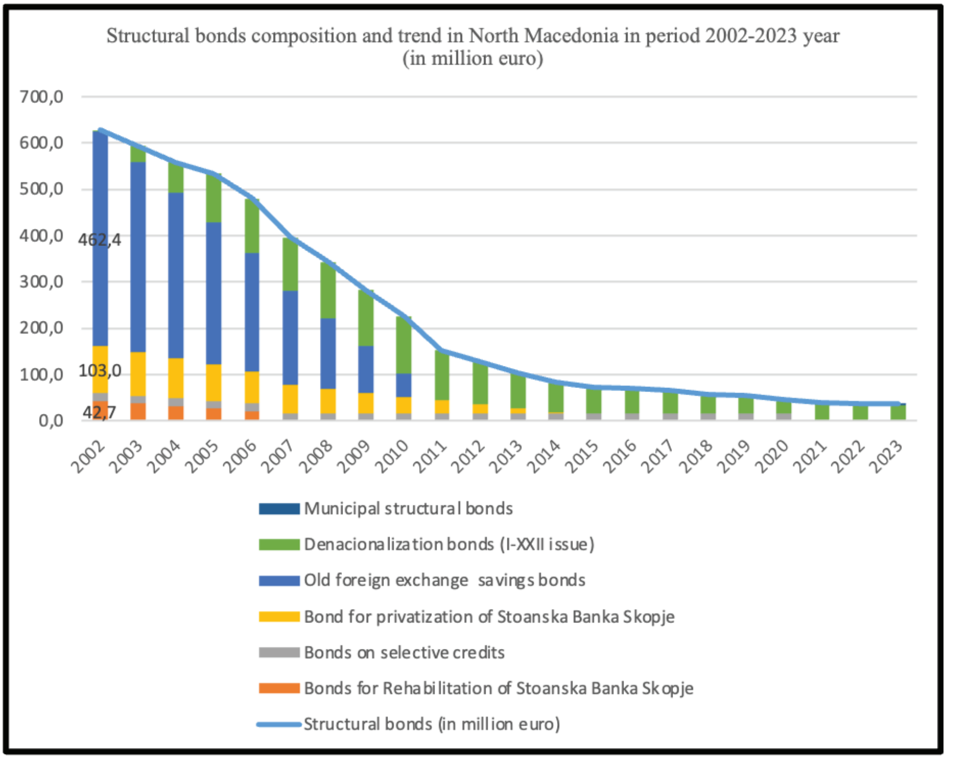
Municipal structural bonds represent newer category of bonds, first issued in 2023 year, for 3 municipalities in the North Macedonia, intended to support financial stability of the municipalities, thus to finance the due, unpaid municipal obligations occurred till 2021 year. As they are relatively new, their structure and specific terms may evolve based on market demand and local government needs. This instrument involves the issuance of zero-coupon structural bonds with a maturity period up to ten years, providing municipalities with the necessary funds to settle their outstanding obligations and enhance their financial capacity.

Evolution and Trends of Structural Bonds in the North Macedonia (2002-2023)

The trend of each particular structural bond in the period 2002-2023 year, reveal critical insights into the country's fiscal policies and economic challenges. As presented in the Figure 7, there are general and specific remarks on the trend of structural bonds over the observed period:

- *Declining of the overall structural bonds volume:* The total value of structural bonds has shown a notable decline over the years, dropping from 626.9 million euros in 2002 to just 37.3 million euros in 2023. This trend indicates a diminishing reliance on structural bonds as a source of financing.
- *Changed composition of the structural bonds 'portfolio over the observed period:* While at the beginning of the observed period there was a dominance of Old Foreign Exchange Savings Bonds (participating with 74%), followed by Bond for Rehabilitation and for Privatization of Stopanska Banka, as of 2012 onwards, the dominant are Denationalization bonds, representing almost the whole structural bonds' portfolio in 2023.

Graph 7. Trends and Composition of the Structural Bonds in the North Macedonia (2002-2023)



Source: Ministry of Finance of the Republic of North Macedonia (n.d.-a) (graph created by the author).

- *Bonds for Rehabilitation of Stopanska Banka AD Skopje* were phased out after 2007, with no further issuance, highlighting a significant shift in fiscal strategies post-rehabilitation.

- *Bonds on Selective Credits* remained unchanged till 2019 when they were completely paid off in 2020.
- Bonds for Privatization of Stopanska Banka AD Skopje decreased steadily from 103.0 million euros in 2002 to 0.0 million euros by 2015, indicating a shift away from privatization financing as the bank underwent reforms.
- Old Foreign Exchange Savings Bonds showed a declining trend, vanishing completely from 2010 onwards, signalling a resolution of older debt obligations.
- Denationalization Bonds initially increased from 1.9 million euros in 2002 to a peak of 117.8 million euros in 2006. These bonds are still having new issuances, reflecting changes in government policy regarding denationalization processes.
- The Municipal Structural Bond has the first issuance recorded in 2023 (4.2 million euros), which reflects a new strategy to enhance local financing through municipal instruments.

Generally, the gradual decline in traditional structural bonds indicates a move towards alternative financing mechanisms or reliance on different types of public debt.

The Specifics and Structure of the Government Securities in Republic of North Macedonia

Government securities as defined in the Law on Public debt, are risk-free securities, issued by the Ministry of Finance on behalf of the Government of the Republic of Macedonia.

They can be:

- Short term Treasury bills with maturity ranging from one to twelve months and
- Medium and Long-term Government bonds with maturities ranging from two to thirty years.

While Treasury bills are discount securities, issued and paid under nominal value, and sold under discounted value, Government bonds are issued and paid at nominal value and are sold at the price reached on the auction. Government bonds bear semi-annual or annual coupon interest until maturity and the nominal value of each bond is 10.000 denars.

