

**PROJECT INFORMATION DOCUMENT (PID)  
APPRAISAL STAGE**

Report No.: PIDA34777

<b>Project Name</b>	Second Municipal Services Improvement Project (P154464)
<b>Region</b>	EUROPE AND CENTRAL ASIA
<b>Country</b>	Macedonia, former Yugoslav Republic of
<b>Sector(s)</b>	Water supply (30%), Wastewater Collection and Transportation (15%), Solid waste management (15%), Energy efficiency in Heat and Power (20%), Sub-national government administration (20%)
<b>Theme(s)</b>	City-wide Infrastructure and Service Delivery (60%), Municipal finance (25%), Municipal governance and institution building (15%)
<b>Lending Instrument</b>	Investment Project Financing
<b>Project ID</b>	P154464
<b>Borrower(s)</b>	Ministry of Finance
<b>Implementing Agency</b>	Project Management Unit
<b>Environmental Category</b>	B-Partial Assessment
<b>Date PID Prepared/Updated</b>	05-Oct-2015
<b>Date PID Approved/Disclosed</b>	07-Oct-2015
<b>Estimated Date of Appraisal Completion</b>	09-Nov-2015
<b>Estimated Date of Board Approval</b>	22-Dec-2015
<b>Appraisal Review Decision (from Decision Note)</b>	

**I. Project Context**

**Country Context**

Former Yugoslav Republic of Macedonia (FYR Macedonia) is a small, land-locked country in South-East Europe with a strong track-record of macro-economic stability. FYR Macedonia has made impressive progress in steadily recovering from the economic, political and social fallout from the 2001 ethnic conflict and obtained European Union (EU) candidate status in 2005.

Economic growth has been above the regional average since 2009. The country also has been able to preserve macroeconomic stability in the presence of economic crisis. Between 2002 and 2009, FYR Macedonia grew at 3.9 percent annually, although since 2009 the average GDP growth rate decreased to 2.1 per year. In 2014, the economy grew by 3.5 percent and the country reached the highest growth among the six South East Europe countries. Macedonian currency is pegged to the Euro, since 1995, and has successfully supported price stability and has maintained inflation rate to 2.4 percent over the last decade. Macroeconomic policies have been geared towards keeping the external balance manageable, and monetary policy has responded quickly to any possible threats to

the exchange rate.

Economic growth in FYR Macedonia, however, has not yet translated into significant poverty reduction or improved welfare of the poorest 40 percent of the population. While average consumption growth (used as a proxy for measuring shared prosperity) increased by 1.1 percent between 2003 and 2008, consumption growth of the bottom 40 percent decreased by 1.5 percent annually in the same period. Although not comparable to the consumption-based data prior to 2008, most recent income-based data for 2010 and 2011 shows a similar pattern: a slight decline in overall income, more pronounced for the bottom 40 percent. Although since the outbreak of the crisis FYR Macedonia managed to decrease unemployment from 32.4 percent in 2009 to 28.6 percent in 2013, unemployment remains high at around 28 percent of the labor force in 2014 that is significantly above the EU average of 23.6 percent, and productivity and wages are low. High unemployment is a critical feature of the story, with poor labor market outcomes disproportionately affecting the bottom 40 percent, many of whom also have less education and lower quality housing. In addition, gender inequality remains, and female labor force participation (for women aged 15-64) is still low at 51 percent, well below regional average of 62 percent. Sustaining the recent employment creation momentum and translating economic growth into jobs and income will help reduce poverty and improve the standard of living of all Macedonians. Therefore, helping the authorities to tackle these important challenges is a crucial reason for continued World Bank Group (WBG) engagement.

