



Project Information Document (PID)

Concept Stage | Date Prepared/Updated: 20-Feb-2019 | Report No: PIDC26457

**BASIC INFORMATION****A. Basic Project Data**

Country North Macedonia	Project ID P168014	Parent Project ID (if any)	Project Name Agriculture Modernization Project (P168014)
Region EUROPE AND CENTRAL ASIA	Estimated Appraisal Date Nov 06, 2019	Estimated Board Date Feb 12, 2020	Practice Area (Lead) Agriculture
Financing Instrument Investment Project Financing	Borrower(s) Republic of North Macedonia	Implementing Agency Ministry of Agriculture, Forestry and Water Economy	

Proposed Development Objective(s)

Improve competitiveness and strengthen public institutions in the agriculture sector.

PROJECT FINANCING DATA (US\$, Millions)**SUMMARY**

Total Project Cost	40.00
Total Financing	40.00
of which IBRD/IDA	35.50
Financing Gap	0.00

DETAILS**World Bank Group Financing**

International Bank for Reconstruction and Development (IBRD)	35.50
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Non-World Bank Group Financing

Other Sources	4.50
EC: European Commission	4.50

Environmental and Social Risk Classification

Concept Review Decision



Moderate

Track II-The review did authorize the preparation to continue

Other Decision (as needed)

B. Introduction and Context

Country Context

- 1. The Republic of North Macedonia is a landlocked country in the heart of the Balkans characterized by its mountainous terrain, intersected by valleys and lowlands.** It is a transit region that sits on two of the ten Pan-European transport corridors identified to promote economic integration in Europe. Its proximity to the European Union (EU) provides the country with access to a large export market with 650 million customers. According to the last census (2002), the country has about two million people of which 25 percent live in the capital Skopje, 40 percent reside in rural areas, and the remaining share of population lives in smaller urban centers. The estimated annual population growth is close to zero. North Macedonia has one of the largest diasporas in the world (as share of total population) with more than 500,000 citizens estimated to reside abroad – mostly in Western European countries and North America.
- 2. North Macedonia stands at a turning point in its history as an independent nation.** On June 12, 2018, the Governments of North Macedonia and Greece signed the *Prespa Agreement* aimed at resolving the decade-long country name dispute, and in January 2019 both the Parliaments of North Macedonia and Greece endorsed the necessary constitutional changes that allowed the country to be renamed from the Former Yugoslav Republic of Macedonia to *Republic of North Macedonia*. Resolution of the name issue, which has been inflicting political and economic damage since 1991, is essential to consolidate North Macedonia's EU accession process and will enable the country to become more deeply integrated with regionally and globally. In April 2018, the European Commission (EC) recommended that the European Council approves the opening of negotiations with North Macedonia.
- 3. North Macedonia has had a good track record of conducting macroeconomic policies and business environment reforms.** The country managed to decrease public debt from 45.7 percent of GDP in 2002 to 23 percent in 2008. Prudent macroeconomic policies prior to the global financial crisis enabled the country to create the fiscal space for a countercyclical fiscal policy. This centered around stimuli for public employment, pensions, and public works that helped to largely mitigate the crisis impact in 2008–09 and again in 2011–12. To spur investment, the Government spent more on road and civil infrastructure and abolished the profit tax on reinvested earnings for 2009 to 2014. It lengthened the list of goods given preferential tax rates; exempted tax for foreign direct investment (FDI) in technological industrial development zones; and supported consumption by ad hoc pension hikes, a reduction of social insurance contribution rates, and employment subsidy schemes. Monetary policy was also accommodative. The National Bank reduced interest rates to encourage credit growth and avoid deposit withdrawals. These measures helped the economy to grow at an average of 2.7 percent from 2012 to 2017, despite the political uncertainty during 2015 to 2017 that adversely affected investors' expectations and led to a temporary recession during 2017.



4. **Growth and fiscal measures helped increase employment and reduce poverty after 2009.** The employment rate increased by 9 percentage points to above 44 percent in 2017. Job creation was supported mainly by public spending for large-scale public projects, new active labor market policies and government support for employment in Special Economic Zones, while new public jobs in public administration, health, education, and water supply constituted more than 20 percent of net employment growth in the period 2009 to 2013. Growth has also been pro-poor. Between 2009 and 2015, poverty fell by about 12 percentage points from 35 to 23 percent.¹ It is estimated that during these six years, 240,000 people were lifted out of poverty. However, unemployment is still high at 22 percent, and labor-force participation is low, especially for those younger than 25 and older than 55, and for women. In addition, poverty remains high in rural areas, and the reduction in poverty since 2009 was not sufficient to close rural-urban gaps in living conditions. While the urban poverty headcount is 17 percent the rural poverty headcount remains at nearly 30 percent.

