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SDG Financing Landscape in North Macedonia

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Acknowledgements

This report was commissioned by the United Nations Resident Coordinator Office in North Macedonia and conducted in the period July – November 2021, as part of the United Nations North Macedonia efforts to open dialogue and strengthen focus in the country on Financing the SDGs. This study aims to provide a basis to stimulate dialogue on financing with government and private sector, including financial institutions and regulators, as well as international community on how to best align financing flows towards accelerated achievement of sustainable development priorities in the country. The assessment was written by Marjan Petreski from Finance Think – Economic Research and Policy Institute, Skopje, with contributions from Lilian Kandikjan, Partnerships and Development Finance at the UN Resident Coordinator's Office in North Macedonia. The study was overseen and supported by United Nations North Macedonia and consulted with the World Bank, and the IMF. The UN would like to particularly thank the following colleagues who supported the preparation by providing inputs or comments: Joana Babushku (Economist, UN Resident Coordinator's Office, UN North Macedonia), Sanja Madzarevic-Sujster (Senior Economist, Western Balkan, World Bank) and Pavlina Zdraveva (Climate Change Projects Manager, UNDP North Macedonia).

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Executive summary

The objective of the SDG Financing Landscape Analysis is to provide an overview of the comprehensive landscape of financing flows in North Macedonia, with the aim to identify potential approaches and activities that can contribute to greater alignment and investment by all stakeholders towards the implementation of SDGs. This analysis is in line with the Addis Ababa Action Agenda's objective of transparently identifying and aligning all financing flaws from all sources with economic, social and environmental priorities. The analysis is based on the Development Finance Assessment (DFA) and the INFF BB1.2 Financing landscape assessment methodologies. Sources of data include the state budget, monetary and external statistics of the central bank, and the publicly available information from other government institutions.

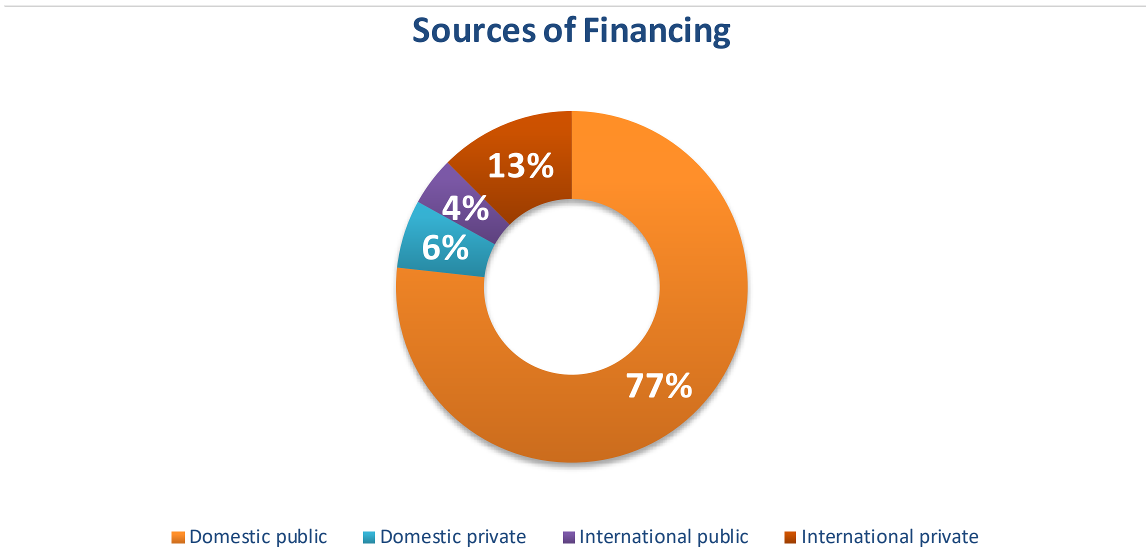
The total annual financing envelope in North Macedonia is assessed at EUR 5.3 billion. Dominant part of it, 76.7 per cent, come from *domestic public sources*, which are and remain to be the key potential financial source for achieving SDGs. *International private financing* is second in volume, representing 12.5 per cent of the financial envelope. *Domestic private financing* represents 6.3 per cent, while *international public financing* represents the smallest volume, with only 4.5 per cent share.

Domestic public financing flows, including public revenues, revenues of the state-owned enterprises and domestic public borrowing, secure about EUR 4 billion annually. Tax revenues, the most important component, have been steadily increasing until just before the pandemic hit in 2020, yet, at about 17 per cent of GDP remain comparatively lower to EU countries. In particular, the effective rates of income tax remain low, undermined with the large share of informal economy, inefficiencies in tax collection, existing regressivities in the tax system, multitude of tax exemptions and low nominal tax rates.

International private financing, being composed of FDIs, commercial borrowing abroad and international remittances amounts to about EUR 660 million annually. FDIs averaged about EUR 300 million annually in the last decade, a dominant part being equity financing, yet lagging behind the achievements of regional peers and with significant year-to-year variations. On average, additional EUR 100 million is secured through debt financing from abroad by non-FDI-related private actors, while additional EUR 200 million through private remittances.

Domestic private financing, composed of bank corporate credits, non-bank financing and public-private partnerships, secures about EUR 330 million annually. Bank financing is dominant in the Macedonian financial system, securing about EUR 300 million annually and steadily increasing. Crediting conditions have been favourable for more than a decade, yet risk-averse crediting policies hindered greater credit extension by the banks. However, investment picked up from 17.8 per cent of GDP in the 1990s to nearly 30 per cent in the 2010s, attaining the level considered necessary for high and sustained GDP growth rates. On the other hand, the role of bank financing for MSMEs remained limited. Public-private partnerships remain significantly underdeveloped source of funding in North Macedonia, with changes expected in this area in the next period in view of the draft PPP law[52].

International public financing, comprising international government borrowing and official development assistance contributed with about EUR 230 million annually. In particular, the role of ODA has been on a constant decline, from 2.9 per cent of GDP in 2006 to 1.1 per cent in 2019. International public borrowing remains important vehicle for reducing the crowding-out effect in the domestic financial system. About two thirds of international public borrowing is secured through private creditors (bulk of which through the issuance of a Eurobond), while the rest is dominated by the multilateral creditors of which the World Bank is the largest one.



Public Domestic	€ 4.03 billion
tax revenues	1.87
social contributions	1.01
non-tax revenues	0.30
other government revenues	0.13
public domestic borrowing	0.11
SOE revenues	0.59
PPPs	0.03

Public International	€ 0.23 billion
public foreign borrowing	0.11
ODA	0.12
other official flows	-

Private Domestic	€ 0.33 billion
private borrowing	0.33
CSR	-
domestic philantropies and NGOs	-

Private International	€ 0.66 billion
FDI	0.29
remittances	0.21
foreign commercial loans	0.16
international NGOs	-

North Macedonia ranks lowest among the Western Balkans peers when the key source of domestic public financing is considered – government revenues. However, the level of indebtedness is moderate in the same comparative perspective. North Macedonia ranks above the regional average in terms of the domestic credit to the private sector, as the key source of domestic private financing. The country is among the lowest regional performers in terms of FDI inflow, as well receives the lowest relative amount of remittances among the Western Balkan countries.

Emerging regional initiatives and country-specific developments in the Western Balkans may secure additional sources of SDG financing over the short and medium term. Blended finance is operational under the Western Balkans Investment Framework (WBIF), while WB EDIF Guarantee Facility provides guarantees and counter-guarantees to financial intermediaries. Green for Growth Fund (GGF), structured as a public-private partnership and the Regional Energy Efficiency Program (REEP), an environmental trust fund, are two regional initiatives focused on green economy. Lately, there are emerging steps towards enacting green tax and issuing green bonds, as well as increasingly using subsidies to support SDG-related goals.

The majority of the state aid programs in North Macedonia could be related to the four SDGs prioritized by the government: growth and decent jobs; industry and innovation; reduction of poverty and inequality; and clean and affordable energy; nevertheless, there is scope for greater transparency and targeting of subsidies. For the state aid programs channeled through the Financial Support to Investment Law and the Fund for Innovation and Technological Development, supporting companies, jobs, growth and innovation are explicit objectives. Other programs are focused on reducing poverty, inequality and increasing the quality of education. Finally, a limited number of state aid programs channeled through the Ministries of Environment and of Economy explicitly target clean energy.

Greater focus of all actors – government, banks and institutional investors, private sector companies and international community is key to ensure greater financing for sustainable development and accelerate long term sustainable development of the country. Specific recommendations with proposed actions for each of these stakeholders – including further alignment of public finance policies and incentives, banks' and institutional investors' financing criteria and decisions and private sector core business activities with sustainability objectives - are indicated in the last chapter of this analysis.

1. Introduction

The **2030 Agenda for Sustainable Development** aims at a fundamental transformation of society, and its patterns of production and consumption. This transformation requires changes in mindsets and behaviors; realigned incentive systems; a conducive and enabling public policy environment; and the deployment of innovative technologies that are more energy- and resource-efficient. Investments on a massive scale are needed to create sustainable infrastructure and low-carbon, high-efficiency production methods that will accomplish the transformation. Hence, financing is key to realizing the 2030 Agenda and the **Addis Ababa Action Agenda (AAAA)** is the core framework for actualizing the means of implementation.

Governments, international financial institutions, and private financial markets should direct adequate flows of resources into sustainable investment. They must also take steps to reduce the flow of resources into unsustainable uses by shifting the structure of incentives and the thrust of legislation and regulation to lower the attractiveness of, and returns from, such investments. Globally, since 2015, the engagement of governments, the private financial sector and other non-state actors in mobilizing resources for the 2030 Agenda has grown. Financial sector policymakers, regulators and supervisors, and market participants are taking steps toward building a more sustainable financial system. Sustainable finance has grown rapidly, as evidenced by the explosive growth of green bonds and the development of innovative SDG-related financial instruments (e.g. SDG, sustainability, and social bonds). Many financial jurisdictions have taken explicit steps to "green" their financial systems. Private market participants, particularly institutional investors, are also changing their approach, encouraging longer-term time horizons on financial markets. They support efforts to integrate environmental, social and governance factors into business models, and encourage the disclosure of the sustainability profile of firms in which they invest, thereby driving changes in the way enterprises are managed. They are also taking initiatives that encourage the transformation to the low-carbon economy, such as portfolio decarbonization.

Progress is still insufficient and too slow globally. Sustainable finance is still only a small fraction of overall financial activity in private markets, as it is only now beginning to be mainstreamed into the business models of the financial industry. The finance needs for SDG investments are vast and urgent. Domestic public finance is key, especially to providing public goods and essential services. In many developing countries, the mobilization of domestic public resources still falls well short of requirements; and external public resources, including official development assistance (ODA), remain essential in many countries. It is, therefore, important to make progress towards meeting the ODA commitments of the Addis Ababa Action Agenda. However, the public sources of funding in all countries, rich and poor alike, clearly do not suffice to fund the SDGs. Hence, private finance is an essential component of the financing of the 2030 Agenda. Beyond the funding gaps, other shortcomings hinder progress. In many developing countries, relatively underdeveloped and weak financial systems limit the range of available instruments for mobilizing private resources, while the weak institutional capacity to formulate and present bankable projects impedes the ability to mobilize private investment. Across all countries, the lack of a pipeline of sustainable, bankable projects at scale, and of established and broadly accepted methodologies for assessing the risk of new technologies and sustainable investment projects, hinder the mobilization of more sustainable finance and impede the redirection of flows away from traditional, non-sustainable investments.

As a result, key priorities remain underfunded—sustainable infrastructure; modern, efficient, and renewable energy systems; transportation, waste and water management systems—while potential private sector sustainable investment projects do not find the funding they need because of the perceived risk and the lack of an appropriate project pipeline.

In the meantime, financing landscape is in a process of constant evolution, while global challenges multiply. The pandemic of Covid-19 represented an unprecedented shock which caused disruptions in production, falling commodity prices, financial market volatility and rising insecurity – all earthshaking economic growth and compounding already existing risks. Over the past two years, the globe saw a retreat from the multilateralism, a discontent in globalization, accumulation of debt and ore frequent and severe climate shocks. Altogether, these make sustainable financing more challenging, and further undermine the attainment of SDGs by 2030.

North Macedonia adopted the 2030 Agenda and endorsed SDGs in 2015. In particular, the government undertook "reduced inequality" and "leave no one behind" as key principles underpinning its activities. While the sustainable development's economic, social and environmental dimensions have been streamlined in Government's program, as well as strongly cross-liked with the EU accession process, the country has not yet adopted a visionary national development strategy. However, such strategy covering a bi-decennial period has been commenced in 2021, while some other strategic documents are in place: foremost the Government Program 2021-2025, the Economic Reform Program 2020-2022 and the National Plan for the Adoption of the Acquis (NPAA). Their short duration hardly resonates a visionary strategizing, however.

