

IV. WORLD BANK GROUP STRATEGY

A. Experience and Lessons Learned

53. **World Bank Group support over the FY07-FY10 CPS was highly relevant under both CPS pillars: (i) fostering job-creating economic growth and (ii) improving governance and transparency.** Both of these areas have remained central to FYR Macedonia's development agenda, and Bank Group activities were designed to provide direct support through targeted interventions.

54. **The FY07-10 CPS Completion Report (CPSCR) assessed results in four "outcome clusters" linked to the CPS pillars and EU accession.** The clusters, which were introduced in the CPS Progress Report to improve program synergies and monitoring, included: i) *growth and competitiveness*, ii) the *business environment*; iii) *human development*, and iv) *infrastructure*.

- **Growth and Competitiveness:** Bank knowledge and advisory products helped strengthen the authorities' understanding of key fiscal and economic challenges. Examples include a FY08 Country Fiduciary Assessment (CFA) which provided an assessment of financial management and public procurement systems, and a FY08 Public Expenditure Review. A Country Economic Memorandum (CEM) followed in FY09 with a detailed analysis of the restraints to sustained growth in FYR Macedonia and strategies for boosting investment in both physical and human capital. The Bank also financed the development of the Industrial Policy Strategy (the first of its kind since independence in 1991). The aim of the Strategy is to align industrial policy with the EU's Lisbon growth and jobs strategy, increase the competitiveness of the national economy and build a knowledge-based society. In addition, an investment operation upgraded agricultural standards and institutions to comply with EU Accession requirements. In response to the global economic crisis, the Bank provided just-in-time non-lending assistance through the FY09 Policy Note on Crisis Response.
- **Business Climate:** The Bank and IFC helped to reduce and streamline business registration and other commercial procedures, particularly through the "Regulatory Guillotine," while increasing the efficiency and transparency of the judiciary, including case management and commercial dispute resolution. The Bank also helped improve the flexibility of its labor market through targeted Policy Notes and strengthen land administration through focused studies on Access to Land for Investments and Security of Land Tenure, the Land Market Study, the Illegal Objects Study, a Pilot exercise on inventory of state land in urban Strumica, all of which provided the basis for the successful Real Estate Cadastre project.
- **Human Development:** Bank assistance helped strengthen access to and the quality of primary and secondary education, and boosted central and local planning under an ongoing decentralization effort. Investments strengthened the sustainability and financial management of healthcare, and improved the pension system and administration of benefits. The (FY09) Programmatic Poverty Assessment and (FY10) Western Balkans Regional Study on Safety Nets have helped understand the contours of poverty in the country and the region more broadly and increase government capacity in collecting and using survey data. Within its education sector program, the Bank financed the development of the Overview of Sectoral Issues and Needs for Future Interventions in FYR Macedonia's Higher Education and Research.
- **Infrastructure:** Investments helped to modernize the management and operations of the country's rail operations, and improve regional and local roads network, and the motorway to

Serbia. Non-lending assistance played a significant role in making the railway sector more efficient. The Bank financed the development of the Technical Note on the Status of the railway sector and Recommendations for improving the Operational and Financial Performance. An Adaptable Programmatic Loan (APL) upgraded energy transmission infrastructure and promoted sound energy planning and regulation. Less than satisfactory ratings in the human development and infrastructure clusters were attributable to mixed results on indicators and delays on the Global Environmental Facility (GEF) program supporting renewable energy and energy efficiency. A Water Sector Assessment is helping to strengthen the institutional capacity and identify the water supply needs and investment requirements to address growing water shortage in the south-east of the country.

55. **The World Bank supports a portfolio of 14 loans and four grants totaling US\$337.4 million in commitments.** The FY05 Cadastre and Registration Project is rated Highly Satisfactory. Three projects—the FY05 Business Environment Reform and Institutional Strengthening (BERIS) Project, the FY07 Sustainable Energy GEF, and the FY09 Conditional Cash Transfer—are rated Moderately Unsatisfactory or Unsatisfactory. One project—FY07 Legal/Judicial Implementation—is deemed at risk. The FY09 disbursement ratio was 13 percent, mainly because of disbursement delays from slow portfolio implementation during the country’s elections, and an initial delay in implementing the FY08 Regional and Local Roads Support project. At end-FY10, the disbursement ratio was 17.4 percent.

Table 3: Portfolio Performance as of July 1, 2010

Sector	Project name	Board	Revised Closing	IDA/IBRD US\$m	Dis. (%)	Age (yrs)	Latest IP	Latest DO
HD	EDUC MOD	Dec 2003	Dec 2010	5	80	6.4	S	MS
	SOC PROT	May 2004	May 2011	9.8	72	6	S	MS
	COND CASH TRANSFER	June 2009	Feb 2014	25	5.8	0.9	MU	S
	HLT SEC MGT	May 2004	Dec 2010	10	58	6	S	S
SD	ECSEE APL #3 (F	Jan 2006	Mar 2011	25.0	52	4.3	MS	MS
	REG & REAL ESTA	Mar 2005	Dec 2013	26.1	49.4	5.1	HS	HS
	RAILWAYS REFORM	Sep 2005	Oct 2010	19.4	75.2	4.6	S	S
	TTFSE 2	May 2007	Sep 2011	20	49.5	2.9	S	S
	REGI/LOCAL ROADS	May 2008	July 2013	105.2	24.1	2	S	S
	AGR STRENGTHENI	June 2007	Sep 2011	20	62.5	2.9	MS	S
	MUNICIPAL DEVEL	Mar 2009	Dec 2014	25	3	1.1	MS	S
	SUSTAINABLE ENE	Dec 2006	Mar 2011		12.7	3.4	U	MU
PREM	LEG/JUD IMPLMNT	June 2006	July 2011	12.4	33.8	3.9	MS	MS
PF	BUSINESS ENV RE	June 2005	Dec 2010	11.3	24.7	5	MU	MU
				319.7	35.5	3.9		

