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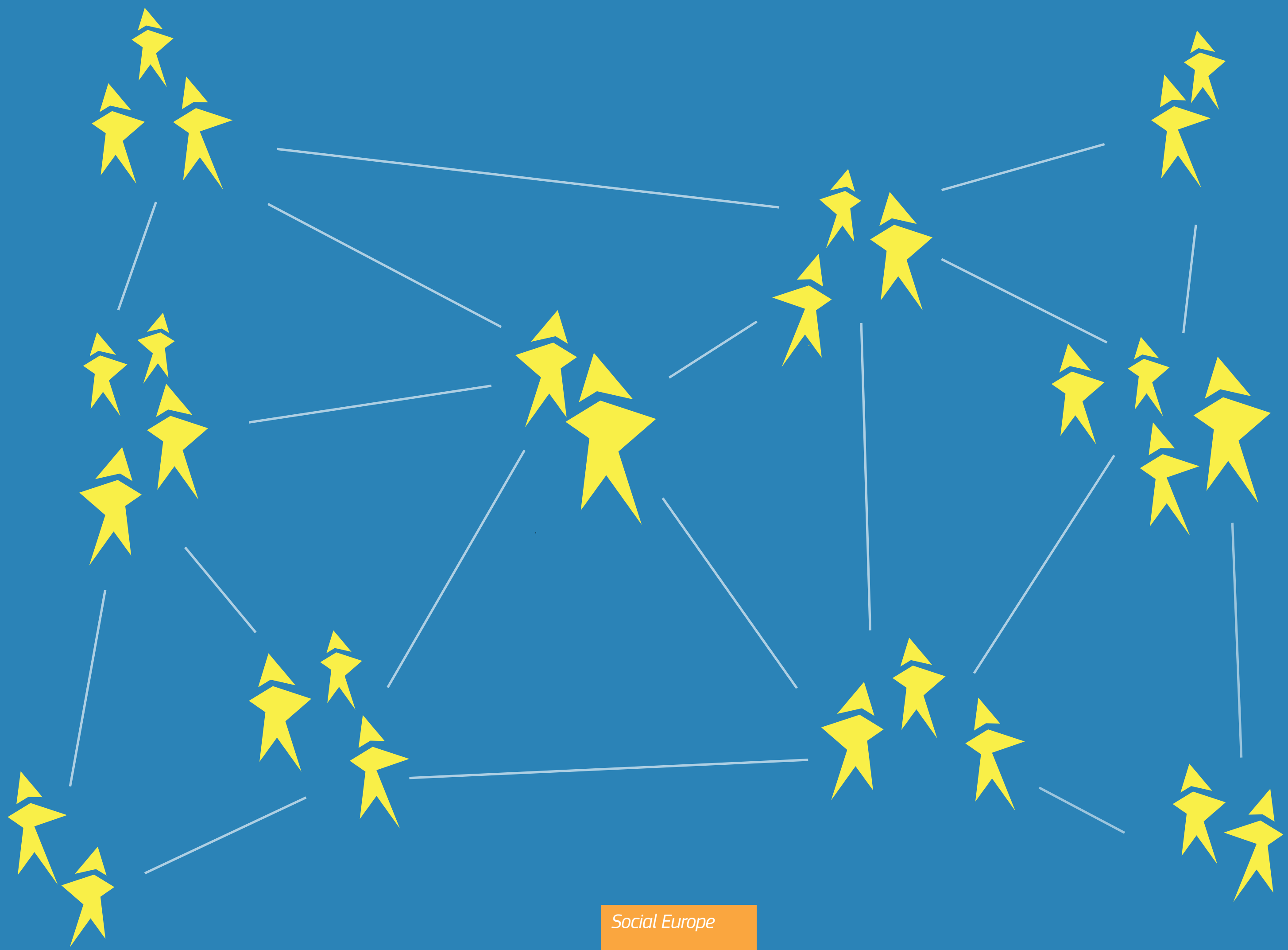
EUROPEAN SOCIAL POLICY NETWORK (ESPN)

Financing social protection

North Macedonia

Maja Gerovska Mitev



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European Social Policy Network (ESPN)

ESPN Thematic Report on Financing social protection

North Macedonia

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The European Social Policy Network (ESPN) was established in July 2014 on the initiative of the European Commission to provide high-quality and timely independent information, advice, analysis and expertise on social policy issues in the European Union and neighbouring countries.

The ESPN brings together into a single network the work that used to be carried out by the European Network of Independent Experts on Social Inclusion, the Network for the Analytical Support on the Socio-Economic Impact of Social Protection Reforms (ASISP) and the MISSOC (Mutual Information Systems on Social Protection) secretariat.

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Summary

Financing of social protection in North Macedonia is not only a reflection of the economic developments in the country, but also the result of political and social changes in the period 2005-2016. Apart from low economic growth, a low employment rate and demographic factors, the financing of social protection during the period analysed was also largely dependent on political choices. These included 'populist measures' that have contributed to the introduction of unproductive social transfers and an increase in the social insurance fund deficit.

During the period 2005-2018, overall expenditure on social protection increased by 2.1 percentage points (pp), and in 2018 it accounted for 15.3% of GDP. Overall social spending is much lower than the EU average (28.2% in 2016) and is close to that of Romania (14.6% in 2016), Lithuania (15.2% in 2016) and Latvia (15.4% in 2016).

Pension expenditure accounts for most of the total spending on social protection: 60.7% of all social transfers in 2018. In 2018, pensions accounted for 9.3% of GDP. The main sources of pension financing in 2017 included social contributions from economically active persons (54.5%) and general government contributions (43.5%). Social contribution rates were reduced and exemptions from contributions were made to promote employment during this period, albeit with a negative effect on the fiscal capacity and the sustainability of the social protection system.

Health spending constitutes 28.7% of total spending on social protection. There was a negligible increase (1.3 pp) in health spending between 2008 and 2018. In 2018, spending on health stood at 4.4% of GDP. Other social spending, including social assistance and unemployment assistance, represents only 10.5% of all social transfers. The slight change of 0.3 pp between 2008 and 2018 was mainly due to the introduction of categorical social benefits, which did not effectively tackle poverty in the more vulnerable groups. Spending on social and unemployment assistance in 2018 amounted to 1.6% of GDP.

During the period analysed, social security coverage was not widened, although attempts were made in 2015 to extend the obligation to make social security contributions to incomes from temporary service contracts and copyright contracts. However, due to large public protests, this measure was scrapped.

Due to the low employment rate and low economic growth, as well as demographic factors, there is a general trend of topping up the shortfall in social contributions with general government contributions. Social protection in the country is financed through a mix of contributory and tax-financed sources. Other sources (co-financing, participation, private insurance, etc.) are negligible and do not represent a significant factor in the overall social protection revenues.

In that respect, the existing mix of sources of financing for social protection in the country faces many challenges, including: (i) vulnerability to structural changes in the labour market; (ii) predominant reliance on general government budget to compensate for the fiscal costs of the insurance funds; (iii) lack of full potential of social contributions, due to the significant informal labour market in the country; and inherently (iv) risk of evasion.

