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CEA Center for Economic Analyses

Policy Brief

Does the level of public debt matter? Debt Sustainability of Macedonia

Key points

- *Public debt is on an unsustainable path, with annual deficits adding to the debt at a pace exceeding the rate of economic growth*
- *The public debt stabilizing primary balance is projected at negative 0.8%*
- *The fiscal policies are continuing towards the increasing public debt-to-GDP ratio in the midterm plans without significant government policies for consolidation*
- *The indicative threshold of public debt-to-GDP over 50% is on the brink to be easily achieved and topped over*
- *The rule of law and quality of institutions is directly linked to the sustainable level of public debt*

Recommendations

- *To place the budget policies and the public debt on a more sustainable fiscal path Macedonia must consolidate the budget expenditures and increase efficiency of public spending.*
- *The increased public debt with limited fiscal space cannot be unraveled by adjustments of the one side of the ledger (revenues or expenditures) but a combined policy that needs a political consensus.*
- *The long-term fiscal imbalance requires sensible adjustments to all discretionary and mandatory spending. The transfers, social and state aid expenditures as notable contributors to the excessive and rapidly rising debt burden through the increasing deficits should be better targeted, monitored and rationalized.*
- *The public debt dynamics toward potential path of stabilization is highly sensitive to the interest rate and economic growth rate, thus a slide in the projected economic growth rate or significant change in the real interest rate may significantly affect the debt dynamics and the debt stabilizing primary balance.*

Understanding the problem of public debt: How we got here?

In public finance management, the erosion of fiscal transparency and discretionary policies can lead to unexpected increases in debt, with adverse financial and economic consequences for taxpayers and the society as a whole;

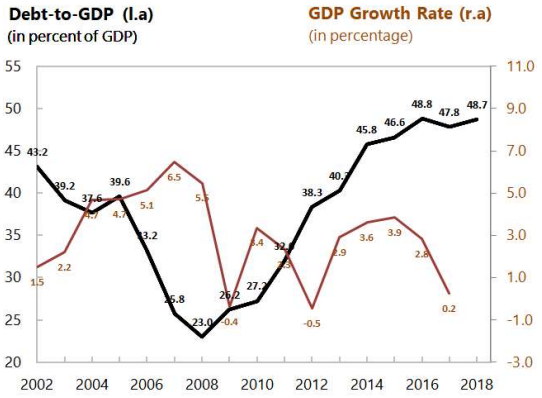
Lessons learned from the past imply that it is not solely the size of the public debt that counts, but that there is increasing focus on the "quality" of the debt stock, since it impacts the financial sector and the real economy as it shrinks the space for private investments and lowers future growth prospects.

In the Macedonian context, a clear erosion of fiscal discipline and transparency has taken place in the past decade, and the public debt sustainability came to an increasing interest since the public debt more than tripled in the period between 2007 and 2018, from 96,076 mill MKD (1,569 mill EUR) to 319,906 mill MKD (5,202 mill EUR) as of the end of 2018; tax revenues over public debt decreased significantly, and the remaining debt burden ratios deteriorated as well. Despite concerns over the rising public debt load, the government's intent is pursuing on new debt instruments generating additional debt. The public debt raising is not far from the overall global trends as it has more than doubled as debt-to-GDP ratio in the last decade from 23% of GDP in 2008 to 48.7% at the end in 2018[1].

The "controversial" narrowing or the scope of the public debt excluding the debt of the NBRM and the non-guaranteed sovereign debt of the public enterprises and companies established by the state or municipalities, was amended in 2014, distancing itself from the IMF/WB guidelines on wider scope of defining calculating and managing the debt[2].

A fiscal rule has been proposed as a constitutional change in 2014 as an initiative to the Parliament for a fiscal rule of 60% of the GDP as well as a budget deficit of 3%, however there were no amendments in the Constitution.

Figure 1 Debt-to-GDP and Real Growth rate trends in Macedonia



Source: Based on MoF data

As of 2019 the proposed amendments to the current public debt law that stipulates and envisages changes towards inclusion of the non-guaranteed debt in the scope of the public debt; net expression of the debt; "pulling-out" a strategy for public debt management as a stand-alone strategy away from the Fiscal Strategy where the maximum amount of net debt for the first year of the mid-term strategy will be set and defining a deadline for preparation of the annual public debt report[3].