56. **Current financial management arrangements will continue to be used for project implementation as the performance to date has been generally satisfactory.** In parallel, possibilities of expanding the use of country systems to additional areas related to financial management will be assessed. So far, country systems have been used in the area of flow of funds through the Treasury and the National Bank instead of using commercial banks. In addition, in many projects civil servants are being appointed to work on project implementation. In the coming CPS,

the possibilities of using country systems in other areas such as external audit, internal controls and internal audit will be assessed. In particular, the focus will be on better use of the Treasury accounting and reporting for project purposes instead of creating parallel duplicate systems for accounting and reporting within the implementation units.

The CPS FY07-10 Completion Report

57. **Implementation of the FY07-FY10 CPS yielded several lessons:**

- **Bank assistance in support of EU accession was largely successful and should continue in the next CPS.** Bank support was particularly valuable in aligning government policy with EU requirements. For example, the FY07 Agriculture Strengthening and Accession project strengthened the capacity of the Ministry of Agriculture, Forestry and Water Economy (MAFWE) to disburse and track funds for rural development in a way compliant with EU standards, including the EU funds allocated to farmers.
- **The focus on leveraging coordinated support from FYR Macedonia’s development partners has allowed for greater impact and greater selectivity.** To increase the effectiveness of external support, the Government and its international partners agreed on a joint action plan to implement a Program Based Approach (PBA) concept in FYR Macedonia starting with five program areas: business environment/competitiveness, human development, agriculture, environment, and governance. The World Bank in close partnership with the EU delegation played a critical role in supporting the move toward a PBA and providing expert guidance. World Bank assistance positioned the country to better plan for and absorb EU pre-accession funds. The EU has decided to start linking the Instrument for Pre-Accession (IPA) funds with sector approaches starting in 2011.
- **Stepped-up collaboration between the World Bank and IFC promoted synergies and improved development outcomes.** For example, the Bank and IFC established in early 2009 a “One-Stop-Shop” support approach, which aims to integrate and coordinate Bank Group advisory services to improve the business environment and country competitiveness. Given the success of this and other programs, this CPS will continue to foster and strengthen Bank Group synergies, including by involving Bank staff in the concept phases of IFC advisory services, and supporting Bank-IFC consultations on key knowledge and analytical activities.
- **Efforts to jointly review and monitor CPS implementation have paid dividends and should continue over the next CPS.** The Bank and the Government established a successful collaborative mechanism for monitoring portfolio implementation—the CPS Implementation Stocktaking Tool. Each quarter the Ministry of Finance and Bank staff identify short and medium term portfolio milestones, key bottlenecks, and proposed actions to be taken by the Bank and the Government to strengthen implementation. The portfolio is then discussed at regular government sessions, and the conclusions are communicated to the Bank and Ministries in the form of a government decree.
- **Simplified project designs that accurately account for limited in-country capacity may improve portfolio performance.** Some Bank operations had overly complex designs, particularly in defining expected results, and in some cases this complexity resulted in implementation delays. The FY07 Sustainable Energy GEF project, which was restructured in June 2010, is an example. Realistic assessments of government capacity and implementation

timeframes are important as the World Bank has opted to avoid free-standing Project Implementation Units (PIUs) in an effort to strengthen national institutions for project implementation.

- **Flexibility was crucial to the FY07-FY10 CPS, and will be fundamental going forward.** The Bank was able to quickly respond to the Government’s request to scale up a regional roads project from US\$25 million to US\$105 million, and by early 2009 was preparing a DPL to respond to the growing economic and financial crisis.
- **Continued consolidation of the portfolio will enhance results and provide resources for timely analytical engagement.** Consolidation will make better use of the Bank’s resources and Government managerial capacity, free up scarce internal resources for more analytical and advisory work with the Government on emerging challenges, and allow for the Bank to focus selectively on developing coordinated programs with other international partners.

Partnerships and participation

58. **The Bank Group continues to be a significant development partner to FYR Macedonia, with disbursements of around US\$50 million per year.** In addition, the Bank portfolio has attracted around US\$40 million in grants or co-financing from different sources, and more than US\$100 million in parallel financing. For example, the Education Modernization Project attracted US\$2.5 million of trust fund co-financing for each dollar of Bank financing; and US\$70 million parallel financing from EBRD almost matched the Bank’s US\$105 million for Regional and Local Roads. FYR Macedonia has a solid track record in using trust funds for project preparation, utilizing around US\$4 million for preparation of seven projects of the currently active portfolio.

