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COMMISSION STAFF WORKING DOCUMENT

ECONOMIC REFORM PROGRAMME

OF

NORTH MACEDONIA
(2023-2025)

COMMISSION ASSESSMENT

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1. EXECUTIVE SUMMARY

Following a slowdown in growth in 2022 as the economy of North Macedonia was hit heavily by the surge in global energy prices, the economic reform programme (ERP) projects that growth will gradually accelerate in 2023-25 due to an increase in public and private investment. Economic activity slowed down throughout 2022, as domestic demand weakened and GDP growth dropped to an estimated 2.1%. Inflation rose to a record level, mainly as a result of increases in global energy and commodity prices. The country's heavy dependence on energy imports led to a sharp deterioration in its current account. The ERP's baseline scenario is that output growth will accelerate due to strengthening foreign demand and a large surge in investment. The latter will be due to a marked increase in public capital expenditure supported by measures to improve implementation capacity. Annual real GDP growth is expected to gradually accelerate to an average of 4% in 2023-2025. Net exports are set to have a negative impact on growth, but to a gradually diminishing extent. The ERP's growth scenario seems somewhat optimistic given significant downward risks to growth (e.g. uncertainties about the future course of the Russian war of aggression, of global energy and commodity prices, and of global financial market conditions; domestic pressures on inflation, such as high wage growth; and major implementation and management risks for both private and public investment).

Public finances improved in 2022 despite large-scale energy support, but the government's plans for medium-term fiscal consolidation are back-loaded, thus postponing the return to the pre-pandemic primary balance until after the programme period. Inflation and other factors caused income from taxes and contributions to rise above the planned levels in 2022 and the fiscal deficit was lower than targeted at 4.5% of GDP. The ERP projects that fiscal consolidation will continue in 2023-2025, with the overall government deficit dropping to 2.9% of GDP in 2025. However, the primary balance is projected to return to its pre-pandemic level only in 2027. Consolidation would initially be driven by increased revenue based on tax reforms that streamline preferential tax treatments and exemptions and, pending adoption by the parliament, would apply as of January 2023. On the expenditure side, the intended savings are not well specified. The public debt level is expected to remain above 60% of GDP throughout the programme's lifetime.

North Macedonia is facing a number of key challenges.

- **The need to restore fiscal space means that consolidation could be brought forward with the help of tax and governance reforms.** As regards the 2023 budget, any excess revenues (e.g. any generated through the planned solidarity tax) as well as potential underspending on the energy support budget should be used to reduce the deficit. Untargeted support measures should be gradually withdrawn. The 2022 tax reform package is an important step towards increasing public revenue and should be extended with further tax base-broadening measures. In parallel, shortcomings in staffing and technical capacities in the Public Revenue Office need to be addressed. Strengthening fiscal governance would facilitate the return to a more prudent fiscal position. The provisions of the new Organic Budget Law (OBL) and particularly the fiscal rules should be swiftly implemented. The fiscal council should be enabled to start working in the course of 2023.

- **The execution of the government's large investment agenda is vulnerable to risks stemming from deficiencies in public investment management (PIM) and in the monitoring of fiscal risks inherent in the operations of public sector entities.** The implementation of the 2021 PIM Action Plan therefore needs to be accelerated and the new PIM unit in the Ministry of Finance must become operational and start to develop joint methodologies and criteria for the appraisal, selection and monitoring of investment projects applicable to all public sector entities. The need to raise additional private financing for these projects requires the development of new financing structures and controlling the associated fiscal risks. This particularly includes a new legal framework for public-private partnerships.

- **A challenging business environment is undermining the competitiveness of domestic companies, investment and global value chain (GVC) integration.** This applies to a large part to the informal economy and involves a lack of skills, innovation and technology adoption; a complex legal and regulatory environment; low productivity; and the need to make progress with the digital transition. The impact of the COVID-19 pandemic and Russia's invasion of Ukraine (including high energy, commodity and food prices, combined with supply chain disruptions) has exacerbated these structural challenges and impaired competitiveness. Companies are also affected by vulnerabilities in GVCs. The need to accelerate structural reforms has become even more important in order to promote a sustainable recovery in the medium term. Improving the competitiveness of local companies and benefiting from the post-crisis restructuring of GVCs will require improvements to human and physical capital and the business environment (including better enforcement of business regulation and corporate governance; addressing the informal economy; promoting the digital transition; a more focused investment and export promotion strategy; and less complex state aid rules). Greater investment in research and innovation as well as progress in regional integration could further support competitiveness.

- **Russia's aggression against Ukraine and the energy crisis clearly demonstrate that the green transition is the country's best chance to reduce its vulnerability to external shocks and become more energy-independent**. The economy of North Macedonia is currently characterised by high energy intensity; inefficiencies in the ageing energy production system; persistently high dependence on highly polluting lignite coal; and inefficient energy use. The energy supply is unreliable and needs to be further diversified. The clean energy transition can help to lower energy prices over time and reduce reliance on imports. Renewable energy still accounts for only a relatively small share of power generation. Energy efficiency can significantly reduce the impact of energy costs on the economy's competitiveness by reducing the overall need for energy, but measures to improve energy efficiency will have to make significant progress. The energy transition and the sustainability of the energy system are priorities in various strategies and action plans adopted by the country, thus demonstrating the government's commitment to the green transition. However, implementation is a challenge and requires enhanced institutional capacity and coordination (including a governance mechanism, an action plan and a monitoring mechanism for a 'just transition' process).

- **The education system does not adequately equip young people with the key competences – skills and knowledge – that they need to actively participate in the labour market.** North Macedonia has made good progress in terms of raising the number of people with higher education, but an inadequate quality of education and business structures is contributing to the persistently high level of unemployment and a still significant share of young people not in employment, education or training (NEET). The education strategy and related action plan prioritise equipping young people with high-quality skills to prepare them for the labour market, but state financial support is insufficient and intersectoral coordination still needs further improvement. Students and families receive limited career guidance when making important choices and curricula are not always consistent with labour market needs.

The policy guidance jointly adopted at the Economic and Financial Dialogue of May 2022 has been partially implemented. The government has adopted two sets of fiscal measures to mitigate the impact of the energy and cost of living crisis on vulnerable households and firms. It has presented fiscal consolidation plans, which project a return to the pre-pandemic primary balance by 2027. It has secured important amendments to tax laws in order to increase public revenue by broadening the tax base for direct taxation and VAT. The government has started work on secondary legislation to the new Organic Budget Law, which was adopted by the parliament in September 2022, and has launched the appointment procedure for the new Fiscal Council. It has set up a dedicated unit in the Ministry of Finance for public investment management and has made progress towards the adoption of a new law on public-private partnerships. The central bank has tightened monetary policy in line with developments in inflation and taken further measures to take forward its strategy to increase the use of the local currency (denarisation). Efforts continued to improve the national e-services portal (www.uslugi.gov.mk) which provides electronic services to citizens, but progress is below expectations. The country is showing a continued commitment to streamlining para-fiscal charges, but progress in implementation is slow. As regards the green energy transition, the adopted National Energy Action Plan sets out clear commitments and timelines, including the delayed establishment of the Energy Efficiency Fund (the legal and regulatory framework is still missing) and the much needed adoption of secondary legislation in the area of energy efficiency. Progress in increasing the technical and engineering capacity of the Energy Department in the Ministry of Economy and the Energy Agency was limited. North Macedonia has focused the development of a new financing formula on primary and secondary education and is planning to review the financing of the vocational education and training (VET) system. For higher education, a new formula has not yet been developed. The new law on VET has been drafted but its final adoption is pending. Staff have received training in order to improve the Centres of Social Work. As regards active labour market policies, North Macedonia is providing more targeted solutions. However, no new measures specifically for low-skilled and vulnerable unemployed individuals have been introduced. The structural reform measures set out in last year's ERP (2022-2024) have only been partially implemented.

The key challenges identified in the ERP match those identified by the European Commission. The planned structural reform measures almost entirely focus on addressing these identified key challenges. The structural reform measures, often rolled over from last year's ERP, follow a fairly consistent approach for the country's economic development and are to a good extent coherent with other national plans and strategies. In an effort to better support the post-pandemic economic recovery and to deal with the fallout of Russia's war against Ukraine, the ERP has proposed various measures to promote inclusive and sustainable economic growth in line with the EU's priorities of the green transition and (albeit to a more limited extent) digitalisation. The impact assessment for the structural reform measures could be further improved to make it possible to prioritise the measures on the basis of their economic, social and environmental impact. The common EU growth model for the green and digital transitions will also have to be further strengthened in the ERP process for North Macedonia (particularly in the current geo-political context).

2. ECONOMIC OUTLOOK AND RISKS

Following a partial recovery from the recession caused by the COVID-19 pandemic recession, North Macedonia has been severely hit by the fallout from Russia's war of aggression against Ukraine. Annual GDP growth dropped to 2.1% in 2022[1] from 3.9% in 2021 as external demand weakened, disruptions in global supply chains persisted, and global food and energy prices rose rapidly. Headline inflation surged to 19.8% in October 2022, reflecting the economy's high sensitivity to the global energy and food price shock, before abating somewhat in November and December.

The programme's baseline scenario predicts that real GDP growth will accelerate during the ERP's lifetime. Growth is projected to average 4% per year in 2023-2025 (about one percentage point lower than in the previous programme) mainly due to a larger negative contribution from the external side. Investment is expected to increase by 7.1% annually on average, while private consumption is set to expand at a more moderate rate of 3.2% per year. The output gap is projected to stay negative for longer than anticipated in the previous programme, and will only close in 2024-2025. Exports are projected to pick up from 2024 in line with strengthening foreign demand. This, together with accelerated investment growth, will also spur imports (+6.6% year on year on average in 2023 -2025) but by less than exports (+7%). Overall, the negative contribution to growth from the external side is set to gradually diminish over the programme's lifetime.

The programme presents two alternative macroeconomic scenarios based on risks to the baseline projection. The materialisation of unfavourable external risks, assuming that annual export growth turns out lower by 1.9 percentage points (pps) compared to the baseline scenario, would result in average annual output growth of 3% between 2023 and 2025 (compared with 4% in the baseline scenario). The domestic risks scenario assumes weaker growth of investment in response to lower implementation of public infrastructure projects and withdrawal of fiscal support for private enterprises. This would lead to lower average annual output growth of 0.4 pps when compared with the baseline scenario.

The ERP baseline scenario seems overly optimistic. The expected surge in investment might be hampered by significant deficiencies in public investment management that obstruct the planned implementation of budgeted capital expenditure. This also concerns the planned introduction of structural financing instruments, such as public-private partnerships. The large build-up of inventories by private-sector companies in 2022 (in anticipation of possible further input price increases) may keep private investment lower than expected for a time, at least in 2023. Moreover, the macroeconomic and fiscal outlooks continue to be affected by high uncertainty related to the further economic fallout from Russia's war of aggression against Ukraine (particularly on energy supply and inflation) and tighter financing conditions that are further limiting domestic demand. North Macedonia has limited direct exposure to Russia or Ukraine, but its economy is sensitive to rising commodity prices.

(1) Macroeconomic and fiscal estimates and forecasts covering the period 2022-25 have been taken from the ERPs themselves; if available, preliminary macroeconomic and fiscal outturn data for 2022 have been taken from the relevant national sources (national statistical office, ministry of finance, central bank).

North Macedonia - Comparison of macroeconomic developments and forecasts

	2021		2022		2023		2024		2025	
	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**
Real GDP (% change)	4.0	**3.9**	2.3	**2.7**	2.5	**2.9**	2.8	**4.1**	n.a.	**5.0**
Contributions:										
- Final domestic demand	5.6	**5.5**	6.3	**7.2**	3.4	**3.6**	3.0	**5.3**	n.a.	**5.8**
- Change in inventories	1.1	**n.a.**	1.5	**n.a.**	-0.5	**n.a.**	0.0	**n.a.**	n.a.	**n.a.**
- External balance of goods and services	-2.8	**-1.6**	-5.4	**-4.5**	-0.4	**-0.7**	-0.2	**-1.2**	n.a.	**-0.8**
Employment (% change)	1.1	**n.a.**	1.1	**n.a.**	0.9	**n.a.**	0.7	**n.a.**	n.a.	**n.a.**
Unemployment rate (%)	15.5	**n.a.**	14.8	**n.a.**	14.7	**n.a.**	14.6	**n.a.**	n.a.	**n.a.**
GDP deflator (% change)	6.1	**3.6**	10.3	**12.4**	7.3	**7.5**	2.3	**2.4**	n.a.	**2.0**
CPI inflation (%)	3.2	**3.2**	12.7	**14.3**	7.9	**8.5**	4.0	**2.4**	n.a.	**2.0**
Current account balance (% of GDP)	-3.5	**-3.1**	-7.8	**-7.4**	-4.8	**-5.6**	-3.6	**-2.1**	n.a.	**-1.2**
General government balance (% of GDP)	-5.4	**-5.4**	-5.4	**-5.1**	-4.4	**-4.6**	-3.3	**-3.4**	n.a.	**-2.9**
Government gross debt (% of GDP)	51.8	**52.0**	51.4	**49.5**	51.6	**51.0**	52.5	**51.8**	n.a.	**51.4**

Sources: Economic Reform Programme (ERP) 2023, Commission Autumn 2022 forecast.

The import-driven inflationary pressures of 2022 are expected to subside during the ERP period, but domestic factors may pose a risk to price stability. Inflation increased significantly in 2022 due to higher prices for food, energy and transport that were themselves mainly due to increasing global prices. Average annual inflation rose to 14.2% in 2022 (3.2% in 2021). The central bank tightened its monetary stance by raising the key policy rate from 1.25% to 5.25% in nine consecutive steps between April 2022 and February 2023. Headline inflation started to decline in November, due to decelerating price rises for food and energy products [2], but core inflation did not slow down and only stabilised somewhat in January 2023. Food and energy together account for almost 60% of the domestic CPI structure and price increases for these two categories explain about 75% of headline inflation. The country's industry (particularly its food producers) are heavily dependent on imports and not only for energy. The programme projects that annual average consumer price inflation will fall to 8.5% in 2023 and back to its long-term average of about 2% in 2025. This is based on a projected slowdown in the growth of energy prices and decreasing price pressures for primary goods. North Macedonia is a small and open economy with a de facto currency peg, so its price level is largely determined by international price developments. However, although the programme's assumptions about global price developments seem plausible in the medium term, domestic factors (e.g. further strong increases in nominal wages that may potentially lead to a wage-price spiral) may nevertheless pose a risk to price stability. The government raised the minimum wage by 12% starting from April. It is also planning to raise public sector wages further this year. Higher average nominal wages would also accelerate the increase in pensions under the new indexation formula, thus creating additional demand pressures.

The current account deficit is projected to narrow gradually to 1.2% of GDP in 2025. The current account deficit rose markedly in 2022, to 6% of GDP, on account of a widening energy trade deficit that reflected the country's high dependence on energy imports. A marked increase in private transfers (remittances) and in the services surplus, helped by a rebound in tourism, partly offset the deterioration in the energy trade balancet. The projected narrowing of the current account deficit over the ERP cycle will be mainly due to a significant improvement in the trade in goods balance (by a total of 7.6 pps in 2022-2025) which is itself due to stronger external demand and lower import prices. The surplus in the trade in services balance is predicted to increase until 2024 but to fall after that. Inflows from remittances are

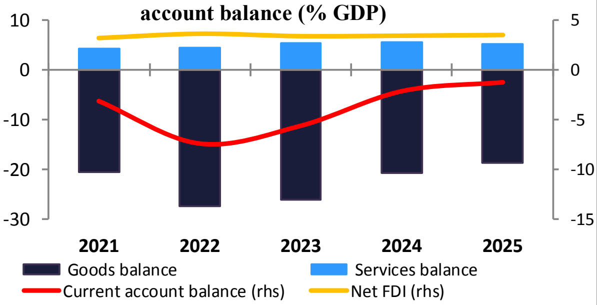
(2) This was driven by global price developments and was supported by government subsidies and regulatory measures to contain food price inflation.

forecast to continue fluctuating considerably between years but will hover around their pre-COVID-19 five-year average (16.7% of GDP) throughout the programme's lifetime. The programme does not explain the uneven movement of current transfers. The primary income deficit would widen markedly in 2024 and remain at that level in 2025. Here, too, the programme would have benefited from more explanation. Overall, the drop in the current account balance seems plausible given the background projections of strengthening export demand and declining global commodities prices, but it is still quite optimistic regarding its size of the fall.