According to the last official census of 2002, FYR Macedonia is an ethnically diverse country, with 64.2 percent of the population made up of ethnic Macedonians, 25.2 percent ethnic Albanians, 3.9 percent ethnic Turks, 2.7 percent Roma, 0.5 percent Vlachs, 1.8 percent Serbs, 0.8 percent Bosnians, and 1.0 percent others, with Roma recognized as a particularly vulnerable group in the country (the most recent official census data of Roma living in FYR Macedonia are from the 2002 Population Census which registered 53,879 Roma citizens - approximately 2.7 percent of the total population). According to a 2011 World Bank/EU/United Nations Development Program (UNDP) survey, the absolute poverty rate for Roma (PPP US\$4.30 income based) was 41 percent, as compared to 14 percent for the non-Roma population. While unemployment rates are high in FYR Macedonia as a whole despite recent progress with its reduction, 53 percent of Roma adults (ages 15-64) are unemployed, as compared to 28 percent of the whole population. Roma are also among the group of workers that are likely to receive less than the minimum wage from their employers. Differences exist also in health and housing conditions, educational level, and Roma women lag behind men on most counts.

### **Sectoral and institutional Context**

Improving the living standards of the population requires more effective and efficient public service delivery. Given the unfolding decentralization process that was launched in 2005 and brought delivery of many of the basic public services to the municipal level, better performing municipalities are crucial to delivering this ambitious agenda. The number of municipalities was consolidated from 123 to 85 in 2005 and then further reduced to 81 in 2013 due to the changes in the Law on Territorial Organization. The changes led to creation of larger municipalities with more rural areas included in their jurisdiction. In 2007, the municipalities that have cleared their arrears entered into the second phase of decentralization process - i.e. fiscal decentralization to undertake new responsibilities such as managing primary and secondary education, some social services, cultural institutions and firefighting. Parallel to this, municipalities started to receive block grants to implement these new functions and then progressively assumed responsibilities for maintenance

and improvement of municipal infrastructure such as water supply and wastewater treatment systems, solid waste management, local roads, street lighting, pre-school, primary and secondary school, local cultural institutions. Since 2011 municipalities also acquired responsibilities for management of state land. To date, municipalities provide key public services and infrastructure for their citizens and local businesses. Local authorities also influence, shape, and maintain stable inter-ethnic relations at the level closest to citizens.

Municipal governments control over 7 percent of public spending at the moment. During the decentralization process, regulations for local borrowing were established, and municipalities may now borrow for capital investments. From 2009 to 2013, a share of own source of municipal revenues increased from 26 percent to 35 percent. Property tax collection increased almost five times, though its share of overall revenues is yet modest. The biggest increase of own source of revenues come from Land Development Fees, Lighting fees and other charges for the use of public space. The long delayed process of transferring state owned urban land to local governments has also begun to yield income from asset sales.

While the municipal revenue overall has increased rapidly, this has not translated into higher level of capital investments at local level. Average municipal capital investments for 2008-2012 as a share of GDP for FYR Macedonia was 1.4 percent, which was lower than EU 27 and new EU member states. It is also lower than most other countries in the region, except Albania and Bosnia and Herzegovina. Furthermore, communal services have suffered from delayed maintenance, rigid price control, and poor financial management. This leads to a vicious cycle of deteriorating assets and lack of funding for new investments.

Most local public services such as water supply and sanitation, solid waste management and urban transit are provided by Communal Services Enterprises (CSEs) owned by municipalities. Although CSEs are legally independent from their municipal owners, most of them in practice do not work as independent, commercially-oriented utilities. CSEs usually operate based on informal arrangements with municipalities, for example, using infrastructure owned by municipalities or the state to provide services, and proposing tariffs approved by the municipalities. In addition to the municipality being the owner, policy-maker, and regulator, it is also a major user of CSE services through its own institutions, which lowers the CSEs accountability to the average customer. In order to reduce the burden on municipal budgets and free up resources to increase investments, operational and financial management performance of CSEs needs to be improved. Reforms in the water sector are currently being advanced, partly supported by the Danube Water Program, and include regulatory benchmarking of CSE performance and a review of the level and tariff setting policies for water and wastewater.