Table 4: Overview of FYR Macedonia’s Development Partners

Partner	Sector / Theme Areas													
	Business environment	Municipal services	Competitiveness	Judicial reforms	Transport	Property rights	Education	Health	Social protection	Agriculture	Water	Climate change	Energy efficiency	Solid waste
EC	x		x	x	x		x		x	x		x		
EIB					x						x			
EBRD		x	x		x								x	
USAID	x	x	x	x			x		x	x			x	x
Germany	x		x								x		x	
Japan			x			x	x	x			x			
Netherlands	x		x	x			x			x		x		
Sweden						x				x		x	x	x
Norway			x									x		
Austria	x		x				x		x		x	x	x	x
Switzerland		x									x	x		
UK	x		x	x										
UN		x					x	x	x			x		x

59. **The Bank will continue its focus on leveraging coordinated support through the PBA.** The Government launched the PBA in five program areas: business environment/competitiveness, human development, agriculture, environment, and governance; the aim has been to better utilize international development assistance, including increasing country's absorption capacity for EU pre-accession funds. Going forward, the Bank and IFC should continue to explore with the Government innovative ways of crowding-in public and private development financing for key areas, and deepen cooperation with the EC to ensure that the Bank Group's global knowledge can continue to inform country's development efforts.

Consultations

60. **External consultations underpinned the preparation of the CPS.** Meetings between the Bank and ministries during 2009-2010 launched the consultation process for the new CPS. These consultations were continued in March 2010, when the ECA RVP and IFC staff met with selected ministers led by the Deputy PM and Minister of Finance to discuss the development priorities and the framework of the CPS. Consultations with representatives of political parties took place in May and June, through meetings with representatives of the largest parliamentary groups. These consultations were critical to ensuring that the program is focused on national priorities and has the support of stakeholders. Despite the differences in party platforms, these consultations demonstrated overall consensus on the priorities related to economic growth, EU accession and sustainable development. During the same period, the Country Office embarked on focused consultations with other stakeholders. The consultation process started through a Client Survey (Box 5) and continued through focus group workshops organized in different regions of the country. Participants in these workshops, made up of representatives of local governments, private sector and civil society organizations, agreed that the economic growth, improvement of infrastructure and business environment, as well as efforts to attract investments should be the main priority of the World Bank assistance.

61. **The Bank Group will continue to expand outreach and communication to strengthen partnerships in the implementation of the new CPS.** Communication tools include the Country Office web site, the Public Information Center (PIC) at the Central Bank, and the Global Distance Learning Network (GDLN) through the affiliation between the World Bank and the British Council. The Bank will also continue to support civil society activities through the Civil Society Fund, as well as through direct involvement in project preparation and monitoring.

B. Areas of Engagement

62. **The objective of the FY11-14 CPS is to support faster, more inclusive and greener growth while helping to prepare for EU accession.** The CPS focuses Bank Group support in three areas of engagement: (i) *faster growth* - competitiveness; (ii) *more inclusive growth* – employability and social protection and (iii) *greener growth* - environmental sustainability and climate action. In these three areas of engagement, the CPS is expected to contribute to specific development outcomes. During the first half of the CPS, contributions toward these outcomes will come mainly from interventions carried forward from the FY07-FY10 CPS. Outcomes in the outer years of the CPS are expected to come from new activities already identified under the new CPS. Table 5 provides a breakdown of ongoing and planned investment operations and knowledge and advisory activities for the FY11-14 CPS.

Box 5. Main Findings of Client Survey

In May 2010, 500 stakeholders were invited to participate in a survey on the role of the Bank in FYR Macedonia. Participants were drawn from national and local governments; bilateral or multilateral agencies; the private sector; NGOs; the media; trade unions; academia or research institutes; and the judiciary. A total of 240 stakeholders participated in the country survey (48%), with more than half of the respondents employees from ministries. Respondents were asked about the role and performance of the Bank as well as about general issues facing the country (see Annex 3 for more details).

Familiarity: Respondents were generally familiar with the Bank, with 58 percent indicating they have been involved with or have been a close observer of the Bank for more than three years.

FYR Macedonia's General Environment: Respondents were less optimistic about the outlook for the country than in 2006. This may reflect the global financial crisis and uncertainty in the ECA region.

Development Priorities: A strong majority indicated that economic growth was FYR Macedonia's most important development priority—with 67 percent identifying it as the number one or two, EU accession followed at 49 percent. Moreover, growth and jobs were identified as the number one priority for reducing poverty. As for what was necessary to stimulate growth, business climate, agriculture, energy infrastructure, and EU accession came out as top factors.

The Bank Group's Role: Most respondents thought the Bank considered economic growth (41%); poverty reduction (24%); and EU accession (15%) as its top three priorities in FYR Macedonia—these were also the top three areas where respondents thought the Bank *should* be focusing. Fostering environmentally sustainable growth also appears high on both lists.

Effectiveness: The Bank continues to be seen as fairly effective, receiving a mean score of 6.4 out of 10—similar to the 2006 rating; and more specifically, is seen as strong in “promoting effective development,” scoring 3.7 out of 5 (3.5 in 2006). Respondents from Government institutions were most favorable while academics were least favorable. The Bank was seen as most effective in helping to strengthen the financial system, promoting infrastructure and bringing about economic growth. Ratings were lower in reducing poverty, increasing employment, and in adapting to climate change.

Lessons: The 2010 Survey results are mixed. The overall ratings for effectiveness remain solid. There are encouraging improvements in the way the Bank is perceived, with better ratings in accessing and dealing with Bank staff. However, importantly, the results were less strong in areas that are seen as the highest priority, such as poverty reduction and promoting EU accession. The focus in the next CPS on growth and employability, therefore, seems borne out by the Survey; but it also underscores the challenge of translating economic growth into better lives for FYR Macedonians. Another lesson is that the Bank must continue to reduce bureaucracy and strengthen its knowledge services, technical expertise, and advisory services, and better tailor this work to the country's particular challenges.