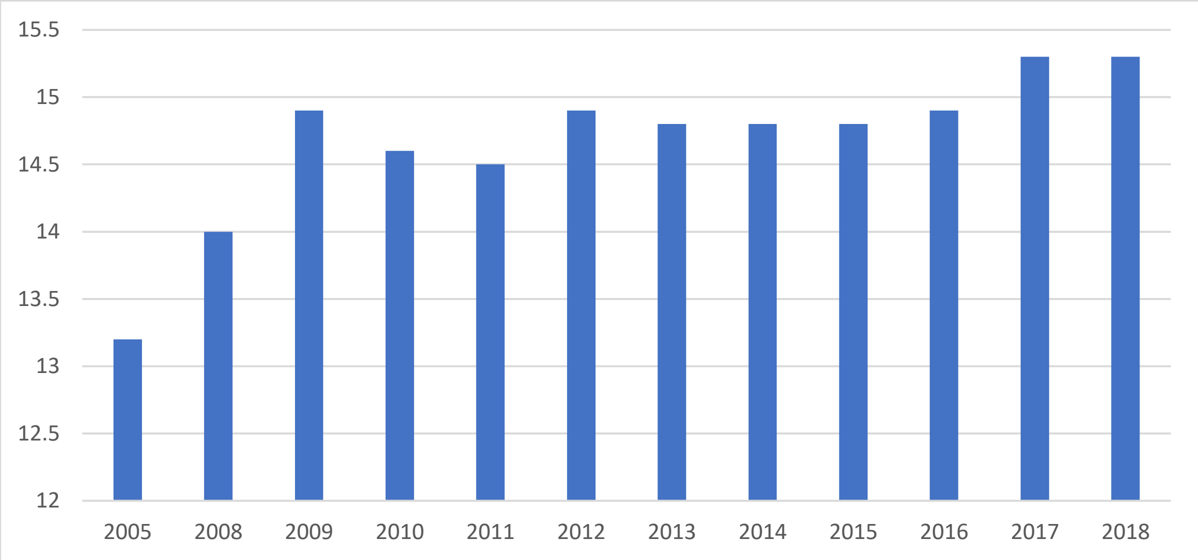
Some potential recommendations could include: (i) the incremental introduction of social contributions on temporary incomes (currently only subject to personal income tax); (ii) the gradual formalisation of businesses with a lower social contribution rate; (iii) increased support for the labour market participation of women, especially in certain ethnic groups (e.g. Albanian, Turkish, etc.). Finally, the set of social protection reforms that is expected to be adopted in 2019 (i.e. pension reform, social protection reform, progressive taxation) should adequately address some of the challenges identified in relation to financing social protection.

1 Current levels and past changes in financing social protection

1.1 Overall expenditure

Aggregate developments in the financing levels of social protection in North Macedonia over the period 2005-2018 show that overall spending on social protection increased by 2.1 pp, and in 2018 it accounted for 15.3% of GDP (Figure1). During the period of the global economic crisis, social protection expenditure in the country increased slightly, which resulted from a number of anti-crisis packages undertaken by the government. While the percentage change over the period 2005-2016 was similar to the EU average increase of 2.2 pp, total social spending remains much lower than the EU average, which stood at 28.2% in 2016. North Macedonia's total social spending is close to that of Romania (14.6% in 2016), Lithuania (15.2% in 2016) and Latvia (15.4% in 2016). The data and analysis in this report are derived from national administrative sources (i.e. the Ministry of Finance, Pension Insurance Fund, Health Insurance Fund, Employment Agency), as well as from international governmental financial organisations.

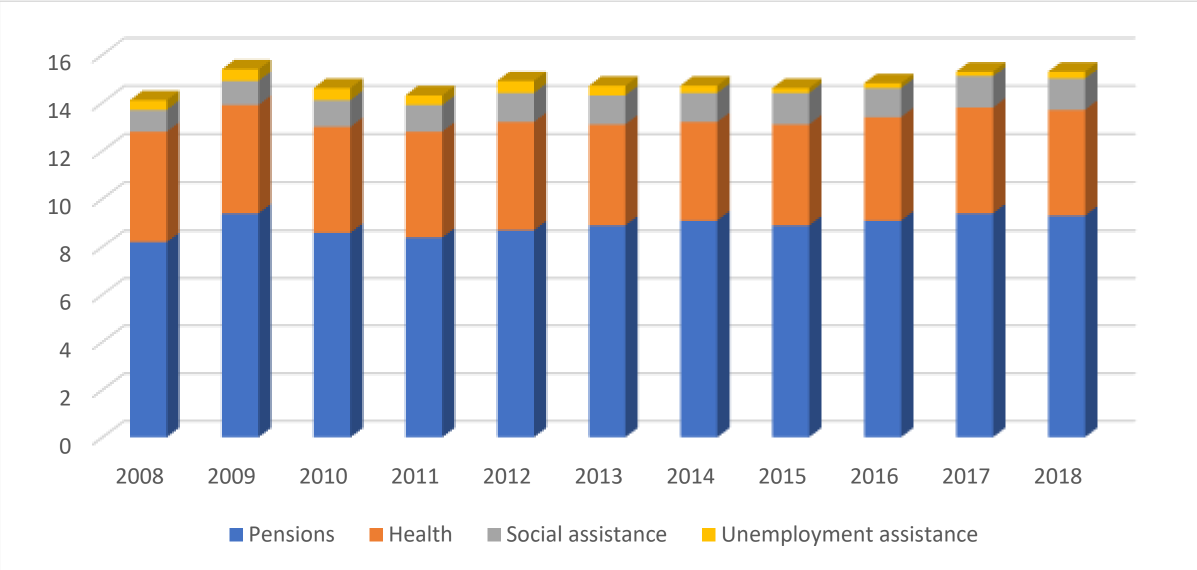
Figure 1: Total spending on social protection, % of GDP, 2005-2018



Source: Author's calculation based on data from the Ministry of Finance (Central Government Budget execution data series, Basic Macroeconomic Indicators), accessed 10.02.2019.

A glance at the separate branches, or functions, of social protection reveals that pensions account for most of the total spending on social protection – in 2018, 60.7% of gross expenditure on social protection . During the period 2008-2018, gross expenditure on pensions increased by 1.1 pp of GDP; in 2018, pensions accounted for 9.3% of GDP (Figure 2). Health spending constituted 28.7% of total spending on social protection. There was a negligible change in health spending in the period 2008-2018, with an increase of 1.3 pp. In 2018, spending on health stood at 4.4% of GDP. Other social spending, including social assistance and unemployment assistance, represents only 10.5% of all social transfers. The slight change of 0.3 pp between 2008 and 2018 was mainly due to the introduction of categorical social benefits, which did not effectively tackle poverty in more vulnerable groups. Spending on social and unemployment assistance in 2018 amounted to 1.6% of GDP. As noted by the World Bank (2018b: 1): 'This is among the lowest in the region and below the average level of spending on social assistance among Europe and Central Asia countries which stands at 2.2 percent of GDP.'

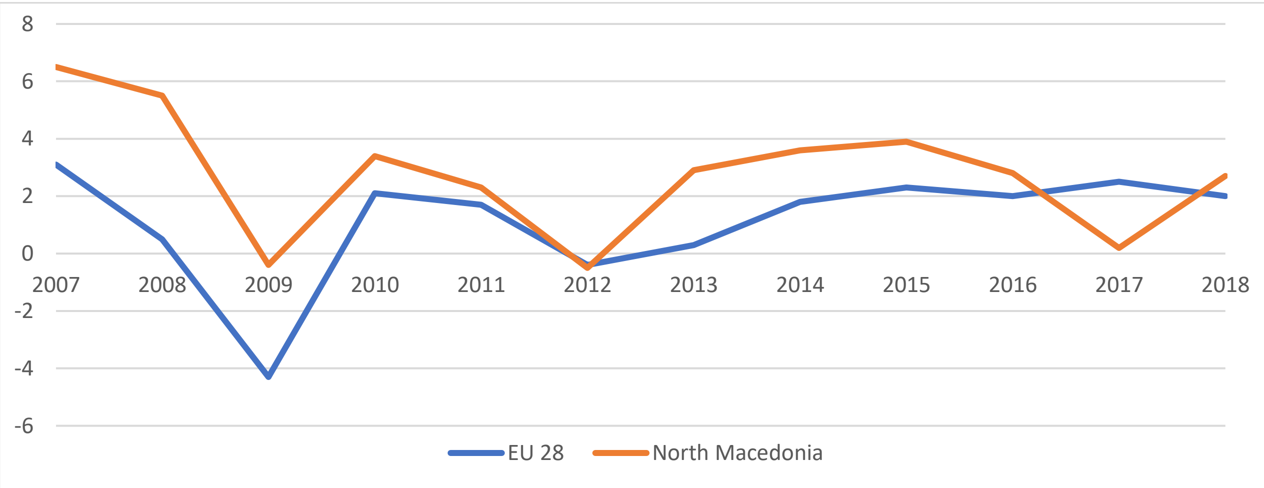
Figure 2: Gross expenditure on social protection by function, % of GDP, 2008-2018



Source: Author's calculation based on data from the Ministry of Finance (Central Government Budget execution data series, Basic Macroeconomic Indicators), accessed 10.02.2019.