Inflows from foreign direct investment (FDI) are projected to fully cover the current account deficit in 2024 and 2025. FDI inflows recovered after a fall triggered by the COVID-19 pandemic and increased to 5.8% of GDP in 2022 (+1.8 pps year on year based on revised FDI data for 2021). This reflected a strong rise in intercompany debt. However, FDI did not fully finance the surging current account deficit in 2022. The programme expects FDI to remain at about its pre-COVID-19 five-year average (3.5% of GDP) throughout the programme's lifetime, reflecting the gradual strengthening of the global economy as well as further 'nearshoring' (foreign companies relocating production facilities closer to their main markets in the EU). Projected FDI inflows in 2023 (3.3% of projected GDP) would again not be sufficient to finance the current account deficit. External debt was 12% higher at the end of the third quarter of 2022 than a year earlier. This was largely due to a rise in private intercompany lending, which is an important instrument for improving liquidity for foreign-owned companies in the country, and which occurred despite a decrease in general government external debt. External debt stood at 85.7% of GDP (+1.5 pps year on year) with long-term debt accounting for the bulk of the total (70%). A high level (some 40%) of total external debt is made up of intercompany loans and trade credits, which are a less risky and more flexible category of debt. External competitiveness (as measured by the real effective exchange rate (REER) deflated by the CPI) slightly decreased. The REER rose by 1.1% due to an increase in the nominal effective exchange rate, with relative prices remaining stable. Nominal unit labour cost (ULC) rose by some 7% in 2022, reflecting the stark increase in nominal wages in a context of subdued productivity growth. The programme contains an external debt sustainability analysis that is based on the IMF approach. This analysis projects a slight rise in overall external debt between 2022 and 2025 (+1 pp). Foreign reserves shrank heavily in the first half of 2022 but recovered later in the year. Foreign reserves were more than 14% lower at the end of June 2022 compared with a year earlier, mainly on account of higher conversion of domestic denar-denominated savings into euro-denominated deposits; the surge in energy imports; and high external debt payments. The exchange markets stabilised somewhat over the summer, with seasonally high inflows of foreign currency that exceeded the central bank's expectations and were supported by a EUR 250 million private placement of government securities in Germany in September 2022. The reserve levels at the end of December 2022 were equivalent to almost 4 months of prospective imports.

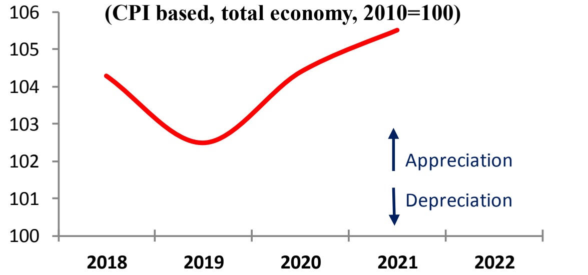
Graphs: external competitiveness and current account

Graph II.3.1a: **North Macedonia - Current account balance (% GDP)**



Source: Economic Reform Programme (ERP) 2023.

Graph II.3.1b: **North Macedonia - Real effective exchange rate, (CPI based, total economy, 2010=100)**



Source: Economic Reform Programme (ERP) 2023, Central Bank.

The country's banks remain well-capitalised and liquid. Banks continue to dominate the financial sector of North Macedonia, accounting for some 79% of the sector's assets. Banking sector concentration remains moderate, with some 57% of assets held by the three biggest banks in 2022. 10 of the sector's 13 banks are predominantly under foreign ownership, accounting for some 75% of the sector's assets. The banking sector's tier-1 capital amounted to 16.3% of risk-weighted assets at the end of the third quarter of 2022 (+0.4 pps year on year). Liquidity indicators point to a slight deterioration, compared with one year earlier, but remain at a high level. The funding of bank loans by deposits (the main funding source for banks) dropped slightly, with the loan-to-deposit ratio higher at the end of the third quarter than one year earlier (+5.4 pps year on year to 87.7%). The ratio of non-performing loans (NPL) to total loans decreased year on year (by -0.3 pps to 3.2% at the end of the third quarter of 2022) and loan-loss provisioning improved. The central bank's strategy to apply different reserve requirements for bank deposits in foreign and local currency contributed to households' denar deposits posting annual increases since November 2022. Private-sector credit growth accelerated in 2022 (by +3.8 pps to 9.6% year on year). Overall, the ratio of loans denominated in foreign currency to total loans had increased at the end of the third quarter (by 1.2 pps year on year to 43%), partly because corporations needed extra liquidity to cover their energy purchases. The currency denomination of domestic credit nevertheless moved further towards denar-denominated loans towards the end of the year. The central bank's key macroprudential role was reinforced by the passing of the Financial Stability Law in the parliament in July 2022. The Law also formally establishes the Financial Stability Committee, an interinstitutional body that monitors the financial system. A number of other key legislative acts in the financial sector are planned for adoption by the government in 2023. There appears to be scope to increase the financial sector's role in reaching climate and energy targets in line with European and international commitments by adopting policy measures in the area of sustainable finance (such as sustainability disclosures, sustainable finance taxonomies etc.).

Table 2

North Macedonia - Financial sector indicators

	2018	2019	2020	2021	2022
Total assets of the banking system (EUR million)	8 187	8 945	9 490	10 363	11 103
Foreign ownership of banking system (%)	71.4	72.8	75.0	76.3	77.7
Credit growth (aop)*	6.6	7.2	6.4	5.8	9.6
Deposit growth (aop)	8.6	9.6	7.8	8.3	4.2
Loan-to-deposit ratio (eop)	91.5	88.4	87.1	86.9	90.4
Financial soundness indicators (%, eop)					
- non-performing loans to total loans**	5.2	4.8	3.4	3.2	2.9
- regulatory capital to risk-weighted assets	15.0	14.8	15.3	15.8	16.6
- liquid assets to total assets	30.6	31.9	32.5	32.4	30.0
- return on equity	16.0	11.7	11.3	12.9	12.2
- forex loans to total loans	41.4	42.3	42.3	41.2	43.2

* corrected for the write-offs

** including the impact of write-offs.

Sources: National Central Bank, IMF.

3. Public finance

The budget deficit was lower than planned in 2022 due to higher than expected revenue and under-execution of expenditure. The revised budget passed by the parliament in July raised the target for the central government fiscal deficit from 4.3% to 5.3% of GDP, mainly to reflect anti-crisis measures to mitigate the impact of rising food and energy prices on households and to support companies' liquidity. Allocations for subsidies and transfers were raised by 40%, but capital expenditure was lowered by 15.7% (compared with the original plan). The actual fiscal deficit of 4.5% of GDP was lower than the revised target. This came on account of an inflation-driven boost to tax income, on the one hand, and of under-execution of several expenditure categories, most notably transfers to the state-owned electricity company ESM and capital expenditure, on the other hand. In addition, public arrears accumulated during 2022. Central government revenue rose by 11.3% compared with 2021, with VAT receipts posting the largest annual increase (+22.4%). Income from social contributions, which temporarily benefited from fiscal support to employer contributions in the case of wage increases, rose by 9.9%. Current expenditure increased by 6.9%, which was less than the 8.3% increase in total expenditure. At 89.2% of budget, implementation of capital expenditure was higher than the average for the previous 5 years (2021: 79%). Over 70% of the actual deficit financing in 2022 came from foreign loans (including a private placement in Germany in the autumn) and from donor support (including the first tranche of a precautionary and liquidity line (PLL) from the IMF to a value of EUR 110 million) [3].

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Table II.3.3:

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

	2021	2022	2023	2024	2025	Change: 2022-25
Revenues	32.4	31.8	32.8	32.5	32.4	0.6
- Taxes and social security contributions	28.8	27.8	28.6	28.7	28.7	0.9
- Other (residual)	3.6	4.0	4.2	3.8	3.7	-0.3
Expenditure	37.8	36.9	37.4	35.9	35.3	-1.6
- Primary expenditure	36.6	35.7	36.0	34.3	33.7	-2.0
of which:						
Gross fixed capital formation	4.2	4.4	6.3	6.2	6.2	1.8
Consumption	10.8	10.9	10.1	9.7	9.3	-1.6
Transfers & subsidies	21.5	20.5	19.7	18.5	18.3	-2.2
Other (residual)	0.0	0.0	0.0	0.0	0.0	0.0
- Interest payments	1.3	1.2	1.4	1.6	1.6	0.4
Budget balance	-5.4	-5.1	-4.6	-3.4	-2.9	2.2
- Cyclically adjusted	-4.6	-4.7	-4.2	-3.2	-3.2	1.5
Primary balance	-4.2	-3.9	-3.2	-1.8	-1.3	2.6
- Cyclically adjusted	-3.3	-3.5	-2.7	-1.6	-1.6	1.9
Gross debt level	52.0	49.5	51.0	51.8	51.4	1.9

Sources: Economic Reform Programme (ERP) 2023, Commission calculations.

The programme's fiscal scenario projects gradual consolidation based primarily on a significant lowering of the current spending-to-GDP ratio. The programme expects the fiscal balance to improve by 2.2 pps between 2022 and 2025 [4] to 2.9% of GDP. Consolidation

(3) Table 4.6. in the ERP, which is based on the July budget revision, does not reflect the actual outcome of financing in 2022. The amount of foreign loans in 2022 was significantly lower than projected in Table 4.6. This meant that the government had to draw down its deposits at the central bank – rather than replenishing them, as anticipated, in view of the large foreign debt repayments due in 2023.

(4) As the fiscal deficit was 4.5% of GDP in 2022 (below the programme's projection), the expected consolidation in the fiscal balance between 2022 and 2025 would be closer to 1.9 pps.

would start later than stated in the consolidation plan presented in the previous year's ERP (when the fiscal deficit was projected to already reach 2.9% in 2024). This is plausible because GDP growth in 2022 was lower than anticipated in the 2021 programme and also because of the energy crisis. A major share (1 pp) of the projected improvement in the general government fiscal balance would come from the revenue side in 2023. The ERP projects that the overall revenue ratio will then begin to decline again, but that tax revenue will remain broadly stable as a share of GDP [5]. The expenditure-to-GDP ratio is also projected to rise in 2023 (by +0.5 pps year on year), albeit by less than the revenue ratio. Consolidation of expenditure would be strongest in 2024. Overall, the revenue ratio (total revenue to GDP) is expected to rise by 0.6 pps in 2022-2025. The expenditure ratio is projected to fall by 1.6 pps in this period despite a large increase in capital expenditure (+1.8 pps). This places the burden of adjustment on current expenditure, which is projected to be significantly reined in (falling by 2.2pps between 2022 and 2025) – due largely to a decline in government consumption (-1.6 pps) that is not explained further in the programme. The 2025 deficit would nevertheless remain larger than the pre-crisis 2019 deficit of 2.2%. The primary deficit is projected to decline from 4.2% of GDP in 2021 to 1.3% in 2025, but would remain above its pre-crisis level (0.8%) throughout the programme's lifetime. The latter would only be reached in 2027 according to the programme. The ERP's projection for the narrowing of the cyclically-adjusted primary budget deficit between 2022 and 2024 points to a fiscal tightening of around 1 pp in 2023 and also in 2024, even as the output gap is projected to remain negative. The programme expects the output gap to close and the fiscal stance to become neutral in 2025.

The 2023 budget benefits from revenue reforms and provides for continued energy crisis support and a surge in public investment. The general government fiscal deficit is projected to drop only moderately in 2023 to 4.6% of GDP (down from an actual deficit of 4.5% of GDP in 2022). The programme expects the general government's total revenue to amount to 32.8% of projected GDP, which is 2.2 pps higher than the actual 2022 outcome. In addition to benefitting from a level of inflation that is still high, revenues would be boosted by 0.5% of GDP in 2023 on account of the tax reforms adopted by the government in December 2022. These reforms broaden the tax base for direct taxation and VAT, and, pending full adoption by the parliament, would be applied as of January 2023. The reduced VAT rate on electricity for households has been increased from 5% to 10% on 1 January 2023, as planned, and it is expected to be fully normalized to 18% by 1 July.[6] Additional revenue amounting to another 0.5% of projected GDP would be raised from the EU's energy support grant (EUR 80 million or 1.6% of projected 2023 total revenue, of which EUR 72 million are disbursed in 2023). Total expenditure would amount to 37.4% of projected GDP in 2023, which is 2.4 pps above the 2022 level. The government plans to achieve some savings from the phasing-out of untargeted crisis support measures and from cutting government consumption, while at the same time strengthening support to the vulnerable and scaling up public investment. Social transfers are projected to rise by 9.7% in 2023 due to an expected increase in healthcare cost (mainly due to the government plan to settle the large payment arrears accumulated by the health fund). The 2023 budget contains allocations for energy subsidies to the domestic electricity producer ESM (EUR 250 million or 1.7% of projected GDP). This suggests that there may be some potential for reallocations or savings because the budgeted amount seems overly generous against the background of the recent and further projected drop in global electricity prices. However, the government has phased out some untargeted support measures: VAT reductions on oil derivatives and gas were already discontinued in 2022, as

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(5) This assumption is plausible because 2023 revenue will be boosted by the one-off EU energy support grant (EUR 72 million out of a total of 80 million, or 0.5% of projected GDP).

(6) The government estimates that the fiscal cost of this measure will amount to some 0.3% of total expenditure in 2023.

well as subsidies for social contributions on pay increases that had been introduced in 2019 (the IMF expects that the latter will produce fiscal savings of 0.5 pps of GDP in 2023). The programme also refers to further savings (0.2% of GDP) from a reduction in government operating costs, but without identifying concrete sources. Capital expenditure would increase by over 70% compared with 2022 (+2.4 pps in terms of GDP). This amount includes substantial funds for the continuation of Road Corridor VIII and X-D construction [7].

Debt dynamics

The ERP projects that general government gross debt will peak in 2024 at 51.8% of GDP before declining slightly to 51.4% by the end of 2025. The primary budget deficit is projected to narrow by a total of 2.6 pps in 2022-2025, which indicates that its impact on the change in the debt-to-GDP ratio will decline. In line with expectations for a gradually more benign price environment, the debt-decreasing impact of inflation is projected to diminish, while the effect from real growth is forecast to increase and to become the main debt-reducing factor. An anticipated rise in yields means that interest payments are expected to have a stronger debt-driving impact, while the contribution from stock-flow adjustments is projected to turn positive in 2023-2025, partly in response to government plans to replenish its deposits at the central bank.

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

	2021	2022	2023	2024	2025
Gross debt ratio [1]	**52.0**	**49.5**	**51.0**	**51.8**	**51.4**
Change in the ratio	1.2	-2.5	1.5	0.8	-0.3
Contributions [2]:					
1. Primary balance	**4.2**	**3.9**	**3.2**	**1.8**	**1.3**
2. "Snowball" effect	**-2.3**	**-5.6**	**-3.3**	**-1.5**	**-1.8**
Of which:					
Interest expenditure	1.3	1.2	1.4	1.6	1.6
Growth effect	-1.9	-1.2	-1.3	-2.0	-2.4
Inflation effect	-1.7	-5.6	-3.4	-1.1	-1.0
3. Stock-flow adjustment	**-0.7**	**-0.8**	**1.5**	**0.4**	**0.1**

[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) 2023, Commission calculations.

General government debt is projected to remain above 50% of GDP and public debt to remain above 60% of GDP during the programme's lifetime. A negative primary balance as well as stock-flow adjustments will lead to an increase in the debt ratio in 2023 and 2024 (see the box above). The public debt level, which includes the debt of public enterprises, is set to rise to 60.6% in 2023. Public enterprise debt, most of it external public debt with government guarantees, is expected to peak at 9.5% in 2024 (one year later than expected by the previous programme) and to decline to 8.4% in 2025. The maturity structure of public debt implies important refinancing requirements over the medium term. The ERP estimates that gross financing requirements in 2023 will amount to 10.3% of projected GDP, mainly on account of the repayment of the 2016 Eurobond due in July (3% of GDP) and the still high fiscal deficit (4.6% of GDP). Financing needs would drop to 6.4% of GDP in 2024 but rise slightly to 7.7% of GDP in 2025, when the 2018 Eurobond (EUR 500 million) matures. These figures do not include potential calls on contingent liabilities that the government has assumed by guaranteeing the debt of public enterprises. Financing is expected to be ensured through domestic and foreign borrowing (including Eurobonds), donor support from international financial institutions (IFI), EU macro-financial assistance, and new financing instruments such as green bonds. In March 2023, the government issued a Eurobond in the amount of EUR 500 million.

(7) The 2023 budget includes EUR 215 million earmarked for the construction of part of Road Corridor VIII and X-D by the Bechtel-Enka consortium. A special law that replaces standard public procurement rules for this project has been adopted. To solidify the fiscal cost and manage fiscal risks, the IMF had requested the authorities to undertake an independent and comprehensive feasibility study as a structural benchmark under the 2022 PLL for North Macedonia.

The structure of general government debt implies moderate risks. External debt accounted for some 60% of total general government debt at the end of 2022. This has remained unchanged since the end of 2020. Compared with the end of 2021, the share of fixed interest rate debt in total debt decreased by 4.2 pps year on year to 75.3% at the end of the third quarter of 2022 (still comfortably above the 60% threshold set in the Public Debt Management Strategy). Foreign currency debt accounted for 76% of total debt (unchanged from last year) and the share of euro-denominated debt as a proportion of total general government debt rose to 92.3% (+ 0.5 pps year on year). Risks stemming from exchange rate depreciation are mitigated by the de facto currency peg to the euro. The government's continuing strategy of extending the maturities of domestic issues is likely to enable it to gradually refinance more of the maturing external debt by issuing new domestic debt.