Climate Change: The 2010 Client Survey introduced a focus on climate change, and the findings are notable. While not a top priority, respondents felt fairly strongly that climate change is a serious problem and should be considered when thinking about growth policies in FYR Macedonia. Moreover, a strong majority (68%) want the Bank to be “quite involved” in climate change efforts. There was also strong agreement on the need for investments in energy efficiency and renewable energy; and again, respondents indicated that that they believe the Bank Group should play a role in securing these investments.

Table 5: Operations FY11-14

Ongoing Operations FY11-14					
Faster Growth: Competitiveness		More Inclusive Growth: Employability and Social Protection		Greener Growth: Environmental Sustainability and Climate Action	
Ongoing investment projects (closing date)					
Business Environment	FY11	Education Modernization	FY11	Sustainable Energy Project	FY12
Railway Reform	FY11	Health Sector	FY11	(GEF)	
ECSEE APL3	FY11	Management		Agriculture Strengthening	FY12
Legal and Judicial	FY12	Social Protection	FY11	and Accession Project	
Implementation Project		Investment Loan (SPIL)			
Second Trade and Transport	FY12	Conditional Cash Transfer	FY14		
Facilitation Project		Project			
Real Estate Cadastre and	FY14				
Registration Project					
Regional and Local Roads	FY14				
Project					
Municipal Services	FY14				
Improvement Project					
New Operations FY11-12 (delivery date)					
Additional Financing	FY11	DPLII	FY11	Disaster Management	FY11
(ECSEE APL3)				CRIF	
				Energy Project	FY12
				(Hydropower)	
Non-lending (AAA) FY11-14 (delivery date)					
Regional REPARIS	FY11	Western Balkans	FY11-	Energy Efficiency TA	FY11
Higher Education AAA	FY11	Programmatic Poverty	FY14	Comprehensive Water	FY11
National Procurement Study	FY12	Assessment		Sector Assessment	
Western Balkans Regional	FY12	Labor market reform TA	FY12	Green Growth and	FY12
Study on Innovation		Science/Technology TA	FY12	Climate Change	
Western Balkans	FY11-	Health Policy TA	FY13	Agriculture and Climate	FY12
Programmatic Financial	FY14			Change TA	
Sector				Water Capacity Bldg. TA	FY12

63. **The CPS is structured to be particularly flexible over FY13-14 given the uncertainty on the pace of economic recovery and the rapidity of evolving development challenges.** Economic and fiscal conditions could shift significantly over the next few years, and the Bank may be requested to tailor its support to new circumstances. Knowledge of climate-related threats is accumulating, and new data or findings may suggest new strategies or instruments.

C. Principles of Engagement

64. **The selection of financial operations and knowledge and advisory services under this CPS, including programs to be identified in later years, has been or will be influenced by three key principles that reflect the findings of the CPSCR, government priorities, and the country environment:**

- **World Bank Group assistance will be directed to support FYR Macedonia’s EU accession.** The CPS will help FYR Macedonia to develop and align policies with the EU *acquis*, and strengthen government capacity to implement related policies.
- **The CPS will leverage financing and expertise from within the World Bank Group and FYR Macedonia’s development partners.** As both public and private financing is expected to remain limited over the near term, the World Bank will capitalize on existing and new programs that engage multiple partners to maximize development impact. For example, the Bank and IFC plan to expand their integrated “one-stop-shop” approach to business climate reforms to activities in energy efficiency and renewable energy. The Bank plans to enhance its engagement with authorities to help the country better absorb and implement resources from other donors, while actively seeking partnerships on programs related to the CPS. For instance, the Bank is already collaborating with Sweden and Norway on the Green Growth and Climate Change assessment and advisory support.
- **As noted above, the CPS is structured to be flexible in the outer years given uncertainty on the pace of economic recovery and the rapidly evolving development challenges.**

65. **Complementing these principles, the CPS will continue to move toward greater selectivity and portfolio consolidation started under the current CPS.** Selectivity entails deciding where the Bank Group can most effectively and strategically direct its scarce resources, which is largely determined by client demand and the Bank Group’s comparative advantages. In addition, selectivity suggests greater scrutiny on the most appropriate mechanisms for Bank assistance, whether loans, grants, technical assistance, analytical support, or other means. As recommended in the CPSCR, the Bank is also striving to consolidate the portfolio into fewer, larger operations over FY11-14 to enhance the effectiveness of its assistance. The aim is to continue the reduction in the portfolio begun in the current CPS to move from 14 operations at end FY10 to about seven by the end of the FY11-FY14 CPS period.

66. **In addition, the CPS program also reflects a deepening sub-regional focus in the Western Balkans and South East Europe.** FYR Macedonia is already benefiting from projects in the regional Trade and Transport Facilitation in South East Europe program and the Energy Community of South East Europe. During this CPS period, the Bank expects to expand the Catastrophic Risk Insurance Facility (CRIF) to include FYR Macedonia, with a particular emphasis on climate change. In addition, FYR Macedonia will continue to engage in regional economic and sector work (ESW) as a means of utilizing available World Bank resources for knowledge generation more efficiently. Key areas in this regard include poverty analysis, social policy, innovation and the financial sector. Going forward, new priorities could be added, based on client demand and the amenability of the topic/sector to a regional rather than a country approach.

D. Outcomes

67. **The CPS recognizes that the goals of faster, more inclusive and greener growth are interconnected.** For example, agriculture is central to accelerating growth, yet is also related to green growth and climate change. The FY11 DPL addresses macroeconomic stability, financial strengthening as well as health and pension reform, and will therefore contribute to outcomes in faster growth and social inclusion. As such, the mapping of CPS outcomes to the CPS’s three areas of engagement reflects the cross-cutting nature of the interventions. Activities under this CPS will consider and capitalize on these linkages and relevant opportunities.