The most important drivers of the level and structure of total social spending in the country include: low economic growth, a low employment rate, the structure of the economy (significant informal economy – 18.3% in 2017, self-employment – 12.9% in 2017, etc.), as well as demographic factors. According to Ministry of Finance and Eurostat data, during the period 2007-2018, the real growth rate decreased from 6.5% in 2007 to 2.7 in 2018, and it never reached levels above 4% after 2008 (Figure 3). In 2018, the real growth rate of GDP was 2.7% and is projected to be 3.2% in 2019.

Figure 3: Real gross domestic product growth rate – volume,North Macedonia and the EU-28, 2007-2018



Source: Eurostat database [tec00115].

In addition, although the employment rate witnessed a continuous increase between 2005 and 2018 (11 pp for the whole period), it was still only 44.9% in 2018; this is insufficient to enable more generous social spending, either as part of the employee's contributions or through taxation. Despite the fact that the working-age population (aged 15-64) accounted for 70.2% of the total population in the country in 2017, only 50.5% of this demographic group was employed in 2017. The proportion of people above 65 was 13.3%. Though this figure is lower than in the EU-28 (19.4% according to 2017 data), still there are significant pressures on healthcare and long-term care, as well as on the pension system.

In general, it may be noted that social protection expenditure has been maintained and has not decreased, despite the pressures indicated above. The effectiveness of social transfers is most visible in relation to pensions, as they reduce the risk of poverty in North Macedonia by 14.8% (2017 data). Other social transfers only negligibly reduce the risk of poverty (3.7%). Still, overall social spending in the country remains low. More importantly, the country suffers from inefficiencies related to: sustainability (pensions), underfunded services (primary and preventive healthcare) and inadequate targeting (social assistance and unemployment compensation).

1.2 Pension expenditure

ESSPROS - North Macedonia

Provisional data based on the European System of Integrated Social Protection Statistics (ESSPROS) for North Macedonia became available for the first time at the beginning of April 2019 (see Annex, Table A1, Figure A1 and Table A2), and cover only the period 2015 and 2016 (data for net social protection benefits are not yet published). Comparison between social protection expenditure estimations based on national data used in this report and ESSPROS data show that there is almost no difference.

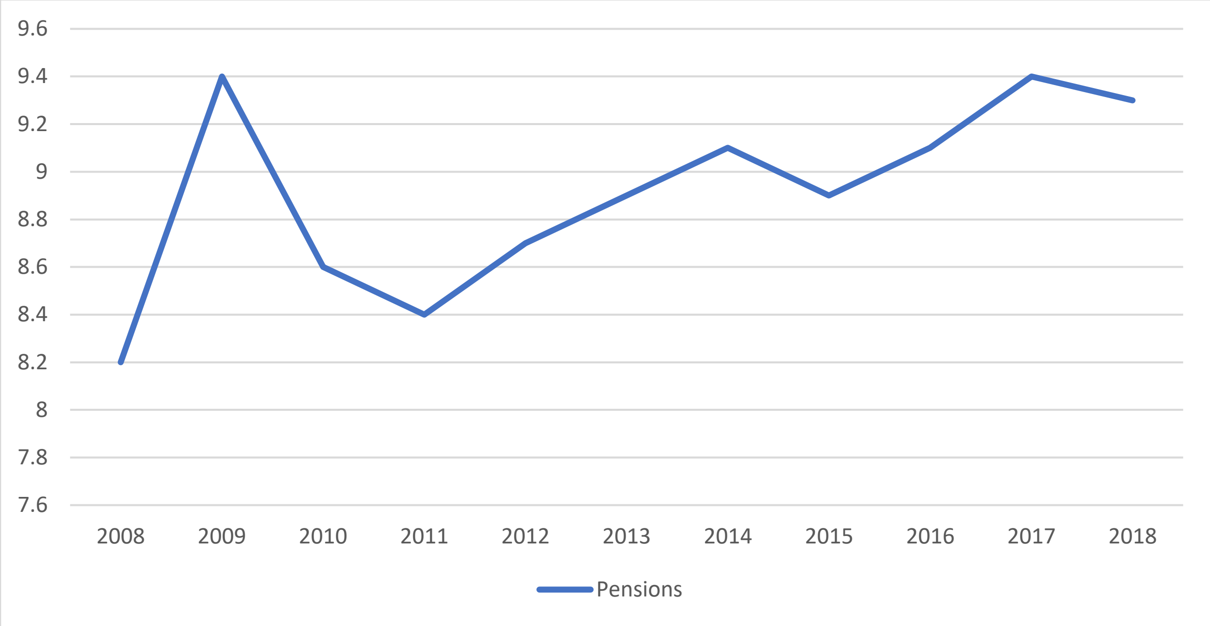
According to ESSPROS data (Table A2), social protection expenditure in 2015 and 2016 amounted to 14.1% and 13.9% of GDP, respectively . The bulk of the EUR 1,349.36 million in 2016 was consumed by old-age expenditure, which represented 5.4% of GDP in 2016. The second significant expenditure item is sickness/healthcare, with 4.1% of GDP in 2016. All other social protection expenditure items are below 2% of GDP: 1.6% for survivors, 1.4% for disability, 0.9% for family/children, 0.2% for unemployment and 0.2% for social exclusion. All non-means-tested benefits represented 4.1% of GDP in 2016.

As already indicated, pension expenditure accounts for most of the social protection expenditure in North Macedonia. Between 2008 and 2018, pension expenditure increased by 1.1 pp, i.e. from 8.2% to 9.3% (Figure 4). The increase is the result of a number of public policy measures, among which: ad-hoc supplementary pension increases, reduced contribution rates and contribution payment waivers introduced to promote employment. Such policies resulted in rising pension expenditure, as well as a growing pension insurance fund deficit.

During the period 2014-2017, formal indexation mechanisms were abolished in favour of fixed-amount increases. The approach was widely interpreted as populist – both by the political parties then in opposition and by the media – as it coincided with a number of early parliamentary elections. In 2017, pensions in the first pillar were increased by a fixed amount of 621 Macedonian denars (MKD) (EUR 10). In the second pillar, there is a periodic indexation with the cost of living, if the pension is paid by fixed annuity. Also, contribution payment waiver has frequently been used as a measure to promote employment, which has only resulted in rising pension expenditure and growing deficit. Pension deficits are an additional challenge. As indicated in an IMF statement (IMF, 2016), the sizeable pension deficit of 4.5% of GDP (reflecting relatively generous benefits, low contribution rates and low labour force participation) is projected to more than double by 2030.

From 2019, North Macedonia switched indexation, moving from half by wage and half by price growth toward a system of price indexation. This is expected to reduce the pension deficit, while preserving the purchasing power of pension benefits (World Bank, 2018b).

Figure 4: Pension expenditure, % of GDP, 2008-2018



Source: Author's calculation based on data from the Ministry of Finance (Central Government Budget execution data series, Basic Macroeconomic Indicators), accessed 10.02.2019.

