Program Information Document (PID)

Concept Stage | Date Prepared/Updated: September 20, 2018| Report No: 130418

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
FYR Macedonia	P149794	FYR Macedonia Fiscal Efficiency and Competitiveness DPF	
Region	Estimated Board Date	Practice Area (Lead)(s)	Financing Instrument
Europe and Central Asia	April 2019	Macroeconomics, Trade and Investments	Policy-Based Guarantee
Borrower(s)	Implementing Agency		
FYR Macedonia	Ministry of Finance		

Proposed Development Objective(s)

The DPF supports policy reforms that aim to improve (i) public finance efficiency and (ii) private sector competition.

Financing (in US$, Millions)

SUMMARY

Total Financing	200

DETAILS

Source:	
IBRD Guaranteed	70
Private non-guaranteed	130

Decision

Following corporate review, decision was taken to proceed with the preparation of the operation.

B. Introduction and Context

Country Context

A decade after the global financial crisis, FYR Macedonia faces fiscal vulnerabilities in the context of low growth and uncertain political and external environment. The political turmoil of 2015-2017 adversely affected investors' expectations, leading to a slowdown in FDI and under-execution of the public investment program that brought growth down to zero in 2017. High unemployment and inactivity, and a lack of private sector dynamics due to barriers to entry and competition in product markets and in critical backbone service sectors such as energy and education, hamper the potential growth. While the fiscal stimulus measures of 2009-16 helped keep growth and jobs in FYR Macedonia, their fiscal cost poses threat to sustainability. The public and publicly guaranteed debt-to-GDP ratio doubled since 2008 to 47.6 percent in 2017, while fiscal deficit averaged 2.2 percent of GDP or 3.6 percent of GDP once the off-budget road agency finances are included. Further fiscal risks stem from pressures on pensions from aging population, re-accumulation of public arrears and the high level of state-owned enterprise (SOE) indebtedness. The efficiency of public spending in areas like education, health, infrastructure, and agricultural subsidies suggests that the same output levels could be achieved with 13 percent less public spending. There is also scope for raising revenues by improving tax collection, which is characterized by broad tax exemptions, compliance challenges, and informality.

After a period of political stalemate, a new government in office since July 2017 embarked on an ambitious reform program to safeguard macroeconomic stability, improve the wellbeing of its citizens, strengthen the competitiveness, and pursue FYR Macedonia's European and international integration aspirations. The proposed operation supports reforms to improve efficiency of public finances in the areas of tax policy, public spending and public finance management that would contribute to the medium-term fiscal sustainability. In addition, it supports reforms aiming to boost competitiveness through energy, procurement and inspection reforms. Reducing the deficit and stabilizing debt over the medium-term will reassure financial markets ahead of the 2020-2023 refinancing surge at 15 percent of GDP a year. Ensuring fiscal sustainability and promoting market competition can go a long way in reducing poverty and advancing shared prosperity in FYR Macedonia, as described in the 2018 Systematic Country Diagnostic.

Relationship to CPF

The proposed operation is fully consistent with the FY15–FY18 Country Partnership Framework. It helps the authorities strengthen its fiscal and public finance management, as envisaged in the Outcome Area 1, and improve conditions for private investments and more clean energy production as envisaged in Outcome Areas 2 and 4, under Pillar I. Ensuring fiscal sustainability and promoting market competition can go a long way in reducing poverty and advancing shared prosperity in FYR Macedonia. The IMF provides a set of technical assistance and surveillance under the Article IV. The EC and the Bank coordinate technical assistance on PFM, and procurement.

C. Proposed Development Objective(s)

The objective of the program is to support policy reforms that aim to improve (i) public finance efficiency and (ii) private sector competition. These reforms substantiate the government Fiscal Strategy 2019-2021 by helping the authorities design fiscal measures that will not only achieve the debt stabilizing levels but ensure the social protection of the vulnerable. It also strengthens the market competition and reduces the cost of doing business.