I: Faster Growth—Competitiveness

68. **The CPS will provide support to enhance macroeconomic stability and competitiveness.** FYR Macedonia, like many countries in ECA, confronts an economic and financial environment far more challenging than existed prior to the 2008-2009 crisis. As ECA was the worst hit of all developing and transition regions, FYR Macedonia's primary trade and financial partners are expected to show tepid growth over the short-term. In addition, capital will likely be scarce and imports sluggish. In this context, the Bank Group has and will continue to engage closely with the authorities to identify where it can provide support to improve macroeconomic stability. Identified interventions include the following.

69. ***CPS Outcome – Continued Macroeconomic Stability.*** The second operation of the DPL will help consolidate macroeconomic stability by supporting measures to maintain sustainable debt levels, furthering reforms to the pension system, and strengthening the health financing system. It will also bolster the resilience of the financial sector by adopting a new law to consolidate the independence and accountability of the Central Bank, while at the same time improving coordination between the Central Bank and the Ministry of Finance and establishing a Supervisory Committee to increase the supervisory capacity of relevant bodies. The associated trust fund supports implementation of the reforms to promote economic growth and job creation through improvement of the investment climate and the strengthening of governance and efficiency in the public sector.

70. ***CPS Outcome – Land Reform: Establish an efficient land administration system.*** The FY05 Real Estate Cadastre project has been supporting development of an efficient and effective real estate cadastre and registration system, with a view to developing land and real estate markets. Additional financing for this project was approved in FY10, which will extend the project's closing date until December 2013. Planned activities under this CPS include supporting the digitization and vectorization of cadastre maps, facilitating data sharing among public, private, and government institutions, upgrading the national geodetic reference infrastructure, and supporting the development of national spatial data infrastructure in line with the EU's INSPIRE Directive. The project will also build capacity within the Authority of Legal and Property Affairs, which oversees property and legal issues involving public authorities and agencies.

71. ***CPS Outcome – Judicial Reform: Increase the efficiency of the judicial system and improve courthouse infrastructure.*** The FY06 Legal and Judicial Implementation project, which is expected to close in July 2011, will continue to improve the efficiency and effectiveness of judicial services. Remaining activities will aim to strengthen judicial institutions; support implementation of new bankruptcy legislation; develop a framework for administrative disputes by improving judicial management; and invest in court infrastructure, such as constructing and rehabilitating courthouses and enhancing judicial information technology systems. IFC has also been contributing to the judicial reform and access to justice, through its Alternative Dispute Resolution Project, which promotes usage of mediation as alternative to court proceedings.

72. ***CPS Outcome – Municipal Services: Improve local services and infrastructure in selected areas.*** The Municipal Services Improvement Project, which became effective in mid-2009, will help selected municipalities to: (i) improve the financial performance of specific investments; and (ii) build the capacity of municipalities and their communal service enterprises, particularly by

undertaking financial reforms, enhancing communications with residents, and increasing transparency—as measured by participation in international performance benchmarking. To date, the project has elicited interest from about a dozen municipalities, and most loan funds are expected to be committed during the next two years.

73. ***CPS Outcome – Roads: Improve road infrastructure and resilience to climate change and strengthen management capacity.*** The FY08 Regional and Local Roads Program Support Project, which is due to close in 2013, will continue to build capacity of the Agency for State Roads and invest in rehabilitation of the regional and local road network, with a view to expanding access of isolated communities to markets. The FY07 Second Trade and Transport Facilitation project, which closes in FY11, will continue efforts to lower transport and freight costs, particularly by improving border crossing facilities, upgrading a road corridor section to motorway standards, and harmonizing and improving telecommunications and cargo data exchange between railways and customs. Under this project, freight processing times will be reduced and non-tariff trade obstacles removed between FYR Macedonia and its neighbors. IFC will consider its support to structure PPP for modernizing and managing the toll road system of Corridor X and the concession of Corridor VIII highways.

74. ***CSP Outcome – Education: Improve quality in higher education.*** World Bank Technical Assistance in FY11/12 will support the Ministry of Education and Science in making informed policy choices with regard to financing of higher education, including establishment of bodies for external quality assurance in accordance with good practice and European agreements and guidelines, and will support development of internal quality assurance. In preliminary discussions, the Government has expressed interest in exploring a possible follow-on education project in the outer years of the CPS.

75. ***CPS Outcome – Increase financing and investment in competitive fields.*** FYR Macedonia has potential for a diversified economy and for significant investments and exports, including, *inter alia*, automotive components; healthcare products and pharmaceuticals; agribusiness and food processing, and metals and metal products. Though FYR Macedonia has supported a specialized agency entitled *Invest in Macedonia* to attract FDI to these and other sectors, capital inflows remain below expectations. In this context, IFC will continue to support programs over this CPS that improve the country's business environment and promote financing and investments in competitive sectors. Through its regional Investment Climate program, IFC will help FYR Macedonia to improve its business environment in line with the overall EU accession agenda, including in tax administration and trade logistics. IFC expects to provide equity and long-term financing and advisory assistance to commercial banks to support lending to SMEs, agribusiness enterprises, and trade finance, including through IFC's Global Trade Finance Program. IFC will explore opportunities to finance competitive local companies in pharmaceuticals, construction materials, and healthcare. In parallel, IFC will focus on supporting regional players and south-south investments, especially in sectors where FYR Macedonia has clear competitive advantages for exports. Through its corporate governance and international standards programs and technical regulations with a focus on agribusiness, IFC will continue to assist private companies to improve their access to finance and increase their exports.