While some progress towards the achievement of SDGs is in place, and interlaced with the primary goal of the government – to accede the EU, still a deeper SDG analysis is needed. In particular, the financing options for the 2030 Agenda in North Macedonia has not been conducted so far. Without a National Development Strategy in place, it is very difficult to succinctly portray the financing landscape of SGDs in North Macedonia. The volume of financing flows currently serving the SDGs is challenging to be established and figures are therefore less readily available.

The objective of this study **is to provide an overview of the financing landscape in North Macedonia and partial analysis of incentives (subsidies) as a starting point to open a more detailed debate on SDG financing aspects relevant in the country.** The document opens in Section 1 with mapping and analysis of the different volumes, mixes, lengths, and sequencing of sources of financing available in North Macedonia and comparison with relevant peer countries. The rest of the study is organized as follows: Section 2 looks into the financing landscape from the viewpoint of recent trends; Section 3 looks into a comparative perspective and assesses the SDG financing gap in North Macedonia. Section 3 also focusses on one particular instrument to incentivize greater alignment and investment congruent with SDGs: subsidies; Section 4 concludes and discusses the policy space and recommendations.

2. Financing landscape

In this section, we have sought to measure public and private financing flows based on available data to try and clarify their scope and nature. The analysis is based on the four financing quadrants provided in Development Finance Assessment (DFA) and the INFF BB1.2 Financing landscape assessment (adjusted to the available sources for North Macedonia):

Figure 1 – SDG financing quadrants

	Public	**Private**
Domestic	Taxation and non-tax revenues Domestic borrowing State-Owned Enterprise revenues PPPs	Bank corporate credits Other type of private financing (lending by other financial institutions to the private sector) PPPs
International	Government borrowing abroad Official development assistance	FDI inflows Borrowing abroad by private entities Remittances

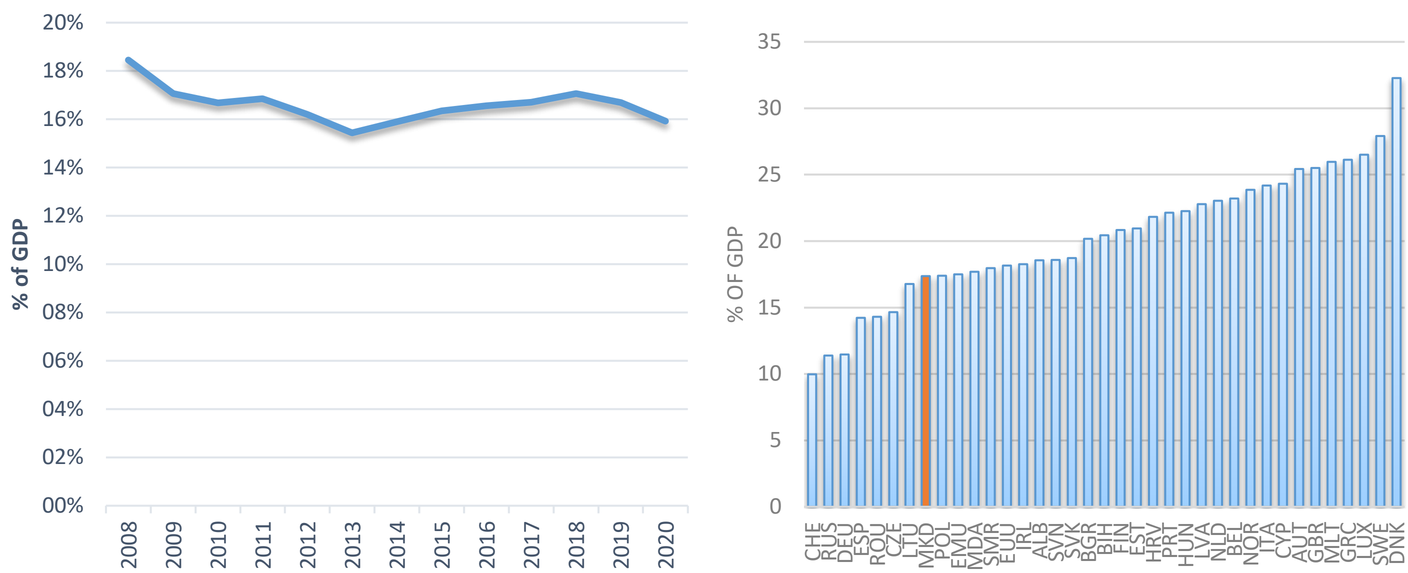
Source: Adjusted from INFF BB1.2 Financing landscape assessment.

2.1. Domestic Public Finance Flows

Domestic public resources have a unique role to play in financing for sustainable development. The relation between the collection f revenues and their efficient spending for quality public goods and services forms the basis of the social contract between the citizens and the state.

Government revenues in North Macedonia amount to about EUR 3 billion, of which EUR 1.7 billion represent tax revenues, while one billion social contributions revenues. In 2020, tax revenues declined by about EUR 200 million compared to 2019. In general, the potential to increase finance for SDGs is insufficient in the public revenues (**Figure 2**) as the share of taxes in GDP has been stagnant over years, with some improvement just before the pandemic hit. With the existing tax rates, North Macedonia is one of the countries with relatively low tax revenues, although the level is similar to that in the Czech Republic, Lithuania and Poland. This has been determined by a combination of factors like: failure to expanding the tax base, inefficient tax collections, large tax exemptions (inter alia, to support the FDI attraction policy), and low tax rates on income.

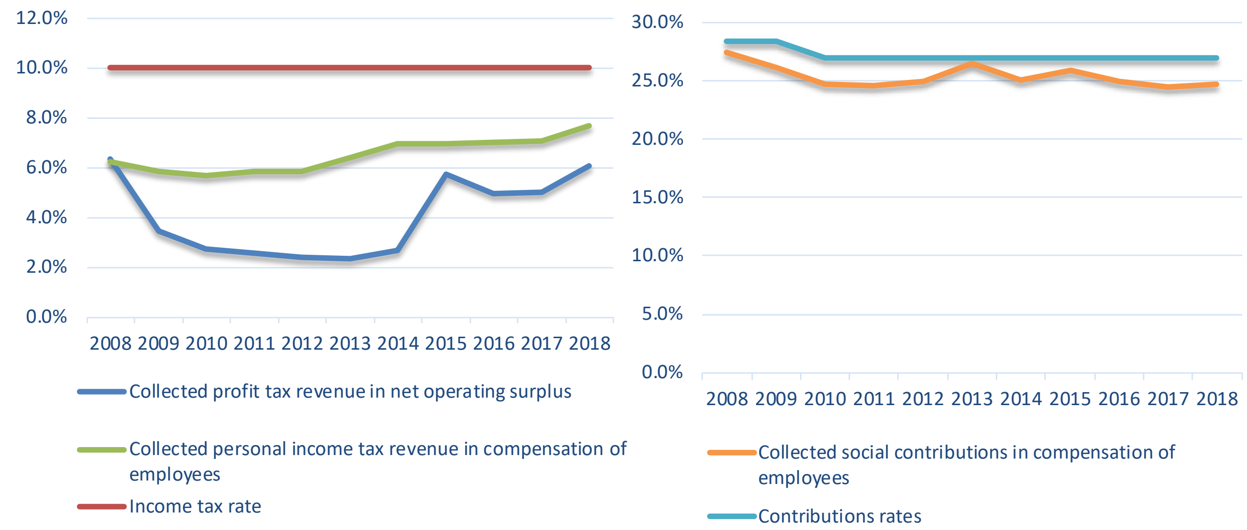
Figure 2 – Tax revenues as % of GDP



Source: World Development Indicators and state budget.

We provide some overview of these aspects of the tax system. **Figure 3** estimates the effective tax rates on income (personal and corporate), despite with approximation of the respective fiscal revenue shares in the income from employment and rents, and in net operating surplus, respectively. When compared to the applicable tax rate of 10%, it is clear that the effective rate has been quite lower, particularly for the corporate income, which in particular years was driven by the full exempt of reinvested profit from taxation. Few personal income exemptions – full or partial – on top of the universal personal tax reduction, like for copyright contracts in the areas of science, culture, music etc., as well as capital gains and income, contribute to the low effective tax rate, although the high informal employment which hovers around 16% has a strong role to play. Even among formally employed, the incidence of 'envelope wage' is assessed at 17.8% in 2017 (Finance Think, 2017) and at 69.9% for those who have been insured at the minimum wage. Therefore, grey areas in the tax collection and the potential need for revision of some tax exemptions constitute potential for enhancement of the domestic sources of revenues to finance sustainable development.

Figure 3 – Effective tax rates (left: income tax; right: social contributions)



Source: State Statistical Office and state budget.

Note: In 2019, a marginal personal income tax rate of 18% was in force for personal income exceeding MKD 90.000 monthly.

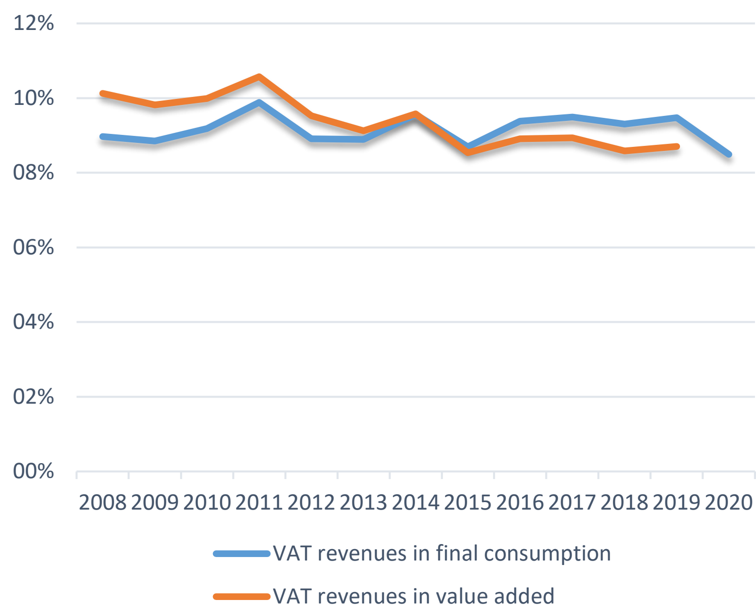
In terms of differential tax burdens onto population, some regressivities are still in place. Until recently, 50% of the average wage represented a basis for calculating social contributions for the lowest wages, though it automatically lost importance with the minimum wage increases. On the other end, however, earners are exempt of social contributions in case their wage exceeds 16 average wages. Instead, such regressivity should capsize to relief those most in need, potentially by further expansion of the personal tax exemption.

SDG link: Existing regressivities in the tax system undermine societal cohesion, reduce domestic public revenues and make the attempt to introduce progressive income taxation politically and economically hardly feasible.

Except for combatting the informal economy, North Macedonia is scarce with other domestic potential tax base (as are natural resources) and hence expansion of the existing tax base and improving tax collections, followed by potential increase in taxes for particular segments of the population should form the tax-policy near-term path. For example, the IMF (2019) and the World Bank (2019) has been continuously articulating the need for consolidation of the tax base and increases in particular taxes (e.g. property tax) as vehicles to increase tax financing and reduce the pressure for borrowing. Particularly, direct taxes contribute with only 19% in total tax collections. However, the attempt to introduce progressive personal income taxation in 2019 failed (the new tax regime existed only in 2019 and was put on hold for 3 years), mainly because the Ministry of Finance (2019) estimated that the additionally collected funds through the marginal tax rate of 18% were undermined by about 51% with the taxpayers changing behavior who decided to transfer some of their incomes in the neighboring tax jurisdictions (mainly Bulgaria and Kosovo) which still have more favorable tax regimes in place. Therefore, any attempt to increase taxes must be done after grey areas have been resolved to a satisfactory extent and in wide consultation with the relevant stakeholders.

Similar hurdles emerge when the VAT is considered as the most profligate source of domestic public funding (44.4% of tax revenues are sourced from VAT). This is not a surprise, since countries at the level of development of North Macedonia usually have stronger share in tax revenues of indirect taxes, the opposite being the case in advanced economies. The VAT in North Macedonia is defined through two rates, 18% and 5% (and a new 10% rate introduced to assist the accommodation and food service sector to recover from the crisis induced by the pandemic). Over time, various tax exemptions have been introduced and the list significantly expanded. This and the potential inefficiencies in tax collection and the grey economy contributed to a declining share of VAT revenues in either final consumption or values added (**Figure 4**). Moreover, VAT share in final consumption further declined in 2020 during the pandemic.

Figure 4 – Effective tax rates (VAT)



Source: State Statistical Office and state budget.

On the other hand, despite numerous attempts and, in particular, election promises to make the VAT system and, generally, the tax system more favorable for start-ups, micro businesses and propulsive industries, not much has been achieved. Starting in 2020, the threshold above which a legal person has to register for VAT purposes has been doubled, from one to two million denars of annual turnover, which is favorable for such small businesses and potentially reduces the cost of the inspection system. The Government planned to revise and reduce the taxation burden for the IT sector, but this is yet at the level of idea.