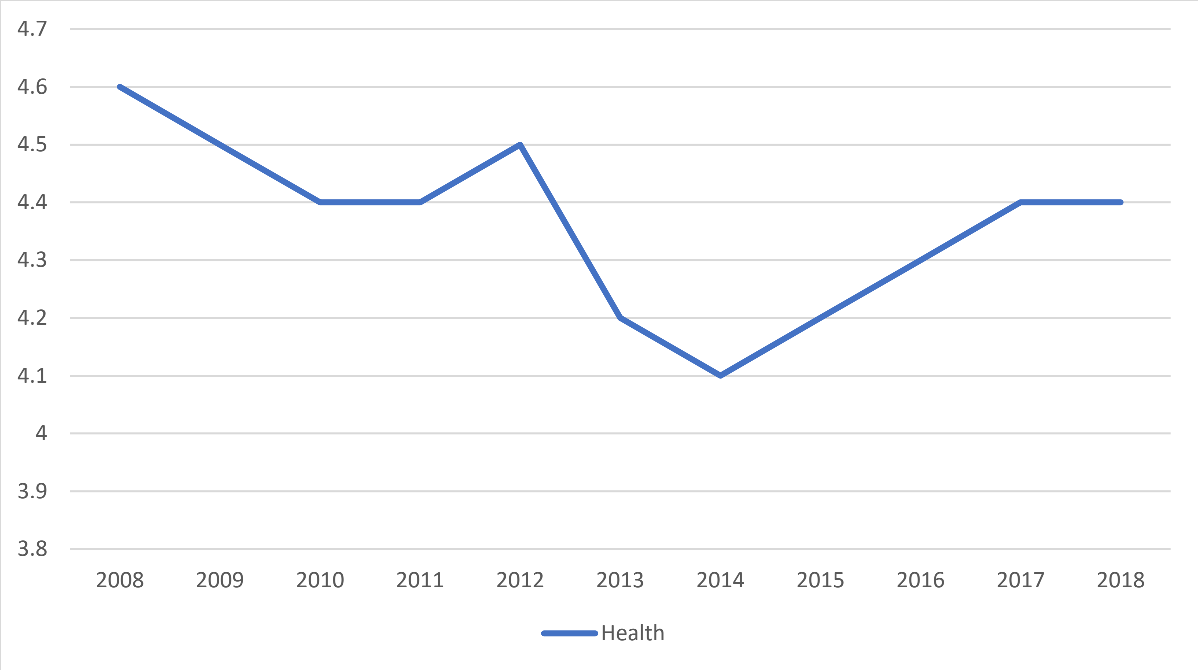
Recent changes and the ongoing reform of the pension system are designed to improve fiscal sustainability, with the following measures: (i) consumer price indexation of pensions, with a supplementary 25% wage indexation if real GDP grows at above 4% per year; (ii) harmonisation of accrual rates by lowering the pay-as-you-go (PAYG)-only accruals for post-2018 service and raising all service year accruals for second-pillar participants; (iii) a contribution rate increase of 0.4 pp in 2019 and 2020; (iv) switching second-pillar members over 50 to the PAYG pillar and transferring all employees in hazardous occupations from a multi-pillar system to the PAYG pillar. In the short run, these measures will bring revenues to the budget, but there will still be a need to generate more fiscal savings (World Bank, 2018a).

The reform package also includes a Law on Social Security for older people (65+), planned to be adopted in 2019. Under this law, those who have a contributory record of less than 15 years (which is a required minimum for establishing the right to a pension) will acquire the right to a 'social pension' (of MKD 6,000, or close to EUR 100 per month). The law aims to provide a minimum income for people aged 65+ who do not receive a pension or guaranteed minimum assistance. In addition, these beneficiaries will acquire the right to an energy subsidy of MKD 950 per month (EUR 15) (similar to that provided to guaranteed minimum assistance beneficiaries). According to the government assessment, it is expected that around 4,000 people aged 65 and above will be eligible for this.

1.3 Healthcare expenditure

Healthcare expenditure is the second biggest item in overall social protection expenditure. Between 2008 and 2018, healthcare expenditure declined negligibly (0.2 pp), from 4.6% to 4.4% of GDP (Figure 5).

Figure 5: Health expenditure, % of GDP, 2008-2018



Source: Author's calculation based on data from the Ministry of Finance (Central Government Budget execution data series, Basic Macroeconomic Indicators), accessed 10.02.2019.

A significant issue in relation to health expenditure in North Macedonia is 'out-of-pocket payment'. According to the latest World Health Organization 'Health Systems in Transition' report on North Macedonia (WHO, 2017: 129) the 'major portion of out-of-pocket payments are the result of direct payments for privately purchased health care services and informal payments'. Somewhat older data – from the World Bank 'Life in Transition Survey' – indicated that over 40% of the population made informal payments to receive health services (World Bank, 2015). The household consumption survey of 2016 shows that on average 3.4% of total household income is spent on health (State Statistical Office, 2017).

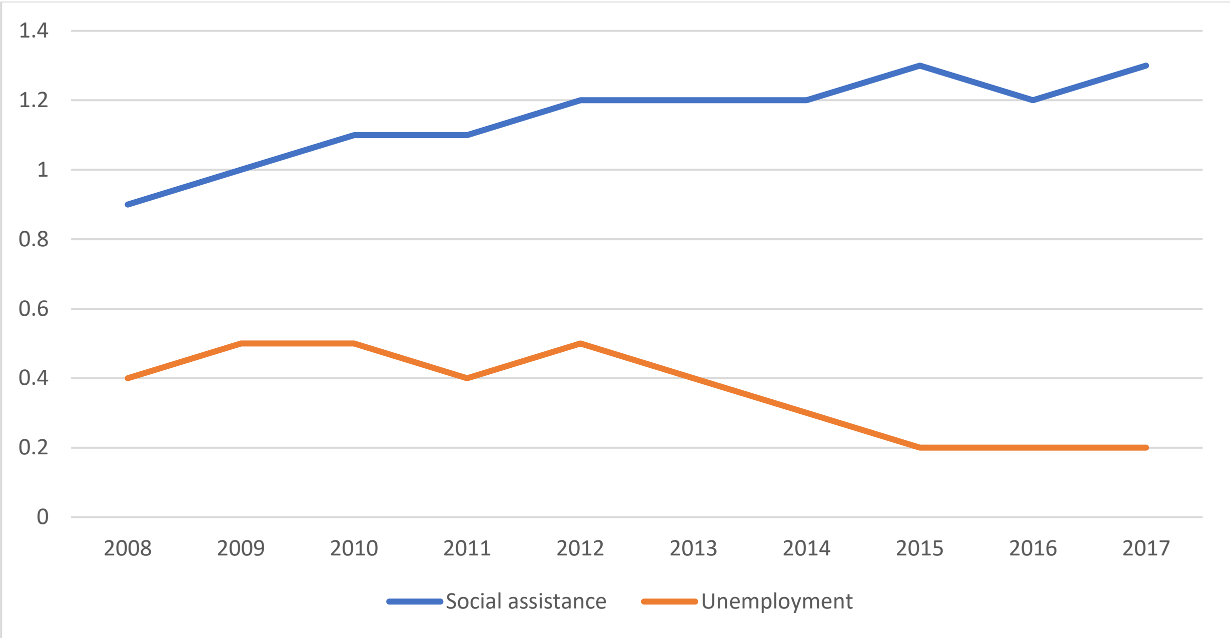
1.4 Other social protection expenditure

Other social protection expenditure, including social assistance and unemployment assistance, represent only a small part of overall social protection expenditure. As can be seen from Figure 6, during the period 2008-2018, social assistance expenditure increased by 1.6 pp; in 2018, it represented 1.3% of GDP. On the other hand, expenditure related to unemployment compensation and active labour market programmes saw a decrease of 0.2 pp, making up 0.2% of GDP.