Sensitivity analysis

The programme includes a sensitivity analysis of the fiscal deficit based on three parameters, in line with the alternative macroeconomic scenarios. The first parameter is GDP growth. If average annual real GDP growth is lower than projected, by 1.1 pps in 2023-2027, the budget deficit would increase by an average of 0.8 pps per year compared with the baseline projections. The second parameter is capital expenditure. Lower capital expenditure (about 70% realisation compared with the baseline) would imply an annual reduction in GDP growth of 0.5 pps and an average annual increase in the deficit of 0.4 pps, mainly on account of the negative impact on tax revenue. The third parameter is tax collection. If tax collection falls by 5% per year, this would increase the budget deficit to 4.2% on average in 2023-2027 (compared with 3.5% in the baseline scenario and 4% in the same risk scenario set out in last year's programme for the period 2022-2026). The programme also assesses the exposure of the debt portfolio to interest rate risks (if interest rates rise in 2023 by 1pp more than assumed in the baseline scenario, the debt-servicing cost would surge by 5.4%), and the impact of a 10% depreciation of the euro with respect to other currencies in the portfolio (leading to a 0.1% increase in debt-servicing cost in 2023).

Ongoing tax reforms are supporting fiscal consolidation, but the planned consolidation of expenditure needs to be underpinned with sufficiently concrete measures. The programme outlines revenue-increasing measures (some of which have yet to be adopted) but remains vague on options for streamlining expenditures, even though a large fall in the current spending ratio is projected to drive the planned deficit reduction over the ERP period. On the expenditure side, the government is bolstering targeted fiscal support to vulnerable households to deal with the rising cost of living, while at the same time adhering to a number of broad-based, untargeted energy support measures. The mandatory indexation of minimum wages, which is raising average wages (and therefore also public sector wages) and the indexation of pensions[8] will probably reduce expected savings. Furthermore, potential savings in the biggest category of subsidies (in agriculture, which accounted on average for 1.2% of GDP in 2015-2022) have not been considered in the consolidation plans. At the same time, the planned large increase in capital expenditure, which as a percentage of GDP is expected to rise from an estimated 3.4% of GDP in 2022 to 5.3% in 2023, seems overly ambitious in view of the government's poor track record in executing its public investment plans and the deficient framework governing public investment. Plans to attract more private funds to finance public capital projects (as set out in the October 2021 Fiscal Sustainability and Economic Growth Support Plan) have made little progress. These plans include improving the legal framework for public-private partnerships (PPP), which suffers from

(8) The government has budgeted a 10% rise in pension payments for 2023 compared with 2022, to take account of the new indexation formula. The actual increase turned out to be 8.4% in March 2023, which may alleviate pressures on the expenditure side.

fragmented terms and conditions and a lack of central oversight of fiscal risks. Currently, fiscal risks, such as contingent liabilities arising from PPPs financed by municipalities, are not systematically reported to the central government [9]. Such ambitious plans for capital spending might therefore imply an upside risk for the budget balance, though not necessarily for an improved public expenditure structure. On the upside, the government's December 2022 tax reforms provide for a 'solidarity tax' (a one-off tax on excess corporate profits), which is currently in the parliamentary adoption phase. The government estimates that the revenue from this tax, which is not included in the 2023 budget, could amount to an additional 0.5% of GDP (EUR 76 million), though only as a one-off measure. In addition, the inclusion in the 2023 budget of sizeable allocations for energy subsidies to the domestic electricity producer may not be needed in full and could serve as a buffer to ensure that the public investment budget would not need to be cut mid-year. They could alternatively be used to lower the 2023 deficit and accelerate mid-term consolidation.

The structure of current expenditure will remain focused on social transfers over the programme's lifetime. Social transfers, including pension payments (taking into account the new pension indexation formula and the planned ad hoc pension increase in 2023), [10] amounted to some 52% of total current expenditure in 2023. Social transfers are expected to decline as a share of GDP from 16% in 2022 to 15.3% in 2025. The share of subsidies (primarily agricultural subsidies followed by subsidies to public and private enterprises) is projected to drop from 4.5% of GDP to 3% during this period. Capital expenditure is nevertheless expected to rise gradually over the programme's lifetime from 10% of total expenditure in 2022 to 17.5% in 2025. However, to improve the public expenditure structure, the focus from current to capital spending in the budget would require the implementation of the planned improvements in the selection and management of public investment.

The new Organic Budget Law (OBL) greatly improves the fiscal framework, but progress on other issues is slow. In September 2022, the parliament passed the draft OBL, which provides for the introduction of fiscal rules and a fiscal council and strengthens the medium-term budget procedure. Work on the by-laws and preparations for the new fiscal council to begin work in 2023 is progressing. However, the implementation of wider-ranging measures to improve the planning, allocation and execution of investment projects (as presented by the government in its 2021 Action Plan on the basis of the IMF's 2020 Public Investment Management Assessment (PIMA)) is progressing only slowly. The government has set up a dedicated unit in the Ministry of Finance to ensure centralised oversight of public sector investment, including public enterprises. This unit now needs to start developing a harmonised appraisal methodology for project selection. The new OBL also gives the Ministry of Finance a central role in selecting new investment projects, but this has been delayed by staff shortages. To improve the legal framework for PPP, the government has finalised a draft law, which includes provisions for better management of fiscal risks. This draft law has been submitted to the European Commission for review. It addresses a number of shortcomings in the current legal framework governing PPPs and concessions, such as a lack of detailed administrative guidelines on selecting, implementing and managing PPP

(9) The new Organic Budget Law requires the government to include a description of fiscal risks (at a minimum, those pertaining to the government's contingent liabilities) in the annual fiscal strategy; and the Fiscal Council to assess fiscal risks relating to a number of bodies, including public enterprises and public-private partnerships.

(10) Pension expenditure accounted for 31.4% of total current expenditure in 2022 and 27% in the 2023 budget. Budget transfers to the Pension and Disability Fund increased by 37% in 2015-2022, but the Fund's pension expenditure rose by 40%.

projects; and also limited central oversight (each contracting authority sets its own contract formats and terms and conditions).

4. KEY STRUCTURAL CHALLENGES AND REFORM PRIORITIES

This chapter sets out the Commission's independent analysis of the economy of North Macedonia and identifies the country's main structural challenges. Addressing the immediate impact of the COVID-19 pandemic as well as risks stemming from Russia's invasion of Ukraine has been a priority for the government. However, medium- to longer-term prospects for both economic growth and resilience to external shocks will depend on the country's ability to implement structural reforms. Each of the country's main challenges influences overall competitiveness in its own way. These challenges very often reinforce each other, however, so it will be essential to address them in order to boost productivity and inclusive growth in the medium- to long-term. The three most significant challenges identified by the Commission – and overall shared by North Macedonia – are:

(i) improving the quality and relevance of the education system to increase employment and mitigate skills mismatches;

(ii) improving the competitiveness of domestic companies (including digital transition), integration into GVCs and reducing the informal economy;

(iii) modernising the energy sector and transitioning to clean energy.

Education outcomes do not sufficiently meet the needs of the labour market. This prolongs the transition from school to work and therefore feeds the informal economy, out-migration and poverty. Key factors that undermine the country's competitiveness, investment and global value chains (GVC) integration include a challenging business environment, a lack of skills, innovation and technology adoption, low productivity, a distortive effect of subsidies on competition and the need to modernise and digitalise public administration. A sustainable post COVID-19 recovery and the need to tackle the economic fallout of Russia's war of aggression against Ukraine points to the need to advance the longer term transition to green growth (particularly in the context of geo-political shocks exacerbating the energy crisis). Such a green transition entails significantly improving energy efficiency, promoting the distribution of less polluting energy production sources and investing in renewable energy sources.

North Macedonia also needs to continue to tackle corruption, improve the rule of law and strengthen its institutions in order to promote competitiveness. Addressing these fundamental needs is a prerequisite for successfully transforming the economy. The Commission is closely following issues to do with strengthening the rule of law and the fighting of corruption in its enlargement package, including the report on North Macedonia.

Furthermore, the country should proactively implement the Energy Community's Decarbonisation Roadmap to achieve the agreed climate and energy targets, and strive towards establishing a carbon pricing instrument compatible with the EU ETS.

Key challenge #1: Improving the quality and relevance of the education system to increase employment and mitigate skills mismatches

The relatively high resilience of the country's labour market during the COVID-19 pandemic gives reason to hope for a slow recovery. Employment has steadily improved over the last decade. The COVID-19 pandemic interrupted this trend, but recent figures suggest some positive developments that may indicate a recovery, though still below the pre-pandemic levels. In the third quarter of 2022, the employment rate (20-64) increased by

2.1 pps to 61.9% and the activity rate by 1.3 ppspps to 72.1%, compared with the third quarter of 2021. This is corroborated by the slightly shrinking unemployment rate (20-64), which fell from 15.5% to 14.2% in the same period but is still well above the EU-27 average (5.9%). The impact of the COVID-19 pandemic, as demonstrated by the main socio-economic indicators, has so far been partially mitigated by the package of measures adopted by the government. However, long-lasting negative effects of the pandemic are still possible due to limited fiscal space. The COVID-19 pandemic primarily hit low-skilled workers, especially people working in agriculture, transport and manufacturing, while employment continued to increase among those with tertiary education. The ERP acknowledges the deficiencies of the labour market under the key challenge 'Strengthening of human capital for inclusive development', but the proposed measures only address some aspects and no new relevant measures have been added to those that were included in the previous ERPs.

Some fundamental structural weaknesses of the labour market remain. Women and young people are particularly exposed to unemployment and inactivity, as are people with disabilities and the low-skilled (particularly Roma). The population is also ageing and regional differences are causing unbalanced development with high unemployment rates in the North-East (32% in 2020), Polog (25%) and South-West regions (24%), including for young people. Nationally, 75.4% of all unemployed had been unemployed for more than 12 months in 2020. This is more than twice the rate in the EU-27 (35.8%) and higher than in the other countries in the region. The quality of available jobs remains an important issue to address in order to increase the opportunities for higher educated people and tackling possible 'brain-drain'. 27.6% of young people in employment have jobs that do not correspond to their level of education (World Bank, 2020). Regional disparities are strong and the employment gap remains high between the South-East (the best-performing region) and the North-East (the worst-performing region). The government developed the 2021-2027 National Employment Strategy with the ILO's support to promote more and better jobs for all. The strategy, together with the 2021-2023 action plan sets three key objectives: (1) improving the quality of learning outcomes at all levels; (2) strengthening the role of the policies for the development of the economy and enterprises in the creation of decent jobs; and (3) strengthening the inclusiveness of labour market policies. The strategy was adopted in November 2021 and aims not only to address the structural challenges affecting employment growth but also to mitigate the consequences of the COVID-19 pandemic. The government also works on a law on labour market regulation, planned for adoption in 2023, in order to improve its active labour market policies. The law is expected to provide for the contracting of external service providers; introduce lifelong career counselling; and permit social partners to establish foundations to promote employment opportunities.

Young people in particular continue to face obstacles to entering the labour market. Youth unemployment (15-24) remains high and had stagnated at 35.7% in 2021. Many young people have only informal jobs, are low paid and do temporary or part-time work. North Macedonia adopted a new implementation plan in 2022 to reinforce the Youth Guarantee which has been in place since 2018 and led to a significant reduction of youth unemployment from 45.4% in 2018 to 35.6% in 2019 (albeit slowed down by the COVID-19 pandemic). Notwithstanding this success, 26.2% of the total youth population (15-29) were not in employment, education or training (NEET) in 2021. The NEET rate decreased by 2 ppspps compared to 2020, which was also due in part to an assumed decline in the youth population (ILO, 2022). Youth unemployment and NEET rates both remain substantially above the EU-27 averages of 16.6% and 13.1% respectively. In 2021, around 40% of NEETs had been looking for employment for longer than one year. 64.1% of all NEETs had a secondary education in 2021 – compared with 50.2% in 2016 (ILO, 2022). The employment rate of recent graduates (20-34) was only 54.5%, which was one of the lowest rates in the region and in the EU as a whole (the EU-27 average was 79.6%). 39.7% had been unemployed for more than one year in 2021. NEET rates are higher for women (26.1% in 2021) than for men (22.4). The gender gap reflects the social conventions and pressures which prioritise women's roles within the family (OECD, 2020). 22.1% of all NEETs are disengaged from the labour market by care and family responsibilities (ILO, 2022). The further success of Youth Guarantee will hinge to a significant extent on improving the public employment service's capacity (particularly in terms of human and financial resources) as well as that of providers of other key services such as social protection and education. In addition, pending reforms should be accelerated, including the Law on VET and the Law on Adult Education.

Spending on active labour market policies is relatively high, compared to the region, but lower than the EU average. Spending reached 0.27% of GDP in 2020 (the EU-27 average was 0.61% of GDP in 2020). Despite the countrywide implementation of the Youth Guarantee, there has been no comprehensive impact assessment of the effectiveness of active labour market policies for many years. Active labour market policies have a limited scope and cover less than 25% of the poor. However, 66.8% of young unemployed aged 15-29 were involved in some type of active labour market programme in 2020. Better targeting of the most vulnerable categories could involve a combination of additional benefits and specific labour market activation and skills development or the establishment of mobile units to reach out to and work with vulnerable groups (also taking into consideration the experience gained from previous outreach support). Recent progress notwithstanding, the public employment service's capacity is constrained by limited specialised human resources; insufficient staff training; limited national funding for active labour market policies that are increasingly dependent on EU funding; and limited investment in infrastructure (OECD 2021).

Reform measure 2 of the ERP ('Increasing the flexibility of the labour market') continues from the previous year and aims to extend labour legislation (including active employment programmes) to non-standard forms of work. As part of a new law on labour relations that is planned for adoption in 2022, the measure is needed in order to address the current lack of legislation on remote working and working from home. Furthermore, specific active labour market measures will be directed at people in an unfavourable social position and primarily the recipients of guaranteed minimum assistance. Reform measure 2 is intended to help increase the employment rate, decrease unemployment, and reduce poverty and social exclusion. However, the measure only partly addresses the key challenges.

The insufficient relevance and quality of education continues to contribute to skills mismatches, leading to persistent unemployment and underuse of young people's potential. The education system contributes to the lengthy school-to-work transition by failing to identify and meet the needs of the labour market. Some of the issues related to the quality of education in North Macedonia that had already been identified in the past are still evident. The skills mismatch continues to be a major obstacle to people finding work. Job mismatches in terms of young tertiary graduates aged 15-34 working in jobs below their education level stood at 35% in 2019 (ETF, 2019). According to a survey of the OECD, 24% disagree with the claim that skills learned in the education system meet the needs of their job and 50% of surveyed firms identify applicants' lack of skills as a reason for unfilled vacancies (OECD 2022). However, new school and VET curricula do focus more on the needs of the labour market. In addition, North Macedonia has put in place an institutionalised process and tools for monitoring/forecasting skills needs in order to properly align VET, higher education, and upskilling and reskilling offers with labour market needs. The 2021-2027 National Employment Strategy and the 2021-2023 Employment Action Plan are intended to reduce the skills mismatch (15-64) by 5%; to improve the average score of students in North Macedonia in the Programme for International Student Assessment (PISA) 2025 assessment; and to increase the share of adults (25-64) in training to 16%.

The education system of North Macedonia does not provide young people with the key competences and skills they need to actively participate in the labour market. International student assessments show substantial weaknesses for students in North Macedonia and reveal disparities in learning outcomes based on the place of residence, ethnicity, socio-economic status and gender. This continues to constrain companies' competitiveness and their deeper integration into the global economy. The country's PISA results were significantly better in 2018 than in 2015, but it still ranks low among the other participating countries (68th place out of 78) and lower than its regional peers. The TIMSS 2019 survey results show a similar situation, with the country's students coming 45th in mathematics and 51st in science out of the 58 assessed countries. The gender gap is a particular issue because boys are performing worse than girls. This gender gap is far greater than the international average (North Macedonia has the third largest global gender gap in reading performance). Other significant gaps are linked to students' socio-economic status, educational path and the language of instruction. The OECD has signalled that there is a specific problem in fostering a 'growth mind-set'. PISA data also highlight the need for improvements in the quality of teaching because half of all students do not achieve basic literacy and numeracy skills by the age of 15, A positive trend is that percentage of low performers in each subject shrank by at least 9 percentage points between the 2015 and 2018 PISA assessments.

A reform of the education system was planned in the 2018-2025 education strategy but requires increased funding. The education strategy and the related action plan both prioritise the provision of quality skills to young people to prepare them for the labour market. However, these two documents also state that financial support is currently insufficient and that there is no intersectoral coordination. Public spending on education is clearly insufficient. North Macedonia has steadily reduced its spending on education from 4.62% of GDP in 2011 to 3.9% in 2020. This level is currently below the EU-27 average of 5.0% in 2020 and also below peer-country averages. The education system is also impaired by the inefficiency of public spending (World Bank, 2019). Discrepancies in student-teacher ratios in schools are also significant and are reducing the overall quality of education. North Macedonia has developed a new financing model that aims to make the funding of primary and secondary education more transparent and to regulate how the municipalities redistribute funds from the Ministry of Education and Science.