In its program for 2011-2015, the Government underscored the importance of investments in urban infrastructure and municipal services to support economic growth and employment. The Government program puts increasing emphasis on balanced economic growth across municipalities and regions to help create equal opportunities and facilitate economic integration by improving their infrastructure. The crisis in the Euro zone puts additional exigency to the Government goal of improving infrastructure as the basis for accelerated economic growth and development. On-going Bank-financed Municipal Services Improvement Project (MSIP, P096481) is one of the Government's instruments to provide access to investment funds to municipalities that cannot yet afford to borrow from other sources, and the proposed Second Municipal Services Improvement

Project (MSIP2) will actually present the second phase of MSIP with an aim to respond to the continuing strong demand by the municipalities for the local infrastructure financing.

## II. Proposed Development Objectives

The proposed Development Objective of MSIP2 Project (PDO) is to improve transparency, financial sustainability and inclusive delivery of targeted municipal services in the participating municipalities.

## III. Project Description

### Component Name

Municipal Investment Sub-loans

### Comments (optional)

This component will provide sub-loans to municipalities for investments in (i) revenue-generating public services, and (ii) other projects of high priority for the municipalities and with cost-saving potential. The types of infrastructure to be financed under this component will include water supply and sanitation, solid waste management, roads, street lighting, storm water drainage, and energy efficiency improvements for municipal buildings, among others.

### Component Name

Poverty/Social Inclusion Investment Grants

### Comments (optional)

This component will provide investment grants to municipalities as an incentive for them to invest in infrastructure improvements in poorer and marginalized communities within their jurisdictions.

### Component Name

Project Management, Monitoring and Evaluation, and Capacity Building

### Comments (optional)

This component will support operational costs of the PMU and assists with project implementation and monitoring, as well as finance consultancy services and technical assistance for (i) sub-project preparation/implementation and local capacity building for municipalities and CSEs, and (ii) national level institutional strengthening.

## IV. Financing (*in USD Million*)

Total Project Cost:	28.97	Total Bank Financing:	28.97
Financing Gap:	0.00		
<b>For Loans/Credits/Others</b>			<b>Amount</b>
Borrower			0.00
International Bank for Reconstruction and Development			28.97
Total			28.97

## V. Implementation

The implementation arrangements of MSIP2 will follow the implementation mechanisms of the existing MSIP operation to capitalize on the already established and well-functioning PMU at the MOF. In particular, the PMU will be responsible for project implementation, according to the requirements of the Borrower and the World Bank, and have full responsibility for project financial management, and monitoring and evaluation. The PMU will promote the project among municipalities, and will receive and evaluate proposals for sub-projects according to criteria agreed

with the Bank and recorded in the Project Operational Manual (POM). The POM will specify project procedures for participating municipalities and the PMU, and refer to Bank project documents, including procurement guidelines and Loan Agreement, as part of the POM.

While the existing PMU has a proven track-record of preparation and implementation of MSIP, adding a new project will significantly increase PMU's workload, since PMU is expected to play an important role in reviewing and assisting in improving technical designs prepared by the project participating municipalities and will also need to provide extensive implementation support for the municipalities during tender processes and sub-projects implementation. To this end, PMU capacity was carefully assessed to ensure that it has sufficient man-power for execution its functions under MSIP2 with respective staffing plan developed and agreed with the Bank and the MOF.

The Bank will provide close supervision and implementation support to the project to monitor and evaluate its results and achieving PDO, and recommend timely actions, whenever needed, to ensure successful completion of the project supported activities, including project restructuring. The Bank will carry out regular implementation support missions and an in-depth mid-term review.

## VI. Safeguard Policies (including public consultation)

<b>Safeguard Policies Triggered by the Project</b>	<b>Yes</b>	<b>No</b>
Environmental Assessment OP/BP 4.01	<b>x</b>	
Natural Habitats OP/BP 4.04		<b>x</b>
Forests OP/BP 4.36		<b>x</b>
Pest Management OP 4.09		<b>x</b>
Physical Cultural Resources OP/BP 4.11		<b>x</b>
Indigenous Peoples OP/BP 4.10		<b>x</b>
Involuntary Resettlement OP/BP 4.12	<b>x</b>	
Safety of Dams OP/BP 4.37		<b>x</b>
Projects on International Waterways OP/BP 7.50	<b>x</b>	
Projects in Disputed Areas OP/BP 7.60		<b>x</b>

**Comments (optional)**

## VII. Contact point

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