Expenditure on social assistance has been increasing since 2008, but the rise has been due to categorical, rather than well-targeted benefits. The number of households receiving the two explicit anti-poverty programmes (social financial assistance and permanent financial assistance) has more than halved over the past 10 years due to the low-income threshold, and expenditure on these programmes dropped from 0.6% of GDP in 2005 to 0.2% of GDP in 2016 (Figure 7). The child allowance has also been reduced over the same period, in terms of both coverage and budget (from 0.09% of GDP to less than 0.02% of GDP). At the same time, categorical benefits have increased with the introduction of parental allowance in 2009. This benefit is provided to mothers who have given birth to a third child. Compared to other social assistance programmes, the parental allowance programme's benefit level is very high, MKD 8,362 per month (EUR 135), and is granted until the third child reaches the age of 10. By 2016, expenditure on this programme made up 0.4% of GDP (World Bank, 2018b).

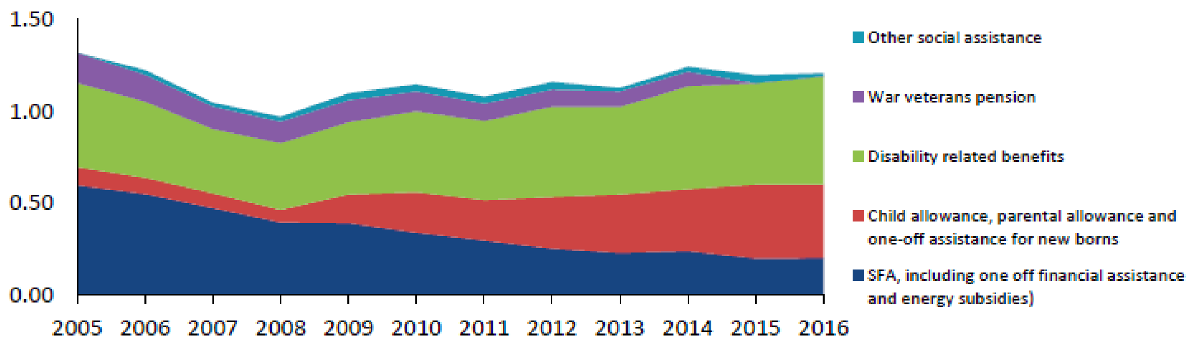
With the new Law on Social Protection (adopted in May 2019), spending on social protection will be more equitable across the different vulnerable groups and different programmes. Unlike the current approach, which uses different equivalence scales for different rights, the use of one equivalence scale for all means-tested benefits provides the possibility of equal treatment among people in similar circumstances.

Figure 6: Expenditure on social assistance and unemployment, % of GDP, 2008-2018



Source: Author's calculation based on data from the Ministry of Finance (Central Government Budget execution data series, Basic Macroeconomic Indicators), accessed 10.02.2019.

Figure 7: Spending on social assistance programs, % of GDP, 2005-2016



Source: World Bank (2018b).

2 Current mix and past changes in the sources of financing social protection

Social protection in the country is financed through a mix of contributory and tax-financed sources. Other sources (co-financing, participation, private insurance, etc.) are negligible and do not represent a significant factor in the overall social protection revenues. The structure of social protection financing has changed in the period 2005-2017, mainly reflecting reforms in relation to a reduction in social insurance contribution rates, transitional pension reform costs, and the overall ratio of contributors and insured persons. While sources of pension and health revenues include both social contributions and general government spending, other social protection branches – e.g. social welfare, disability protection and child protection – are predominantly funded from government tax revenues. Provisional ESSPROS data – available only for 2015 and 2016 – show that social protection financing by general government contribution has increased very slightly (0.1 pp in this period), while financing from social contributions has fallen by 0.5 pp (see Annex, Figure A2). The main reform that has had an impact on the structure of social protection financing was the reduction in social insurance contribution rates from 2009 onwards (Table 1). The goal of this reduction was to cut labour costs and improve labour competitiveness. This led to a decline in contribution revenues and contributed to a widening of the overall social insurance funds deficit.

Table 1: Social insurance contribution rates, 2008-2019, %

Type of contribution	Rate 2019	Rate 2010-2018	Rate 2009	Rate pre-2009
Compulsory Pension and Disability Insurance	18.4	18	19	21.2
Compulsory Health Insurance	7.4	7.3	7.5	9.2
An additional contribution to health insurance in case of injury at work and occupational disease	0.5	0.5	0.5	0.5
Compulsory contribution for unemployment insurance	1.2	1.4	1.4	1.4

Source: Public Revenue Office, http://www.ujp.gov.mk/en/vodic/category/700, accessed 10.02.2019.

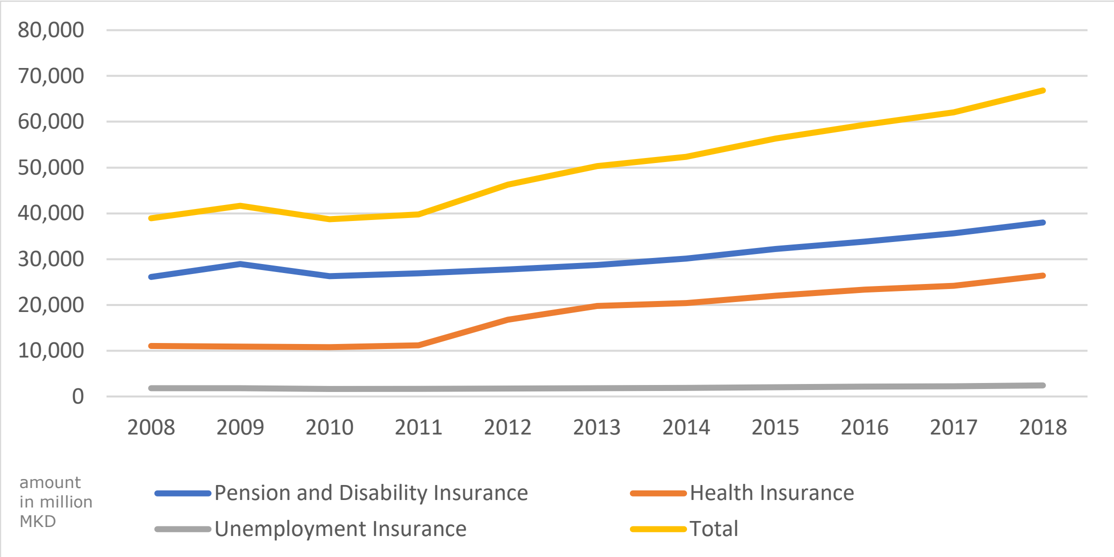
Additionally, the introduction of the second pension pillar in 2006 as a mandatory defined-contribution component for all first-time employed diverted 6% of the overall 18% pension contribution rate from the public Pension and Disability Fund to the private pension funds.

The pension system generates a sizeable deficit, which in 2019 stands at 4% of GDP. Projections show that if there is no reform, the pension deficit will reach 6% of GDP by 2030 (World Bank, 2018a).

Public Revenue Office figures show that, apart from unemployment insurance, revenues collected from social security contributions trended upward in the period 2011-2018 (Figure 8). Revenues collected for health insurance had the biggest increase – 140% from 2008 to 2018.

The financing of the set of proposed new social protection rights (guaranteed minimum assistance, educational allowance, 'social pension', etc.) requires additional funds and budgets. In that respect, the government has proposed a new Law on Personal Income Tax. This stipulates the introduction of progressive taxation. Incomes above MKD 90,000 (EUR 1,460) a month will attract an additional 8% tax, while incomes below this threshold will continue to be taxed at 10%. According to government estimates, this will only affect 1% of wealthier citizens; the expected revenues from this measure are EUR 25 million. The plan is for the increased revenue to be directed to financing of the new social protection rights.