Government securities are sold via auctions conducted by the National Bank of the Republic of North Macedonia, acting as the Ministry of Finance’s agent. Only authorized direct participants, which include all banks in the Republic of Macedonia, can take part in these auctions directly. Other interested residents and non-residents may participate indirectly through the banks. (Public Debt Management Strategy of the Republic of Macedonia for the period 2006–2008, 2005).

Going back to history, the first auction of government securities was successfully launched in January 2004, by issuing 3-month treasury bills. In the same year, as a result of a promotional campaign and the great interest of the investors for these risk-free instruments, 6-month treasury bills were successfully introduced, while in 2005, 12-month treasury bills and 2-year government bonds were introduced.

Although the auctions for government securities were quite successful, their growth was modest until 2011, reaching €350 million. However, since 2012, when the amount rose to €805 million, there has been a significant and continuous upward trend throughout the observed period, reaching the level of €3,034 million, representing nearly the whole Government’s domestic debt in 2023.

Due to the expansive use of government securities as a funding source to meet public spending needs, the Ministry of Finance has already established the practice of holding regular auctions of government securities, presented in the Calendar of Issuance of Government Securities. The calendar is published on the website of the Ministry of Finance on a regular basis, at the beginning of the relevant period.

According to the Ministry of Finance‘s Annual Report on Public Debt Management for 2023, a total of fifty-six auctions were held for government securities or more specifically:

- one auction for 6-month treasury bills,
- twenty-four auctions for 12-month treasury bills,
- four auctions for 2-year government bonds,
- one auction for 2-year government bonds, and
- twenty-six auctions for 15-year government bonds.

The total amount of issued and realized government securities at the auctions in 2023 was 73,416.09 million denars, although the demand amounted to 78,400.56 million denars (Public Debt Management Department, Ministry of Finance of the Republic of Macedonia, 2018, 2019, 2020, 2021, 2022).

The structure of a continuous government securities portfolio consists of 12-month treasury bills, 2-year bonds, 3-year bonds, 5-year bonds, 7-year bonds, 10-year bonds, 15-year bonds, and 30-year bonds.

As of December 31, 2023, the percentage share of long-term securities in the maturity structure of government securities was 77.07%, (with the domination of 15-year government bonds, representing over 46% of the total government securities portfolio) while the share of short-term securities was 22.93%. This structure can be considered a favourable one, as issuing long-term securities reduces the risk of refinancing debt.

The ownership of the government securities portfolio is distributed among commercial banks in the country, pension funds, insurance companies, savings banks, individuals, and legal entities, as well as other institutional investors from both the domestic and foreign markets. As of December 31, 2023, the percentage share of banks in the ownership structure of government securities was 32.66%, pension funds contributed with 46,6%, insurance companies with 7,4%, and the other investors' participation is about 13%.

It is important to note that while banks were the dominant holders of government securities at the outset of the auctions, this situation has significantly improved over time. However, considering that funds from banks should ideally be used to finance the activities of the business sector and citizens rather than for state debt, this structure is favourable but still requires adjustment. The participation of banks should continue to decrease to benefit the civil sector, which currently accounts for only about 1% of the government securities portfolio.

In 2023, the Ministry of Finance issued Citizens bonds with a 2-year maturity and an interest rate of 5.0% as well as Green Government bonds for the first time, amounting to 600 million denars with a 2-year maturity and an interest rate of 4.75%. It is expected that the introduction of these medium-term indexed instruments would encourage the financing of development projects within North Macedonia and facilitate the movement of financial markets.

CONCLUSION

Over the past three decades, North Macedonia, as a former Yugoslav republic, has experienced significant transformations in its public debt landscape. From the onset of its independence in 1992, the country's public debt has increased more than tenfold, reflecting the challenges and shifts in its economic policies and external environment.

In the early years following independence, particularly in the first decade from 1992 to 2002, North Macedonia's public debt remained relatively stable, with the debt-to-GDP ratio hovering between 35% and 40%. The subsequent decade, however, marked a period of significant fluctuation in public debt to GDP levels, starting from the lowest point in 2008 at approximately 23%, till the highest one of 62,1% reached in 2023, due to significant borrowing to finance economic measures in response to external shocks of COVID-19 pandemic and energy crisis.

Throughout these three decades, North Macedonia's public debt has evolved from a primarily external debt structure to a more diversified portfolio, incorporating both domestic and external elements.

Namely, in the first decade, external debt exclusively contributed to the total public debt portfolio, dominated by foreign commercial banks and international and bilateral official creditors. In recent years, however, domestic debt has become an essential part of the public debt portfolio, contributing nearly 40%. The current external public debt, although still dominant and financed by various sources, substantially relies on the issuance of Eurobonds to private creditors, with official creditors (multilateral and bilateral) contributing only one-third of the external public debt. This current distribution highlights the government's strategic determination to strengthen activities at capital markets through Eurobonds, indicating a shift towards more market-based financing while still maintaining relationships with multilateral institutions for additional support.

As the external debt is still dominant in the public debt portfolio, the government is actively working to stimulate capital markets through as issuance of mid-term domestic debt instruments (Citizens bonds, Green government bonds as well as Project Bonds) which would intense the dynamic of the domestic financial market.

Despite improvements in public debt structure and management, the government needs to implement further measures to increase the size of the domestic government debt market and reduce reliance on volatile external funding. Additionally, enhancing the liquidity of domestic government securities through the development of a secondary market is essential. This improvement would alleviate pressure from foreign exchange fluctuations, international creditors, and volatility in the global financial market, allowing for a more flexible debt policy.

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