Macedonian government routinely overestimated the budget revenues and expenditures. CEA calculations illustrate that average annual overestimation of 2009-15 planned revenues was around 7%[4] and that of 2009-2015 planned expenditures was around 6%.[5]

The current Fiscal strategy (2019-2021)[6] plans and projects further increase of the public debt to 53.3% of GDP in 2019, 54.5% of GDP in 2020 and 53.2% in 2021[7]. Furthermore the arrears generated pose additional distress yet an important factor (hidden debt) that potentially affect the debt sustainability.

[1] Q3 2018 public debt-to-GDP measured at 48.2, q4 2018 48.7

[2] *What Lies Beneath: The Statistical Definition of Public Sector Debt, IMF staff discussion note, 2012*

[3] The debt brake or fiscal rule as explicit long-lasting constraint on fiscal policy through numerical limits on budgetary aggregates, not intended in these amendments, neither establishment of fiscal council, amendments and discussions that were formerly announced as to be undertaken

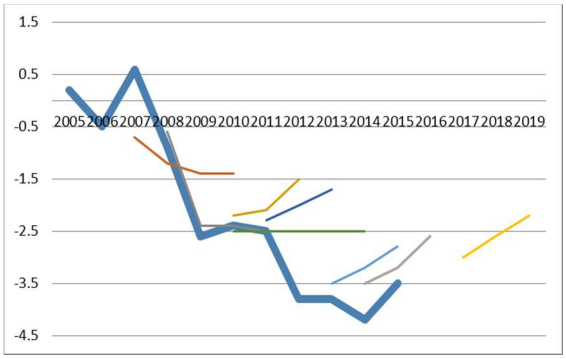
[4] Planned revenues as per the executive budget proposal compared with actual revenues as per the final account.

[5] Planned expenditures as per the executive budget proposal compared with actual expenditures as per the final account.

[6] Revised Fiscal strategy 2019-2021, as of January 2019

[7] Revised Fiscal strategy 2019-2021, as of January 2019

Figure 2 Deficit bias as a percentage of the GDP in Macedonia



Source: Author's calculations based on Ministry of Finance data and economic reform programs in Macedonia.

This situation calls for new efforts to contain vulnerabilities rising from increasing levels of public debt although taking on debt is one of the ways in which countries can finance the needed investments in infrastructure, human capital or public works. However, good debt management is critical for these investments to be successful.

Table 1 Evolution of debt burden indicators

DEBT BURDEN RATIOS		2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018[8]
Total public debt-to-GDP	% of GDP	0,23	0,26	0,27	0,32	0,38	0,40	0,46	0,47	0,48	0,47	0,49
Total public debt-to-Revenue	% of revenue	0,70	0,84	0,90	1,08	1,30	1,44	1,65	1,62	1,71	1,64	1,64
Debt service-to-GDP	% of GDP	0,02	0,03	0,02	0,02	0,02	0,04	0,03	0,06	0,05	0,04	0,06
Debt service-to-Revenue	% of revenue	0,07	0,08	0,08	0,08	0,07	0,14	0,10	0,22	0,16	0,14	0,19
Gross financing needs-to-GDP	% of GDP	0,03	0,05	0,04	0,04	0,05	0,07	0,06	0,09	0,06	0,06	0,07
Gross financing needs-to-revenue	% of revenue	0,08	0,15	0,14	0,14	0,17	0,25	0,22	0,30	0,22	0,19	0,24
Total Net Public Debt-to-GDP	% of GDP	0,23	0,26	0,27	0,32	0,38	0,40	0,46	0,47	0,48	0,47	0,49
Total Net Public Debt-to-Revenue	% of revenue	0,70	0,84	0,90	1,08	1,30	1,44	1,65	1,62	1,71	1,64	1,64
Total Gross Public Debt-to-potential GDP	% of potential GDP	0,16	0,19	0,19	0,23	0,28	0,30	0,35	0,36	0,39	0,39	0,41