Figure 8: Revenues from social security contributions, in million MKD, 2008-2018



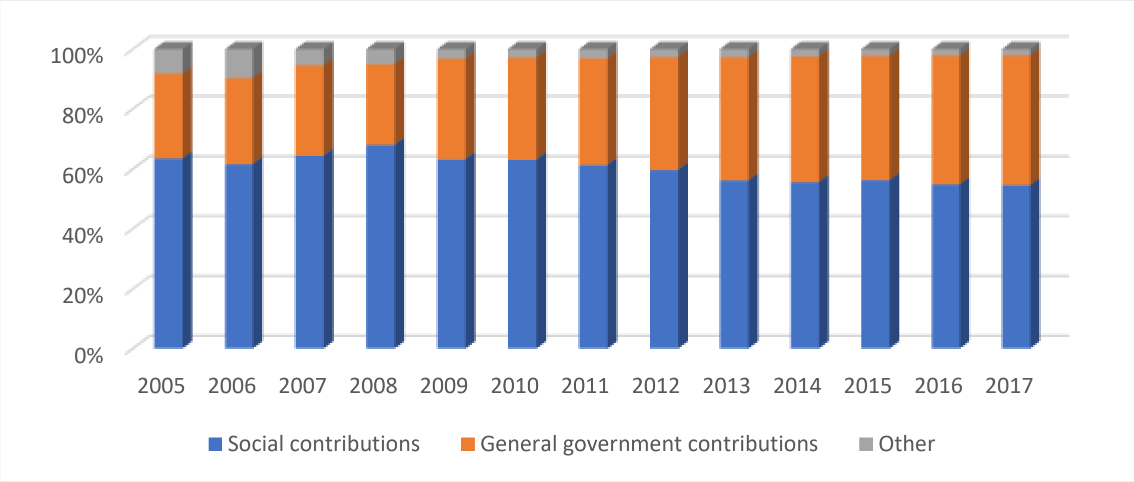
Source: Public Revenue Office, http://ujp.gov.mk/en/statistika/naplata/18/0/0, accessed 10.02.2019.

2.1 Pensions financing

The main sources of pension financing include social contributions from economically active persons and general government contributions. As can be seen from Figure 9, since 2009 contributions from the economically active have been declining, a result of the reduction in the pension contribution rate from 21.2% to 19%, and then 18% of gross wage. In 2017, 54.5% of pension revenues were financed from social contributions, while 43.5% came from the general government budget.

In 2015, there was an attempt to widen social security coverage. Changes to the Law on compulsory social contributions (Official Gazette of RM 180/14) extended, as of January 2015, the obligation to pay social security contributions on income from temporary service contracts and copyright contracts. The changes provoked widespread public protest and disagreement, mainly because they did not open access to all social insurance rights to temporary service workers/copyright contracts, and could exacerbate the already high unemployment and poverty rates in the country. The protests occurred in a period when other similar demonstrations were being organised (student protests, anti-government rallies, etc.), all of them objecting to the lack of transparency and representativeness, and to the violation of human rights. At the end of July 2015, the government proposed scrapping the changes, which were then repealed by parliament on 1 August 2015. The main reasons for the abolition of these measures, as stated by the then Minister of Finance, were: 'other Government measures that have exhausted the intended effects in the meantime. Project "Employing Macedonia" has resulted in [the] transfer of about 4,000 individuals to full-time employment in the private sector over the past three months. The second measure has been the transformation of the job status of a number of persons who worked as part-time employees in the public sector to a full-time employment' (Government of the Republic of North Macedonia, 2015).

Figure 9: Sources of pension revenues, in %, 2005-2017



Source: Author's calculation based on data from the Pension and Disability Fund, accessed 10.02.2019

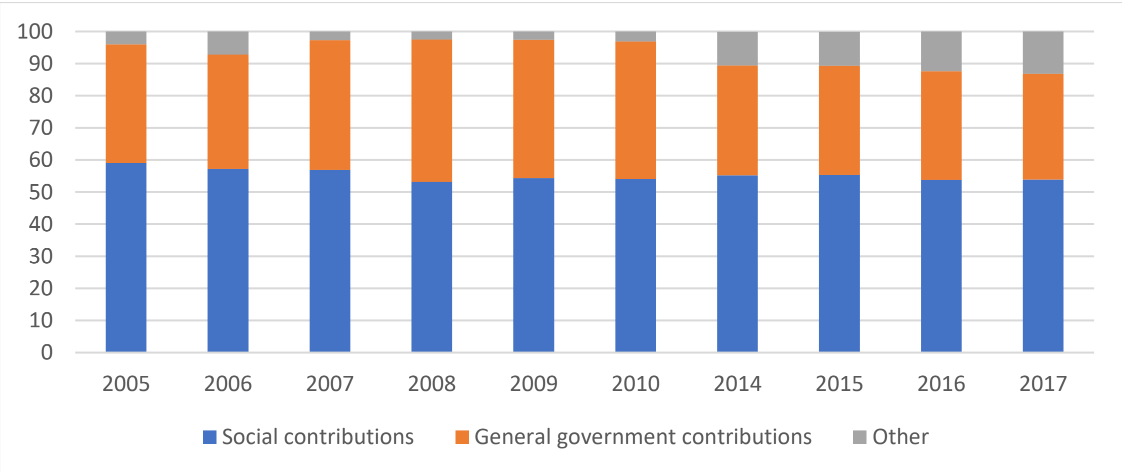
In terms of mode of financing, the Macedonian old-age pension system is a mixed scheme, including one unfunded and two funded pillars. The structure of the pension pillars is as follows:

- First pillar (unfunded): mandatory, insurance based on generational solidarity (PAYG);
- Second pillar (funded): mandatory, fully funded pension insurance; and
- Third pillar (funded): voluntary, fully funded pension insurance.

2.2 Healthcare financing

Similar to pension revenues, health revenues from social contributions decreased by 5.1 pp over the period 2005-2017 (Figure 10). In 2017, social contributions represented 53.9% of all health revenues, while the general governmental contribution amounted to 32.9%.

Figure 10: Sources of health revenues, in %, 2005-2017



Source: Author's calculation based on data from the Annual Reports from the Health Insurance Fund, www.fzo.org.mk, accessed 10.02.2019

Financing of the health system includes both contributions (from economically active persons) and general government funding. Public healthcare is funded exclusively by the Health Insurance Fund (HIF). There are different rates and bases of payment of the health insurance contribution. Actively employed persons pay 7.30% of their gross wage, while farmers pay 7.30% on 20% of their average gross wage. Retired persons pay 13% of their pension, while those unemployed and not covered by insurance from any other source pay

5.40% on 50% of the average national wage. It is important to note that for some categories of insured persons, the contributions are paid by the respective state agencies and institutions, namely:

- for those unemployed who are beneficiaries of unemployment insurance – the Agency for Employment;
- for social welfare beneficiaries – the Ministry of Labour and Social Policy;
- for pensioners – the Fund for Pension and Disability Insurance;
- for 'uninsured' persons – the Ministry of Health.

The Health Insurance Law provides for the possibility of co-payment exemptions. The annual maximum amount of co-payment for one insured person is set at 70% of the previous year's national average net wage. There are other – lower – limits of 40% and 20% for persons on a low income, children, and persons above the age of 65. Additional co-payment exemptions include:

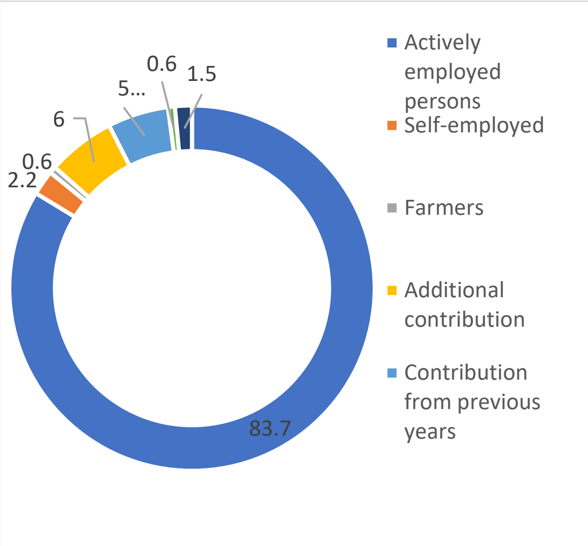
- insured persons for a medical check-up at the chosen general practitioner (GP), as well as emergency medical assistance on call;
- beneficiaries of permanent financial assistance, persons in public residential care and in foster care, according to the Law on Social Protection, except for prescription medicines issued under primary health protection and treatment abroad;
- persons in mental health residential care and persons with mental health issues who do not have parental care;
- children with special needs, according to the Law on Social Protection;
- participants in the programmes of the Ministry of Health (i.e. blood or tissue donors, children aged up to one year);
- war veterans and war disabled people and their families.