Major reforms are being made in VET, but important legislation is still pending to improve the quality of teaching. Approximately 56% of upper-secondary students in North Macedonia follow a vocational pathway (42 641 students in 2019/2020). This proportion is comparable to that in the rest of the Western Balkans and higher than the EU-27 average (43%). In 2019, 79% of the country's VET graduates later enrolled in tertiary education – compared with 53% of students from general schools (World Bank, 2019). The low rate of transition of students from general upper-secondary education to higher education means that almost half of those who leave secondary school have not acquired a specialisation that equips them to participate in the labour market. The country's reforms particularly focus on the establishment of new regional VET centres, but the operationalisation of the three regional VET centres (in Tetovo, Kumanovo and Ohrid) is hampered by their weak capacity to implement large infrastructure projects and by the slow parliamentary adoption of the necessary legislation (particularly the Law on VET and the Law on Adult Education). The lack of technical skills among vocational-school graduates is seen as a major bottleneck by companies in North Macedonia. This lack arises because VET schools use teaching and learning methods that are largely theoretical; offer limited practical training; and suffer from a lack of teaching and learning materials (OECD, 2019).

Reform Measure 1 of the ERP ('further development of the qualification system'), which has been rolled over from previous years, addresses the key bottleneck in the education system and builds on the activities implemented in 2022 (e.g. the adoption of the new curricula and the establishment of a National Council for Higher Education and Scientific Research that contributes to the development of new norms and standards). A national assessment of the education system will be included into the Law on Primary Education; regional VET centres will be further developed; and there are plans to adopt a new Law on VET and a new Law for a National Qualifications Framework. The government also envisages closer cooperation with companies to establish new VET curricula. The modernisation of the three regional VET centres will be key to implementing this measure and such centres of excellence need to be further developed throughout the country. The modernisation of VET has led to more students enrolling in VET and participating in work-based learning. The number of classes which incorporated dual training components has grown from 97 in the school year 2021-2022 to 225 in 2022-2023. The ERP signals that education is among the government's top priorities, but the measure's expected impact on competitiveness could be further strengthened.

Adults' participation in learning is low. The percentage of adults participating in learning was 2.6% in 2020, which is significantly below the EU-27 average of 10.8% in 2021. Further development of qualifications, arrangements for validation of non-formal and informal learning and upskilling/reskilling programmes throughout the country are key to bringing medium-skilled and low-skilled people into the labour market. Promoting lifelong learning and the strengthening of non-formal education should help to improve workers' technical and managerial skills. This can support fast productivity growth in companies and industry.

The continuing gender gap undermines the overall economic potential of North Macedonia. The gender employment gap (the difference between the employment rates of men and women aged 20-64) was 19.9 ppspps in 2020 (the gender gap in EU-27 was 10.8 pps in 2021). The low level of employment activity of females (20-64) is characterised by a high level of inactivity among low-educated women (79% in 2020). This is largly due to women's traditionally lower presence in the labour market; disincentives for women to work; caring and household duties; women's lack of confidence in their skills and labour market prospects (OECD 2021). In 2019, 36% of women in the working-age population (15-64) were only educated up to lower secondary education, compared to 26% of men (OECD 2022). Women are much more likely to be low paid. Estimates of earnings indicate a significant gender pay gap and the potential for discrimination in the labour market against women. Women in North Macedonia also have a working life that is on average 10.6 years shorter than that of men (2020).

Emigration and population ageing are further contributing to the weakening of skilled workforce of North Macedonia. Emigration of workers is a serious impediment to business. The shortage of jobs – and secure well-paid jobs in particular – is the greatest obstacle to preventing young people from leaving the country and causes a substantial brain-drain. According to projections, the share of the population aged 65 and above will double from 12.5% in 2015 to 25.4% in 2050, thus placing significant strain on the social protection system. This trend will gradually reduce the share of the working-age population (those aged 15-64) from 70.6% in 2015 to 60.4% in 2050 (ILO, Decent Work Programme, 2019). About 59% of businesses struggle to find workers with appropriate skills (OECD 2020). Available analysis recommends that all labour market policies should be mutually consistent and contribute to keeping workers in the country, including by regularly analysing and monitoring emerging skills gaps at the national, regional and local levels and by recognising skills acquired outside the formal system or abroad (ETF 2021).

Key challenge #2: Improving the competitiveness of domestic companies (including digital transition, integration in GVCs and reducing the informal economy)

North Macedonia presents ten measures related to this key challenge 2 in its ERP. Those measures that are more closely linked to the European Commission's assessment of this key challenge are analysed in this section. The others are analysed in Annex A.

A challenging business environment is undermining the competitiveness of domestic companies, investment and integration into the GVC. This includes a large informal economy, a complex legal and regulatory environment and a skills shortage. It also requires the enhancing of innovation, technology adoption, business-academia collaboration, access to finance and investment in greening the economy. Digitalisation of the economy has not proceeded enough. The future success of the economy and of domestic companies mainly depends on the success of a broad range of structural economic reforms in these areas. Prioritising and strengthening targeted public policies to address the underlying structural obstacles to domestic companies' competitiveness could help promote productivity, integrate more domestic enterprises into GVCs and continue to attract FDI[11]. Some progress has been made, but the country's policies to increase competitiveness need to be effectively and continously implemented as well as stepped up in order to have a more lasting impact (OECD 2021), particularly since existing structural weaknesses have been exacerbated by the economic fallout from Russia's war of aggression against Ukraine.

Competition from the large informal sector continues to represent an important constraint for domestic businesses. The informal economy operates on unequal terms with formal businesses and is regularly ranked among top ostacles for doing business in North Macedonia[12]. The most prominent forms of the informal economy are unregistered labour and partially undeclared wages. Estimates vary according to definitions and methodology but essentially range from 38% of GDP (according to IMF estimates) to 23.3% (Finance Think, 2022). The strategy and the action plan to formalise the informal economy require the high-level political commitment of all relevant institutions and will have to be more vigorously implemented, assessed and reviewed, with specific attention being paid to the business environment component. Informal workers remain a high proportion of the total workforce, but this has declined to around 12% in 2021. Designing policies to increase productivity (e.g. by reducing regulation, addressing the skills mismatch and further digitalising public administration) will reduce the informal sector (Finance Think, 2022). Over and above the tax legislation adopted at the end of 2022, it will be necessary to continue implementing the country's Tax System Reform Strategy and rationalising parafiscal charges.

Measure 11 of the ERP, 'Streamline the use of parafiscal charges', which has been rolled over from 2022 and linked to the policy guidance, envisages activities to optimise, consolidate and streamline parafiscal charges. The relevant methodology was developed with EU support. Piloting amendments from the list of 377 parafiscal charges as well as the establishment of a web-portal in view of enhanced transparency are planned from 2023 onward. The government has assigned the Ministry of the Economy to coordinate the process, but the decision to streamline 100 selected parafiscal charges will have to be adopted by the

(11) National laws (including the Law on Trading Companies, the Law on Technological Industrial Development Zones, the Law on Financial Support of Investments, the Law on State Aid Control, and the Law on Strategic Investment) have no unified definition of a foreign investor

(12) www.enterprisesurveys.org

government as a whole. Political commitment will be important because streamlining the parafiscal charges will most probably reduce the income of the public bodies concerned. The measure has potential in terms of fighting the informal economy. Its impact on competitiveness should be further clarified.

Measure 15 of the ERP, which has been rolled over from the previous year and linked to the policy guidance, aims at introducing mechanisms for formalising informal work in sectors with a high incidence of undeclared activity. The measure is relevant but is somewhat limited in scope as action continues to be based on two donor-funded projects and the focus is primarily on temporary workers. The measure looks at the employment part of policies but ignores other important aspects contributing to the informal economy (e.g. the overall business environment and taxation, including social security contributions). The measure could benefit from the planned adoption of a new 2023-2025 strategy. It does not take into account the medium-term impact of the COVID-19 pandemic on the labour market and undeclared work. Its impact on competitiveness has not been quantified and the impact on employment and gender has not been sufficiently considered.

The operational environment for companies can be improved by digitalising public administration, deploying digital technologies (high capacity networks and 5G) and developing digital skills. A fixed broadband connection to the internet is used by 92% of enterprises with 10 or more employees, but smaller companies still face obstacles. Work is ongoing to upgrade the e-portal in order to develop a more user-oriented service delivery. The number of registered users and completed services on the portal is increasing but remains below expectations. Many of these services remain purely informational and cannot be fully performed online (OECD, 2022). The use of the interoperability system is still constrained by a lack of communications software in many institutions and a reluctance to fully exploit its capabilities. A comparatively high 10% of businesses surveyed in the Balkan Barometer 2022 indicate that they do not have the skills required to use online services. The Commission's country report notes the need to develop and adopt a strategy for developing digital skills and a reference framework for digital literacy throughout the society. Digitalisation can reduce corruption (ÖGfE, 2022).Transparency through enhanced digital services is also an important way to reduce the country's informal economy. Overall, there is a particular need to increase access to broadband; expand available e-government services; and develop digital skills. The ERP includes measure 10 which aims to broaden the scope for digital services (see Annex A).

The lack of skills is holding back economic growth and the development of a knowledge society, so increasing investment in human resources is vital. Major skills shortages persist with regard to labour market needs, entailing long school-to-work transition. Analysis of systematic training needs is lacking. Businesses have major concerns regarding the appropriateness of skills taught in the education system and labour shortages (World Bank, 2022; Balkan Barometer 2022). A weak education system that has failed to respond to labour market demand is an incentive for emigration, especially among the young (OECD, 2022). Data from the 2021 population census shows a large outflow of young workers from the labour force. Ongoing reforms that focus on revamping the vocational education system could help address this problem.

The regulatory framework's lack of transparency and predictability continues to affect the business environment and the competitiveness of domestic companies. The government's approach to simplifying the business environment is not sufficiently systematic and consistent. In the Balkan Barometer 2022, transparency of government regulations and decision-making, predictability and stability of policies and rules, as well as consultation processes on proposed legislation are perceived as relatively problematic. Strategic documents place business and industrial policy principles under the competence of different authorities that have overlapping and conflicting mandates. This makes for a complex and inefficient institutional set-up. Existing strategies often lack proper evaluation mechanisms, indicators and systematic impact assessment.

Transparency and effectiveness of state aid remains insufficient. This is due in part to the large number of state aid providers, the lack of an updated registry and the still insufficient competences of the Commission for the Protection of Competition in state aid supervision. Instead of tackling the country's 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. In the 2019 Global Competitiveness Index, the country ranked 112 (out of 141 countries) when it came to the 'distortive effect of taxes and subsidies on competition'. The effects of state aid on efficiency and competition have not yet been assessed (Finance Think, 2021). There is no strategy to adequately determine priorities, goals and policies for investment activities in the country's Technological Industrial Development Zones (TIDZ). Policy regarding special economic zones should be targeted and time-limited, and not distort competition for domestic firms attempting to enter similar value chains. Sustainable development of these zones requires competitiveness anchored in a friendly business environment, instead of mainly targeting investment in labour-intensive production (World Bank, 2022).

As a precondition for the establishment of a state aid registry, measure 14 of the ERP aims at setting up a management information system on state aid that connects different institutions. The state aid registry and the information system are still not in place, although efforts have been made to develop the electronic information system. The measure is relevant and is prioritised by the Commission for Protection of Competition as a regulator: it will build a network of the relevant institutions, has the potential to enhance transparency for the general public and to create a level playing field for companies. The expected impact on competitiveness is not quantified.

North Macedonia remains an emerging innovator according to the EU innovation scoreboard, but innovation activity remains low overall. At 0.4 % of GDP (including a small share from the private sector), the economy's expenditure on research and innovation remains significantly below the EU average. In particular, the private sector's participation in overall research spending remains low at 0.1% of GDP. Allocations to the Fund for Innovation and Technological Development (FITD) and its programmes have increased, but their effectiveness, design and methodology can be improved by an independent evaluation. Links between enterprises and other innovation actors are very weak. To overcome the lack of strategic direction towards innovation, North Macedonia plans to adopt a smart specialisation strategy in 2023 and to develop measures for its implementation. Measure 16 aims at supporting the innovation environment (see Annex A).

The impact of the COVID-19 pandemic, the economic fallout from Russia's war of aggression against Ukraine (particularly the energy crisis) and supply chain disruptions have exacerbated existing structural challenges and reduced competitiveness. Inflation and the price of energy are seen as the most serious risks for companies' operations in 2023 (Economic Chamber survey, 2022). Tackling immediate crisis-related challenges has been a priority, but reforms fostering competitivness need to be strengthened (also because growth prospects could be compromised if the war further aggravates global trade and energy prices). A prolonged crisis will probably hurt the industry even more as demand from EU countries declines amidst possible recessionary developments (including important trade partners).**Strengthening targeted public policies to address structural obstacles to domestic companies' competitiveness could help to further integrate domestic enterprises into GVCs.** In spite of efforts, such as setting up an online business-to-business portal to match businesses with local suppliers, linkages between the FDI sector and the rest of the economy[13] need to be further improved to continue the structural transformation of the economy (e.g. the spill-over effects of FDI into local know-how and technology), economic growth and job creation (OECD 2021). The ERP has also recognised this. The focus should be on attracting FDI that can source more content locally. The high-end segments of regional and global supply chains have potential, but harnessing this requires a sufficient level of investment in innovation and meeting quality standards. This is a critical barrier to GVC integration for many industries, including the automotive sector (OECD 2021).

Concrete policy actions in export promotion and sustainable integration into GVCs require enhanced capacities to meet the quality standards of relevant industries and GVCs. Over the past decade, FDI has driven some change in the country's export structure towards higher value-added products such as chemicals and machinery and transport, and away from traditional food and clothes exports. North Macedonia could nevertheless benefit from a transition to a more sophisticated participation in GVCs (i.e. advanced manufacturing and services). 43% of non-exporting companies surveyed in the Balkan Barometer 2022 indicated that their goods and services are not suitable for exports. This percentage is slightly above the regional average. The Strategies for Export Promotion and Smart Specialisation, which are due to be adopted in the near future, and enhanced opening of digital sales channels [14] will further help domestic companies to transition to higher value-added activities and to diversify their export base – thereby benefiting from a possible post-crisis realignment of production networks. Services have been the engine of the post-COVID-19 recovery (World Bank, 2022) and further developing certain service sectors such as logistics, transportation, and information and communication technologies could be an opportunity for domestic companies.

North Macedonia could benefit from a realignment of global production networks. A trend towards 'nearshoring' has recently been discerned, with foreign companies relocating their production capacity to North Macedonia from more distant locations as part of an effort to reorganise their global supply chains. The ERP also refers to higher annual inflows of FDI, ongoing policies to attract new FDI, reforms of the business environment and an ongoing regrouping of global supply chains towards nearby locations. For instance, in an FDI survey conducted by the Economic Chamber of North Macedonia at the end of 2022, some of the surveyed companies reported a transfer of businesses from Ukraine as well as new investment in North Macedonia.

The Economic and Investment Plan for the Western Balkans, the further development of a common regional market and the digital and green transitions will increase the economy's competitiveness. There is further potential in regional cooperation in digital transformation (including e-government) and in strengthening energy resilience (including by transition to energy efficiency and renewable energy sources). Moving towards a greener/more circular economy represents a new source of revenues, cost savings and job creation for SMEs in particular. At present, however, most businesses have taken no action or only minor steps to change their operations into more environmentally friendly operations and

(13) The country has made some progress in fostering linkages between local firms and multinational firms. The Law on Financial Support of Investments encourages these linkages, providing financial support for the establishment and promotion of co-operation with suppliers registered in North Macedonia

(14) Online sales account for only a small portion of business sales. According to the Balkan Barometer 2022, 39% of respondents from North Macedonia who sell over the internet claimed that less than 5% of their sales were made online.

investments (World Bank, 2022). A range of financial initiatives[15] such as the 2022-2026 Plan for Accelerated Growth exist to support the private sector in its greening efforts.

Key challenge #3: Energy sector modernisation and transition to clean energy

North Macedonia has four measures related to this key challenge 3 in its ERP. Two of them, which are more closely linked to the European Commission's assessment of this key challenge, are analysed in this section. The other two are analysed in Annex A.

The economy of North Macedonia is characterised by its heavy dependence on energy imports; high energy intensity; inefficiencies in the ageing energy production system; a persistently high dependence on highly polluting lignite coal; and inefficient energy use. Energy supply is not sufficiently secure. North Macedonia imports over 30% of its domestic energy needs, is fully reliant on imports for gas and oil, and has limited quantities of coal. The country's gas network is only connected to Bulgaria (with obvious risks of gas delivery interruption bearing in mind complete reliance of North Macedonia on Russia for gas imports) and the work of connecting up to regional gas pipelines is progressing only slowly. Approximately 67% of electricity is domestically produced and 33% is imported. Import needs in 2022 were further exacerbated by the lower outputs of hydro plants due to drought. Domestic electricity production relies heavily on lignite and fuel oil (57%) [16] followed by hydro (22.5%), gas (16.7%), wind (2%), biogas (1%) and solar (1%). Electricity prices in North Macedonia are regulated for universal service suppliers[17] and have remained below the import price, as well as below the European market price. This contributes to gaps in energy infrastructure and catering for the utility providers' financial losses puts additional pressure on the government's budget.