Source: Authors calculations, based on data of MoF

Debt Sustainability Analysis Scenarios and Results

IMF (2010) suggests that Macedonia should take into account a prudent level of 25% of public debt over GDP (following also an IMF Vulnerability study from 2007), as there is no consensus among researchers and academicians on what would be the appropriate public debt target for emerging markets. IMF suggests a generally-accepted conclusion that emerging markets can sustain lower levels of debt than advanced economies because economic and institutional features limit both the feasibility and the credibility of these countries' debt-servicing abilities (Reinhart, Rogoff and Savastano (2003), IMF (2002)). This clearly states that the rule of law, quality of institutions is directly linked to the sustainable level of public debt in a specific country

Further, an approach of IMF on modelling government's budget constraint results in prudent level of public debt-to-GDP of around 20%. Thus, Macedonia as a hybrid regime with eroded fiscal

[8] 2018 indictors: debt value is based on Q3 public debt as available, GDP projections based on Macroabc model, 2008-2017 public sector data based on budget execution reports, 2018 enacted budget, 2019 adopted budget, 2020-2021 fiscal strategy projection data, 2022-2024 authors' assumptions, explained throughout.

transparency, eroded rule of law and with a low good governance level (EC and EU 2015) should not rely on the 40% pubic debt over GDP level and should consider lower levels as a prudent sustainable level of public debt. Macedonia as a candidate country to join EU Macedonia should not even think to take into account the 60% debt-to-GDP Maastricht criteria as a prudent level.

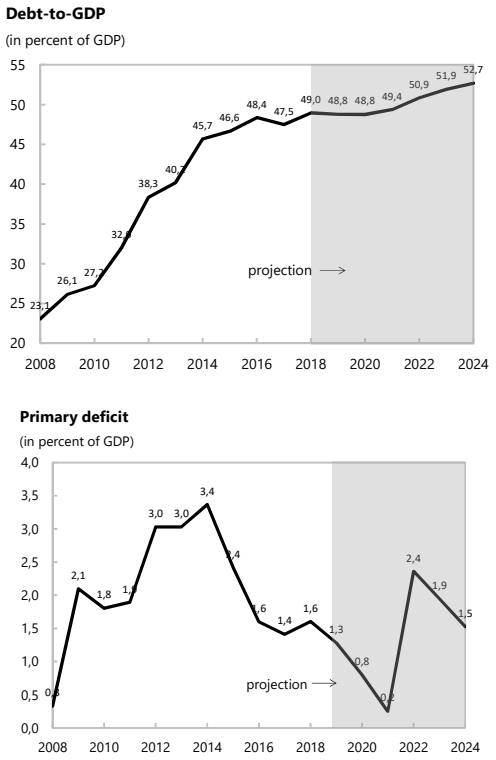
A proper assessment of fiscal policy and public debt trajectory must be based on certain macroeconomic baseline assumptions, notably economic growth and the interest rate on public debt, as well as the likelihood that fiscal risks might materialize[9]. It is widely considered that the Macedonian public debt-to-GDP is on unsustainable path and there is a need for a monitoring tool that will not only trivially follow-up the debt-to-GDP ratio but also, the gross financial needs and the "quality" of the public debt generated.

Under a ***baseline scenario*** of the debt sustainability analysis of the IMF indicates that the rapid rise in public debt since 2008 has largely depleted the fiscal space which can be considered as unsustainable especially due to increasing financing need in the medium run, faced with the need to service the external debt of the existing Eurobonds (maturing debt in 2020, 2021 and 2023). In projection of a more conservative economic growth, compared to the GoM, while following the DSA model (anticipating moderate growth scenario of 3% real economic growth rate in 2019, up to 3.5% from 2022 to 2024), under the IMF's DSA risk based approach for a low/high scrutiny country and in-line with the projections for public debt in the following mid-term period, the debt is expected to exceed both the 50% of the GDP and the 10% of gross financing needs (GFN) to GDP as benchmarks of emerging markets (EM). Although at this point (end of 2018) the benchmarks threshold has not been reached yet by neither of the conditions, however it is on the brink of both benchmarks.

Under the baseline scenario by using the IMF MAC DSA model the public debt of Macedonia is expected to increase close to 53% of the GDP in the following period to 2024. The baseline scenario is based on the current projected government policies with considering Q3 2018 debt level as the final starting point for debt for 2018[10], 2019 data are based on the 2019 budget while the 2020-21 data are based on the Fiscal strategy 20219-2021[11] projections for the budget.