5. **North Macedonia is highly vulnerable to natural hazards, including floods, droughts, forest fires, landslides, earthquakes and extreme temperatures that are amplified by climate change.** The flood risk is higher than in any other country in the Europe and Central Asia region. A major flood disaster could derail economic growth, affect critical infrastructure, cause losses in agricultural incomes, and disrupt rural livelihoods. Agriculture is the most vulnerable sector to climate change. As climate change causes more frequent floods and droughts, the crop yields could drop by 20 percent (North Macedonia - Systematic Country Diagnostic, World Bank 2018). As temperatures rise and precipitation becomes more variable, droughts will particularly affect southern and eastern part of the country and jeopardize agricultural production and water quality in these regions.

Sectoral and Institutional Context

6. **Agriculture plays a critical role in the country's economy as an important full and part-time employer in rural areas.** Primary agriculture contributes 11 percent to GDP. Full-time formal agricultural employment accounts for 17.9 percent of total employment. There is also a large number of part-time farmers and a significant number of informally employed in the sector. In addition, the agri-business sector is an important industry. Employment in agri-business accounts for 19 percent of total manufacturing jobs and its turnover accounted for 22.8 percent of total manufacturing turnover (World Bank, 2017). Noteworthy is that agri-business industry turnover is geographically evenly distributed across the country, which underlines the unique role that agriculture can play in promoting broad-based growth and jobs in rural areas. Food products represent about 10 percent of total exports and there has been an improvement in the primary agriculture balance of trade since 2014. North Macedonia exports vegetables and fruit, tobacco, and beverages (mostly wine). With regard to livestock production, sheep is the only segment with significant export potential. The country's main markets for primary agricultural exports are the Western Balkans, the EU, and Russia.

7. **Given the importance of the sector for the country's economy, the Government identified agriculture as one of its economic priorities.** To this end, the National Strategy for Agriculture and Rural Development for the period 2014-2020 serves as a major long-term strategic document that sets-up objectives, policies and measures to develop agriculture and rural areas in the country. The Strategy's key policy goal is "increasing the competitiveness of agriculture and food industry, rural development and sustainable management of natural resources", with four

¹ Poverty is measured as absolute poverty using the poverty line for upper-middle income countries (UMIC), estimated at \$5.5/day in 2011 purchasing power parity (PPP)— the cost in UMIC countries of satisfying a minimum caloric requirement and typical non-food consumption.



specified priority areas: the improvement of technological and market infrastructure; strengthening integration in the agri-food sector; providing access to production factors; and improving rural infrastructure.

8. Agriculture suffers from several structural imbalances, which prevent it from reaching its true productive potential. Primary agricultural production remains caught in a low-productivity – low-income trap. While more than 40 percent of the agricultural land holders are under 45 years of age (2013) and the agricultural labor force is relatively young, structural constraints impede these farmers from realizing their potential on and off the farm and from effectively participating in the higher-value agriculture value chains. With an average farm size of less than two hectares and about half agricultural producers being semi-subsistent, the potential to selling surplus production to markets, produce at scale and higher quality, promote integration among small-scale producers, and introduce innovation are very limited. In addition, smaller agricultural producers and agri-businesses lack the access to new technologies and market opportunities, as well as quality agricultural knowledge and skills in various areas, including business management, quality management, logistics, financial literacy, and domestic and international marketing.

9. Agricultural land holdings are small, on average less than two hectares, and made up of multiple parcels. This land structure affects farm productivity, efficiency of resource uses, and competitiveness. The National Strategy 2014-2020 recognizes agricultural land consolidation as an important instrument to address fragmentation and to improve productivity. Pilot projects funded by the EU and implemented by the Food and Agriculture Organization of the United Nations (FAO) in cooperation with the Ministry of Agriculture, Forestry and Water Economy (MAFWE) have recently initiated the land consolidation process in two areas with the objective to enlarge farm size, optimize farm holdings in order to increase efficiency of agricultural production and establish necessary infrastructure, including roads and irrigation structures.

10. Agriculture competitiveness is constrained by the lack of access to inputs and of sufficiently large and reliable volumes of agricultural quality products. Small producers, which dominate the sector, participate mainly in short value chains that typically end at local green or wholesale markets. As contract farming is not yet widely developed, transactions remain largely ad hoc and contract breaches and delayed payments are frequent issues. Poor post-harvest management and practices, including poor sorting and grading and suitably packaging for transport, undermine product freshness and quality. In addition, North Macedonia has limited and technically outdated cold storage capacities, which are often not adequately located to serve producers and buyers efficiently. The sector requires the establishment of buy-out and distribution centers with adequate logistical arrangements as well as infrastructure, technology, and know-how to provide a full range of grading, sorting, and packing services that meet buyers' quality and delivery requirements. In addition, technology and capacity to meet food quality and sanitary- and phytosanitary standards to access the EU and other high-end markets need to be built gradually.