Also, insured persons have a right to a refund of certain defined medical costs. In 2017, the HIF paid out MKD 63.9 million (EUR 1.08 million) in refunds, which represents an increase of 21% over 2016.

Health insurance contributions are collected by the Public Revenue Office (PRO) and then allocated to the HIF. The HIF purchases services and devices from health providers on behalf of the insured, through a broadly defined basic benefits package.

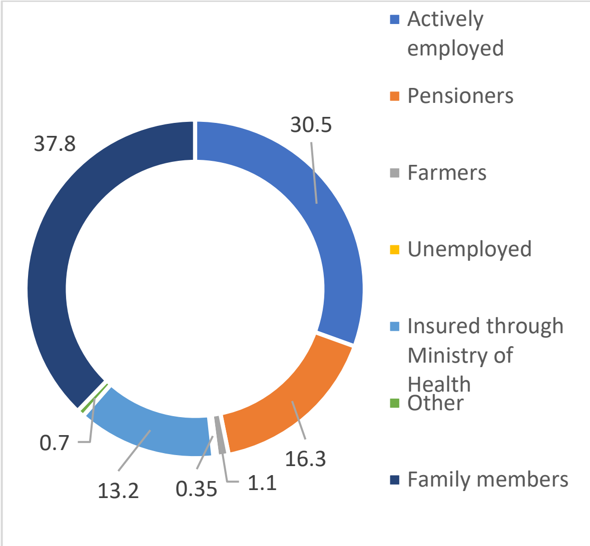
Health-sector revenues are heavily dependent on payroll contributions from the population in formal employment. Formal-sector employees provided 84% of all contribution revenues (Figure 11), even though these workers represent only 30.5% of the total insured population (Figure 12). This means that a small percentage of the population finances most health-sector costs, and that health revenues are sensitive to employment and economic downturns (World Bank, 2015).

Figure 11: Sources of health insurance contributions, %, 2017



Source: Health Insurance Fund, 2017.

Figure 12: Persons with health insurance, %, 2017



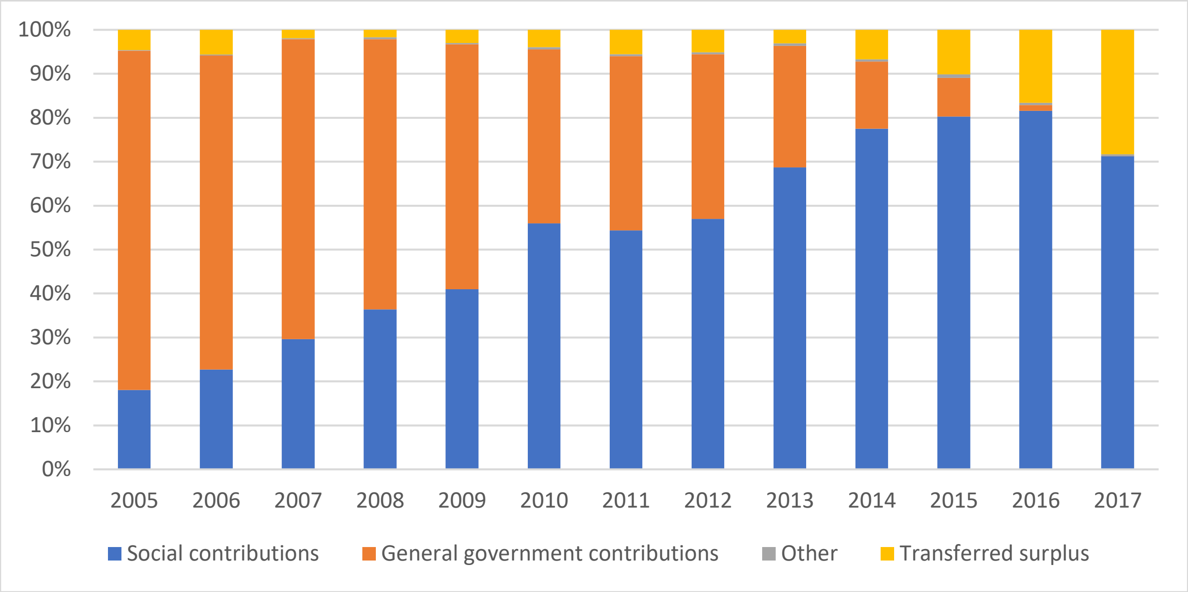
Source: Health Insurance Fund, 2017.

According to the Health Consumer Powerhouse data for 2017, North Macedonia is one of the group of countries where patients are frequently expected to make unofficial payments for medical services (Health Consumer Powerhouse, 2018: 84).

2.3 Other social protection financing

Other social protection branches include: unemployment insurance (from which active employment measures are also funded) and social welfare (inclusive of child welfare and disability assistance). Unemployment insurance is financed from payroll contributions, but there are also some budget allocations to the Employment Agency. In 2017, according to its Annual Report, the revenues of this agency, which provides unemployment compensation as well as active employment services and measures, consisted of 72% from payroll contributions; meanwhile general government contributions consisted of 1.31% of all revenues. The rest came from: other sources - 0.57% and transferred surplus from the previous year - 16.57%. (Employment Agency of the Republic of North Macedonia, 2018: 40). As can be seen from Figure 13, in the period 2005-2017, social contributions increased as a source, compared to general government contributions. Among other things, this is also due to the changes in the administration of financial rights administered by the Employment Agency: up until 2009, the agency was paying health insurance contributions for the registered unemployed, due to which it received a higher level of revenues from the government.

Figure 13: Sources of revenues of the Employment Agency, in %, 2005-2017



Source: Employment Agency of North Macedonia, Annual Reports 2005-2017.

3 Strengths and weaknesses of the existing mix of financing options and potential future sources of financing - national debate on the topic

The social protection system in North Macedonia is a combination of existing legacies introduced before the country's independence in 1991, and a patchwork of reforms introduced afterwards. The social insurance system, created before 1991, is based on the Bismarckian contributory principles that provides social protection rights according to the labour market status. However, due to factors such as a low employment rate, ad-hoc pension increases, unsystematic policies related to the active labour market programmes that favour exemption for up to five years from social contributions (health and pensions), etc., the system faces serious fiscal implications.

In addition, categorical social welfare benefits, such as the parental allowance for the third child introduced in 2010, consume most of the tax-financed non-means-tested expenditure, while at the same time they do not contribute to poverty alleviation. For example, spending on the main anti-poverty social assistance benefits (social financial assistance and permanent financial assistance) dropped from 0.6% of GDP in 2005 to 0.2% of GDP in 2016, while the parental allowance for the third child stood at 0.4% of GDP in 2016 (World Bank, 2018b).

There are a number of work disincentives that are created by the labour taxes, social assistance programmes and unemployment benefits. The minimum labour contribution stands at 50% of the average wage, which is regressive for those earning less. The tax wedge is 39% for low wages and 31% for above-average wages (World Bank, 2018b). Social assistance beneficiaries are also negatively affected if they accept a job: if beneficiaries earn income above the benefit amount, they will be immediately withdrawn from the system. There are some exceptions for those going on the public works programme; but even then the unclear criteria governing the active labour market programmes mean that social assistance beneficiaries are reluctant to jeopardise their beneficiary status. Lack of affordable child and elderly care prevents many women from entering the labour market.