Key Results

1. Reduction in general government arrears by end 2019.
2. Decline in the average unit price of pharmaceuticals by end 2019.
3. Increase in the social assistance coverage of the bottom quintile by end-2019 2019.
4. Increase in the public revenues from the personal income tax increase by end 2019.
5. Increase in the public revenues from excises from 2019.
6. Increase in the percentage of consumers able to freely choose an electricity supplier on the open market by 2019.
7. Increase in the average number of bidders per public procurement procedure by end 2019.
8. The main inspectorates relevant for businesses put in place a risk-based system for inspections in 2019.

D. Concept Description

The Strengthening the Efficiency of Public Finances pillar of the DPF aims to mobilize additional revenues, improve efficiency of spending programs, and strengthen the public finance management. With the Organic Budget Law government aims to strengthen the institutions for conducting fiscal policy to ensure sound medium-term planning and prevention of re-accumulation of arrears. Policy reforms of health sector and social benefits aim to improve efficiency of spending through improved procurement of pharmaceuticals and consolidation of various social benefit programs, while at the same time aiming to improve targeting to the poor. Government revenues as a share of GDP, particularly from direct taxation, are much lower than in other European countries, and still eroding. Faced with the constrained fiscal space, tax reform aims to rationalize tax exemptions and introduce progressivity in personal income taxation that would increase revenue and improve equity.

The Boosting Private Sector Competitiveness pillar supports strengthening market competition in public procurement and energy sectors, and the inspection reform. An overreliance on the fiscal stimulus for growth has increased the vulnerability of the economy. Combined with the political turmoil, the under-execution of public investment program led the economy to halt in 2017. Macedonia's growth potential needs to be unlocked by removing obstacles for market competition and market entry, job creation, and reducing the administrative burden to businesses. Enabling the competition in product markets through the public procurement reform, in critical backbone service sectors such as energy sector, as well as removing the barriers to business conduct would help unlock some potentials over the medium term.

E. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

Some of the prior actions are expected to have high positive social and gender impact. The DPF addresses issues such as fiscal sustainability critical for sustainable poverty reduction and shared prosperity in the medium term. In the short term, while abolishing the parental allowance might have adverse social impact, the compensatory actions and the introduction of the better-targeted Guaranteed Minimum Income with an increased threshold and a benefit will have positive direct social impact on the poor. The pharmaceutical reform aims to reduce pharmaceutical prices and include more cost-effective therapies under the basic package, thus reducing private participation for higher quality therapies. The energy law introduces the obligation to the government to develop the annual energy poverty programs.

Environment Impacts

The reforms supported by the DPF will have high positive environmental impacts and will contribute to mitigation and adaptation measures to combat adverse climate impacts. The new Law on Energy will deliver climate change co-benefits for (i) mitigation through the unbundling of the energy sector, regulating the supply of renewable energy; and (ii) adaptation through the requirement to address the energy poverty. The positive impact on the environment is also expected through the introduction of the excises on fuel that would reduce the consumption of a good with a negative externality for the environment and thus help reduce emissions.

CONTACT POINT

World Bank

Contact: Sanja Madzarevic Sujster
Title: Senior Economist
Tel: (1) 202 8484 808
Email: smadzarevic@worldbank.org

Borrower/Client/Recipient

Contact: Mr Dragan Tevdovski
Title: Minister of Finance
Tel: (389) 2 3255-300
Email: finance@finance.gov.mk

Implementing Agencies

Ministry of Finance
Contact: Mr Rilind Kabashi
Title: State Secretary
Tel: (389) 2 3255-300
Email: rilind.kabashi@finance.gov.mk

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: http://www.worldbank.org/projects

APPROVAL

Task Team Leaders:	Sanja Madzarevic-Sujster, Marc Schiffbauer

Approved By

Country Director:	Linda Van Gelder	