11. The Government's agricultural support measures fail to effectively address these sector constraints. Public support for agriculture in North Macedonia has been highly generous in recent years. Between 2010 and 2015, annual budgetary transfers to farmers represented 1.14 percent of GDP and on average were double that of other Western Balkan countries and almost 60 percent higher than the EU28 average. Market support and direct payments (MSDP) per output and area/ animal represent 80 percent of agriculture budget outlays on average. The high share of MSDP has raised questions on the effectiveness of this type of support and its capacity to facilitate the necessary structural adjustments, e.g. land and farm consolidation, productivity enhancement, and modernization through technology investments. The support payments are also skewed towards only a small number and often lower-value products: Tobacco received 27.7 percent of total MSDP support (EUR100 million in total or EUR4,350 per tobacco farmer household) although it contributes only 5.1 percent to total agricultural output. Field crops received 14.9 percent of MSDP support, followed by vineyards, grapes, and wine (12.2 percent); cattle (9.3 percent); milk (8.4 percent); fruits



and vegetables (5.2 percent) and sheep and goats (4.5 percent). These support payments entail few incentives for farmers to modernize their practices, and at the same have not been effective in alleviating poverty nor proven to be an effective rural safety net. A rebalancing of public support from the current MDSP toward broader rural development measures in line with EU best practices in farmer support could bring greater efficiency gains at the farm-level and allow for a better use of public resources towards improving sector competitiveness.

12. The institutional landscape for agriculture and rural development is complex. The MAFWE is responsible for policy design, management and coordination. The implementation of agricultural and rural development programs, including national projects and the Instrument for Pre-accession Assistance for Rural Development (IPARD) lies with the Agency for Financial Support in Agriculture and Rural Development (AFSARD), which is also the Paying Agency. Advisory services are provided by the National Extension Agency, which operates through 33 local units. The Food Safety and Veterinary Agency is responsible for food safety and veterinary activities, while the Phytosanitary Directorate of the MAFWE is responsible for phytosanitary control and prevention. Since 2014, the Inspection Services for Agriculture have become a distinct institution. Local governments do not have an explicit agricultural mandate, but most of them employ agricultural and environmental service staff, which mainly provide advice to local farmers.

13. While crop production dominates the agricultural production with an average share of 75 percent in total value, the remaining 25 percent comes from the livestock production, and enhancing food safety is of particular concern for livestock farming. Although the country's food safety standards have improved, its food safety and veterinary policies, as well as required infrastructure are not yet aligned to the standards of the EU Acquis Communautaire. In the past few years the systems have received considerable support from the EU Instrument of Pre-accession Assistance (IPA) for harmonizing the national legislation with the EU Acquis Communautaire—rights and obligations binding on all EU member states. Aligning food safety standards with EU requirements is essential to successful growth of the food-processing industry and free movement of agricultural produce in the market. As the North Macedonia moves towards EU accession, the MAFWE's key objectives to address these food safety challenges include: (i) upgrading its food safety establishments for products of animal origin, including establishments for animal by-products; and (ii) setting up of an EU compliant system for official control of live animals and animal products. To this end, the EU is in the process of programming its IPA 2019 with the MAFWE, in which an indicative budget of EUR4 million, out of total EUR9 million required, has been allocated towards establishment of a compliant and dedicated system for disposal and /or processing of animal by products (ABPs) in line with EU requirements.

14. Overall institutional capacity in the sector is weak and requires improvement. Public agricultural services do not sufficiently meet the needs of farmers and agribusinesses to address and comply with the veterinary, phytosanitary, food safety requirements required to access the large regional markets. In addition, MAFWE Sector for Rural Development, responsible for planning, programming, managing, and carrying out the monitoring and evaluation of the rural development program, including the national agriculture support program, has no monitoring and evaluation (M&E) system in place to assess the effectiveness of its agricultural support policies and programs and provide evidence-based decision support to Government for policy reform and adjustment. Furthermore, AFSARD capacity is weak and requires further investment to ensure the implementation of an increasing volume of the national and IPARD measures.