SDG link: Tax burden for micro and small enterprises remains the same as for the other companies, particularly after they reach the turnover threshold of two million denars. No specific incentives on the tax-burden side have been introduced for particular MSMEs or for high-job-creation industries.

Public finance efficiency and effectiveness is under scrutiny within the "Public Finance Management" (PFM) Reform Program. The one of 2018-2021 was adopted by the Government in 2017, with overall objective to "ensure efficient and effective allocation of public funds towards activities that contribute to economic growth and development and maintain effective management of the use of public funds in all areas and sectors of public administration". However, priorities have been only partially advanced, part of the delay caused by the outbreak of the pandemic. Key areas for intervention included: implementation of formulation, adoption and further development of the macroeconomic model, adoption of new/revised organic budget law, preparation of the debt management strategy as separate document and effective public-private partnership and concessions system. Such issues have been advanced with the preparation of the Fiscal and Tax Strategies of North Macedonia.

The Organic Budget Law has been prepared and opened for wide consultations, but has not yet been adopted by the Parliament. A structural solution for the under-execution of capital expenditures, as below displayed on **Figure 12**, has been proposed by the Ministry of Finance, namely a tool which withdraws allocated funds to budget users for capital investment in case of significant underperformance in one period and return of these funds in case a significant improvement occurred by the end of the year. Presently, there is no information on the efficiency of the tool, while the under-execution of capital investment continues.

The Organic Budget Law clearly introduces and articulates the mid-term budget planning, which was highlighted in the 2019 Financing for Sustainable Development Report. The mid-term planning components advanced by the end of 2020 and over 2021 in the other strategic documents of the Ministry of Finance, as well as in the underlying programming documents. Yet, in absence of a National Development Strategy (underpinning, inter alia, the sources of growth and hence the generation of domestic finance), it is hard to assess the extent to which the mid-term framework is realistic or constitutes a wish list. Nonetheless, a medium-term budget framework can be a cornerstone of effective tax reform and development policy and an important element of broader effective government planning.

SDG link: The Organic Budget Law explicitly introduces the principle of gender equality which secures the application of the gender-responsive budgeting in North Macedonia. It dedicates gender-responsible indicators in the Annual report for the budget execution. The Law has an SDG tag.

[1]

2.2. Domestic Private Finance Flows

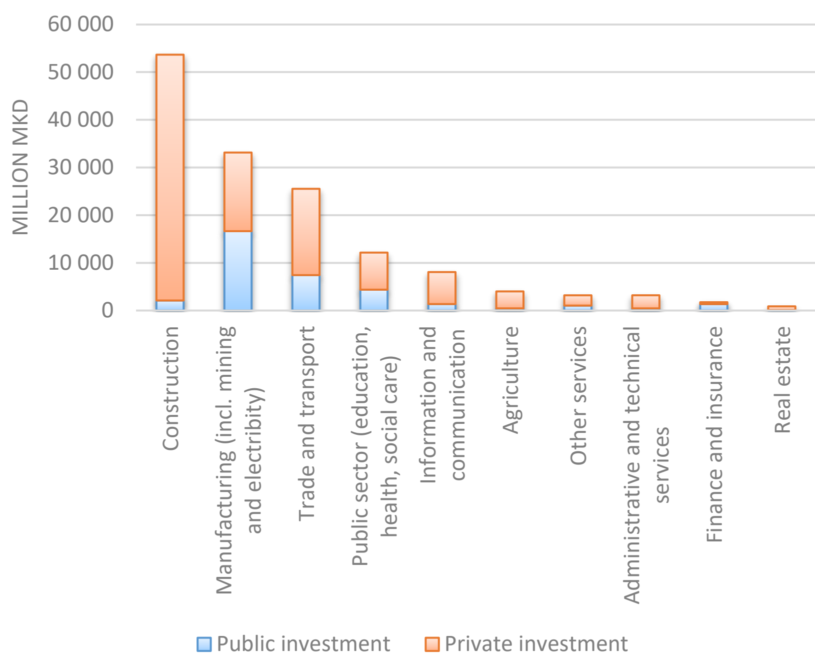
In terms of domestic financing flows, commercial banks are one of the important sources. Financial system is dominated by banks based on the share of financial assets. Outstanding loans in GDP accounted for 53.6% in 2020, being nearly 6 billion EUR and secured by a stable financing from the large and growing deposit base. Yet, such share is still lower than the EU averages. The interest rates have been constantly declining: for example, the average active

[1] For example, the recent project in the Western Balkan countries: https://web-sme-csp.com/republic-north-macedonia/en/

interest rate fell from 6.8% in 2015 to 4.6% in 2020, providing further room to easing credit conditions. However, periods of credit rationing, determined by non-economic circumstances, frequently led firms to refrain from significant investment. Hence, business loan growth has been consistently lagging behind the consumer loan growth (five-year averages of 2.4 per cent versus 9.3 per cent), yet securing about 300-350 million EUR of new loans per year.

Overall, investment have been constantly growing in North Macedonia, from 17.8 per cent of GDP in the 1990s, over 21.8 per cent in 2000s to 29.8 per cent in 2010s. The achieved level in 2010s is quite satisfactory, given growth rates of above 5% certainly require investment-to-GDP ratio of over 25 per cent. However, such growth rates were not delivered, at least not in a systematic way. Part of the reason is certainly the low starting level inherited from the ex-socialist times, as well the capital disinvestment present during the early transition periods. In newer times, however, the reason may be the wrong prioritization of investment, particularly of public ones. **Figure 5** documents that the largest investment in North Macedonia in 2019 have been in construction, followed by manufacturing, and trade and transport, dominant part of which were private.

Figure 5 – Investment by sector and ownership, 2019



Source: State Statistical Office.

Yet, bank financing remains with limited access to entrepreneurs and MSMEs, as banks still pursue conservative landing policies, while SMEs and entrepreneurs, especially the young ones, lack collateral and there is widespread perception of inability to repay loans (EIB, 2016). On the other hand, MSMEs have rarely accumulation of own funds, let alone large funds, and hence have higher need for external financing (ILO, 2020). A rough estimate of the non-bank financing from other financial institutions stands at about EUR 30 million in 2020, but unlikely includes new forms of financing.

There are several sources of public or mixed financial support for MSMEs in North Macedonia. Notable progress has been made by the Innovation and Tech Development Fund, which now provides grant, loan and co-share finance of innovation, spin-outs and scale-ups. The Development Bank of North Macedonia is a state-owned bank providing financing to MSMEs and export-oriented companies. Several lines of loans were provided by the European Investment Bank (EIB) to the Development Bank and distributed through the commercial banks (including through the crisis induced by the pandemic), as well as a direct support to companies in sectors such as transport, water and energy, totaling over EUR 1 billion, of which an estimated 80% went in the hands of MSMEs. The Development Bank also offers a credit guarantee scheme, capitalized with EUR 4.2 million. Likewise, the EBRD secures more traditional forms of funding form MSMEs, most notably for increasing their competitiveness and facilitating the access to the EU market.

Public-private partnerships exist in North Macedonia for a decade and a registry is nested in the Ministry of Economy. However, the take up of such opportunity is very low: slightly over 30 PPPs have been awarded since 2013[2], with an assessed total value of EUR 332 million; hence they have not seen the expected success, especially after recent failures in the areas of landfills ("Drisla") and hydropower ("Chebren" and "Galishte"). Still, there have been success stories (the two airports as well projects related to hydro power-plants). Issues like public administration inefficiency, technical obstacles and corruption have ben frequently mentioned as obstacles (e.g. Analytica, 2018).

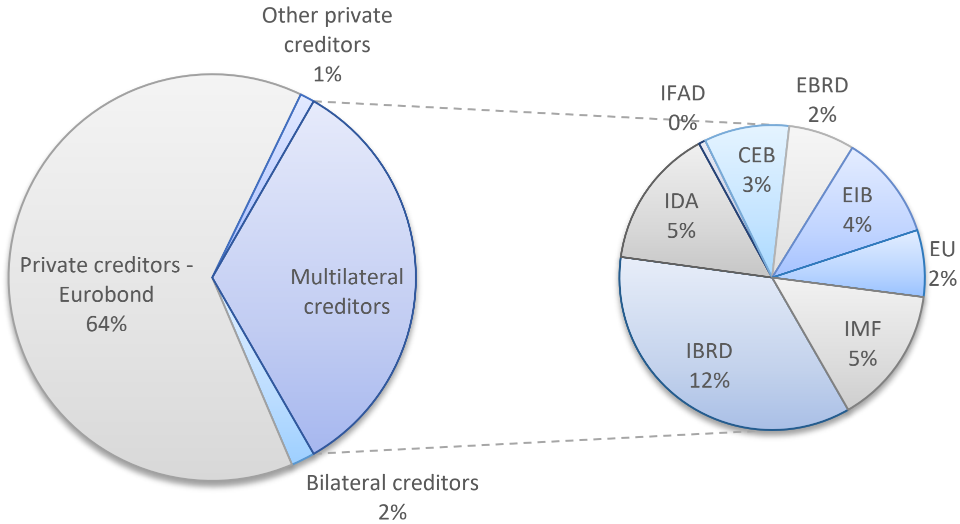
SDG link: Financing envelope for MSMEs in North Macedonia significantly increased over the last decade. Yet, there is still insufficient utilization of such funds driven by deficient financial literacy, complex administrative procedures and still conservative bank lending policies.

2.3. International Public Finance Flows

Given its upper middle-income status, the net official development assistance (ODA) to North Macedonia has been very low and declining from 2.9% of GDP in 2006 to 1.1% in 2019, yet representing about 120 million EUR annually. The largest grantors remain the European Union and bilateral donors. The low shares of tax revenues fueled public borrowing, which soared from 23% of GDP in 2007 to about 49% in 2019, and further to 60.2% during the pandemic of Covid-19 (2020). However, before the pandemic, the net borrowing requirement stalled at about 350 million EUR per year, of which the composition has been 60:40 in favor of international borrowing. Concessional loans have been minimized with the large repurchase of debt in 2007; afterwards, the commercial borrowing has been dominant (**Figure 6**). North Macedonia issued a Eurobond in several occasions, the latest one (EUR 700 million in May 2020 after the outbreak of Covid-19). Yet, for major part of such borrowing, the specific purpose was not declared but funds were rather used for general financing of the budget which left the space for non-prioritized and low-return investment.

[2] http://www.economy.gov.mk/page/javno-privatno-partnerstvo

Figure 6 – Structure of international public borrowing (2020)



Source: Ministry of Finance.

SDG link: The country has been able to secure international funds to finance budget needs, particularly in economically challenging years (e.g. 2011 and 2020) at relatively favorable conditions, hence securing that corporate financing is not crowded out domestically.

Nevertheless, considerable part of the public borrowing has been related to particular projects (**Figure 6**, right), like road infrastructure (loans from the World Bank – IBRD and IDA, EBRD and ExIm Bank China for building new and reconstruction of existing roads), railroads (EBRD loan and a grant from WBIF), gasification (loan from Deutsche Bank, Erste Group and EIB), municipal services (World Bank loan), social services (World Bank loan), water supply and sewage disposal (KfW, EIB loans), concessional loans for SMEs (EBRD loan through Macedonian development bank) and others.

SDG link: Multitude of the loans listed in the previous paragraph supported the fiscal space and specifically aimed to improve the delivery of public services and provision of basic services such as water, energy, sanitation, securing that nobody is left behind. Another part of loans contributed to enhancing infrastructure (SDGs 6, 7, 9, 11) and supporting growth and employment (SDG 8), both conducive to economic development. However, no loans have been clearly focused on, e.g. green investments and that would be an opportunity.

Albeit, the proper size of investment needs in North Macedonia has not been assessed rigorously. After the outbreak of Covid-19, the EU and the IMF were the first to extend financing to the country, before the Eurobond and World Bank proceedsarrived; previously, their shares in multilateral borrowing has been negligible or zero.

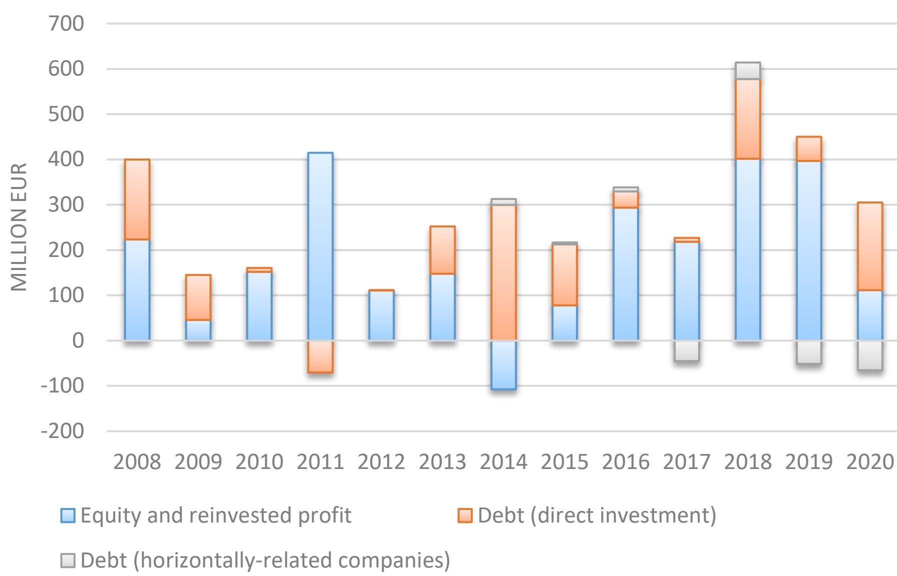
Part of the development assistance is channeled through the civic organizations. Some of them play an important role in correcting policies and/or delivering services in key SDG areas, such as, employment, health, education and social services. In some municipalities, particular social services remain to be delivered by local NGOs, as Municipalities are yet facing technical and funding difficulties in design and delivery. There is no clear-cut data on the total amount of NGO funding (also related to the turning focus of donors towards public institutions), but the impact of the work of the NGO sector remains important in the last couple of years.

