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PROJECT PERFORMANCE ASSESSMENT REPORT



FORMER YUGOSLAV REPUBLIC OF MACEDONIA
Policy-Based Guarantee

Report No. 106177

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PROJECT PERFORMANCE ASSESSMENT REPORT
FORMER YUGOSLAV REPUBLIC OF MACEDONIA
POLICY BASED GUARANTEE
(G-2080-MK, P125837)

June 30, 2016

IEG Human Development and Economic Management Department
Independent Evaluation Group

Currency Equivalents (annual averages)

Currency Unit = Macedonian Denar (MDen)

2011	US\$1.00	MDen 44.23
2012	US\$1.00	MDen 47.89
2013	US\$1.00	MDen 46.39
2014	US\$1.00	MDen 46.43
2015	US\$1.00	MDen 51.48

Abbreviations and Acronyms

CPS	Country Partnership Strategy
DPL	Development policy loan
EU	European Union
FPD	Financial and Private Sector Development
FSC	Financial Stability Committee
FSI	financial soundness indicators
FYR	Former Yugoslav Republic
GDP	gross domestic product
HD	Humana Development
HIF	Health Insurance Fund
IBRD	International Bank for Reconstruction and Development (World Bank)
ICR	Implementation Completion Report
IEG	Independent Evaluation Group
IEGHE	IEG Human Development and Economic Management Department
IMF	International Monetary Fund
MIS	Management information system
M&E	Monitoring and Evaluation
NBRM	National Bank of FYR Macedonia
OGRM	Official Gazette of the Former Yugoslav Republic of Macedonia
OPCS	Operations Policy and Country Services
PBG	Policy based guarantee
PPAR	Project Performance Assessment Report
PREM	Poverty Reduction and Economic Management Network
PSIA	poverty and social impact analysis

Fiscal Year

Government: January 1 – December 31

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Director, Human Development and Economic Management	:	Mr. Nick York
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This report was prepared by Zeljko Bogetic, with research analyst support of Lancine Conde, who assessed the project during June-August 2015. The report was peer reviewed by Shahrokh Fardoust and panel reviewed by Chad Leechor. Aline Dukuze and Viktoriya Yevsyeyeva provided team administrative support.

Principal Ratings

	ICR*	ICR Review*	PPAR
Outcome	Satisfactory	Moderately Satisfactory	Moderately Satisfactory
Risk to Development Outcome	Moderate	Moderate	Moderate
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Satisfactory

* The Implementation Completion Report (ICR) is a self-evaluation by the responsible Bank department. The ICR Review is an intermediate IEGWB product that seeks to independently verify the findings of the ICR.

Key Staff Responsible

Project	Task Manager/Leader	Division Chief/ Sector Director	Country Director
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IEG Mission: Improving World Bank Group development results through excellence in evaluation.
About this Report

The Independent Evaluation Group assesses the programs and activities of the World Bank for two purposes: first, to ensure the integrity of the Bank's self-evaluation process and to verify that the Bank's work is producing the expected results, and second, to help develop improved directions, policies, and procedures through the dissemination of lessons drawn from experience. As part of this work, IEG annually assesses 20-25 percent of the Bank's lending operations through field work. In selecting operations for assessment, preference is given to those that are innovative, large, or complex; those that are relevant to upcoming studies or country evaluations; those for which Executive Directors or Bank management have requested assessments; and those that are likely to generate important lessons.

To prepare a Project Performance Assessment Report (PPAR), IEG staff examine project files and other documents, visit the borrowing country to discuss the operation with the government, and other in-country stakeholders, and interview Bank staff and other donor agency staff both at headquarters and in local offices as appropriate.

Each PPAR is subject to internal IEG peer review, Panel review, and management approval. Once cleared internally, the PPAR is commented on by the responsible Bank department. The PPAR is also sent to the borrower for review. IEG incorporates both Bank and borrower comments as appropriate, and the borrowers' comments are attached to the document that is sent to the Bank's Board of Executive Directors. After an assessment report has been sent to the Board, it is disclosed to the public.

About the IEG Rating System for Public Sector Evaluations

IEG's use of multiple evaluation methods offers both rigor and a necessary level of flexibility to adapt to lending instrument, project design, or sectoral approach. IEG evaluators all apply the same basic method to arrive at their project ratings. Following is the definition and rating scale used for each evaluation criterion (additional information is available on the IEG website: <http://worldbank.org/ieg>).