II: More Inclusive Growth—Employability and Social Protection

76. **The Bank will continue to support innovative and effective investments in social protection and human capital.** The failure of past growth to translate into lower poverty makes it important for the Bank to deepen its support to government efforts to reach the poorest and most vulnerable. At the same time, the importance of human capital to FYR Macedonia's long term competitiveness and job creation necessitates sustained assistance in education.

77. **CPS Outcome – Social Safety Net: Cash benefits reach the most vulnerable.** The FY09 Conditional Cash Transfer (CCT) Project will contribute to social protection and human capital. The program, the first of its kind in ECA, will condition cash benefits on secondary school enrollment, and will be expanded to primary and pre-primary, as well as health care and adult training programs. In addition, the CCT project aims to improve the administration of services under the social safety net, including oversight mechanisms, service delivery, and monitoring and evaluation. Harmonizing overlapping programs is another means to improve the existing system, which has achieved broad coverage and effective targeting. More broadly, the project aims to leverage increased efficiency to realize fiscal savings, which may create space for an increase in spending on social assistance, which, at 1 percent of GDP, is low compared to averages in ECA (1.7%) and the OECD (2.5%).

78. **CPS Outcome – Health: Improve Health Outcomes.** Despite improvements in health care delivery and financing resulting from multiple investments channeled through the World Bank financed policy and investment operations in the last ten years, there is scope for further Bank engagement in the health sector. Health care is not, as such, included in the *acquis communautaire*; this suggests the value of continued Bank engagement in a sector in which it has built relationships and important country knowledge. The DPL has already identified some of the policy areas in which the Bank can provide advice through non-lending Technical Assistance (TA). In addition, the Government has expressed interest in a possible investment loan in the outer years of the CPS to address areas such as reducing financial vulnerability of the system and preventing the deterioration of health outcomes.

79. **CPS Outcome – Employability: Reduce impediments to hiring.** The proposed FY11 DPL will help strengthen the business climate by supporting a reduced labor tax wedge, more efficient public sector spending and financial sector reforms. Key reforms include reducing Social Insurance Contributions to 27 percent of the gross wage, and measures to safeguard the long-term sustainability of the pension and health sectors. In addition, the FY11 DPL will support government efforts to restrain growth in public sector wages and improve the process through which wages are set in the public sector. DPL support will be linked to improvements in the social safety net, including improved targeting of benefits.

III: Greener Growth—Environmental Sustainability and Climate Action

80. **The Bank will undertake a flagship program of analytic work to help FYR Macedonia better understand the macro-economic case for investing in green sectors and “greening” brown sectors as a stimulus for stronger growth.** This work will initially focus on key areas where the Bank supports ongoing or planned programs, such as in energy, water, transport, agriculture, urban development, land administration, education, and procurement. Among other outcomes, this assistance will help promote adaptation to climate change and lower-carbon growth

options into policy and investment planning decisions. Lending operations implemented through this pillar will serve as important learning platforms for how green growth objectives can be reached through investments—in ways more explicit than in previous operations.

81. ***CPS Outcome–Energy: Improve energy sector efficiency and environmental sustainability.***

This is an area where the World Bank Group can achieve synergies in support of stronger and more sustainable CPS outcomes:

- **IFC will contribute to a more efficient energy sector by supporting public-private participation in “greener” energy.** A particular focus will be on supporting the construction of new hydro power plants. Though the Government has recently passed a new concessions law that is generally consistent with international best practice, many by-laws and regulations have yet to be adopted. In addition, the Government has limited experience implementing PPP projects. IFC can play an important role through both financing and advisory services. It plans to provide advisory assistance and long-term financing to banks to support on-lending to small hydro-power plant projects. For example, IFC is implementing a new regional Advisory Services program entitled "*Renewable Energy in the Western Balkans with a focus on Small Hydro Power Plants,*" which supports investments in FYR Macedonia, Albania, and Bosnia and Herzegovina. This project is expected to facilitate more than US\$300 million in financing, including US\$30 million from IFC, to support the construction of 100 small hydropower plants with a total installed capacity of 200 MW and carbon mitigation potential of 1Mt CO₂/year. The project's key objectives include: (i) improving the existing regulatory framework to enable sponsors to develop and construct small hydropower plants; (ii) strengthening their designs and business plans in collaboration with sponsors; and (iii) working with selected financial institutions in the Western Balkans to improve their capacities and knowledge on small hydropower plants and project financing, which may entail IFC providing financing to financial institutions to on-lend to small hydro projects.
- **IFC will look for opportunities to engage with financial institutions in FYR Macedonia which want to provide lending to industrial sector clients for improving energy efficiency or setting up small renewable energy projects (small hydro, wind, biomass etc.).** IFC will channel financing and advisory assistance to support sustainable energy programs, particularly to replicate residential and small and medium enterprise (SME) energy efficiency programs from other countries, and promote financing for sustainable energy projects by local banks. These activities would be complemented with workshops and seminars targeting a wider public to promote energy efficiency and best renewable energy technologies. Energy efficiency products might also be of interest for SMEs as it helps to them to reduce production costs using more energy efficient equipments and to improve their competitiveness.
- **IBRD will also support the energy sector.** Additional financing for the Energy Community of South East Europe (ECSEE) APL 3 is proposed in FY11 to extend an electricity transmission interconnection from Stip in eastern FYR Macedonia to Nis in Serbia. The Government has asked the Bank for support in FY12 for a hydroelectric power facility in Lukovo Pole in the north-west part of the country and may be interested in an energy efficiency project for schools and health facilities in FY13. These projects will help meet and/or reduce energy demand, which is expected to grow by 2.6 percent annually over the next decade. These goals are important as more than half of FYR Macedonian firms surveyed indicated that electricity supply is a problem. The ongoing GEF Sustainable Energy Project will support the Government in setting up a large-scale national program to retrofit public buildings in order to increase energy efficiency of these