SDG link: Bulk of development assistance channeled through CSOs is explicitly related to SDG areas like decent & green jobs, poverty reducing, tackling inequalities, empowerment of women, environmental impacts. Aggregate effects are, yet, hard to measure, due to lack of data.

2.4. International Private Finance Flows

Long and thorny transition over the 1990s brought only brownfield foreign direct investment in the country, part of which related to the privatization of the state-owned capital. The onset of the "Invest in Macedonia" campaign in 2007 increased the average FDIs inflows to 5.5% of GDP over 2000s and 3.6% over 2010s, expanding the financial envelope of the capital account of the country and reaching 400 million EUR in 2019. Yet, the last decade saw an average of only 300 million EUR. **Figure 7** presents the structure of FDIs, which has been quite wavering from year to year, yet with somehow dominant share of the equity financing of FDIs (including the reinvested profit).

Figure 7 – Structure of foreign direct investment



Source: National Bank of North Macedonia.

SDG link: There is sufficient empirical evidence that FDIs created jobs (directly and indirectly) in the country, particularly in the period after 2007. The FDI-attraction strategy, however, was backed by heavy subsidization schemes and rode on the then waves of some industries (e.g. automotive/electronics) moving towards Europe's southeast. While bulk of the factories which settled in North Macedonia do not exert large negative externalities (e.g. they are not (large) polluters), yet some key aspects have not been sufficiently assessed, e.g.

environmental and inequality impacts. The debate on jobs' decency remains delicate, likewise.

Beyond the debt financing of FDIs, the rest of the non-government non-financial sector has been borrowing at a variable pace over the preceding decade, yet averaging about EUR 100 million annually (the total gross external debt of the non-financial enterprises in 2020 amounted to EUR 2.4 billion).

Finally, international remittances constitute a unilateral transfer that feeds directly in Macedonian households. According to the Balance of Payments data, these amount to about EUR 200 million annually, but this a conservative estimate mainly based on formal transfer channels. Estimates based on surveys (e.g. Petreski and Jovanovic, eds. 2013) estimate an amount of 4% to 10% of GDP, which also corroborates the IMF (2014) finding that additional 400 million of remittances are channeled through informal means. Petreski and Jovanovic (2016) document that more than 90% of remittances are used for everyday consumption.

SDG link: Remittances strongly work to alleviate poverty and reduce income inequalities. Their poverty-reduction effect is estimated of a similar magnitude to that of the social assistance.

While financing envelope for seed funding of innovation and startups significantly increased lately, it still remains hindered, despite recent advances, mainly driven by external sources. The European Investment Bank supports a number of venture capital funds: South Central Ventures is active in North Macedonia (EIB, 2017); I2Ban is a Macedonian-focused business angel network, so likely to consider seed investments, as is Ceed-Macedonia (EIB, 2016). For dedicated IT and financial technology investing, Bulgaria-based LaunchHub has a Western Balkans regional focus, and funds seed and early stage companies (Culkin and Simmons, 2018). According to the European Business Angels Network, there are three local business angel networks in North Macedonia, but investments are negligible both in number and size.

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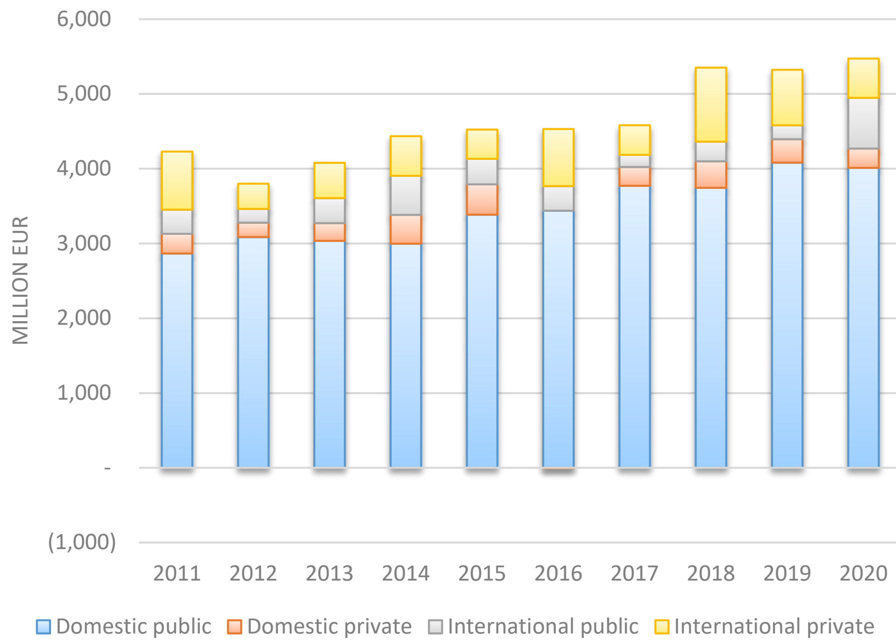
Figure 8 aggregates the overall financing flows by year along the four axes: domestic public, domestic private, international public and international private. For a decade, the financing envelope expanded from about 4.2 billion EUR in 2011 to 5.3 billion in 2018 and 2019 to 5.5 billion in 2020. It is worth to note that the increase is generally driven by the expansion of the domestic public sources, while in some years spikes are determined by changes in volatile financing-flow categories, like FDIs or domestic credit. Interestingly, the financing envelope expanded in 2020 – the pandemic year, mainly because of the soaring of international borrowing by the government to counteract the socio-economic consequences of the pandemic. While, international private financing fell primarily because of the cessation of companies' borrowing abroad, as FDIs and remittances did not fall far below their pre-pandemic averages.

Figure 8 – Financing flows over time



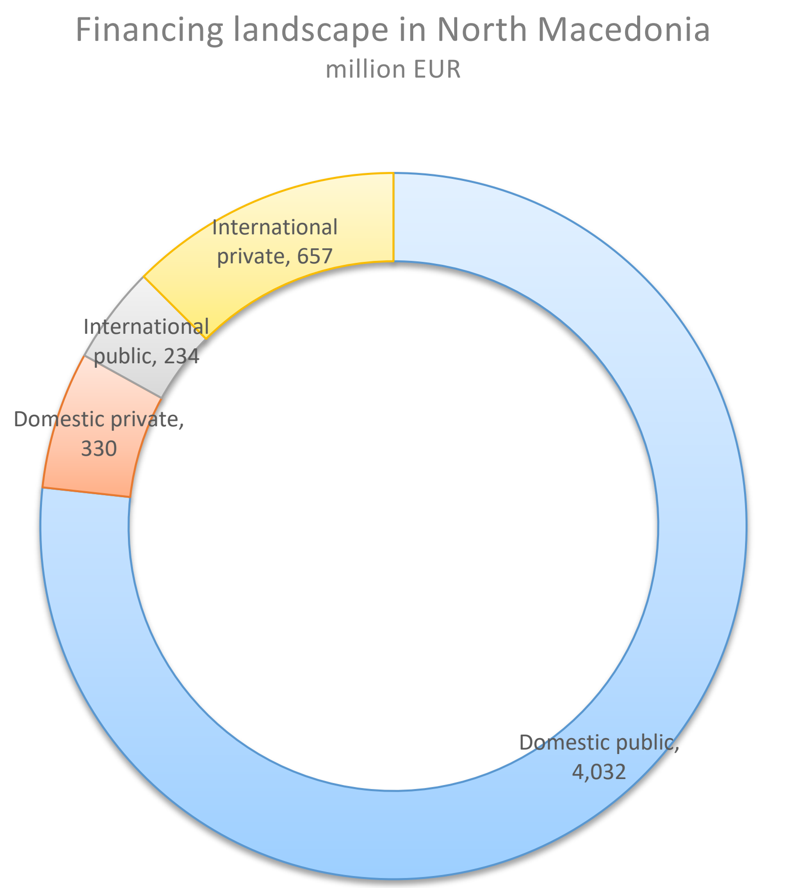
Source: Various sources referred to in the previous graphs.

3. SDG Financing: analysis, comparison, instruments and incentives

3.1. Overall financing envelope and budget spending – SDG links

Based on the presented figures in Section 2, the annual financing envelope in North Macedonia, on average, is assessed at EUR 5.3 billion (2019 value). Note that this is the current financing envelope, but following two adjustments: i) some values are taken from the pre-pandemic year, to avoid the peculiarities that the pandemic brought, and which are expected to be one-off and hence corrected (e.g. the excessive international borrowing seen in 2020); and ii) 10-year averages were used for categories exerting high year-to-year volatilities, namely FDIs, remittances, non-FDI corporate borrowing, PPPs and SOE revenues, to reflect the steady-state financing flows rather than those determined by one-time events and circumstances. **Figure 9** disaggregates the financing by two axes: public-private and domestic-foreign. 76.7% of the financing envelope is secured through domestic public sources, including public revenues, revenues of the state-owned enterprises, domestic public borrowing and public-private partnerships. International private financing is of second importance, representing 12.5% of the financing envelope and being composed of FDIs, commercial borrowing abroad and international remittances. Domestic private financing represents 6.3%, composed of bank credits and non-bank financing. Finally, international public financing is of least importance, with only 4.5% share, and comprising international government borrowing and ODA.

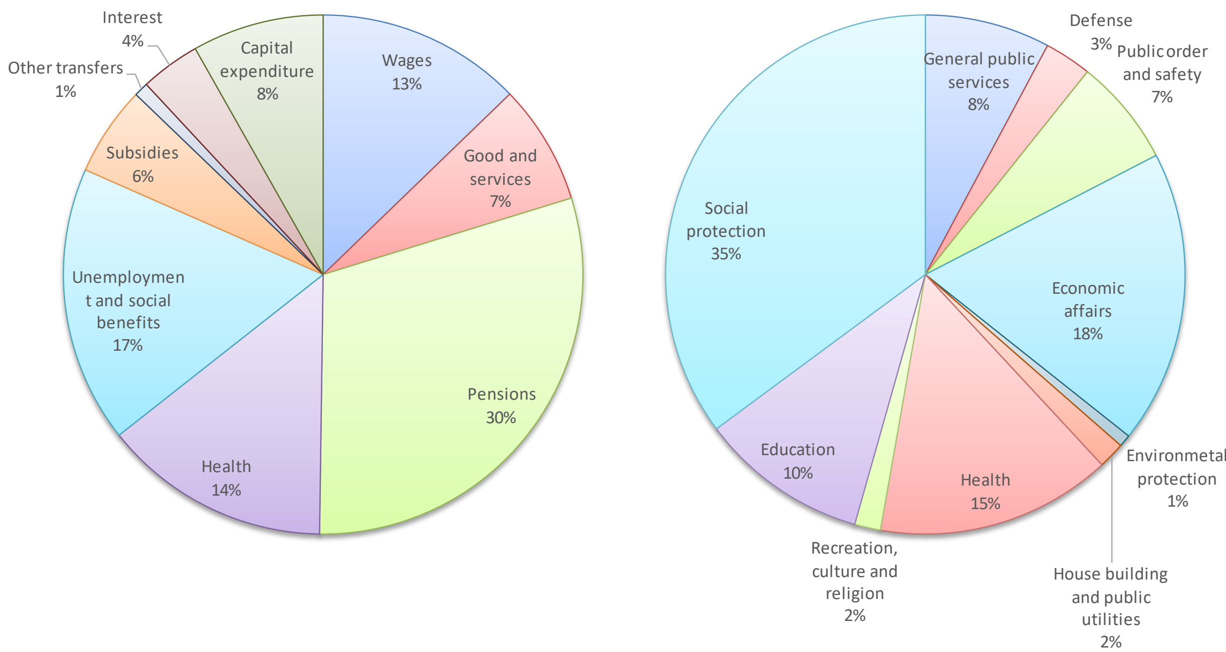
Figure 9 –Financing landscape in North Macedonia, annual figures



Source: Ministry of Finance, National Bank of North Macedonia, Ministry of Economy, World Development Indicators.