Finally, as in other post-socialist countries of Central and Eastern Europe, the practice is widespread of employers formally paying social contributions on the minimum wage, while employees receive additional undeclared (envelope) wages. According to Williams and Bezeredi (2017: 250), the prevalence of wage under-reporting in North Macedonia is most frequent in: '(i) the construction sector, followed by agriculture, hotels, restaurants and cafes; (ii) male employees than female employees (15.1 per cent compared with 10.1 per cent), although women receive a greater proportion of their net income in the form of an undeclared (envelope) wage than men (i.e., 45 per cent compared with 20 per cent); (iii) part-time employed and (iv) proportion of employees receiving an under-reported wage declines with age, and a greater proportion of Albanian ethnicity employees are likely to receive envelope wages'. Wage under-reporting presents a form of tax evasion, which is a serious risk when considering new financing options for social protection.

The existing mix of financing sources of social protection in the country faces many challenges, including: (i) vulnerability to structural changes in the labour market; (ii) predominant reliance on the general government budget to compensate for the fiscal costs of the insurance funds; (iii) lack of full potential of social contributions, due to the significant informal labour market in the country; and inherently (iv) risk of evasion.

The set of social protection reforms that was adopted in 2019 (i.e. pension reform, social protection reform, progressive taxation) should adequately address some of the identified challenges related to the financing of social protection.

To improve the potential of future sources of financing for social protection, several recommendations can be put forward:

- the incremental introduction of social contributions on temporary incomes (currently subject only to personal income tax);
- the gradual formalisation of businesses with a lower social contribution rate;
- increased support for the labour market participation of women, especially among certain ethnic groups (i.e. Albanian, Turkish, etc.); and
- abolition of the practice of social contribution exemptions from the active labour market programmes.

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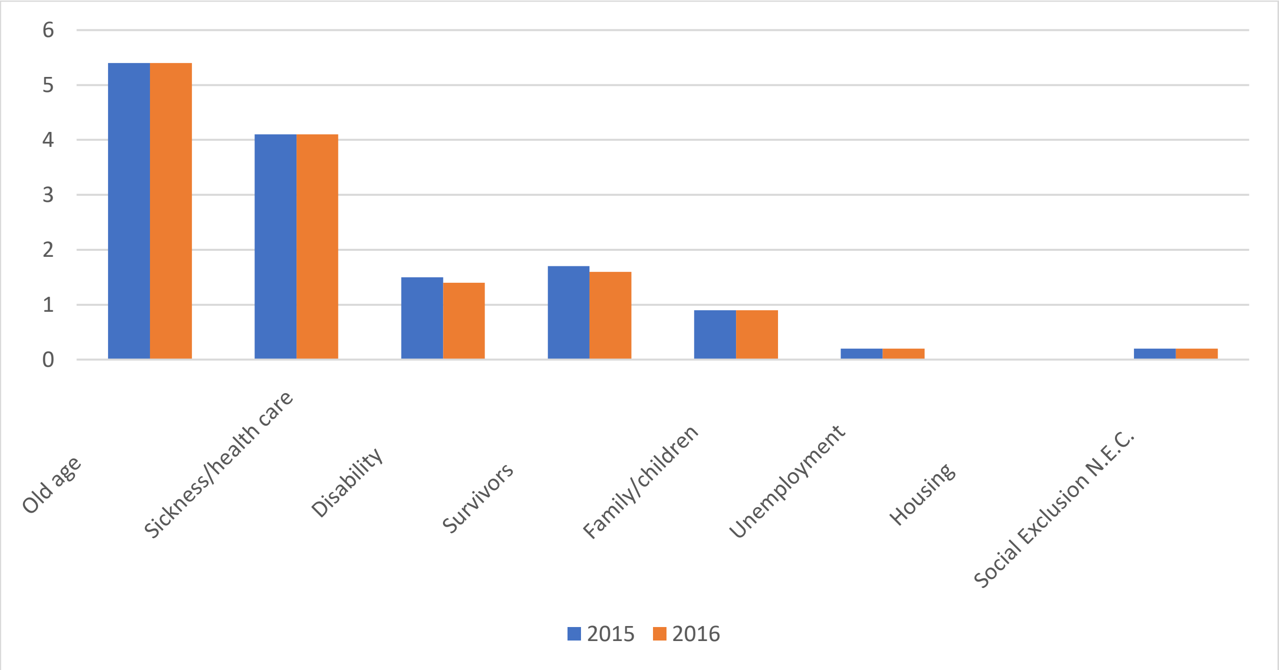
Annex

Table A1: Social protection expenditure, in % of GDP

Geographical area	2015	2016
European Union 28	28.4	28.1
Bulgaria	17.9	17.5
Croatia	21.8	21.3
North Macedonia	14.1	13.9
Romania	14.6	14.6
Serbia	22.1	21.5
Turkey	12.0	:

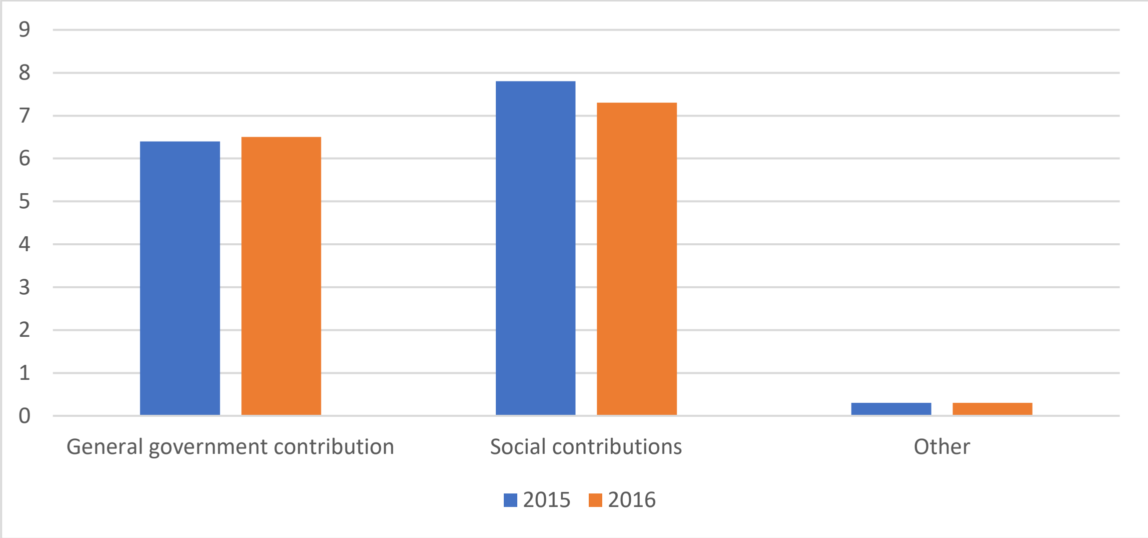
Source: Eurostat, 2019 [spr_exp_sum].

Figure A1: Social protection expenditure by function, in % of GDP



Source: Eurostat, 2019 [spr_exp_gdp].

Figure A2: Social protection receipts by sector of origin and type, in % of GDP



Source: Eurostat, 2019 [spr_rec_gdp].

Table A2: Pension expenditure (total and old age), in % of GDP

Geographical area	Total pensions		Old-age pensions	
	2015	2016	2015	2016
European Union 28	12.8	12.6	9.8	9.7
Bulgaria	8.6	8.4	6.7	6.5
Croatia	10.7	10.4	5.5	5.5
North Macedonia	8.0	7.9	5.4	5.4
Romania	8.1	7.9	6.8	6.7
Serbia	12.2	11.6	9.3	8.8
Turkey	7.1	:	5.5	:

Source: Eurostat, 2019 [spr_exp_pens].

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