buildings. It will provide capacity building support for this national program while at the same time finance energy efficiency measures in schools, kindergartens and hospitals. The ECSEE APL3 is supporting the “green agenda” by reducing power losses and increasing the stability of the power system, mainly by strengthening the transmission network. The planned FY11/12 Energy Efficiency TA will help the Government strengthen the institutional capacity of key agencies overseeing energy use, catalyze the market for energy efficiency services, and address tariff structures and other regulatory barriers to energy efficiency. The Bank would assist FYR Macedonia in meeting its obligations under energy *acquis* and Energy Community Treaty. These activities will be coordinated with the EC-funded technical assistance to the regulatory agency and involve the World Bank Institute managed regional program for building institutional capacity in energy efficiency.

82. ***CPS Outcome – Water and Solid Waste: Strengthen integrated water management capacity in line the EU Water Framework Directive.*** Water management in FYR Macedonia faces many challenges, including aligning the sector with the EU environment *acquis*, which requires a more integrated approach to managing water resources while responding to the demands and interests of, *inter alia*, agriculture, energy, and natural resource protection. The planned FY11/12 Water Sector Capacity Building TA funded by trust funds will help support government reform efforts and focus analysis on priority water-related topics. Studies may address ways to more efficiently manage bulk water supplies; pilot a river basin in geographic area; or develop sector-wide priority investment programs. To achieve programmatic synergies, the Municipal Services Improvement Project is on-lending to municipalities to cover utility expenditures that rehabilitate water infrastructure, while encouraging institutional reforms through its performance grant component. IFC will consider its advisory support to larger municipalities in the country to address their environmental issues by providing support to concessionaires in solid waste management or in the future waste water projects.

83. ***CPS Outcome – Agriculture: Align sector with EU requirements; strengthen sector competitiveness; adapt to climate change.*** Agriculture plays an important role in FYR Macedonia’s economy and accounts for 18 percent of GDP and substantial employment in rural areas, where 21 percent of the population lives in poverty. The FY07 Agriculture Strengthening and Accession Project will continue efforts to strengthen the institutional capacity of the Ministry of Agriculture to distribute EU Rural Development funds, restructure the irrigation system, and develop veterinary capacity for an EU-compliant food safety system. In addition, the project is supporting the development and dissemination among farmers of a Code of Good Agricultural Practices integrating biodiversity and agriculture and promoting sustainable soil and water management. An FY10 agriculture and climate change TA program funded by Regional Trust Fund (TF) resources is raising awareness of the potential implications of climate change. It will also sponsor a agriculture and climate change impact assessment, and develop a country-specific menu of adaptation options in consultation with the Government and farmers.

84. ***CPS Outcome – Policymaking for Green Growth and Climate Action: Inform and support implementation of “win-win” solutions.*** Beyond specific investments, the Bank Group and the Government agree that much more needs to be understood about the possible developmental impacts of climate change and the opportunities for green growth. FYR Macedonia’s other development partners share this view. The Bank, with envisioned financial contributions from Sweden and Norway, will support the Government to develop policy recommendations related to climate change, sustainable development and green growth, focusing on identification of “win-win” investments in high priority areas. Support will be provided through policy notes in energy, water, agriculture, industry and transport that assess the economic costs and benefits of green growth and climate

change policy actions. In addition, the World Bank will support the Government in implementing its policy decisions by seeking to include these recommendations in its own investment programs whenever possible. This analytical work will commence in 2010 and its results will inform future World Bank support.¹⁴

85. The Bank will assist the Government in establishing new catastrophic risk insurance. The World Bank and the Government are working on the preparation of FYR Macedonian participation in the Southeastern Europe and Caucasus Catastrophe Risk Insurance Facility (SEEC CRIF). The overall objective of the SEEC CRIF is to increase access to financial protection for the Government as well as homeowners, farmers and small and medium enterprises (SMEs) from losses due to weather extremes caused by climate change and geo-hazards, such as earthquakes, landslides, droughts, floods, hail, etc. The CRIF is expected to provide particular support to the Government in terms of forecasting climate-related impacts. The World Bank would provide an IBRD loan to finance FYR Macedonia's participation in the Facility.

E. The CPS Financing Program

86. A significant share of IBRD financing over FY11-FY14 will come from ongoing operations approved during the previous CPS. Total remaining disbursements are expected to amount to some US\$205 million during the FY11-14 CPS period.

87. The total volume of new IBRD commitments under the CPS over FY11 and FY12 is expected to amount to about US\$104 million. The Government has asked for a total envelope that would imply lending of similar amounts over FY13 and FY14. Overall lending amounts will depend on the IBRD's lending capacity and demand by other borrowers as well as Government demand and performance in the course of the CPS period. The lending program for the last two years of the CPS will be discussed with the authorities closer to the time of the CPS mid-term Review. The CPS plans to include policy-based lending, beginning with US\$30 million for the second operation of the programmatic DPL in FY11. The DPL operation will focus on public expenditure management and reforms to the social safety net. Later DPLs would focus either on growth and competitiveness and/or a green growth agenda resulting from the analytical work set to begin in FY11.