The public debt dynamics shows increase of debt-to-GDP change rate in the following five years[12] with an increasing trend from 2019 to 2024. Overall in the period considered we project a change of increased debt-to-GDP of positive 3.9 p.p.

Figure 3 Debt-to-GDP and primary deficit to GDP trend



Source: Based on data from MoF and projections of author

Macedonia is running and continue to run a primary deficit throughout the period as it is main contributor to the increased public debt. The current level of the primary balance as well as the projected primary balance might not be sufficient to stabilize the debt-to-GDP ratio (risk of being on an explosive path) and further fiscal adjustment are required to bring the primary balance to a level that is necessary to service public debt and even towards debt reduction. Although projected and evidenced drop in the

[9] Modernizing the Framework for Fiscal Policy and Public Debt Sustainability, IMF, 2011

[10] The final debt for 2018 might be higher when the updated data is to be published

[11] Upon publication of the first revised Fiscal strategy for 2019-2012 the projections are in line with the revised strategy

[12] the projection period is set to current plus five years as to increasing uncertainty on a longer run under the assumptions

primary balance (2017-2019), the past has shown a deficit bias[13], in the medium run the primary deficit is expected to stabilize on a three year period however the financing needs to increase further along the line especially when the maturing long term bonds are to be serviced, increasing the primary deficit however not reaching over 2.5%.

Within the baseline scenario a decomposing of the public debt changes to basic measurable debt-crating flows, provides input on the variables which have significant impact on the movements of public debt and what to expect in the future under the provided assumptions which are in essence comparable with the assumptions of the policy makers.

If the government were to successfully implement the fiscal plans for keeping the primary balance below 2% in the following period and extends its efforts the debt-to GDP ratio is expected to keep its pace.

Figure 4 Debt Economic and Market Indicators

Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2008-2016 [2/]	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	36.4	47.5	49.0	48.8	48.8	49.4	50.9	51.9	52.7
Public gross financing needs	5.4	5.6	7.2	5.0	7.4	10.6	9.5	13.9	11.7
Net public debt	36.4	47.5	49.0	48.8	48.8	49.4	50.9	51.9	52.7
Public debt (in percent of potential GDP)	27.2	38.8	40.8	40.8	41.3	42.4	43.9	45.1	46.0
Real GDP growth (in percent)	2.6	0.0	2.8	3.0	3.2	3.4	3.5	3.5	3.5
Inflation (GDP deflator, in percent)	2.7	3.5	1.4	1.9	2.0	2.0	2.0	1.9	1.9
Nominal GDP growth (in percent)	5.5	3.5	4.2	5.0	5.3	5.5	5.5	5.5	5.5
Effective interest rate (in percent) [4/]	2.7	2.9	2.6	2.9	3.1	3.6	3.7	3.8	3.9

As of 20 July 2018		
Sovereign Spreads		
Bond Spread (bp) 3/		348
5Y CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	n.a.	n.a.
S&Ps	BB-	BB-
Fitch	B	BB

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	2.5	-0.9	1.5	-0.2	0.0	0.6	1.5	1.1	0.8	3.7	
Identified debt-creating flows	2.4	-3.6	2.7	-0.1	0.0	0.7	1.5	1.1	0.8	4.0	
Primary deficit	2.2	1.4	1.6	1.3	0.8	0.2	2.4	1.9	1.5	8.2	-0.8
Primary (noninterest) revenue and grants	29.5	28.9	29.8	31.1	30.7	30.5	29.7	29.7	29.9	181.6	
Primary (noninterest) expenditure	31.6	30.4	31.4	32.3	31.5	30.8	32.0	31.7	31.4	189.7	
Automatic debt dynamics [5/]	0.2	-5.0	1.1	0.2	-1.0	-0.9	-0.9	-0.8	-0.8	-4.1	
Interest rate/growth differential [6/]	-0.9	-0.3	-0.7	-1.0	-1.0	-0.9	-0.9	-0.8	-0.8	-5.3	
Of which: real interest rate	0.0	-0.3	0.5	0.4	0.5	0.7	0.8	0.9	1.0	4.2	
Of which: real GDP growth	-0.9	0.0	-1.3	-1.4	-1.5	-1.6	-1.6	-1.7	-1.7	-9.5	
Exchange rate depreciation [7/]	1.1	-4.8	1.8	1.2	0.0	0.0	0.0	0.0	0.0	1.2	
Other identified debt-creating flows	0.0	0.0	0.0	-1.6	0.2	1.3	0.0	0.0	0.0	-0.1	
Please specify (1) (e.g., privatization receipts) (+ reduces financing needs	0.0	0.0	0.0	-1.6	0.0	0.0	0.0	0.0	0.0	-1.6	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., other debt flows) (+ increases financing needs)	0.0	0.0	0.0	0.0	0.2	1.3	0.0	0.0	0.0	1.5	
Residual, including asset changes [8/]	0.2	2.7	-1.2	-0.1	0.0	-0.1	0.0	-0.1	0.0	-0.2	