Pre-existing challenges have been exacerbated by Russia's invasion of Ukraine. The economy's high level of reliance on imports and the high degree of trade openness directly affect domestic inflation. The impact of high energy prices, inflation, supply chain disruptions, rising debt levels and increased borrowing costs for businesses and households is considerable. Businesses have identified rising energy costs as their biggest challenge (Economic Chamber, 2022) and these continue to have an impact on the country's policies, competitiveness and public finances. Inflation is showing signs of slowing down, but sharply rising food and energy prices pushed inflation to almost 20% by the autumn of 2022 [18], which was more than in peer countries in the region. Direct trade and financial links with Russia and Ukraine are limited, but there is significant energy exposure to Russia (particularly in terms of natural gas imports from Russia (through Bulgaria) which accounts for close to 10% of the energy mix of North Macedonia)[19].

The strategic framework for green energy transition is well-developed, but progress in implementation is limited. The authorities are designing policies and strategies to support the transition towards a low-carbon economy/clean energy. This includes required investment in new renewable energy sources; the gas interconnection with Greece; completion of gasification of the country; and investment in energy efficiency. In 2019, North Macedonia

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(15) Still, various proposed financing instruments have yet to be established

16) The decline in domestic coal reserves means that electricity generation is heavily dependent on imports of coal and fuel oil.

(17) Essentially all households are provided electricity in the regulated electricity market (from the universal supplier), at subsidized prices, which are among the lowest in Europe adjusted for purchasing power parity. This leads to inefficient use of electricity, and likely hampers investments in future electricity generation, including from renewables and cleaner production facilities.

(18) The 2022 inflation rate was 14.2%.

(19) Diversification is reflected in project pipelines including new interconnections

adopted the 'Strategy for Energy Development up to 2040', which sets out the basic principles of the energy and climate policy of North Macedonia. North Macedonia signed the Sofia Declaration on the Green Agenda for the Western Balkans in 2020, which commits it to decarbonisation. North Macedonia submitted the enhanced nationally determined contribution (NDC) to the United Nations Framework Convention on Climate Change (UNFCCC) in 2021 and in the same year adopted the Long-term Strategy on Climate Action, as well as the Decarbonisation Roadmap within the Energy Community. The National Energy and Climate Plan (NECP) was adopted in 2022[20]. North Macedonia has adopted numerous plans and strategies, but there has been limited progress in implementing green policies. This has resulted in poor air quality, limited waste and water management, and a low use of renewable energy sources (IMF, 2022). One reason for this is the complex institutional set-up, which has a number of weaknesses. Responsibilities at policy level are shared by different stakeholders with conflicting political agenda. This has a negative impact on energy supply and security, and the sector's performance and operational effectiveness. The lack of capacity and skilled staff in the state-owned companies and governmental institutions is causing poor planning on how to tackle the energy crises. North Macedonia established a Sector Working Group on Energy in 2022 to address these institutional issues, but this still needs to prove its effectiveness.

The immediate focus is on helping households and companies to cope with the increase in energy and electricity prices, but longer-term green challenges will also have to be addressed, so that the country and its businesses are better prepared for a prolonged or new energy crisis in the medium term. A state of energy crisis has been put in place in expectation of a very difficult and unpredictable winter (at this stage until April 2023). The government adopted two packages of measures totalling about EUR 750 million in 2022 to respond to the energy crisis. However, the policy of subsidising and maintaining affordable prices for households and SMEs can only be a temporary measure. Objectives of promoting competitive sustainability in line with the green transition and the targets set under the Green Agenda for the Western Balkans (such as decarbonisation, energy diversification, renewable energy generation, energy efficiency, connectivity of electricity and gas networks, and interconnectors) remain unchanged. North Macedonia is therefore and in parallel with these temporary measures planning institutional and legislative reforms coupled with significant investment in line with the Green Agenda. This is also reflected in the more recently adopted National Energy Crisis Action Plan, which contains short-term measures to address the energy crisis and to incentivise renewables and energy efficiency measures; as well as medium-term measures related to the strategic, legislative and institutional framework to promote the transition to green energy and increase energy security. Electricity block tariffs introduced in July 2022 incentivise energy savings and can reduce costly electricity imports (IMF 2022). By contrast, increasing coal extraction, increased imports of coal and fuel oil and even investment in new coalmines and potential extension of the work of TPP Bitola are providing some short-term mitigation, but are not in line with the strategic decarbonisation goals (the country's international commitments require it to phase out coal by 2027[21]). Such an approach risks contributing further to environmental degradation, including reducing the already low level of air quality.

The transition towards a low-carbon economy and clean energy requires significant investment to close large gaps in the energy infrastructure that continue to restrict growth and competitiveness. The government's 2021-27 Intervention Investment Plan states that it will invest a total of EUR 3.1 billion in the energy sector, mostly in renewables (EBRD,

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(20) The Government is considering updating 2022 NECP and Action Plan
(21) National Energy and Climate Plan

2021). However, improving public investment management, including adoption of draft legislation on public-private partnerships, has been delayed. An improved Public Investment Management system, also incorporating climate related information, could further support prioritization of investment projects, including in renewables. Energy diversification needs are pressing and the country's ERP recognises that greater use of renewable energy sources (RES) and energy efficiency improvement is one of the main strategic goals in the energy sector.

Renewables can be produced domestically and reduce the country's need for energy imports. North Macedonia has not yet improved its legal and regulatory framework for the uptake of renewables (ECS, 2022). The amended national renewable energy action plan is in line with the revised binding target of 23% of energy coming from renewable energy sources by 2020 and 24% by 2025. However, renewable energy still accounted for only 17.3% of energy sources in 2021 and – as the planned law on biofuels has not yet been adopted – the share of renewables in transport remains negligible (0.15% in 2020). The capacity cap per type of renewable energy technology has to be removed. An electronic system for issuing, transferring and cancelling guarantees of origin is not yet in place, even though the market operator has been appointed as an issuing body. The rulebook on renewables opens up opportunities for electricity prosumers (both households and small businesses) in principle, but several administrative obstacles still remain in practice. The renewable energy portfolio is mainly based on hydropower, but hydrological conditions are risky and related investment will have to comply with the relevant EU law. Optimising balancing services and investments in energy transmission and energy storage will have to be promoted in order to improve the integration of renewable energy sources with the grid. North Macedonia has made some significant progress by attracting private investment in the construction of some wind parks and photovoltaics (PV). The Ministry of the Economy has prepared a programme for 2023 to promote renewable energy sources and encourage energy efficiency in households by installing PV and solar thermal systems and replacing windows and doors. There are plans to update the Energy Strategy by integrating hydrogen and investment in storage and batteries.

Measure 5, which has been rolled over from last year, is intended to promote renewable energy sources. It is very relevant to energy transition because it will help diversify energy generation and contribute to energy supply security – thereby benefiting the economy – by lowering electricity costs and creating green jobs. The measure foresees the adoption of a law on biofuels and the establishment of a renewable energy guarantees of origin scheme that will provide consumers with transparent information on the proportion of electricity that suppliers source from renewable generation. The measure also refers to new legislation aiming for instance at more simplified administrative procedures for renewable energy. The proposed result indicators do not reflect the specific activities (i.e. the use of biofuels). The impact assessment needs improvement.

Improving energy efficiency reduces the need for energy overall and can thus lower the economy's dependence on energy imports and significantly reduce the impact of high energy costs on competitiveness. The Law on Energy Efficiency of North Macedonia transposes the EU's Energy Efficiency Directive and Energy Performance of Buildings Directive into national law. However, partly on account of limited technical capacity in the Energy Department of the Ministry of the Economy and the Energy Agency, the government has not yet adopted the by-laws needed to implement this law (these are planned for the end of 2023). The long-term buildings renovation strategy and the assessment required by the Energy Efficiency Directive are planned for the second half of 2023. Moreover, incentives for energy efficiency (including the legal and regulatory framework for the establishment, operationalisation and financial sustainability of the Energy Efficiency Fund (EEF)) are lagging behind. Further improving energy efficiency is also a structural benchmark of the IMF's precautionary liquidity loan.

Measure 6, which has been rolled over from last year, is intended to improve energy efficiency. Activity under this measure is very relevant to address the key challenge three, including the adoption of delayed (secondary) legislation; the establishment of the EEF; and adoption of the strategy for the reconstruction of buildings. A refurbished and improved building stock will help pave the way for a decarbonised and clean energy system because the building sector is one of the largest energy consumers and is responsible for a significant proportion of greenhouse gas emissions and air pollution. The labour-intensive nature of the building sector, which is dominated by local businesses, means that renovation of buildings can also play a crucial role in economic development. However, as the ERP has rightly identified, the lack of capacity within public institutions (the Ministry of the Economy and the Energy Agency) for collecting and sharing information, monitoring progress and promoting energy efficiency remains an obstacle. The impact assessment needs improvement.

In line with the EIP and the Green Agenda for the Western Balkans, the EU supports the development of renewable energy sources and less polluting energy sources that will secure the energy supply. The platform for joint purchases of gas will pool demand; coordinate infrastructure use; negotiate with international partners; and prepare for joint gas, hydrogen and liquefied natural gas purchases. REPowerEU[22] also encourages energy diversification as part of enhancing energy security, including diversifying the natural gas supply. Consistent with the EIP and based on the National Energy Action Plan adopted at the end of 2022 with short-term and medium-term measures to address the energy crisis, the new EU Energy Support Package provides immediate assistance in the form of budgetary support. It aims to mitigate the immediate socio-economic needs that result from the impact of rising energy prices on vulnerable households and SMEs, and to set the basis for energy transition and resilience.

The clean energy transition will help lower energy prices over time and reduce import dependence. The government needs to achieve affordable energy security by striking the right balance between imported natural gas, affordable renewable energy and energy storage technologies. Efforts to achieve energy and climate targets by 2030 by increasing energy efficiency and unlocking the potential of renewable energy can significantly contribute to reducing dependence on imported energy sources. The current overlap between different institutions' and stakeholders' remits means that a more coordinated approach is needed for key areas such as energy supply, energy efficiency and renewable energy. Digital technologies can boost the effectiveness of green transition policies. Investing in digital technologies such as smart IoT devices and meters, 5G and 6G connectivity, and digital twins of the energy system will facilitate the clean energy transition and also benefit citizens and companies [23]. Last but not least, a 'just transition' for the planned phase-out of coal by 2027 will have to be ensured in order to mitigate the negative social and economic impacts. In line with the NECP's objective of phasing out coal consumption, a Just Transition Action Plan is planned to be adopted in 2023.

(22) REPowerEU is about rapidly reducing our dependence on Russian fossil fuels by fast forwarding the clean transition and joining forces to achieve a more resilient energy system and a true Energy Union.
(23) COM (2022) 552 final

***Monitoring performance in light of the European Pillar of Social Rights*[24]**

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 concerning equal opportunities and access to the labour market, fair working conditions, and social protection and inclusion for the benefit of citizens in the EU. The European Pillar of Social Rights Action Plan, adopted on 4 March 2021, aims at rallying all relevant forces to turn the principles into actions. Since the 20 principles provide a compass for upward convergence towards better working and living conditions in the EU, 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 alignment of their labour markets and welfare systems with those of the EU.

NORTH MACEDONIA		
Equal opportunities and access to the labour market	Early leavers from education and training (% of population aged 18-24)	Better than EU avg., improving
	Individuals' level of digital skills (basic or above basic)	Worse than EU avg., no change
	Youth NEET (% of total population aged 15-29)	Worse than EU avg., improving
	Gender employment gap	Worse than EU avg., improving
	Income quintile ratio (S80/S20)	Worse than EU avg., improving
Dynamic labour markets and fair working conditions	Employment rate (% of population aged 20-64)	Worse than EU avg., improving
	Unemployment rate (% of population aged 15-74)	Worse than EU avg., improving
	Long term unemployment rate (% of population 15-74)	Worse than EU avg., improving
	GDHI per capita growth	N/A
Social protection and inclusion	At risk of poverty or social exclusion (in %)	Worse than EU avg., improving
	At risk of poverty or social exclusion rate for children (in %)	Worse than EU avg., no change
	Impact of social transfers (other than pensions) on poverty reduction	Worse than EU avg., no change
	Disability employment gap	Worse than EU avg., deteriorating
	Housing cost overburden	Similar to EU avg., improving
	Children aged less than 3 years in formal childcare	Worse than EU avg., improving
	Self-reported unmet need for medical care	Worse than EU avg., no change

Relative to the EU-27 average, North Macedonia faces challenges on a number of indicators from the Social Scoreboard that supports the European Pillar of Social Rights.

North Macedonia has steadily improved its employment and unemployment rates (though they lag behind best performers in the region) and the labour market has been relativly resilient during the COVID-19 pandemic. Targeted measures to bring more people into the labour market are a step in the right direction, but spending on this active labour market policy (0.27% of GDP) remains too low to substantially improve the situation. Despite the favourable trends in employment observed before the COVID-19 pandemic, the unemployment rate remains high and has several distinctive structural characteristics, including long-term unemployment, inequality, and large regional disparities. Women and young people are particularly exposed to the risk of unemployment and inactivity. Despite significant improvements due to the implementation of the Youth Guarantee, the youth unemployment rate (15-24) was 35.7% in 2021, while the rate of NEETs (15-29) in 2021 was 26.2%. The rate of inactivity in the labour market is particularly high for women. 41.8% of the women aged 20-64 were out of the labour market in 2020.

The education system of North Macedonia does not equip young people with the necessary key skills and knowledge. The low quality of the education system contributes to the lengthy school-to-work transition and the skills mismatch continues to be a major impediment to people finding work. New school and VET curricula now focus more on the demands of the labour market, but legislative delays are impeding the operationalisation of the VET centres.

The reform of the social protection system is intended to better target those in need. Social assistance has had very little success in reducing poverty, because social benefits are very low and because of ineffective targeting. The groups most at risk of poverty remain young people, those without education and ethnic communities such as the Roma. North Macedonia plans to continue with its measures to strengthen the system for social inclusion of vulnerable groups, including by improving social services in local communities across the country.

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

(24) The table includes 16 headline indicators of the Social Scoreboard, used to compare performance of EU Member States (https://ec.europa.eu/eurostat/web/european-pillar-of-social-rights/indicators/social-scoreboard-indicators). The indicators are also compared for the Western Balkans and Turkey. The assessment includes the country's performance in relation to the EU-27 average (performing worse/better/around the EU-27 average; generally 2020 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). For data see Annex B. NEET: neither in employment nor in education and training; GDHI: gross disposable household income.

5. Overview of the implementation of the policy guidance adopted at the Economic and Financial Dialogue in 2022

Every year since 2015, the Economic and Financial Dialogue between the EU and the Western Balkans and Türkiye has adopted targeted policy guidance for all partners in the region. The guidance represents the participants' shared view on the policy measures that should be implemented to address macro-fiscal vulnerabilities and structural obstacles to growth. The underlying rationale for the policy guidance is similar to that of the country-specific recommendations usually adopted under the European Semester for the EU Member States. The Commission evaluates the work carried out to implement the policy guidance in the following year's ERP assessments. The table below presents the Commission's assessment of the implementation of the 2022 policy guidance jointly adopted by the EU and the Western Balkans and Türkiye at their Economic and Financial Dialogue at Ministerial level on 24 May 2022.