88. The amount of budget support during the CPS could be affected by FYR Macedonia's growth and economic performance, particularly given a highly uncertain regional environment. For example, if the country is hit hard by negative economic events in the eurozone, it may be interested in greater DPL support contingent on a sound macroeconomic framework. Should there be a need for any significant changes to the currently proposed DPL lending as a result of these or other factors, alternative scenarios would be discussed with Bank Management and presented to the Board in the CPSPR.

89. IFC expects to invest up to US\$100 million in the private sector in FYR Macedonia over the next four years. It also plans to leverage its advisory services to secure private financing for

¹⁴ Sweden and Norway expressed interest in supporting the World Bank in implementing this CPS with approximately US\$2 million to create a multi-donor trust fund to co-finance "green growth and climate change assessment and advisory services" with the World Bank. The work related to "green growth and climate change assessment and advisory services" is designed to attract the support of other international partners.

new hydro-power generation, wind farms, road operation and maintenance, water supply, health and solid waste management.

Table 6: Proposed Indicative IBRD Lending Program by Fiscal Year

	FY11	US\$ million
2 nd Programmatic Development Policy Loan		30
Additional Financing (ECSEE APL3)		19
Disaster Management CRIF		5
	<i>FY11 Total</i>	54
	FY 12	
Hydro Power Project		50
	<i>FY12 Total</i>	50
Possible lending		
	FY13 and 14*	TBD
Growth DPL		
Energy Efficiency		
Education		
Health		
Science, Technology, Innovation		
Additional financing for municipal investments		
	<i>TOTAL</i>	TBD

** Operations listed above represent a menu of possible areas of future financial support. Actual lending operations for FY13-14 will be discussed in annual reviews of Government priorities taking into account the need for greater selectivity and consolidation of the portfolio and will be reflected in the CPS Progress Report.*

F. The CPS Knowledge Program

90. **The 2010 Client Survey and the CPS consultation process revealed strong support for continued analytical engagement with the Bank Group.** Indeed, a higher percent of respondents indicated that the Bank’s knowledge was the “greatest value” to FYR Macedonia than those who answered “financial resources”; and when including “policy and economic advice” as a separate category the percentage over the financial resources category was more than double. As for which areas respondents believed the Bank’s knowledge services were most relevant, respondents answered “Labor Markets and Job Creation” (26%), followed by Agriculture (18%) and Education (16%). The Bank Group envisages an active program of analytical engagement with FYR Macedonia, including in the top priority areas identified in the client survey. Selected areas of engagement include the following: In FY11 the Bank will provide Technical Assistance (TA) in energy efficiency and higher education and will complete a comprehensive water sector assessment. Further, in the second year of the CPS, FY12, the Bank intends to deliver a major analytical study which will look at green growth and climate change, with envisioned trust fund support from Sweden and Norway, a national procurement study, a labor market reform TA, as well as non-lending TA to support the Government’s innovation and science and technology agenda. Plans for FY13 include non-lending TA dialogue in the health sector.

91. **The Bank and IFC’s knowledge programs are also helping to advance FYR Macedonia’s regional integration in the Western Balkans.** IFC will continue implementation of its mainly regional program of advisory services. These are aimed at helping FYR Macedonia meet *acquis* requirements to accelerate EU accession and strengthen the business environment and capacity of the local private sector to compete in a more integrated European market; the program also supports integration within the sub-region of the Western Balkans through the formal sharing of reform experiences and best practices. The Bank will also carry out more regional sector work, including two the ongoing programmatic series – Western Balkans Poverty Assessment, and Western Balkans Financial Sector TA. In addition, the Bank will carry out a Western Balkans Regional Study on Innovation and continue the Regional REPARIS program (Regional Road to Europe Program of Accounting and Reform and Institutional Strengthening) to strengthen corporate financial reporting.

V. RISKS

92. **Implementation of the CPS is subject to the following risks:**

- **FYR Macedonia’s growth outlook is subject to uncertainties on the timing, speed and shape of the recovery from the global crisis.** ECA has been the hardest hit of all regions, and its recovery is expected to be the most protracted. Lower than expected growth could also impact debt sustainability and may require further policy adjustment. This is particularly true given the ongoing instability in Greece and in the eurozone more broadly. The Bank will help analyze the risks through continued monitoring and dialogue with the authorities on the overall macroeconomic context, as well as through analysis of options for remedial measures and program adaptation, contingent on need and government request.
- **Failure to resolve negotiations with Greece on the “name issue” could continue to slow EU accession and dampen public support for reforms.** The Bank will continue to monitor developments closely, including any impact a delay in EU accession might have on political and macroeconomic stability as well as on the Bank’s program.
- **Continued high unemployment may directly affect the social balance in the country, provoke social tensions and undermine Government support to the reform program.** The CPS is focused on employment generation, and supports interventions in social protection and skills development with the aim of translating economic growth and the recent increases in labor participation into more and better jobs for all FYR Macedonians.
- **FYR Macedonia is vulnerable to natural disasters, including, increasingly, severe climate pressures.** The country has suffered devastating earthquakes in the past and seismic activity remains common. Severe droughts are projected and aridity could affect agriculture. The Bank is engaged in analytical work in both the water and energy sectors and will be supporting the country through the regional Catastrophic Risk Insurance Facility.