As domestic public financing constitutes a dominant part of the financing envelope in North Macedonia, we pay attention to a few spending axes. **Figure 10** presents spending by economic items and functions of the government, clearly mapping out that the largest shares are consumed by one segment of the population – pensioners. The shares on social assistance, education, health and environment are comparatively significantly lower. About 18% in 2019 has been secured for economic affairs, an item which presently financially supports investment made by companies (Economic Growth Plan 2018-2020), on top of the spending on energy, telecommunications and transport, hence contributing to SDG 8.

Figure 10 – General government expenditure by economic classification (left) and by functional classification (right), 2019



Source: Ministry of Finance.

Large spending on pensions, about 10% of GDP (1 billion EUR), 30% of the budget (**Figure 10**, left), dominantly contributes to poverty reduction. Until recently, the spending on social assistance programs has been very low, about 1.2% of GDP (139 million EUR), though the comprehensive social reform in 2019 provided for some increase (to 1.4%) and better targeting ensuring that social assistance is indeed received by the poorest and helps them to escape extreme poverty with increased employment opportunities. The reform included almost universal child allowances, which is the key for alleviating child poverty, while abolished the third child allowance for well-off households, hence gradually sparing funds for other vulnerable segments (though, this program has a phase-out of 10 years). In parallel, the reform of social services – toward more focused, inclusive and diversified services - should enhance poverty reduction and exclusion outcomes through a non-monetary component.

SDG link: The spending on and the overall setup of the system for social protection is indispensable for leaving no one behind in North Macedonia. However, while no official indicators exist, the extreme poverty still hovers about 2-3%, suggesting that there are yet niches of the population that may by the furthest left behind.

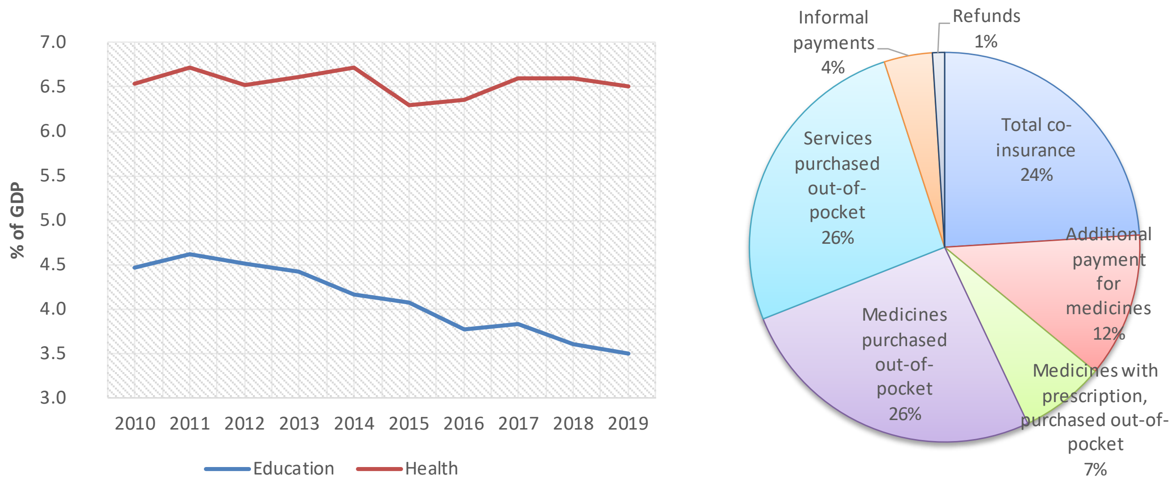
The country spends only 0.17% of GDP on active labor-market policies (including job-related services), which is comparatively low though the highest since 2010. Some of them have been supported by international donors, most notably by UNDP (self-employment program), though the support has been gradually phased out. In general, in the social sphere, the financing provided from the international donors has been quite consistent; examples include the World Bank's Social Services Improvement Project; Municipal Services Improvement Project; Social Insurance Administration Project, then a multitude of grant schemes administered through the IPA II, which funded specific projects and services directly, as well through the non-governmental sector. However, there is no consistent database on the total amount of such financing.

SDG link: Active labor market policies contribute to creation of (decent) jobs. However, spending on passive measures (unemployment benefits and social assistance) remains comparatively larger.

The government spends about 3% of GDP on subsidies, of which a large share goes to agriculture. On paper, they are set to increase agricultural production, but in reality they have fairly strong anti-poverty component. Given the latter is unofficial, the strength of the program in poverty alleviation has not been measured, so the efficiency of the public spending cannot be precisely assessed. However, the program has been identified with other problems which mainly boil down to not generating clear connection between the money spent and the intended outcomes in terms of agricultural productivity (Finance Think, 2016), which is yet an indirect indication about the potentially poor capacity of the program to strengthen sustainability of agricultural households' incomes. Other subsidies generate large financing needs and the list expanded lately. We devote a separate section on the topic of subsidies and its relation with SDGs, later in this study.

North Macedonia faces a declining share of education expenditure in GDP (**Figure 11**, left). This, partially, reflects the declining number of pupils and students (determined by demographic trends), but is confronted with increasing number of teachers and worsening outcomes (Petreski and Petreski, 2018). This potentially suggests that even declining spending is highly inefficient and cannot deliver SDG-related outcomes. With fiscal decentralization, Municipalities are responsible for the administering of the current education spending and large disparities appear there, as larger municipalities take advantage of the economies of scale and hence improve efficiency (World Bank, 2019). Capital investment in education, financed centrally, is mainly focused on renovation of buildings and remains low (only about 5% of all funds dedicated to education). Yet, many donor projects, channeled through the central budget or externally, are in place to improve educational outcomes; notable case is the World Bank's Skills Development and Innovation Support Project.

Figure 11 – General government expenditure on education and health (left) and out-of-pocket health expenditure 2015 (right)



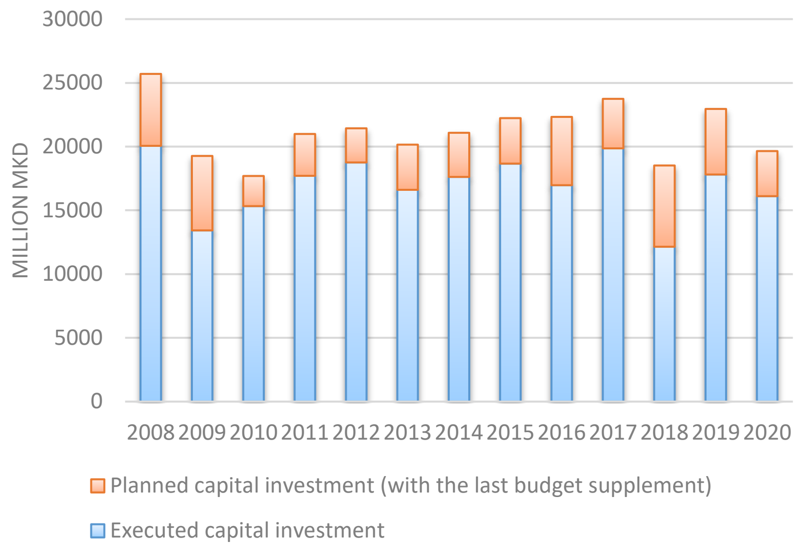
Source: World Development Indicators and Parnardzieva-Zmejkova and Dimkovski (2018).

North Macedonia's total health expenditures stalled between 2010 and 2018 (at 6.5% of GDP) (**Figure 11**, left), and out-of-pocket spending is very high, estimated at 36.7% in 2014. The structure of the latter, displayed on **Figure 11** (right), suggests that more than half is spent on services and medicines paid fully out of the pocket, while non-negligible 4% is yet used to informally reward or bribe medical workers. Despite the universal health insurance coverage, and the success in decreasing prices of drugs, extending social and health benefits to elderly, pregnant woman and some categories of diseases, the out-of-pocket expenditures have been on the rise. Deteriorations have been noted in capital spending on health: between 2012 and 2016, it declined consistently from 9.5% to 3.9% of public health spending (World Bank, 2019). On the other hand, a recent WHO study (2019) showed that every euro spent on health in North Macedonia yields 2.36 euros in GDP, hence representing a high multiplier effect.

The government's focus on investment in infrastructure turned only in mid-2010, marking the end of a forgone period of low-return low-efficient investment (e.g. the "Skopje 2014" project) and orientation towards road, railway, energy, soft and other infrastructure. Yet, ambitions of the government always exceeded the implementing capacities, as realization of state capital investment has been falling behind the plans (**Figure 12**), while options like public-private partnerships remained heavily underutilized for various reasons. Hence, even if sufficient funds have been secured within the budget at a reasonable cost, the underutilization potentially retarded growth to a certain extent. This delivered a quality of infrastructure ranking of North Macedonia at the 11th place among 17 countries in the Central and Southeast Europe.[3] A Public Investment Strategy, which may well be correlated with SDG financing, is not set, rendering the proper assessment of public investment efficiency and multiplier effects hardly possible.

[3] https://libek.org.rs/uploads/files/1453127700.IDm55OER8XxvKUOw.pdf

Figure 12 – Public capital investment



Source: State Budget.

SDG link: The financing of the state investment is linked to SDGs 8, 9 and 11: the creation of jobs and support to economic growth. For some time (beginning of 2010s) North Macedonia remained trapped in an investment circumventing basic infrastructure needs, while large infrastructure investment plans frequently served only elections needs and rarely saw implementation on a significantly large scale. In general, financing of state investment is rarely backed by ex-ante assessment of the multiplication effects nor by prioritization based on, e.g. environmental impact.

3.2. Estimated SDG aligned financing under the State Budget

Not entire available finance in the country – discussed in Section 3.1 - is directly attributable to the achievement of SDGs; in particular, there are items in the state budget, which are of general importance (e.g. civic defense; recreation and culture) and cannot be credited to the SDGs (at least not straightforwardly). We therefore make a classification of the state budget items based on their economic classification, to fit into the SDG groups identified in Kharas and McArthur (2019). **Table 1** gives the disaggregation. Of the total state budget expenditures of EUR 3.5 billion, EUR 2.6 billion (74.8%) may be related to the achievement of the SDGs.

Table 1 – State Budget spending attributable to the SDG areas

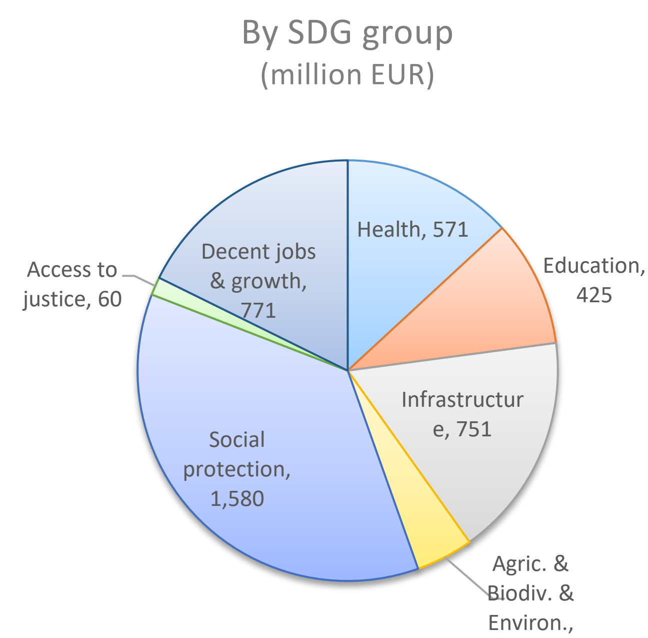
Sector	Mil. EUR
Agriculture & biodiversity & environment	181
Health	557
Education	398
Social spending	1,334
Infrastructure	98
Access to justice	57
Decent jobs and growth	20

TOTAL	2,646
Source: Own classification based on State Budget data.	

On this amount, we add the expenditures of SOEs and PPPs, which are classified in the infrastructure group, domestic private expenditures classified in the decent jobs and growth group, international public spending which is proportionally distributed across the groups; and the international private spending which is distributed between decent jobs and social protection. The total available financing envelope attributable to SDGs in North Macedonia is estimated at EUR 4.4 billion annually.

Figure 18 presents the disaggregation of the SDG-related available finance in North Macedonia by SDG group. Bulk of the available financing ☐is spent on social protection (36.3%).

Figure 13 – SDG financing landscape in North Macedonia (million EUR)



Source: Authors' calculations.