Overall: Partial implementation (48.6%)[25]	
2022 policy guidance (PG)	**Summary assessment**
PG 1: If needed, use the available fiscal space in the 2022 budget to cushion the potential impact of adverse shocks through targeted support to vulnerable households and firms; foresee in the medium-term fiscal plan accompanying the 2023 budget a gradual reduction of the primary deficit-to-GDP ratio to its pre-crisis (2019) level.	There was **partial implementation** of PG1: 1) **Partial implementation**. The government adopted two sets of fiscal measures in 2022 providing support to vulnerable households to cope with the cost-of-living and energy crisis. At the same time, the introduction of block tariffs for electricity led to a more targeted manner of energy support. Some untargeted stimulus measures were suspended (wage subsidies introduced in 2019), others were continued into 2023 (reduced VAT rate on electricity). The government's medium-term fiscal plan foresees a gradual reduction of the general government fiscal deficit from an estimated 4.8% of projected GDP in 2022 to 2.9% in 2025. The primary deficit would, however, not reach its pre-crisis level (0.8%) before 2027.
Set up a central public investment management unit in the Ministry of Finance and ensure its proper functioning.	2) **Partial implementation**. The Ministry of Finance completed the systematization exercise to review its current structure in December 2022. A new Department on Public Investment Management has been created, but still needs to be staffed and made operational.
In line with the Tax System Reform Strategy, design comprehensive tax reforms and draft legislative changes that contribute to enhancing revenue by broadening the tax base, and accelerate the digital transformation of the Public Revenue Office.	3) **Substantial implementation**. In August 2022, the Ministry of Finance announced a set of legislative proposals in line with the Tax System Reform Strategy, aiming at broadening the tax base and streamlining the existing tax exemptions. In December 2022, the Law on personal income tax was amended, the key changes with effect from 1 January 2023 including taxation of capital gains from the sale of securities and stakes in investment funds; taxation of life premiums paid in the voluntary health and pension funds; deferral of taxation of interest gains on deposits by the time of accession to the EU. The laws on corporate taxation and on VAT were also

(25) 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. This is available at https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform-programmes-commissions-overview-and-country-assessments_en.

	amended. The draft laws are currently in the parliament awaiting to be passed. The government dropped initial plans to reintroduce progressive income taxation, which was first introduced in 2019 and then put on hold, with 10% tax rates remaining as flat rate for taxation of personal income tax and 15% for the income gained from games of chance. The forthcoming IFMIS project, includes a component on upgrading the tax IT System, which is expected to support and improve the business processes of the PRO and contribute towards its digital transformation. However, the results of this intervention cannot be expected immediately.
PG 2: Submit the new public-private partnership (PPP) law to the Parliament for adoption and ensure its implementation, including by setting up a fully functioning PPP registry.	There was **partial implementation** of PG 2: 1) **Partial implementation:** The draft law on public-private partnership has been submitted to the Secretariat of European Affairs for further submission to the European Commission for comments.
Ensure central monitoring of all fiscal risks related to state-owned enterprises, PPPs, and Local Government Units by the Ministry of Finance.	2) **Limited implementation:** There is limited progress in strengthening the monitoring of fiscal risks related to state-owned enterprises, PPPs and Local Government Units. The main action taken was the approval of the OBL. Art. 9 is about fiscal principles including prudent management of fiscal risks arising from macroeconomic shocks, guarantees given by the state and municipalities, ownership of public enterprises and other public corporations founded by the state and the municipalities or in which the state or the municipality is a majority owner, public private partnership, etc. The budget department still needs to develop a comprehensive registry of SOEs and a methodology to assess related risks.
Implement the new organic Budget law as soon as it is passed by the Parliament and take the necessary legislative and organisational steps to enable the new Fiscal Council to take up operations.	3) **Substantial implementation:** The Organic Budget Law was passed by the Parliament in September 2022. The Ministry of Finance has started the process of implementation. As required by the OBL, the Academy of Arts and Sciences, the State Audit Office and the National Bank have been invited to nominate candidates for the Fiscal Council and the Ministry of Finance is currently working on relevant bylaws to make the Fiscal Council operational.
PG 3: Carefully assess and analyse price developments and stand ready to tighten monetary policy, if needed, to preserve price stability in the medium term.	There was **partial implementation** of PG3: 1) **Full implementation.** The central bank has carefully monitored the evolution of price dynamics. To curb inflation, the central bank has withdrawn liquidity, and raised policy rates by more than the increases in the euro area, thus also maintaining a substantive interest rate differential in support of the currency peg.
Maintain a transparent and accurate reporting of asset quality and adequate provisioning, further reduce institutional and legal obstacles to swift and effective NPL resolution, all relevant	2) **Substantial implementation.** Key legislations and regulations improved. The Financial Stability law was passed, which formalised the Financial Stability Committee and set up the macroprudential framework for the various entities in the system. Nevertheless, the law on

institutions to continue to reduce data gaps in particular as regards the real estate sector and further implement measures to promote the role of the local currency. Safeguard the national bank's independence in its key statutory tasks, including in staffing issues, in line with the law on the national bank, and to this end exclude the national bank from the scope of the new law on administrative servants and the law on public sector employees.	the national bank still needs to be amended to clearly establish the central bank's macroprudential mandate. To further harmonise with EU regulations, a new Banking Law and Law on Bank Resolution are planned to be adopted by end 2023. Provisioning is broadly adequate. Data gaps remain in the real estate sector, but the central bank has announced raising the counter-cyclical capital buffer to partially address concerns of rising real estate prices. The central bank adjusted banks' denar and foreign currency required reserve requirements on a differentiated basis, also in line with its denarisation strategy. 3) **Limited implementation.** The government proposed amendments to the national bank law to exclude central bank staff from the status of administrative servants, which is pending parliamentary passage, but thus far did not exclude the central bank from the law on administrative servants and public sector employees. In addition, a new law on a public sector wage grid has been introduced for public consultation which includes the central bank. Therefore, despite some efforts, concerns remain about adequately safeguarding the central bank's independence, including in staffing issues.
PG 4: Use the list of mapped para-fiscal charges to evaluate, optimise and rationalise para-fiscal charges at the central and local levels Continue the digitalisation of public services for businesses and citizens by upgrading and enhancing the use of the e-portal for services. Adopt a comprehensive new strategy and Action Plan for formalisation of the informal economy 2023-2025 and ensure high-level political commitment by all institutions relevant for the coordination and implementation.	There was **partial implementation** of PG 4: 1) **Limited implementation**: The Ministry of Economy started evaluating how to optimise 100 para-fiscal charges at the central level. Based on a completed assessment of and a drafted proposal for the legal, institutional and operational framework for para-fiscal charges (including best EU and regional practices), a methodology has been drawn up for streamlining up to100 para-fiscal charges. 2) **Partial implementation:** Digitalisation of public services for businesses and citizens was continued by upgrading and enhancing the use of the e-portal www.uslugi.gov.mk. The number of registered users and completed services on the portal is increasing, but remains below expectations. Many of these services remain purely informational and cannot be carried out fully on line. 3) **Partial implementation**: In order to enable better and more efficient coordination between all relevant institutions and stakeholders in implementing planned measures and activities, the government decided in October 2022 that the Ministry of Finance will take over responsibility for preparing the new 2023 - 2025 Strategy for Formalization of the Informal Economy with an Action Plan. The preparation of the new strategy is under way and is due to be submitted to the government by April 2023. Some progress was made with EU support in detecting, measuring and monitoring the informal economy. The government adopted tax legislation at the end of 2022 to strengthen the tax paying culture and thereby fight the informal economy. According to the data from the State Statistical Office, informal employees as a proportion of total number of employees decreased from 18.6% in 2018 to 12.1% in2021.

PG 5: Increase the number of staff and the technical/engineering capacity of the Energy Department in the Ministry of Economy and the Energy Agency.	There was **limited implementation** of PG 5: 1) **Limited implementation**: The Energy Department in the Ministry of the Economy was reorganised in the summer of 2022 and a few individuals were employed. However, the technical capacities of both the Energy Department in the Ministry of the Economy and the Energy Agency remain insufficient to meet legal obligations. For instance, there is a separate section for energy efficiency but it contains only one member of staff. Staffing of the Energy Agency does not even reach half the systematised work places. North Macedonia has plans to employ five additional staff in 2023 in the Ministry of Economy (Energy Department).
In line with the commitments of the Green Agenda for the Western Balkans: Adopt and implement energy efficiency legislation, including bylaws to the energy efficiency law.	2) **Partial implementation**: North Macedonia has made some progress in drafting rulebooks for energy efficiency in buildings and the assessment of building renovation and heating and cooling potential. According to the Energy Community Secretariat, adoption of the drafted secondary legislation required for the implementation of the Energy Efficiency Law remains of the highest priority for North Macedonia. Adoption of secondary legislation in accordance with the Law on Energy Efficiency is – according to the government's National Energy Crisis Action Plan - planned for the fourth quarter of 2023. The long term buildings renovation strategy and the assessment required by the Energy Efficiency Directive are planned for the second half of 2023. The 2030 energy efficiency targets and policy measures were introduced in the Energy Strategy and the country's NECP adopted in May 2022.
Following the development and adoption of the legal and regulatory framework, establish the envisaged Energy Efficiency Fund.	3) **Limited implementation**: The government provides financial initiatives through the state programme for renewables and energy efficiency, while several international financial institutions are implementing renovation programmes in buildings. With the support of the World Bank, North Macedonia analysed options for the establishment of the National Energy Efficiency Fund and agreement on the institutional model of the Fund was reached (i.e. within the framework of the Development Bank). However, the legal and regulatory framework for its establishment and operationalisation remains to be adopted. According to the National Energy Crisis Action Plan, establishment and operationalisation of the Fund is planned for the second quarter of 2024. EUR 5 million is available for initial financing of the Fund.
PG 6: Develop new vocational education and training (VET) legislation with a focus on inclusion, labour market needs and a new methodology of financing VET as well as provide a yearly report for improving higher education, including recommendations for a new formula for the financing of higher education. Continue efforts to strengthen access to active labour market policies, particularly for low-skilled unemployed and people in vulnerable situations.	There was **partial implementation** of PG 6: 1) **Limited implementation:** The VET law and adult education law have been drafted and adopted by the government but have not been adopted by the parliament. The annual report, which includes recommendations for a new formula for the financing of higher education, has not yet been issued. 2) **Partial implementation:** The government continued with the implementation of active labour market policies. However, no new measures targeting specifically low skilled and vulnerable people have been introduced. Limited resources (human, financial) for PES and ALMPs implementation remain a point of concern. The Employment Service Agency has started preparing the piloting of the IPA-funded 'second chance' programme.

Further increase the capacity of and cooperation between the employment agencies and centres for social work as well as education and training institutions to provide integrated services and measures for improvement of inclusion in the labour market.	3) **Partial implementation:** Work to improve cooperation had continued. With the addendum to the IPA-funded project implemented by the Employment Service Agency, additional capacity building activities have been added for the Agency and the Social Work Centres. Activities will allow them to work better with low-skilled and vulnerable people on increasing their employability and employment prospects.

ANNEX A: ASSESSMENT OF THE OTHER AREA/SECTOR AND STRUCTURAL REFORM MEASURES INCLUDED IN THE 2023-2025 ERP

Public financial management (PFM)

North Macedonia, like most WB6 countries has considerable room for PFM improvement. Various strategic documents related to PFM[26], public administration and public investment management (PIM) are in place, but their coordinated implementation will be important. The Organic Budget Law (OBL) introduces fiscal rules, a Fiscal Council, a multiannual expenditure framework and programme-based budgeting, and its long delayed adoption in September 2022 has paved the way for many PFM reforms in the future. Although a step in the right direction to strengthen PFM, many of these measures may only have an impact in the medium-term, beyond the scope of the current ERP (2023-2025). Important provisions in the OBL, especially with respect to public investment management, will come into effect in 2025; multiple bylaws for the implementation of the OBL are yet to be drafted; key components of the Integrated Financial Management Information System (IFMIS) are being designed and its rollout will take time. These factors reduce the likelihood of tangible impacts on PFM during the duration of this ERP. The digitalisation of PFM helps to promote transparency, efficiency and accountability in PFM. Planned reforms to strengthen PIM management and budgeting practices should, in conjunction with the new OBL, help to reduce the under-execution of the capital investment budget (IMF, 2022). Adoption of draft legislation on public-private partnerships has been delayed. The public internal financial control (PIFC) law to strengthen managerial accountability and internal audit functions is still awaiting adoption. Implementation of the PIFC paper and action plan has been hindered by the COVID-19 pandemic and key stakeholders' limited capacities. Financial inspection is still not functioning properly. The national constitution does not yet guarantee the independence of the State Audit Office and parliamentary oversight of public funds management needs to improve.

Measure 19: PRO digital transformation by setting up ITIS

This measure was first introduced in 2022 and the first preparatory steps towards its implementation have started. The measure addresses the long-standing issue of the Public Revenue Office's (PRO) obsolete and fragmented IT system, which impairs its administrative and operational capacities. The digital transformation of the Public Revenue Office (setting up a modern database, a disaster recovery centre and an advanced information management structure) is intended to improve the effectiveness of revenue management, reduce the informal economy and enhance tax compliance. As the ERP indicates, the PRO is taking an active part in implementing the Action Plan to combat the grey economy at the level of the Ministry of Finance. The European Commission's 2022 country report recommends improvements to the PRO's business processes, the development of a new integrated IT tax system for the PRO, improving its compliance risk management and further extending e-services for taxpayers. The 2021 IMF Tax Administration Diagnostic Assessment Tool (TADAT) assessment concluded that the PRO had developed strengths in the area of taxpayer's services. However, the benefits of these strengths do not fully materialise due to the poor state of its IT system. To this end, measure 19 is relevant, well drafted and describes the key functionalities of the system. The potential risks are well identified and will need to be addressed in order to minimise their impact on the process of implementing the measure (e.g. insufficient institutional ownership and very weak human resources capacities, especially in the IT sector). The IT system is one of the key preconditions for improving revenue collection and features in the updated 2021-2025 Tax System Reform Strategy and the new 2022-2025

(26) a PFM Reform Programme 2022-2025 was adopted in 2022

PFM Strategy. Measure 19, which will be implemented with national funds to the amount of EUR 5 million and is currently planned for 2023-2025, marks a significant advance in this area after a long period of hesitation and inactivity. The description of the measure's expected impact on competitiveness could be improved further.

Green transition

This reform area is closely linked to key challenge 3 and is analysed in Section 4 above. In addition to this analysis and as recognised in the ERP, North Macedonia also needs to unlock the potential of the circular economy, with recycling and reuse becoming the rule and with a significant reduction in the use of natural resources. This will be a challenge given that 51% of the respondents to the Balkan Barometer 2022 indicated that they had not taken any steps to reduce the environmental impact of their respective businesses. Contrary to most of its peer countries, North Macedonia has not yet adopted a circular economy roadmap.

The heavy reliance of municipal waste management and wastewater treatment on donor funds impedes regular maintenance. The national plan for waste management (2021-2031) and the national waste prevention plan (2021-2027) are in place. As the ERP mentions, less than 1% of solid waste is recycled – so almost 99% goes into landfills. Work has begun to build a regional waste management system in several regions. Regional waste management structures are not yet operational, however, and separate collection of waste streams and economic instruments to promote recycling, reuse and waste prevention remains limited. Management of the water supply and the sanitation system remains undeveloped. Work to align with EU law is continuing, but implementing and enforcing existing legislation remains a challenge.

Measure 7: Building wastewater collection and treatment infrastructure in line with EU requirements

This measure has been largely rolled over from last year and remains relevant. Essential structural reforms for the financial sustainability and good governance of the sector have been planned, but the plan is not realistic and no action was undertaken in 2022. To sustainably operate and maintain the significant infrastructure investment that is planned, a real effort should be made to implement and enforce the full-cost-recovery and polluter-pays principles enshrined in the Water Law of 2008. Moreover, decisive steps should be taken to enable the institutional architecture and market design to evolve. Infrastructure development is focused exclusively on IPA and WBIF projects. One positive development for the sector is the recent signature of a EUR 50 million EIB loan to the country. The intermediate targets of the result indicators areun realistic because substantial delays have arisen in procuring related works. The impact analysis is rather superficial. The circular economy is mentioned as a project objective, but the text does not go into any detail as regards the benefits for the country's competitiveness.

Measure 8: Establishing an integrated and financially self-sustainable waste management system

This measure, which is supported by EU funding, has been rolled over from previous years. Modernising waste management systems and increasing recycling rates can reduce pollution, make the circular economy possible and align the country's environmental standards with the EU's. Measure 8 nevertheless lacks some critical elements related to its implementation and investment sustainability. For example, a cost-reflective waste tariff policy is considered to be one of the key elements to ensuring proper quality services and the sustainability of the waste treatment system and should therefore be seen as part of the structural reform in this sector.

Another important milestone is the establishment of the Regional Waste Management Company (RWMC), but this has not been fully completed due to resistance from the Municipality of Sveti Nikole where the central facility should be situated. The completion of the formal process for its establishment should have been listed among the planned activities in 2023. The activities planned for execution in 2022 related to the start of the project to support the implementation of waste management structures in the North-East and East region and the preparation of waste planning documents has been postponed to 2023. The impact analysis is rather generic and needs to be improved. The circular economy is mentioned as a project objective, but the benefits for the country's competitiveness are addressed in only a superficial way.

Business environment and reduction of the informal economy

This area is analysed above in Section 4 as a crucial element of key challenge 2. Structural weaknesses in the business environment continue to be an obstacle for domestic companies, even though North Macedonia was ranked 17 out of 190 economies in the latest World Bank *Doing Business 2020* report. The ERP refers to the growth acceleration plan (GAP), which was adopted in the autumn of 2021 and is intended to boost the private sector's competitiveness and investment in physical and human capital over 5 years. The GAP aims to support fast and sustainable growth, while also maintaining fiscal stability by mobilising capital from the private sector (in addition to the funds received from the state budget). One of the ERP's measures that is mentioned in the GAP is to create a hybrid fund for green and digital start-ups and innovative SMEs.

Measure 13: Hybrid investment fund for start-ups and innovative micro, small and medium-sized enterprises

This measure had been rolled over from previous years and remains relevant. As noted by the OECD competitiveness outlook and SME policy review, the lack of diversification of sources of funding (especially for micro and small businesses) is a major constraint on the local business environment. Commercial loans from local commercial banks are the predominant source of funding. The concept of a hybrid fund was included in the GAP and may point to a new policy trend towards more market-oriented financing of SMEs (as opposed to the cross-policy state aid approach that has been applied to date). However, implementation is facing delays and the government is still considering options for the establishment fund and methods of financing. Leveraging funding for green and digital start-ups and innovative SMEs may be supported by: i) the need to support private capital mobilization, given the reduced fiscal space of the Government; ii) the need to broaden the investor base, both the domestic and foreign one; iii) the importance to continue building the domestic innovation ecosystem; and iv) the significance to leverage existing structures and rely on simple solutions to facilitate implementation and increased feasibility. Measure 13's description should be clearer and more detailed regarding the role of EU funding in the measure's implementation. The government could further quantify the measure's impact on competitiveness.