Source: Based on data from MoF and projections of author, IMF's DSA model

The main indefinable contributor to the debt is the primary budget deficit and is expected to be the main contribution in the following period as well. On a cumulative basis within the projected period its contribution in the change on the public debt is 8.2p.p of GDP, with an average 1.4 pp per annum. The overall GDP growth as projected with moderate rate is contributing to bringing down the debt of - 9.6 p.p. in the projected period on a cumulative basis.

The real interest rate is also a variable that needs to be closely monitored and in the medium run is expected to contribute to increased debt in the following period on a cumulative basis of 5.4p.p.

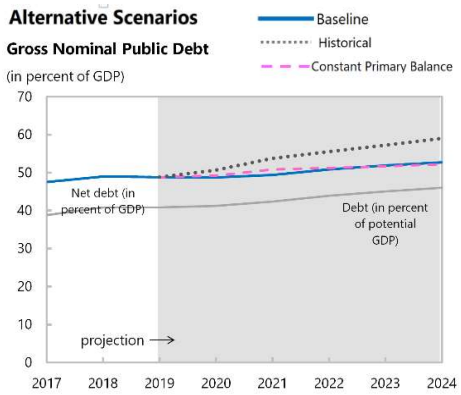
The debt stabilizing primary balance is reaching negative 0.8% of GDP for 2024.The public debt stabilizing primary balance for 2019 is calculated at negative 1.4% of GDP, and moving to negative 0.8% in 2024. This indicates that to reach stabile debt-to-GDP ratio the primary balance deficit should be set

[13] Deficit bias: The tendency of governments to allow deficit and public debt levels to increase

at 0.8% of the GDP or an average 0.5% of GDP in the period considered. It should be noted that debt dynamics is particularly sensitive to the interest and economic growth rate assumptions, thus a slide in the projected economic real growth rate or change in the real interest rate may significantly affect the public debt dynamics and the debt stabilizing primary balance.

The heat map identifies the additional vulnerabilities on the public debt level, gross financing needs and debt profile. Under the baseline scenario the debt profile is highlighting several vulnerabilities mainly to the debt composition from external public debt and held by non-residents and moderately for market perception.

Under the alternative *Historical scenario*, considering the average historical data it is projected that the public debt-to-GDP is increasing higher compared to the baseline scenario. The historical scenario assumes lower annual real growth of 2.1%, based on the average real economic growth in the past decade, and at the same time higher primary deficit also set at the ten year average of 2.2%.



Underlying Assumptions
(in percent)

Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	3.0	3.2	3.4	3.5	3.5	3.5
Inflation	1.9	2.0	2.0	2.0	1.9	1.9
Primary Balance	-1.3	-0.8	-0.2	-2.4	-1.9	-1.5
Effective interest rate	2.9	3.1	3.6	3.7	3.8	3.9
Constant Primary Balance Scenario						
Real GDP growth	3.0	3.2	3.4	3.5	3.5	3.5
Inflation	1.9	2.0	2.0	2.0	1.9	1.9
Primary Balance	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Effective interest rate	2.9	3.1	3.6	3.6	3.8	3.9
Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	3.0	2.1	2.1	2.1	2.1	2.1
Inflation	1.9	2.0	2.0	2.0	1.9	1.9
Primary Balance	-1.3	-2.2	-2.2	-2.2	-2.2	-2.2
Effective interest rate	2.9	3.1	3.3	3.2	3.2	3.2

Considering the lower growth, and higher primary deficit, the resulting situation is higher gross financial needs that are significantly increasing under the historical scenario in compassion with the baseline scenario projections.