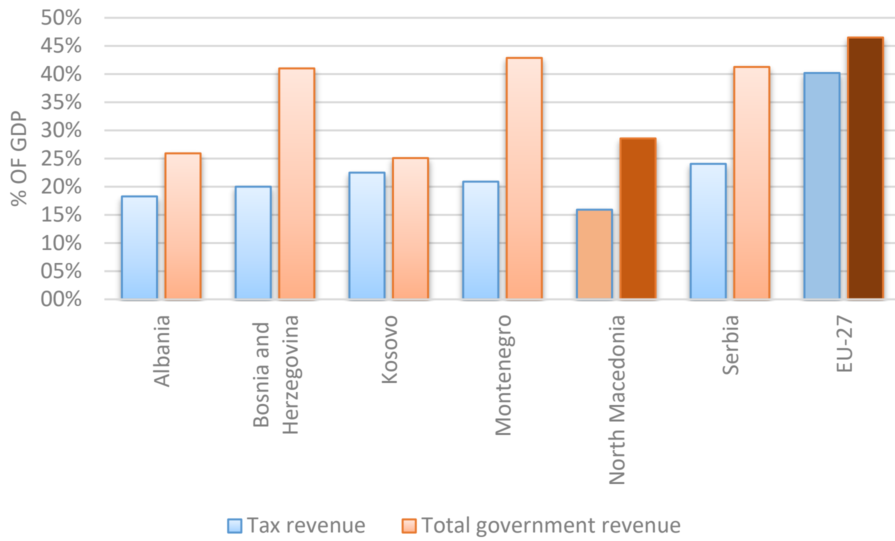
It should be noted that, in the absence of programme-based budgeting and SDG tagging of policies, the above assessment of SDG alignment is approximative. Introduction of SDG tagging as well as more in-depth analysis of policies and their activities alignment to the specific use of the aforementioned funds is needed in the future.

3.3. Comparative perspective: Western Balkans and EU

North Macedonia ranks the lowest among the Western Balkans peers when the key source of domestic public financing is considered – total government and tax revenues (**Figure 13**).

The regional average is about 20% of tax revenues in GDP, while North Macedonia collects only 15.3%. This is less than half of what is collected in the EU-28 (40.2%). Likewise, in total government revenues, North Macedonia tilts the lower end (28.6%), despite Albania and Kosovo collect less than 26%.

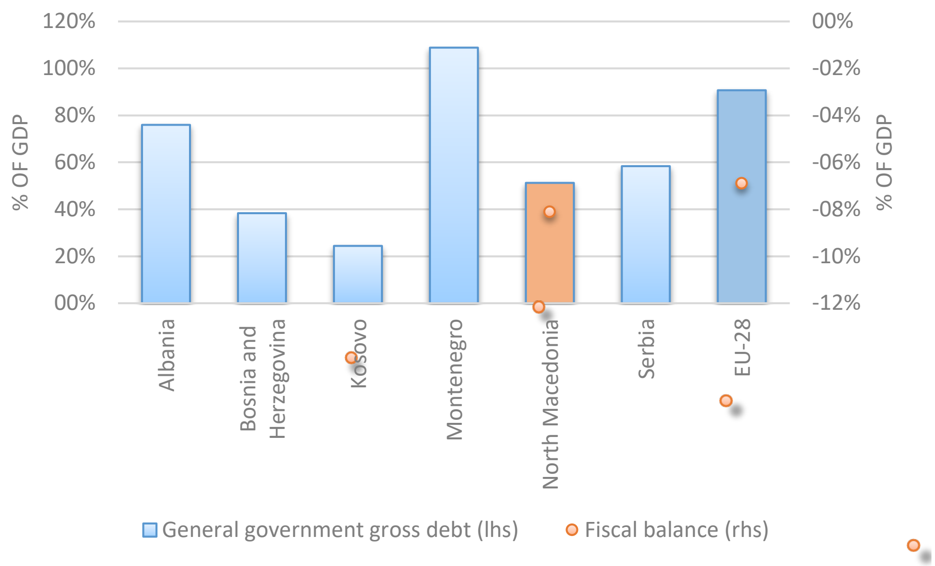
Figure 14 – Total and tax revenue in GDP – comparative overview



Source: World Development Indicators, World Economic Outlook and national authorities. 2020 or the latest available year.

However, the level of indebtness of North Macedonia is moderate compared to the Western Balkans peers, as Kosovo runs the lowest general government debt (24.4% of GDP), while Montenegro the highest (108.8%). The latter is even higher than the EU-27 average (90.7%), despite the EU-27 average hides quite a heterogeneity (**Figure 14**). North Macedonia ran a government debt of 51.3% in 2020. All these numbers should be considered in the light of the pandemic of Covid-19 in this year, which exerted a strong pressure onto national public debts. This is reflected in the size of the fiscal deficits in this year, which ranged from 5.6% of GDP in Bosnia and Herzegovina to 10.8% in Montenegro. North Macedonia's deficit soared to 8.1% in 2020. Even if affected by the pandemic, the differences in the fiscal borrowing reflect the heterogeneity in financing needs that government have beyond the tax and non-tax revenues collected in the budget.

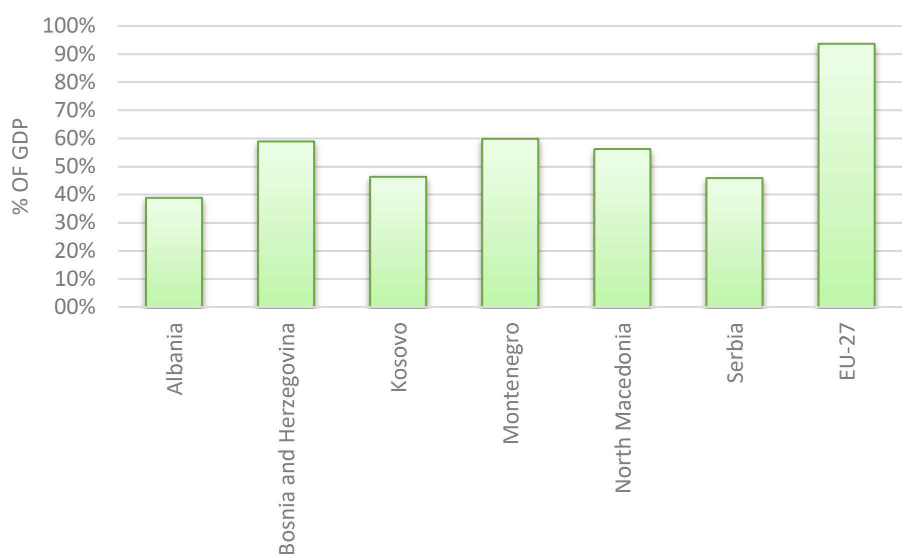
Figure 15 – General government debt and fiscal balance – comparative overview



Source: World Economic Outlook (IMF). 2020 or the latest available year.

North Macedonia ranks above the regional average in terms of the domestic credit to the private sector, as the key source of domestic private financing (56.2% of GDP) (**Figure 15**). However, the source of funding is still far beyond its size in the EU-27 (93.7%).

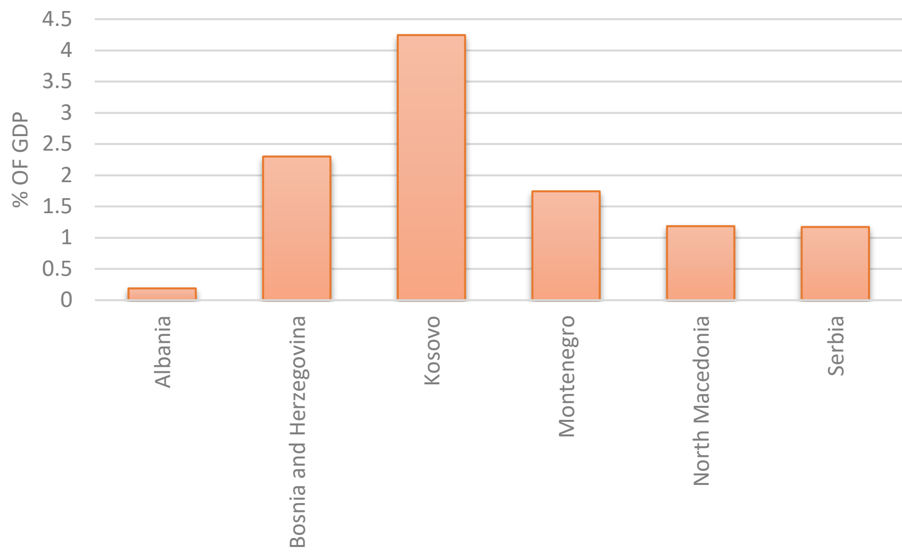
Figure 16 – Domestic credit to private sector – comparative overview



Source: World Development Indicators. 2020 or the latest available year.

While official development assistance lost its significance in the region of the Western Balkans, some variety is still present across (**Figure 16**). Kosovo is still the largest recipient (4.2% of GDP), while Albania the smallest (0.2%). North Macedonia and Serbia receive similar relative amounts (1.2%).

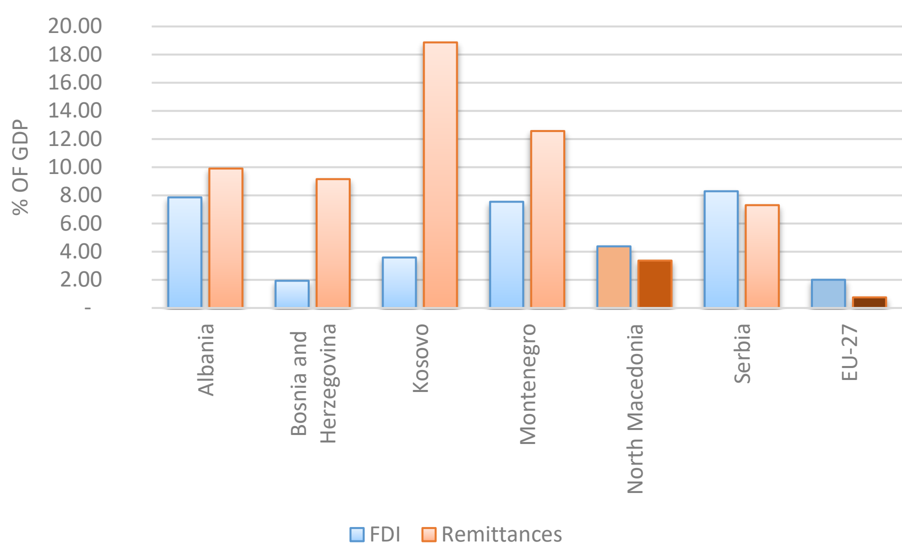
Figure 17 – Official Development Assistance – comparative overview



Source: World Development Indicators. 2020 or the latest available year.

Finally, two flows of international private significance are important for the Western Balkans: foreign direct investment and remittances. **Figure 17** reveals that North Macedonia is among the lowest performers in terms of FDI inflow: in 2020, though, better than Bosnia and Herzegovina and Kosovo. Yet, on average, Albania, Serbia and Montenegro have been outperforming North Macedonia in terms of FDI receipt. Likewise, remittances have been usually outperforming the inflow of FDI in most of the years in the last decade. **Figure 17** also suggests that North Macedonia receives the lowest relative amount of remittances among the Western Balkan countries, but the figure may be plagued by the underestimation of the remittances received through informal channels.

Figure 18 – Foreign direct investment and remittances – comparative overview



Source: World Development Indicators. 2020 or the latest available year.

Overall, Western Balkan countries are alike in many aspects of the potential SDG financing envelope, despite some of them secure higher funding particularly through the domestic public sources which have the key role in the SDG financing pie. In that regard, North Macedonia is underperformer, while the entire Western Balkans is an underperformer with regard to the EU-27 average. Similarly, the financial intermediation / bank credit, as key domestic private source, is not as deep as in the EU-27. Both aspects suggest that a potential for the Western Balkan countries in expanding the financing envelope for SDGs hides primarily in the tax revenues.

3.4. Innovative financing instruments aligned with SDGs

Therefore, financing of the SDGs in the Western Balkans may require substantial public and private funding, both at the national and international level. Some financing instruments have been already deployed, either regionally or nationally to support such funding. One group of such instruments include trust funds and guarantees which particularly relate to certain SDGs like SDG 6 (clean water), SDG 7 (clean energy), SDG 8 (growth and jobs), SDG 9 (industry and infrastructure).

For example, the Western Balkans Investment Framework (WBIF) is one such **blended finance instrument** (grants, loans, national finance) that could support the Agenda 2030. It supports socio-economic development and EU accession across the Western Balkans through the provision of finance and technical assistance for strategic investments. The sectors that it covers include energy, environment, social, transport, and digital infrastructure sectors, as well as support to private sector development initiatives. The WB EDIF Guarantee Facility provides **guarantees and counter-guarantees** to financial intermediaries in the Western Balkans, supporting SMEs with growth potential.

Similarly to WBIF, two Western Balkans' initiatives focused on green economy include: the Green for Growth Fund (GGF), which is structured as a **public-private partnership**; and the Regional Energy Efficiency Program (REEP), a kind of **environmental trust fund** supporting the transposition and implementation of the EU energy efficiency acquis combined with financing to enterprises, households and public sector entities undertaking energy efficiency investments.

The European Investment Bank (EIB) Economic Resilience Initiative (ERI) provides **blended finance** to support the capacity of economies in the Western Balkans to respond to crises and shocks, such as the migrant crisis, while maintaining strong growth. It boosts economic resilience in these regions by investing in infrastructure, developing the private sector and stimulating growth and job creation. ERI offers a package of loans and innovative financial products, while blending funds from the donor community with EIB financing.