Measure 14: Financial support for Roma entrepreneurs

This measure is very relevant (including from a social point of view) because it targets a very disadvantaged part of the country's society. It is based on the country's experience with labour market activation measures and receives EU funding. Implementation of the measure is still at an early stage but some progress has already been noted – including the establishment of a competent team of business facilitators; completion of a study to identify the support needed to access finance and available governmental programmes as well as online information sessions for Roma entrepreneurs. While implementation is proceeding relatively well at this stage, the support provided so far consists mainly of soft measures (e.g. mentoring) and does not always meet the specific needs of the target group. The impact analysis of the social outcome includes some quantification, but the impact on competitiveness should be further developed. Indicators from the previous ERP have been rolled over for the years 2023-2025.

Research, development and innovation (R&D&I)

The Fund for Innovation and Technological Development has evaluated the implementation of the 2015-2020 strategy for research and innovation. Despite some progress, investment in research and innovation remains low at 0.38% of GDP. Participation by the private sector in overall research spending remains particularly low at 0.1% of GDP. Increasing the budget in this area would boost competitiveness and sustainable growth of North Macedonia (especially given the relevance of innovation to the Economic and Investment Plan for the Western Balkans). The Smart Specialisation Strategy (S3) to be adopted in 2023 is planned to serve as the new innovation strategy. Four vertical priorities (smart agriculture and food with higher added value; electro-mechanical industry – Industry 4.0; ICT; and sustainable materials and smart buildings) and two horizontal priorities (energy for the future; and tourism) have been identified. Measures for closer cooperation between academia and the private sector are being implemented and subsidies are being provided to companies to strengthen their research and innovation capacities. The government's support for R&D&I is being provided mainly through state aid schemes implemented by the Fund for Innovation and Technology Development (FITD). A comprehensive evaluation of the impact, efficiency and effectiveness of FITD programmes is lacking. The involvement of several ministries has complicated the coordination of innovation policy (OECD, 2022).

Measure 16: Support for the development of the innovation ecosystem

This measure has been significantly redesigned and extended by the welcome addition of a component related to the Smart Specialisation Strategy. The strategy is planned to be adopted in 2023. The other component of the measure still consists of setting the institutional infrastructure for support of academic-business collaboration – the establishment of a science technology park (STP). Overall, the measure is relevant because it is intended to promote academic-business cooperation, the commercialisation of innovation and RDI investment, albeit not in a very clear and structured way. A clear approach to the design and function of the STP will be important (OECD, 2022). The second part of the measures, the STP, was a measure in several previous ERPs, but adaptation of premises and operational activities has been delayed so that contracts between business and academia will not be concluded until 2025. No progress has been made in the past 3 years. Re-introducing this point in the ERP at a later stage may therefore be considered, once funding for the STP and its ownership have been secured, and specific fields of operation and specialisation have been clarified (including its complementarity with the FITD). Measure 16's expected impact on competitiveness has not been quantified and its impact on employment and gender has not been sufficiently considered.

Digital transformation

An analysis of this area is partly included in the analysis of key challenge 2 in Section 5.1. In line with the regional results of the Balkan Barometer 2022, 52% of surveyed businesses reported some or great satisfaction with digital services for businesses. This improvement also shows that digital services became particularly relevant and increasingly in demand during the COVID-19 pandemic. However, the survey also showed that businesses are not doing enough to improve their employees' digital skills. North Macedonia has continued to successfully implement the Digital Agenda for the Western Balkan and the Regional Roaming Agreement, but further efforts are needed to unlock the full potential of the country's digital transformation. North Macedonia still needs to adopt its ICT strategy, and modernising and digitalising the public sector will require more effort and better cooperation between institutions. Successful e-services include the e-tax system that has simplified tax reporting, and mobile applications like e-VAT that makes it possible for individual taxpayers to file their VAT returns online. E-commerce in the country is growing slowly. Further digitalisation is still hampered by the relatively high cost of digital services and by the low level of digital skills in the population.

Building on the 2018 Digital Agenda for the Western Balkans, the economic and investment plan provides an opportunity to accelerate the digitalisation of government, public services and businesses in a manner that is consistent with the EU's values and legal framework. The ERP's analysis of this sector mainly covers EU-projects related to e-government services to citizens and businesses. Information on the country's strategic investment in, and approach to, digital transformation is largely lacking. However, some of the measures in the ERP (and particularly the following measure) include activities linked to digitalisation.

Measure 10: Broadening the scope of digital services provided on the national e-service portal

This measure has been rolled over from 2022 and the portal has been in place for several years. It has an important role to play in improving the overall business environment and the ease of doing business. A large-scale, EU-funded project to upgrade the e-services portal with new services for companies and businesses started in August 2020. The project identified most of the services that are to be included in this project, as well as the registers that need to be digitalised in order to allow e-service delivery. The number of registered users and, to a lesser extent, the number of applications submitted through this portal appears to be increasing, albeit at a slower rate than expected. The ERP contains a good explanation of the measure's purpose, timeline, impact and potential implementation risks. These risks stem from inefficient coordination and communication between state institutions, a lack of human resources in the IT area and a lack of commitment at operational level. Those risks could significantly compromise the measure's implementation and should be clearly monitored and countered with mitigating actions. The digital transformation aspect is linked to EU support related to e-government services to citizens and businesses. The aspects of national strategic investment, of the strategic approach towards digital skills and of access to broadband (meeting targets set in the National Broadband Plan) are lacking.

Economic integration performance

The economy posted a large increase in trade openness (exports and imports in goods and services as a share of GDP) to 148% of GDP in 2021 after a drop in 2020 to 130 %. The country's trade integration relies on a narrow export base, which incorporates little domestic value added. It is therefore necessary to boost SMEs' internationalisation, productivity and competitiveness. Exporting companies and particularly SMEs still face major obstacles to trade. These obstacles include not only non-tariff barriers (including technical standards) but also administrative obstacles to trade in services (OECD, 2021/2022). The EU is still the country's largest trading partner by far. The EU accounted for 61% of the country's total trade in goods in 2021 (79% of total exports and 46% of total imports). After the EU, the UK is the second biggest trade partner of North Macedonia with 13% of total trade in goods, followed by Serbia, China and Türkiye (5%, 4% and 3.5% of total trade respectively). Since the last quarter of 2021, the merchandise trade balance has deteriorated steadily, largely on account of rising energy prices and reflecting the country's high dependence on energy imports. Exports have been impacted by weaker external demand and by ongoing supply chain disruptions (particularly to the production of automotive components - one of the country's main export sectors). North Macedonia is less exposed to shocks in terms of direct falls in trade with Russia and Ukraine as these were and remain relatively minor trade partners. However, there were relatively high imports of fertilisers from Russia, which reveals vulnerabilities in the current context of Russia's war of aggression against Ukraine(DG ECFIN, 2022). In July 2022, North Macedonia re-introduced export restrictions on wheat, wheat flour and sunflower seeds and extended these restrictions to certain types of wood until the end of 2022. In October 2022, the government decided to lift the ban on exports of wheat, wheat flour and sunflower seeds. The EU is also the country's main provider of FDI. EU companies dominate FDI and accounted for over 95% of FDI inflows into North Macedonia in 2021 (EUR 450 million) – a significant increase on previous years. Significant FDI came from Germany, the Netherlands, Austria and Slovenia. The economic and investment plan, and deepening the regional integration of the common regional market can both increase trade and further enable competitiveness and growth.

Measure 17: Strengthening the market rules in North Macedonia

This measure has been rolled over from 2022. It is implemented with EU funding to strengthen market surveillance. The measure is relevant for further integration of North Macedonia in the EU's single market as provided for by the Economic and Investment Plan, by harmonising its legislation with the EU's on free movement of goods, free movement of services and market surveillance. When referring to further legislative alignment in this area, information should be added about the planned adoption of developed legislation. The expected impact on competitiveness and the environment is only described in general terms. Quantified targets could be provided.

Energy market reforms

An analysis of this area is largely included in the analysis of key challenge 3 in Section 5.1 (energy sector modernisation and the transition to clean energy). The electricity[27] and gas markets are open to competition. The Energy Law adopted in May 2018 transposed the EU's Third Energy Package into national law in the electricity and natural gas sector, as well as part of the Renewable Energy Directive. It establishes, among other points, the rules for organising and structuring the electricity and natural gas markets, as well as the rights and obligations of all market participants. The electricity Market Operator has been designated as a NEMO[28] and day-ahead market establishment is planned for the second quarter of 2023. Recent amendments to the Energy Law advanced alignment with the REMIT regulation (on wholesale energy market integrity and transparency), the CACM Regulation (establishing a guideline on capacity allocation and congestion management) and the TEN-E Regulations (guidelines for trans-European energy infrastructure). The electricity transmission and distribution network operators have been unbundled in accordance with the EU law. Bulgaria and North Macedonia have put in place a new gas interconnection agreement to release exit capacity for the gas pipeline at the cross-border node Kyustendil-Zidilovo that had been booked with Gazprom but not used. The agreement is key to diversifying and securing gas

(27) While there is de-jure competition in the electricity market, there is de-facto no competition in the regulated electricity market, as the state-owned electricity generator, ESM, supplies 100 percent of the demand of the regulated market, at subsidized electricity prices.

(28) Nominated electricity market operator

supplies to North Macedonia. The country is laying the foundation for the long delayed unbundling of the gas transmission system operator (Energy Community, 2022), which is now planned for the end of 2023. The February 2020 Energy Efficiency Law transposes the EU's Energy Efficiency Directive, Energy Performance of Buildings Directive, Regulation on Labelling of Energy-related Products, and Directive on Eco-design of Energy-related Products into national law. The implementing rules are not yet fully in place.

In line with the economic and investment plan, the Commission will support the development of renewable energy sources and less polluting energy sources that will secure energy supply in line with the commitments of the Green Agenda for the Western Balkans.

Measure 9: Increasing the competitiveness of the electricity market

This measure was discontinued on the grounds that it had been largely implemented. However, day-ahead market rules are still to be adopted following the amendments to the Energy Law which transposed provisions of the CACM Regulation that enables market coupling (ECS, 2022). Operationalisation of the day-ahead market is now planned for the second quarter of 2023.

Transport market reforms

Road transport continues to dominate the transport sector. There is limited investment in other means of transportation and no consistent and intelligent system to manage and control transport traffic. Road maintenance is carried out by state companies that operate with old equipment. In 2020, the transport sector's contribution to gross value added was 3.5%, which is lower than the EU average of around 5%. The World Economic Forum's 2019 Global Competitiveness Report ranks the country 84th out of 138 economies for transport infrastructure. Relatively low-quality transport infrastructure, as well as weak trade and transport logistics continue to present barriers for foreign companies aiming to invest in the country. These issues are also causing difficulties for domestic companies. The flagship policy of the economic and investment plan is the further development of the Trans-European Transport Railway Corridor 8, which links North Macedonia with Albania and Bulgaria. This corridor will give the country's companies an alternative export option via Albanian and Bulgarian ports. To start the construction of the Corridor 8/10d highway, an independent and comprehensive feasibility study was undertaken to establish the fiscal cost and to manage fiscal risks (also as a structural benchmark under the IMF's Precautionary Liquidity Loan to North Macedonia). North Macedonia will have to amend legislation to rectify breaches of the provisions of the Transport Community Treaty regarding the opening up of the rail market at the national level. The 32% fatality rate in traffic accidents is high and above the EU average. The law for the creation of a Road Safety Agency still needs to be adopted. Road transport has a significantly higher modal share than rail: 96.7% compared to 3.3%. Road freight has a high 86% share of total freight in North Macedonia; this is higher than the EU average and has a negative environmental impact. Combined transport, which is more environmentally friendly and cost-efficient, is increasing but still accounts for only 1.3% of total freight (OECD, 2021). The ERP largely fails to analyse this sector but does include a related measure – Measure 10.

Measure 10: Implementation of an intelligent transport system (ITS) along Corridor X

This measure, which is also linked to the digital economy policy, has been repeatedly rolled over due to delays. Further work is required to align national legislation with the ITS Directive. An overall strategy for ITS (combined with accompanying resources) is still needed. The ITS should be put in place along Road Corridor X from Tabanovce to Gevgelija, which is a strategic objective of the 2018-2030 national transport strategy. Finalisation of the national ITS strategy and tender documentation have been delayed and are now expected in 2023. The measure aims to improve the safety of road transport and ease traffic flow along Corridor X. The ERP states that expected outcomes include a 17% reduction in travel time and improved safety (i.e. a reduction in traffic incidents by 16.6%). The actual impact on travel time along the corridor remains uncertain, however, because the main bottlenecks are at border crossings and toll stations, which have significantly increased in number in recent years. In addition, the current analysis does not allow to determine the measure's full potential impact on competitiveness and growth.

Agriculture, industry and services

The share of agriculture in the output structure dropped further in 2021 to 9% (-0.8 pps). Its share in total employment also dropped further in 2021 (11.5% – down from 12% in 2020 and 16.6% in 2016). The **agricultural sector** is characterised by an unfavourable farming structure (a large number of very small semi-subsistence farms – the average size of agricultural plots is 1.75 hectares for individual farmers) with mixed agricultural production on small and scattered land plots. The sector's efficiency and productivity are low. The sector was already severely affected by the COVID-19 pandemic, market constraints, a lack of seasonal workers, movement restrictions and difficulties in organising transport and logistics (OECD, 2021). Following the outbreak of Russia's war of aggression against Ukraine and price hikes in energy and fertilisers led to a significant increase in prices for basic food. Data released by the State Statistical Office showed a yearly increase in these prices of almost 30%. The government has introduced subsidies and other mitigating measures. One of the major problems in the country's agricultural sector is the ageing of the labour force – only about 15% of agricultural workers are young (15-24 years old). Low incomes and unfavourable working conditions, as well as deteriorating living conditions in rural areas discourage young people from starting a career in agriculture (FAO, 2021). The sector receives the largest portion of state aid, and subsidies to the sector have been increasing while production has been going down. There needs to be a stronger link between agricultural policies and other sectoral policies such as those on trade, education and SMEs. On the positive side, there is a good level of preparation in the area of food safety, veterinary and phytosanitary policy; and absorption of EU funds under the Instrument for Pre-accession Assistance for rural development (IPARD II) has continued to improve. Advantages for the sector include good access and distribution links to other European markets and potential for structural improvement (e.g. land consolidation, producer groups and cooperatives). Several actions could be taken to increase productivity through innovation and the application of modern technologies (e.g. (i) investing in the skills and know-how of agricultural workers; (ii) strengthening agricultural advisory services; and (iii) connecting agriculture with research, education and tourism).

Measure 19: Modernisation of post-harvest technologies and processing of agricultural products

This measure has been rolled over from 2022, when no significant development took place. The comments from last year's assessment are still valid. The measure is relevant and is consistent with the national priorities set out in the 2021-2028 national strategy for agriculture and rural development. The measure is ambitious enough to impact on the income of the farmers, agriculture cooperatives and producer organisations that are involved. The activities planned under this measure are based on the analysis and recommendations provided earlier by an EU-funded project that helped establish the Common Market Organisation in North

Macedonia. The measure's implementation is funded by a World Bank loan (the World Bank Agriculture Modernisation Project) that also foresees complementary activities for advising and training farmers as potential users of the facilities. There has been a substantial delay in establishing the project's management structure. The lack of a favourable legal and institutional framework for the establishment and operation of the agricultural cooperatives might have a serious negative impact on the project. Moreover, the law on the Common Market Organisation and the establishment of the relevant competent structure within the Ministry of Agriculture, Forestry and Water Economy remains an issue of concern. The exact locations of the purchase centres in Resen and Strumica and of the trading platform in Skopje are not yet known, and construction licences and permits had still not been issued. Activities need to be analysed further to individually reflect all aspects of the preparations for the construction. The estimated costs that concern existing EU funding including the 2019 grant scheme for the modernisation of agriculture in North Macedonia (already under implementation) could be included within the activities and possibly in the activity table. Result indicators are missing for the legal and institutional activities. The values of baseline result indicators are to be clarified.

Even in 2020 and 2021 (when economic activity was hampered by restrictions related to the COVID-19 pandemic), the sectoral and business structure continued their gradual transition towards a higher share of **services** (including trade) in value added and in employment. The output structure is also increasingly determined by the service industries, which together accounted for some 66% of total value added in 2021 (60.4% in 2016 and 64% in 2020). Employment in services remained robust despite the lockdowns. Services were badly hit by pandemic-related containment measures, but they still accounted for over half of total employment in 2021 (57.6%) – a marked increase compared with 5 years earlier (2016: 52.3%), and higher than in 2020 (57%). Tourism and transport continue to account for the largest part of the country's services exports (almost 40% of services exports). Exports of services have increased, but they still represent only around 20% of the value of the country's export basket – indicating the low level of companies' competitiveness (due to weak entrepreneurial skills and significant skills shortages). The ERP includes no measure for this area but does refer tothe service sector's solid export prospects.