15. The proposed project aims to address the structural constraints, help realize the potential of the North Macedonia's agriculture to improve competitiveness, and strengthen public institutions in the agriculture sector. Improved competitiveness in the context of the proposed project relates to farmers' ability to produce agricultural products that meet demand requirements in terms of quality and sell to the market through formalized commercial transactions. The project aims to foster competitiveness in a two-pronged approach: first, through the provision of



demand-driven high-quality advisory services that promote improved agricultural technologies and marketing, expected to enhance overall production capacities, reduce production inefficiencies, and in some cases lead to the conversion to higher quality and/or high-value crops, among others; second, through the establishment of purchasing and distribution centers that facilitate product aggregation, quality sorting and grading, cooling, packaging and logistics to meet different market and buyer requirements. The centers are to foster farmers' market integration by informing them of quality requirements of different destination markets, and by supporting the formation of formalized commercial transactions between producers and buyers. This is expected to lower existing transaction costs, such as contract breaches and delayed payments, and to broaden producers' access to local and/or regional value chains. This is complemented by institutional strengthening measures to promote evidence-based policy decision-making for enhanced sector support services, such as an assessment of the country's current direct payments scheme and rural development measures, and the establishment of a monitoring and evaluation system within MAFWE. Further, the project will stimulate economic opportunities following the improvements in food safety, including adequate management of ABPs, as it will improve competitiveness of local producers to access new markets.

Relationship to CPF

16. The proposed project is aligned with the World Bank Country Partnership Framework (CPF) for North Macedonia for the period January 2019 – June 2023. Specifically, it responds to the CPF objective to improve connectivity and access to markets. The CPF stipulates support investment in agricultural modernization and expansion access to markets. Through advisory services and establishment of purchasing and distribution centers, the project aims to increase capacity to adopt technology and innovate and increase sector competitiveness through uptake of improved production practices by agricultural producers and increased access to domestic and international markets. The project is also in line with IBRD engagement goals, one of which is to contribute to a more productive rural economy with the potential to increase incomes for underserved groups that face greater barriers to achieving sustainable livelihoods, such as women, young people, and minority groups.

C. Proposed Development Objective(s)

Improve competitiveness and strengthen public institutions in the agriculture sector.

Key Results (From PCN)

- (i) Number of project beneficiaries who have adopted an improved agriculture technology promoted by the project;
- (ii) Farmers engaged in new/formalized commercial transactions;
- (iii) The Ministry of Agriculture, Forestry and Water Economy has adopted evidence-based strategic planning tools promoted by the project.

D. Concept Description



The project will include the following three components and sub-components:

Component 1: Promoting agriculture sector competitiveness. This component aims at enhancing farm-level competitiveness and fostering agricultural produce aggregation and market integration. It includes the following two sub-components:

- **Sub-component 1.1 - Advisory One-stop Shop.** This sub-component will establish an advisory one-stop shop that will connect producers and agro-processors to a wide range of know-how and targeted quality advisory services.
- **Sub-component 1.2 – Agriculture Purchasing and Distribution Centers.** This sub-component will construct and operate Agriculture Purchasing and Distribution Centers under a Public-Private Partnership (PPP) model². These centers would serve both to address market fragmentation and as platform for technology demonstration, including for climate smart agriculture to address climate change, and service provision.

Component 2: Strengthening Institutional Capacity for Public Service Support. This component aims at enhancing public support services, including the capacity to design and deliver effective support to the agriculture sector. It includes following two sub-components:

- **Sub-component 2.1 - Support to MAFWE Sector for Rural Development.** This sub-component will strengthen the capacity of the Sector for Rural Development to re-design of the current direct payments scheme, and for the development and integration of rural development measures harmonized with EU standards into the support program aimed at increasing the effectiveness and impact of public support in the sector.
- **Sub-component 2.2 - Support to the Paying Agency (AFSARD).** The sub-component will provide investment support to the Paying Agency to expand office space to accommodate the additional staff, IT infrastructure and equipment.
- **Sub-component 2.3 Support to the Food Safety Agency.** During project preparation, the Bank task team will explore options to support the Agency with the establishment of a comprehensive system for the processing and/or disposal for Animal By-products (ABPs).

Component 3: Project Management. This component will support the establishment of a Project Management Team (PMT) to provide overall project coordination and implementation support, including implementation planning, technical supervision, fiduciary (financial management, procurement), environmental and social safeguards implementation and monitoring and evaluation for all project activities.

² Detailed governance and operating principles for the PPP will be explored during project preparation



Legal Operational Policies	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Screening of Environmental and Social Risks and Impacts

The environmental risks to be considered during the project preparation are mainly those related to the construction and further operation of collection centers, which may include generation of wastes, noise, dust, disturbance to local communities and landscapes. The specific impacts can not be pre-determined as will be identified as part of the development of ESMPs for each specific site where civil works will be implemented. Project social risk mostly concern ensuring vulnerable and small farmers benefit from the project, most notably Component 1.

Note To view the Environmental and Social Risks and Impacts, please refer to the Concept Stage ESRS Document.

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