Another group of SDG funding instruments include taxes and subsidies (payment for ecosystem services and ecological fiscal transfers). Taxes with clear SDG-achievement goal are usually enacted on pollutants and risky products, like fuels, pesticides and tobacco. The so called, **green tax** has been popular across the region of the Western Balkans for some time, but implementation has been fairly slow (likely with the exception of excises on cars depending on the engine polluting level). Recently, Serbia enacted an ecotax for companies (and households) depending on their polluting intensity: top polluters are classified companies in sectors like mining, gas, power generation and distribution and the manufacturing of wood, textile, meat and plastics. North Macedonia is currently in a process of adopting a green tax on fossil fuels (eco-tax), to discourage their usage, as well as assessing the introduction of a carbon tax (see, e.g. CCAP, 2021). Likewise, North Macedonia has been **subsidizing** the transition from heating on fossil fuels (cooking stoves) in households to heating with inverters air conditioners, to reduce pollution.

Finally, bonds with special purpose have seen an increase worldwide to support SDG financing. In the Western Balkans region, it has been only Serbia who recently issued a 7-year green bond to raise EUR 1 billion,[4] with a historically low 1% annual coupon rate. As a rough comparison, a standard Eurobond issued in parallel achieved a 2.05% coupon (with 15-year maturity).

3.5. State aid as a SDG alignment incentive

State aid, and in particular subsidies as the dominant form of state aid, is one frequently used financial instrument by the governments. Compared to general spending, state aid has frequently a pre-defined specific objective, and from that viewpoint it could be more closely related to incentivizing the achievement of a particular development outcome and, hence, if used adequately, direct efforts to and accelerate the achievement of an SDG. In general, state aid is provided either as a scheme of state aid or an individual state aid. As the latter is ad-hoc, in this section, we focus on the schemes of state aid existing in North Macedonia and how these could reconcile with the SDGs.

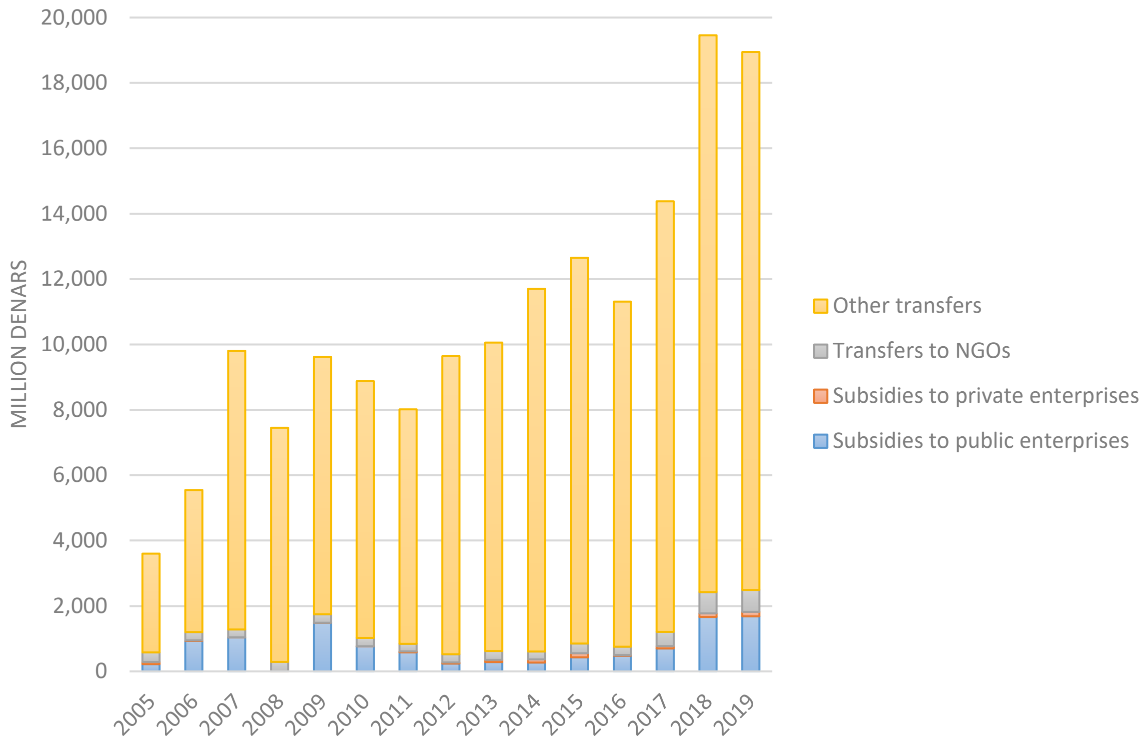
State aid may be granted in various forms, as follows: i) subsidies; ii) exemption, reduction or postponement of the payment of public duties; iii) granting loans on favorable terms; iv) providing guarantees from state aid providers under favorable conditions; v) writing off or taking over debts; vi) investments from state aid providers with a rate of return lower than the rate of return on investment that can be expected when investing under normal market conditions; and vii) reduction of the prices of goods and / or services by the state aid providers below the market prices, especially in case of sale of shares, buildings or land owned by the state aid providers. As the last three are usually ad-hoc (hence likely being an individual state aid), we next focus on the first four types of state aid.

North Macedonia is in an early process of establishing a registry of state aid programs; from that viewpoint, it is very hard to arrive even at the total amount of state aid disbursed. From the viewpoint of the state budget, the difficulty stems from the fact that the budget item “subsidies and transfers” captures expenditures beyond state aid (but excludes the transfers to the LSGUs). In particular, the sub-item “other transfers” involves, for instance, transfers to cultural institutions (like museums and theaters), transfers to regional planning bureaus, transfers to state universities and so on, none of which is a state aid, at least not in the sense we observe it here. **Figure 22** reveals that the amount of state aid (understood with its peculiarities just explained) grew from slightly less than 4 billion MKD in 2005 to about 19

[4] https://balkangreenenergynews.com/serbia-raises-eur-1-billion-in-its-first-green-bond-auction/

billion MKD in 2019. Even if it is taken in relative terms, the nearly fivefold increase over the observed period lends support to the thesis that state aid saw a large growth, outpacing the growth of GDP.

Figure 19 – State subsidies in North Macedonia



Source: State Budget – Final Accounts.

Our primary interest in this analysis is, nevertheless, not the amounts of state aid per se, but rather their potential identification with the SDGs. **Table 3** pursues this objective: it presents a list of state aid programs, grouped around the providing institutions and their respective programs; and then benchmarks each program with the SDGs. The following cautions are needed when making use of the table:

- While the table aims at comprehensiveness, in a situation of absence of state-run registry of state aid, it is hard to claim exhaustiveness. Still, we believe majority of state aid programs are contained[5];
- State aid granted to public enterprises is not presented, mainly because it is usually provided to state-owned enterprise to solve existential or one-off problems. Examples include the subsidies the government provides to the State Railroad Company which

[5] As a validation to this notion, one may consider that the top five institutions when the line 'subsidies and transfers' (except subsidies to public enterprises) from the state budget is considered include: Agency for financial support of agriculture and rural development, the Government (covering, at least partially, the programs of: Agency for foreign investment and export promotion, Fund for Innovational and Technological Development, Tourism promotion agency), Ministry of Education and Science, Ministry of Labor and Social Policy, and the Directorate for TIDZ.

faces constant liquidity shortfalls, and the ad-hoc subsidies provided to some companies known as loss-makers, to bail them out from final closure and prevent lay-offs of workers who are hardly employable elsewhere;

- The table is compiled based on active state aid programs, but excluding the state aid disbursed during the pandemic of Covid-19 (majority of which distributed over 2020). Namely, we consider the pandemic to have been an exceptional event and that major part of the state aid devised and distributed under such circumstances cannot be repeated under any other conditions;
- The assignment of the state aid programs to particular SDGs is loose and reflects authors' views. Hence, some subjectivity bias may be present.

Results reveal that a sheer majority of the state aid programs in North Macedonia could be related to SDG 8: Decent Jobs and Economic Growth. For particular programs, like those stemming from the Financial Support to Investment Law (Agency on FDIs and export promotion) and those of the Fund for Innovation and Technological Development, jobs and growth are explicit objectives[6]. Some of these programs, particularly the programs of FITD, but also some parts of other programs – like subsidies on rural development – could be related to SDG 9: Industry, innovation and infrastructure, particularly because they contain an explicit component of innovation support. Hence, the coverage of SDG 9 in state aid programs is the second largest.

The next lot of SDGs coverage comprehends SDG 1: Poverty reduction, SDG 4: Quality education and SDG 10: Reduced inequalities, all of which get fairly even importance in the state aid programs coverage. None state aid program has poverty/inequality reduction as first-ranked and/or explicit objective, as social benefits have this target. However, some state aid programs have such implicit objectives. For example, while the objective of the agricultural subsidies is to support sustainable production and job creation, they have a strong social component, which is support of the income of farmers. Similarly, many of the educational scholarship distributed through the Ministry of Education and Science have a social component, i.e. target pupils/students from socially vulnerable households.

SDG 7: Affordable and Clean Energy and SDG 13: Climate Action are note so frequently covered but yet besides the limited state aid programs of the Ministry of Environment, they are also explicitly covered through few selected programs of the Ministry of Economy. Other SDGs we hardly relatable with the identified state aid programs, with the exception of the financial support of the government to NGOs which could be assigned to a multitude of SDGs. However, such financial support as a form of a state aid is infinitesimal when compared to the other state aid programs.

[6] It is important, however, to disentangle the objective of a specific state aid program and its association with particular SDG, on one hand, and the actual result the program achieved, on the other. SDG-allocation of state aid program does not mean that they actually contribute towards the achievement of the goal. For example, Petreski and Dimitrova (2021), through using a rigorous impact evaluation method, found that state aid granted to private companies through the Financial Support to Investment Law was largely ineffective, while the one through the Fund for Innovation and Technological Development was largely effective in achieving its set objectives.

With the exception of SDG 16, such SDG coverage of the state aid programs generally resembles the selection of SDGs 1, 4, 8, 13 by the Government of North Macedonia.

It is worth noting that a state aid program may likewise work against a certain SDG goal, usually implicitly. For example, agricultural subsidies on tobacco production are an example in which one could elaborate that it may contradict some of the objectives within SDG 3: Good Health and Wellbeing. The financial support granted as tax/contribution exemptions may be an example that works against SDG 8: Reduced inequality. Namely, there has been some discussion in North Macedonia that subsidies granted to foreign companies in the free economic zones might have put other companies in a discriminatory position, including with regard to the cost of their employees, which were subsidized with social contributions exemption over a long period of time (usually 10 years). While the primary objective of this was to support growth and job creation, it might have worked to increase income inequalities in the country. The thesis has not been verified empirically, though.

Table 2 – State aid programs and SDGs

INSTITUTION / AGENCY	PROGRAM	MEASURES' GROUP / MEASURE	1: No Poverty	2: Zero Hunger	3: Good Health and Well-being	4: Quality Education	5: Gender Equality	6: Clean Water and Sanitation	7: Affordable and Clean Energy	8: Decent Work and Economic Growth	9: Industry, Innovation and Infrastructure	10: Reduced Inequality	11: Sustainable Cities and Communities	12: Responsible Consumption and Production	13: Climate Action	14: Life Below Water	15: Life on Land	16: Peace and Justice Strong Institutions	17: Partnerships to achieve the Goal
Agency for financial support of agriculture and rural development	Financial support in agriculture	Income support to agricultural holdings	■							■				■					
		Additional support for agricultural development		■						■				■					
		Financial support in fisheries	■							■				■					
		Financial support to rural development	■							■				■					
		Technical support to agriculture and rural development								■				■					
	IPARD II 2014-2020	Agricultural sustainability and competitiveness								■				■					
		Balanced territorial development of the rural areas								■		■		■					
		Know-how transfer and innovation in agriculture									■								
Agency for foreign investment and export promotion	Financial support to investment[7]	New jobs support								■									
		Backward linkages support									■								
		R&D support									■								
		Support of investment of strategic importance								■									
		Support to increase capital investment								■									

[7] Some of the measures are paid out directly by the Government.

		Support for the purchase of funds from companies in difficulty
		Support for increasing market competitiveness
		Support for new market expansion and sales growth
Directorate for TIDZ	Financial support to investment[8]	Support to increase capital investment
	DTIDZ Law	Regional aid - participation in eligible costs for productive initial investments and employment
		Tax exemptions - Profit tax
		Tax exemptions - Personal Income Tax
		Tax exemptions - VAT
		Customs exemptions
		Training and development aid
		Exemption from payment of fees related to construction land
		Government participation in the construction costs of a building
Ministry of economy	Support to SMEs and crafts	Support to entrepreneurship and MSMEs
		Support to MSMEs internationalization
		Support to crafts
		Training for MSMEs employees
		A study for sustainable development of MSMEs
	Industrial policy implementation	Support to increase competitiveness in manufacturing
		Co-financing for specialized trainings in manufacturing
		Labs accreditation in construction
		Support of cluster projects
Ministry of environment and spatial planning	Support to investment in environment	Support to investment in environment
	Support to NGOs	Support to NGOs

[8] Some of the measures are paid out directly by the Government.