The main obstacles to competitiveness in the country's **industrial sector** include (i) low productivity and the slow growth rate of productivity; (ii) limited modernisation of production processes and obsolete technologies; and (iii) a significant skills gap. Employment in the industrial sector accounts for 24.1% of total employment (2021). The process of developing a smart specialisation strategy identified the following vertical priorities: the agriculture and food industry; industry 4.0 (including the mechanical, metal processing and automobile industries); ICT; and sustainable materials and smart buildings. Efforts are underway to continuously increase the industry's share of higher-value-added manufactured goods (machinery and equipment, and chemical products) whilst its share of basic goods (iron and steel, and clothing) falls. The country's industrial strategy focuses on the manufacturing industry without sectoral prioritisation. Manufacturing's share decreased slightly in 2021 after gaining ground in previous years. It stood at 14.8% of value added in 2021 (-0.3 pps year on year). Construction's share also declined to a lesser extent (5.8 % of value added, compared with 6.2% in 2020 and an average of 7.2% in 2016-2020) – reflecting weak investment during the pandemic. No specific measure has been included for this area in the ERP.

Education and skills

This area and the relevant reform measure 1 are analysed above in Section 4 under key challenge #1.

Employment and the labour market

This area and the relevant reform measure 2 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. Only a few enterprises have collective agreements at company or branch level. The tripartite Economic and Social Council (ESC) is actively involved in the elaboration of relevant legislation before its adoption, but its participation is limited to proposals that fall under the responsibility of the Ministry of Labour and Social Policy. The ESC's visibility and impact is low. The ESC depends on the budget of the Ministry of Labour and Social Policy for the financing of its activities and its secretariat. At the local level, despite some progress in raising awareness of the benefits of social dialogue, the use of the local economic and social councils as an effective tool to formulate and implement local employment policies is still very limited. The 2021-2027 National Employment Strategy aims to strengthen the role of central and local social dialogue institutions (including by collective bargaining) by 2027.

Social protection and inclusion

The at-risk-of-poverty-after-social-transfer rate decreased slightly by 0.3 pps to 21.9% in 2020. However, research estimates show that child poverty has increased during the COVID-19 pandemic. Social transfers, particularly pensions, are a key way to keep individuals above the poverty line. The pension contribution rate has slightly increased since 2020 from 18% to 18.8%. The maximum allowed fee from pension contributions collected by private pension companies was reduced from 2.25% to 2% in the same period. The process of obtaining social protection benefits that require particular evidence such as disability allowances can be lengthy. The government has adopted the 2021-2027 national strategy for social entrepreneurship that aims to set up a favourable legal framework for social enterprises. However, the pandemic has hampered the updating of other national social protection strategies. The Law on Social Protection strengthens municipalities' resposibilities, but still does not sufficiently recognise their role in designing and adopting their own programmes in the field of social protection. The success of the social reforms package also depends on improving coordination between public employment service (PES) and other services like social work centres, associations, social service providers, health sector operators and municipalities which have legal obligations to provide additional forms of social protection support. The social impact of the COVID-19 pandemic has been mitigated by enabling access to guaranteed minimum assistance (GMA) for individuals who have lost their jobs during the pandemic.

Measure 3: Enhancing the system for social inclusion of vulnerable groups

Reform measure 3 aims to better target cash transfers and increase their effectiveness by connecting them to labour market activation and social services. This measure is crucial for tackling poverty in the country and has been rolled over from the previous year. The new Law on Social Protection was adopted in 2019 with accompanying by-laws providing the comprehensive legislative framework for social protection in North Macedonia. The measure includes the adoption of a Law on Employment and Insurance Against Unemployment to improve cooperation between the various social service providers. The measure also includes developing a new law to provide financial and technical support to social enterprises that focus on improving the employment prospects of vulnerable people, including people with disabilities. The measure also aims at a greater inclusion of people with disabilities in the open labour market and seeks to further deepen cooperation between PES and centres for social work in order to provide support and labour market activation of employable GMA beneficiaries.

Healthcare

The country's healthcare system covers 90% of the population but its capacity remains inadequate. The share of public expenditure on healthcare was 6.58% of GDP in 2018 (the EU-27 average was 6.9% in 2018). Social security contributions accounted for 52.4% of the total health budget in 2020. The contribution rate for the actively employed is 7.3% of their gross wage. The unemployed and those not covered by insurance from any other source pay 5.4% on 50% of the average national wage. Health insurance for injury at work and occupational diseases is paid by the employer (0.5% of the gross salary). The health insurance system provides a broad network of primary healthcare at the municipal level and an extensive network of secondary healthcare institutions. Categories lacking coverage include in particular farmers, people without identification documents and people in irregular jobs and with irregular incomes, most of whom are Roma (Unicef, 2016). Healthcare places a significant financial burden on households. Up to 20% of the average total costs of medical treatment is paid out-of-pocket by the patient. However, robust statistical data on what out-of-pocket payments are used for is missing. In addition, distance or transportation problems and long waiting lists are among the most relevant unmet needs. EU statistics on income and living conditions (EU-SILC) data show that 20.5% of people in the country have difficulty using the healthcare service. This figure is close to the official number of people at risk of poverty and suggests that most of those who have difficulty in accessing healthcare may also be at risk of poverty. The 'Moj Termin' eHealth system that was introduced in 2013 helped to significantly reduce waiting times and should be extended to primary care doctors. The 2021-2030 National Health Strategy identifies strategic goals and is complemented by a strategy and action plan to improve primary healthcare. However, low public expenditure on health and the major shortage of health professionals remain among the biggest challenges.

Measure 4: Strengthening the quality of primary healthcare

This measure has been rolled over from last year. Its main goal is to improve the quality of primary healthcare (PHC) by reforming the PHC payment model to ensure disease prevention, standard-setting and a reducing reliance on a higher level of healthcare, including by increasing the number of specialised general practitioners. The development of a platform is expected to facilitate appointments and ensure the traceability of health data.

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

Area/Sector	2017	2018	2019	2020	2021	EU-27 Average 2021 or most recent year
Energy						
Energy imports dependency (%)	56.2%	58.4%	58.1%	63.3%	n/A	55.6% (2020)
Energy intensity: kilograms of oil equivalent (KGOE) per thousand euro	292,98	267.13	283.84	274.59	n/A	110.35
Share of renewable energy sources in final energy consumption (%)	19.64%	18.18%	17.49%	19.22%	17.29%	21.7%
Transport						
Railway network density (metres of line per km^2 of land area)	26.85 [s]	26.85 [s]	26.9 [s]	26,9 [s]	26.9 [s]	N/A
Motorisation rate (Passenger cars per 1000 inhabitants)	194	200	205	206.7 [s]	231.0 [s]	N/A
Agriculture						
Share of gross value added (agriculture, forestry and fishing)	9.1%	9.8%	9.4%	9.8	8.4 (p)	1.8%
Share of employment (Agriculture, Forestry and Fishing)	16.2% [s]	15.7% [s]	13.9% [s]	12.0% [s]	11.5% (w)	4.3% (2020)
Utilised agricultural area (% of total land area)	49.8%	49.7%	49.7%	50.0%	N/A	40.6% (2020)
Industry						
Share of gross value added (except construction)	20.5%	21.5%	20.8%	19.8%	19.6% (p)	19.9%
Contribution to employment (% of total employment)	23.3% [s]	23.9% [s]	24.1% [s]	23.9% [s]	23.9% (w)	16.1%
Services						
Share of gross value added	62.9% [s]	62.6% [s]	63.4% [s]	64.1% [s]	65.7% [s]	79.2%
Contribution to employment (% of total employment)	53.2% [s]	52.9% [s]	55.0% [s]	57.1 [s]	57.7 (w)	70,9%

Research, development and innovation						
R&D intensity of GDP (R&D expenditure as % of GDP)	0.35%	0.36%	0.37%	0.38%	N/A	2,26%
R&D expenditure – EUR per inhabitant	17.20€	18.8€	19.9€	19.5€	N/A	EUR 734.5
Digital economy						
Percentage of households who have internet access at home	73.6%	79,3%	81.6%	79.4%	83.7%	92.5%(2022)
Share of total population using internet in the three months prior to the survey [% of population 16-74]	75%	79%	81%	81%	N/A	90%(2022)
Trade						
Export of goods and services (as % of GDP)	55.1%	60.4%	62.4%	57.8%	66.2% (p)	50.4%
Import of goods and services (as % of GDP)	69.0%	72.8%	76.2%	70.5%	82.3% (p)	46.7%
Trade balance (as % of GDP)	-18.1%	-16.8%	-18.1%	- 16.8% (p)	-23,2% (e)	N/A
Education and skills						
Early leavers from education and training (% of population aged 18-24)	8.5%	7.1%	7.1%	5.7%	N/A	9.7%
Young people neither in employment nor in education and training (NEET) (% of population aged 15-29)	31.1%	29.8%	24.5%	26.2%	24.2%	13.1%
Children aged less than 3 years in formal child care (% of under 3-years-olds)	10.3%	8.8%	13.0%	6.3%	N/A	36.2%
Individuals who have basic or above basic overall digital skills (% of population 16-74)	32%	N/A	32%	N/A	35%	54%

Employment and labour market						
Employment Rate (% of population aged 20-64)	54.8%	56.1%	59.2%	59.1%	N/A	74.7%
Unemployment rate (% of labour force aged 15-74)	22.4%	20.8%	17.3%	16.4%	N/A	6.1%
Long term unemployment rate (% of labour force aged 15-74)	17.4%	15.5%	12.4%	12.4%	N/A	2.4%
Gender employment gap (Percentage points difference between the employment rates of men and women aged 20-64)	21.9%	21.4%	21.3%	19.9%	N/A	10.6%
Disability employment gap (Percentage points difference in employment rates between people with and without a disability)	29.4%	27.1%	28.6%	33.7%	N/A	23.1%
Real gross disposable income of households (Per capita increase, Index = 2008)	N/A	N/A	N/A	N/A	N/A	110.27
Social protection system						
At-risk-of-poverty or social exclusion rate (AROPE) (% of population)	37.0%	35.3%	34.1%	32.6%	N/A	21.7%
Impact of social transfers (other than pensions) on poverty reduction	14.29%	14.79%	15.00%	15.18%	N/A	37.08%
Income inequality - quintile share ratio (S80/S20) (Comparison ratio of total income received by the 20% of the population with the highest income to that received by the 20% with the lowest income)	6.38	6.16	5.56	5.92	N/A	4.97
Housing cost overburden (% of population)	11.7%	10.2%	9.9%	8.5%	N/A	8.3

Healthcare						
Self-reported unmet need for medical care (of people over 16)	2.5%	2.3%	2.5%	1.7%	N/A	2.0%
Out-of-pocket expenditure on healthcare (% of total health expenditure)	42.43% z	42.11% z	40.38% z	N/A	N/A	14.39% (2020)

w: *data supplied by and under the responsibility of the national statistical authority and published on an 'as is' basis and without any assurance as regards their quality and adherence to EU statistical methodology'*

e: estimated value

p: provisional (Eurostat)

s: Eurostat estimate

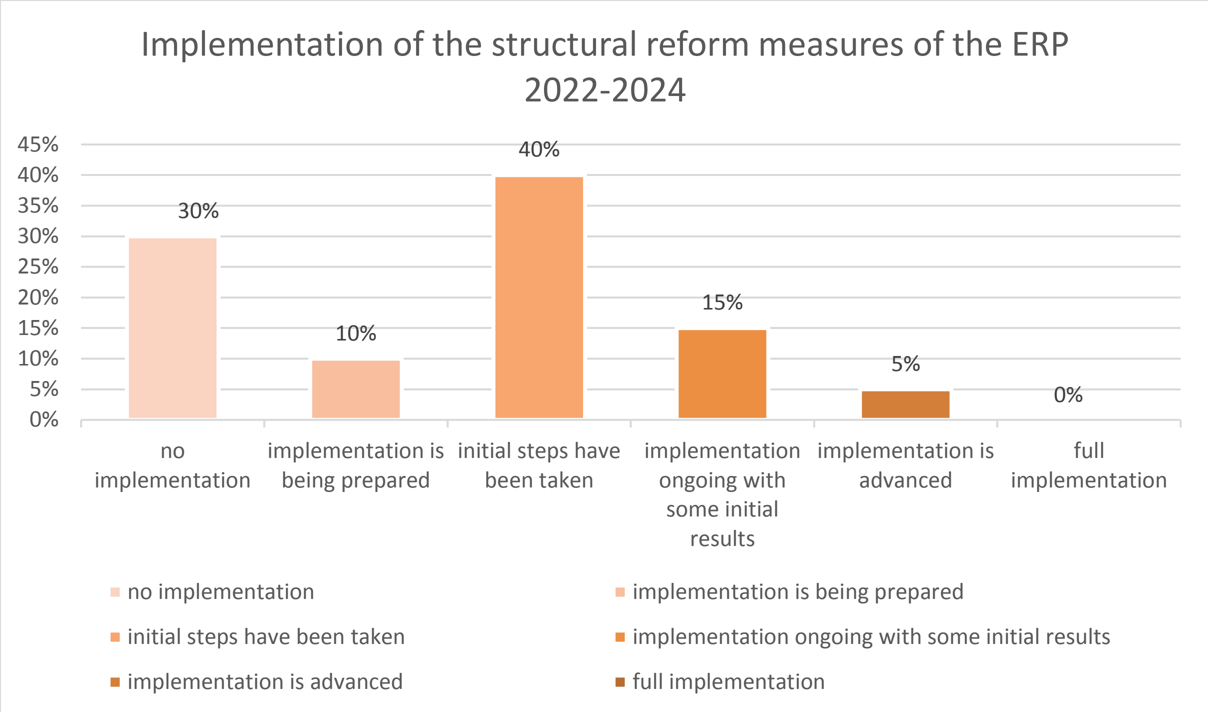
w= data supplied by and under the responsibility of the national statistical authority and published on an "as is" basis and without any assurance as regards their quality and adherence to EU statistical methodology

z: data from World Health Organisation

Source of data in Annex B: EUROSTAT, unless otherwise indicated.

ANNEX C: PROGRESS WITH STRUCTURAL REFORM MEASURES FROM 2022-2024 ERP

Due to some capacity issues in the public institutions as well as the focus of North Macedonia on implementing short-term measures to mitigate the energy crisis, progress in implementing the measures from last year's ERP was mixed (the average score was 1.9 out of 5) and needs some improvement. Activity reports in Annex 11 provide a mostly accurate description of the level of implementation. Implementation is stronger for some measures, including measure 9 on increasing the competitiveness of the electricity market (the measure has been discontinued in the current ERP). By contrast, some measures have hardly been implemented, such as measure 4 (strengthening the quality of primary healthcare), measure 13 (hybrid fund for green and digital start-ups and innovative SMEs), measure 15 (establishment of a management information system for state aid) and measure 17 (enhancing cooperation between the academy and the industry – Science and Technology Park).



ANNEX D: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The government of North Macedonia submitted the 2023-2025 ERP on 2 February 2023. 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. The submitted ERP contains an annex with the list of institutions and individuals involved in the ERP preparation. The government formally endorsed the ERP on 1 February 2023. The coordination process worked well and the attendance to technical meetings was good.

Stakeholder consultation

The draft of the 2023-2025 ERP's structural reforms was posted on the Ministry of Finance''s website from 15 to 29 December. Interested parties were invited to send written contributions. Comments and suggestions received in writing are attached 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 export growth; and (ii) assuming weaker investment. 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.

Fiscal framework

The ERP is based on the latest budget projections following the latest budget revision and on the fiscal data available at the end of the third quarter of 2022. In line with the revised economic growth assumptions, the ERP has raised the deficit projections for 2023 and 2024, compared to previous year's program. 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 execution of capital expenditure, and lower collection of revenue; (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 program also includes an external debt analysis, which presents results from stress tests for shocks to economic growth, to the primary current account and to interest rate changes.

Structural reforms

The chapter on structural reforms follows the ERP guidance note. Reform areas which have not or only partly been included as key challenges in Section 5.1. should have been analysed more in depth in Section 5.2. Reform areas are fully costed and integrated into the fiscal framework. Continued efforts are needed to quantify the impact for each measure. The description of the implementation risks and mitigation measures continues to improve. The

ERP includes 19 measures and exceeds the page limit. Prioritisation of reform measures has focused on addressing the key structural challenges that were identified. Tables 9-11 in the annex have been properly completed. The implementation reports of the 2022-2024 ERP's policy guidance and Table 11 in the Annex are well prepared. The attributed scores largely reflect the implementation level. Though not expressly requested by the guidance note, additional useful information was provided in Annex 2a (on links between reform measures and ongoing or planned investments) or summarised in Annex 4 (result indicators for structural reform measures). Contributions received by external stakeholders during the consultation process were annexed to the ERP.

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