Under the alternative *Constant primary balance scenario*, the primary balance is set at -1.3% of the GDP throughout the period without changes to the other variables. In this setting, the debt-to-GDP is close to the baseline scenario while more evident changes are noted in the first half of the projected period in the gross financing needs since in the baseline scenario the primary balance is projected at lower rate.

The *Macro fiscal stress tests* applied, compared with the baseline indicate sensitivity and vulnerabilities to the debt-to-GDP especially to possible GDP growth changes. When applied a stress test of 1 standard deviation based on the last 10 years of 1.7 p.p. reduced growth in two consecutive years 2020-2021, and a decrease of 1 p.p. in growth with effect of 25 bps inflation reduction, the debt-to–GDP increases by 1.6 p.p. in 2019 and by 4 p.p. in the following period. Consequently, this is reflected in the increase of GFN most significantly reflected in the years when the shock is applied.

Conclusions

- In public finance management, the erosion of fiscal transparency and discretionary policies can lead to unexpected increases in public debt, with adverse financial and economic consequences for taxpayers and society as a whole;

- The government routinely exceeded its budget: fiscal data show budget expenditures and consequent budget deficits increased considerably prior to elections. Also, capital expenditures significantly intensified prior to and during each election cycle, followed by stabilization and a slight decrease. Social transfers increased significantly prior to and during the 2011, 2013 and 2014 elections;

- IMF (2010) suggests that Macedonia should take into account a prudent level of 25% of public debt over GDP, as there is no consensus among researchers and academicians on what would be the appropriate public debt target for emerging markets. IMF suggests a generally-accepted conclusion that emerging markets can sustain lower levels of debt than advanced economies because economic and institutional features limit both the feasibility and the credibility of these countries' debt-servicing

abilities. This clearly states that the rule-of-law, quality of institutions is directly linked to the sustainable level of public debt in a specific country;

- Episodes of the creative accounting gives arguments to the political cycle theory of the public debt in Macedonia. Empirical findings demonstrate that the higher the degree of transparency the smaller the political budget cycle. That is why the fiscal transparency and the education of the taxpayers and citizens about the public finances and the key budget documents and participation is important in infant democracies;

- Under our assumptions for sensitivity of the public debt over GDP to real economic growth rates, it starts to decline only at around 3% real GDP growth. With an annual real GDP growth rate of 4% Macedonia can reach the prudent level of 40% of public debt over GDP only at 2030 and with an annual real GDP growth rate of 7% Macedonia can reach the prudent level of 40% of public debt over GDP at 2023;

- The doubled public debt-to-GDP ratio in the past decade reaching to 49% (Q3 2018) has been mainly driven by fiscal deficit and increasing negative primary balances. The deficits have been a result of an under execution of both tax and non-tax revenues side and increased expenditures mainly incurred through the social and state aid expenditures;

- There is a continued policy of fiscal expansion with optimistic growth scenarios which show significant vulnerability effects on the debt-to-GDP ratio, this is especially evident in the FS projections of expected real growth rates of 4% in 2020 and 5% in 2021;

- Under a baseline scenario projection for the debt path with a mid-term real GDP growth rate of 3% (2019) to 3.5% (2022-2024) and no significant changes in the fiscal policies the public debt is to continue to increase in the next five years as well, reaching almost 53% in 2024, with a positive 4.8 p.p. In this manner the 50% indicative threshold is to be reached and the debt can be classified as on to the risk of being on an explosive path. At the same time the gross financial needs as a percentage of GDP are expected to exceed the 10% indicative IMF threshold, primary and especially as a result of the financing needs for the maturing Eurobond debt due in 2020, 2021 and 2023.

- The primary deficit as a main contributor to the debt under the baseline scenario and without drastic reduction of the primary deficit will continue to be the driver of the debt growth in the next five years. It is expected to stabilize in the mid run and drop in the next three years to 0.2% in 2021, however due to the financing needs of the maturing long term external debt it is expected to rise to 2.4% in 2022. It is essential for the primary balance plans to be obeyed and contain the deficit now only below 2% but even lower, especially in a historic circumstances of deficit bias.