Tourism promotion agency	Tourism support and promotion	Tourism support and promotion
	Tourism development[9]	Subsidies for touristic projects and manifestations
		Subsidies to households in villages for touristic purposes
		Financial support to touristic ideas of students at the faculties for tourism
		Support of projects for innovation and digitalization in the area of tourism
		Support to active tourism
	Domestic tourism support	Subsidies to low-pay workers / touristic vouchers
	Energy efficiency program	Subsidies for purchase and installation of devices for LPG, metan or other fuel
		Subsidies for purchase and installation of solar collectors
		Subsidies for purchase and installation of PVC windows
		Subsidies for purchase of pellet stoves
	Law on touristic zones	Regional aid - participation in eligible costs for productive initial investments and employment
		Tax exemptions - Personal Income Tax
		Tax exemptions - VAT
		Training and development aid
Ministry of labor and social policy	Wage subsidies and active employment programs	Subsidizing social contributions for wage increase in the range 600 - 6000 MKD per month
		Wage subsidies
		Wage subsidy for youth employed in manufacturing
		Employment subsidy for persons with disabilities
	Support to NGOs	Support to NGOs
Fund for Innovational	Midterm program for	Financial support of SMEs with a tendency of rapid growth (Gazelles)

[9] Some of the measures are paid out directly by the Government.

and Technological Development	support of MSMEs	Special financial support (co-financed grants) for SMEs
		Financial support to MSMEs to improve innovation
		Financial support for professional development and practice for newly employed young people
		Improving the environment and preparing legal bases for venture capital development
		Co-financed grants for start-ups and spin-off companies
		Co-financed grants and conditional loans for commercialization of innovations
		Co-financed grants for technological extension
		Establishment of work and investments on business-technological accelerators
		Instrument for application of innovations in the public sector
		Instrument for introducing innovation and technological development in rural development
Ministry of education and science	Secondary education support	Scholarship for pupils in social categories
		Scholarship for pupils Roma
		Scholarship to high-school pupils with disabilities
		Scholarship for pupils orphans
		Scholarship for talented high-school pupils
		Scholarship for talented high-school pupils - sportsmen
		Scholarship for pupils in hospitality/tourism
		Scholarship for pupils in field of textile and leather
		Scholarship for pupils in field of mechanical engineering
		Scholarship for pupils in field of civic engineering/geodesy
		Scholarship for pupils in field of electrical engineering
		Scholarship for pupils in field of agriculture/veterinary
		Aid for purchase of a music instrument

	Tertiary education support	Scholarship for undergraduate studies - social categories
		Scholarship for undergraduate studies - students of informatics, physics and mathematics
		Scholarship for undergraduate studies - Roma
		Scholarship for undergraduate studies abroad (100 best ranked universities worldwide)
		Scholarship for postgraduate studies abroad (100 best ranked universities worldwide)
		Scholarship for doctoral studies abroad (100 best ranked universities worldwide)
		Scholarship for undergraduate studies of foreigners with Macedonian origin
	Scientific aid	One-off financial aid for published paper in international peer-reviewed journal
		Support for pursuing research stay abroad
		Support for participation in international conference
		Support for publishing of conference proceedings
		Support for journal publishing
	Other	Subsidized meal for undergraduates
Development Bank of North Macedonia	Crediting with subsidized interest rate	Export support loan
		SME Loans
		Agricultural credit discount fund
		Micro loans (MSMEs)
		Energy efficiency and renewable energy loans
		Self-employment loan
		Loans for the accommodation capacities
		Loans for child/elderly-care capacities
	Insuring receivables	Export receivables
		Domestic receivables
	Guarantees	MSME Loan guarantee
		Individual guarantee for large companies - exporters

		Customs guarantees (securing customs debt in inward processing)
Government of North Macedonia	Support to NGOs	Support to NGOs
Ministry of health	Support to NGOs	Support to NGOs
Agency for youth and sports	Support to NGOs	Support to NGOs

Source: Authors' collection from the institutions.

4. Recommendations

Recommendations for the government

Governments are the largest and most important but not the only stakeholder that invests in SDGs. The Government of North Macedonia has a significant role to play in delivering development outcomes within the Agenda 2030. This is reflected in the notion that a bulk of SDG financing stems from domestic public sources as well as that this funding, through the government's ability to define various fiscal incentives, such as taxes and subsidies, can to a large extent influence and leverage other funding, especially private domestic and private international financing flows to SDGs. As such, the government's role in aligning financing to SDGs is twofold: on one hand, it can align and benchmark various government programs with SDGs; on the other hand, it can incentivize existing sources of money to work for the SDG, followed by a proactive role in designing alternative and additional financing models. Some venues for work include:

- Government financial planning needs to be set to reflect / aligned with the national SDGs – which should be possible with the pending Organic Budget Law. The first step is to link country-level SDG goals with national allocation processes. By so doing, the national SDG plan will secure what could be actually financed instead of a wish list of what one hopes might be financed. SDG budget tagging is also an important step in ensuring transparency on the level of alignment of public spending with SDGs.
- Interventions both at the revenues and expenditures side of the state budget are needed. On the revenues side, tax base should expand by rapid and focused reduction of the grey economy, which would significantly expand the financing envelope. Introduction of new taxes or increase of existing ones that incentivize achievement of SDG targets, such as through introduction of a CO_2 tax or carbon emissions permits with trading or increase of tobacco tax to improve health outcomes could also be explored.
- When raising new debt financing, intensify the usage of alternative financing instruments, such as green or SDG bonds: government to expand opportunities in the international bond markets and increase access to commercial debt financing. Incorporation of results-based financing (KPIs), as a funding model, whereby the return to investors is tied with particular development outcome could also be considered (e.g. financial products that support investment in eco-friendly housing).
- Subsidies could be further analyzed and updated to ensure they clearly stimulate sustainable development, and do not exacerbate or support activities that negatively impact SDGs.
- Setting up of new financing vehicles such as multi-partner funds or de-risking of private sector investment through providing first-loss, subordinate debt, guarantees (especially in large scale renewable energy projects), etc. would incentivize private sector co-financing. Entrance in blending arrangements or introduction of blended finance instruments, together with IFIs and private sector, could also increase, consolidate and align finance to core national sustainable development priorities.

Such initiatives would allow to leverage greater investment to the priorities with a smaller portion of government funds invested.

- On the budget expenditure side, a comprehensive exercise needs to be done on assessing cost efficiency and a proposal for elimination of inefficiencies. Government expenditures need to have a clear link with the national sustainable objectives and SDGs. Results-based financing may be relevant to consider in order to increase efficiency of spending and accelerate achievement of targeted outcomes in certain spheres. Public-private partnerships remain underutilized in North Macedonia and hence represent an untapped financing potential. The government should elevate the existing effort to investigate the hurdles for pursuing effective PPPs in the country (most notably, the legal framework) in order to devise a plan for further incentivization of take up. Assistance, in terms of technical skills, may be sought from the international community, for example through a dedicated renewable energy fund (IRENA - UNDP, 2021).
- Establish transparent, long-term strategies and targets for priority infrastructure areas linked to the SDGs. Identify priority projects and enable a process for fast-tracking project appraisal, structuring and procurement.

<u>Recommendations for the international community</u>

With the support of the international development partners, a number of innovative finance instruments and platforms have been created in the Western Balkans, to catalyze private capital for sustainable development, and many multi-stakeholder initiatives have been set up to help address key challenges. But, the role of the international community in North Macedonia is far from being complete. Therefore, financing from the IFIs should be continuously available at affordable conditions. Some perspective line of thoughts are as follows:

- It is key that IFIs continue to work as an open system: working more as an intermediary linking multiple projects (not just their own projects) with multiple sources of finance (not just their own finance). Such pan-approach directed to a particular SDG topic will consolidate the development efforts in the country and will make the achievement of the SDGs a step more achievable.
- International community can assist North Macedonia to become more strategic in how it raises capital, building its National Development Strategy around what can actually be financed with public funds used more sparingly and private capital mobilized more effectively.
- International community could further engage in putting in place innovative financing instruments to reduce financing costs for private-sector investors and transfer financing risk to other actors. Blending concessional financing, or grants with private financing, could lower interest rates and relax collateral requirements for MSMEs. Some ongoing initiatives, such as EBRD's activities in blended concessional finance can serve as inspiration.

- International community can undertake more risk onto their own books when commercial capital cannot be raised, including early-stage project development. It can support the design and implementation of risk-mitigation instruments such as government guarantees to reduce investor risk as well as provide guarantees themselves.
- Technical skills in assessing the ineffectiveness of PPPs so far are likely lacking in the country and this gap could be filled by the international community. In general, the international community can step up with technical skills to plan, design, implement and supervise capital investment, i.e. provide support to project preparation and facilitation so that they advance from initiation to full investment maturity.
- International community may be engaged to explore the option to establish a SDG-related first-loss fund, possibly channeled through the Development Bank of North Macedonia.
- International community can support government's efforts in strengthening alignment with SDGs, including through providing technical assistance for SDG tagging within the strategic plans of the institutions and SDG aligned national strategies and financing frameworks, providing expertise for development and setting up of national-level innovative financing instruments.

Recommendations for the private sector

The private sector in North Macedonia could be an important catalyst in mobilizing funds for the SDGs. The yet moderate level of financial intermediation, the dominance of bank financing and the insufficiency of other forms of private financing reveal the untapped potential that hides in the private sectors. Introducing various instruments like green and sustainability bonds may serve as successful vehicles in channeling private funds into SDG-aligned projects. Some challenges inherent to the engagement of the private sector in development projects refer to risk appetite which is a key consideration on the nexus profit – development objectives. Venues for proactivity of the private sector include:

- Central banks can encourage the banking sector to accelerate the alignment of financing with SDGs. Central banks can promote a long-term view of the banking sector, supporting greater bank transparency on extent of sustainable finance in bank portfolio's, ensuring continued stability and resilience of the banking sector, inter alia through increased knowledge sharing and monitoring of risks related to global developments, such as climate change, as well as support of financial innovation and greater financial literacy, to ensure greater access to finance for all.
- Similarly, other regulators, such as Securities Exchange Commission, Insurance Supervision Agency, and Agency for Supervision of Fully Funded Pension Insurance, can monitor and encourage greater alignment of Pension and Insurance Funds' investment decisions with ESG principles. In a similar direction, the Macedonian Stock Exchange has already supported the adoption of codes of conduct on corporate governance among listed companies and could play a crucial role in further promotion and adoption of full ESG standards among listed companies.

- Institutional investors and the banking sector can adopt and apply ESG or other related standards among their criteria when selecting companies to whom they provide equity or debt capital and thereby incentivize private sector to fully transition to sustainable business practices. More banks and institutional investors subscribing to global financial industry standards, such as UN Responsible Banking, Investment and Insurance Principles would also be an important step in that direction.
- Private sector companies can best support the SDGs through aligning their strategies and operations with universal principles on human rights, labor, environment and anti-corruption and take actions that advance societal goals. In that direction, private sector can join the United Nations Global Compact and other initiatives that support corporate sustainability. Companies can also integrate reporting on environmental, social and corporate governance aspects as part of regular annual reporting of companies. Such increased transparency can open up greater access to sustainable finance markets and prepare companies for future stricter regulation as well as improve company's reputation.

Business consulting companies can support companies in integration of ESG standards in their planning and operations, including advisory on integrating sustainability reporting and accessing sustainable finance. On the Agenda 2030, the private sector should partner with the government to create mutually beneficial market development partnership.

Recommendations for the UN Country Team

Finally, the role of the UN Country Team as the technical catalyst of the proposed venues for intervention must not be underestimated. Point of entry in this regard may include:

- UN agencies should support the development of SDG aligned national strategies and support government entities in developing realistic financing frameworks for them, with consideration for inclusion of incentives that best leverage greater financial investment into the objectives of the strategy from all national stakeholders.
- Support sound public finance policies and advise government on tax and subsidy incentives that direct activities and financing to achievement of SDGs, together with IFIs.
- Support the development of new financing instruments and mechanisms that enable multi-stakeholder investments/blended finance.
- Enable access to global expertise and support to access global funding mechanisms supporting various SDG topics acceleration such as the Joint SDG Fund, Green Climate Fund, Global Environment Facility, Adaptation Fund, UN Partnership on Rights of Persons with Disabilities, Migration Multi-Partner Trust Fund, etc.
- Raise awareness about sustainable development / Agenda 2030 and related standards, such as ESG standards, UNEP Responsible Banking, Investment and Insurance Principles and other standards
- Strengthen partnerships and collaboration with IFIs on the issues above.

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