- The debt stabilizing primary balance under the baseline scenario in the projected period, reaching negative 0.8% of GDP for 2024. The debt stabilizing primary balance for 2019 is calculated at negative 1.4% of GDP, and moving to negative 0.8% in 2024. This indicates that in order to reach stabile debt-to-GDP ratio the primary balance deficit should be set at 0.8% of the GDP or an average 0.5% of GDP in the period. It should be noted that debt dynamics is particularly sensitive to the interest and growth rate assumptions, thus a slide in the projected growth rate or change in the real interest rate may significantly affect the debt dynamics and the debt stabilizing primary balance.

- Alternative scenarios show that the fiscal consolidation should be followed in order to avoid the explosive path of increasing of the debt and general gross financing needs. The historical scenario shows that if the decade averages of the main assumptions are to reoccur the debt will increase significantly more and easily reach 59% of the GDP in 2024, adding 10 p.p. compared to q3 2018 debt. The peak of the gross financial needs under the historical scenario are expected to reach above the 10% benchmark but below the 15% benchmark, with its peak of 13.2% in 2021 and 15.1% in 2023, again associated with the financing needs for the maturing debt maturing.

- Alternatively under the constant primary balance scenario of negative 1.3 percentage throughout the period (2019-2024) indicates similar results

as the baseline scenario concerning the dent-to-GDP with steady but increasing debt almost 53%. The GFN under the same scenario follows the baseline with slight differences in the GFN to GDP as a result of the assumed lower/higher primary balances compared to the constant primary balance of the scenario, again peaking in 2021 and 2023;

- Macroeconomic and fiscal shocks can significantly increase both debt and gross financing needs compared to baseline scenario. A *Macro fiscal stress tests* applied, compared with the baseline indicate sensitivity and vulnerabilities to the debt-to-GDP especially to possible GDP growth changes. When applied a stress test of 1 standard deviation based on the last 10 years of 1.7 p.p. of reduced growth in 2 consecutive years 2020-2021, and a decrease of 1 pp in growth with effect of 25 bps inflation reduction, the debt-to–GDP increases by 1.6pp in 2019 and by 4 pp in the following period, reaching its peak of almost 57% of the GDP in 2024. Consequently, this is reflected in the increase of GFN most significantly reflected in the years when the shock is applied.

Policy choices to reduce public debt

- To place the budget and the debt on a more sustainable fiscal path Macedonia must restrain the budget expenditures, increase efficiency of public spending and raise revenues. Increased fiscal discipline both through expenditure cuts and revenue increases involve discomfort but it is much more a political than an economic sacrifice;

- The increased public debt with depleted fiscal space cannot be unraveled by adjustments of the one side of the ledger (revenues or expenditures) but a combined policy that needs a political consensus. Furthermore, the issue may be too large for policies that address only small or limited sections of the budget but significant programs must be reformed.

- The debt reduction i.e. first the deficit reduction process should begin by building consensus around a prudent schedule of budgetary savings

- The long-term fiscal imbalance requires sensible adjustments to all discretionary and mandatory spending. However, the transfers, social and state aid expenditures as the foremost contributors to the excessive and rapidly rising debt burden through the increasing deficits should be rationalized.

- A simple rule of primary deficit below 2% does not seem to be the sole answer to debt reduction due to the low and volatile growth rates. The debt stabilizing primary balance is projected at negative 0.8% however reduction of the debt will require further efforts

- The debt dynamics toward potential path of stabilizing the debt is highly sensitive to the interest and growth rate, thus a slide in the projected growth rate or significant change in the real interest rate may significantly affect the debt dynamics and the debt stabilizing primary balance.

- The rule of law, quality of institutions is directly linked to the sustainable level of public debt.

This Policy Brief was adapted from the Research Paper: Political Economy of Public Debt and Debt Sustainability: The Case of Macedonia: Implementing the IMF's debt sustainability analysis tool for market access countries to Macedonia, developed as part of a Center for Economic Analyses (CEA) project entitled: Fiscal Responsibility: Promoting sustainability and transparency in public debt. The project received funding support from EU through the project Balkan Monitoring Public Finances implemented in Macedonia by Analytica.

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