Outcome: The extent to which the operation's major relevant objectives were achieved, or are expected to be achieved, efficiently. The rating has three dimensions: relevance, efficacy, and efficiency. *Relevance* includes relevance of objectives and relevance of design. Relevance of objectives is the extent to which the project's objectives are consistent with the country's current development priorities and with current Bank country and sectoral assistance strategies and corporate goals (expressed in Poverty Reduction Strategy Papers, Country Assistance Strategies, Sector Strategy Papers, Operational Policies). Relevance of design is the extent to which the project's design is consistent with the stated objectives. *Efficacy* is the extent to which the project's objectives were achieved, or are expected to be achieved, taking into account their relative importance. *Efficiency* is the extent to which the project achieved, or is expected to achieve, a return higher than the opportunity cost of capital and benefits at least cost compared to alternatives. The efficiency dimension generally is not applied to adjustment operations. *Possible ratings for Outcome:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

Risk to Development Outcome: The risk, at the time of evaluation, that development outcomes (or expected outcomes) will not be maintained (or realized). *Possible ratings for Risk to Development Outcome:* High, Significant, Moderate, Negligible to Low, Not Evaluable.

Bank Performance: The extent to which services provided by the Bank ensured quality at entry of the operation and supported effective implementation through appropriate supervision (including ensuring adequate transition arrangements for regular operation of supported activities after loan/credit closing, toward the achievement of development outcomes. The rating has two dimensions: quality at entry and quality of supervision. *Possible ratings for Bank Performance:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

Borrower Performance: The extent to which the borrower (including the government and implementing agency or agencies) ensured quality of preparation and implementation, and complied with covenants and agreements, toward the achievement of development outcomes. The rating has two dimensions: government performance and implementing agency(ies) performance. *Possible ratings for Borrower Performance:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

Preface

This Project Performance Assessment Report (PPAR) was prepared by Zeljko Bogetic (Task Team Leader) under the supervision of Mark Sundberg (Manager, IEG Country Programs and Economic Management). Research assistance from Lancine Conde, Moritz Piatti, and team assistant support from Aline Dukuze (Independent Evaluation Group [IEG]) and Jasminka Sopova (World Bank country office in the Former Yugoslav Republic [FYR] Macedonia) are gratefully acknowledged. The PPAR team wishes to express sincere gratitude to the interviewed government officials, stakeholders, and Bank staff who provided their perspectives and valuable information in the course this assessment (Appendix C).

This PPAR evaluates the policy-based guarantee (PBG) to FYR Macedonia, which was approved on November 10, 2011. Operational phase of policy reforms supported by the operation ended following Board approval and disbursement in 2011. Closing date was December 31, 2012. It is the second in a series of four underway assessing the early performance of PBGs. The other three PPARs are on Serbia, a second PBG on FYR Macedonia, and one on Montenegro. All four operations have taken place in countries in the Western Balkans from 2011-14. Following completion of the four PPARs, a small IEG learning product is envisaged to synthesize high-level lessons from the early use of the PBG instrument.

The objectives of the FYR Macedonia PBG being assessed here were to: (i) improve the government's access to international financial markets, (ii) fortify the sustainability of public finance and the functioning of labor markets, (iii) strengthen social safety nets, and (iv) support the resilience of the financial sector.

The operation was originally envisaged as the second in a series of development policy loans (DPLs), but the series was truncated at the request of the Borrower, and the second operation was converted into a standalone policy-based guarantee early in the preparation, while keeping essentially the same policy framework of the original DPL. Under the operational policy on guarantees, which, at the time, guided PBGs, there was no possibility of a programmatic guarantee, hence the standalone design of the PBG. This was the first PBG operation in FYR Macedonia. It was only the second time in a decade that such an operation was approved by the Bank, following the approval of the Serbia Private and Financial Sector Policy-Based Guarantee in February 2011.

The total amount disbursed by the underwriting international commercial banks (Deutsche Bank and Citibank) was €130 million. The World Bank guaranteed a partial amount (€100 million, equivalent to \$134.9 million) of the principal on the loan. This arrangement leveraged the Bank's capital to help the country raise the needed resources from the international commercial bank markets.

This report presents the findings based on a review of the program documents, project appraisal documents, the implementation completion and results reports, aides-memoires, International Monetary Fund (IMF) and World Bank reports, and other relevant materials. An IEG mission visited Skopje, the capital of FYR Macedonia, from June 28 to July 1, 2015 to interview government officials, IMF staff, Bank staff, and other

stakeholders (see Appendix C for the complete list of persons interviewed). Other bank staff members, IMF representatives, and other information providers were interviewed in Washington, DC. This work was carried out in parallel with, and benefited from, a separate PPAR on the private and financial sector PBG to Serbia.

The assessment aims to verify whether the operation achieved its intended outcomes. The report provides additional evidence and analysis of relevant and comparative data for a more complete picture of the outcomes and factors that influenced them. By covering the period between 2011 and 2015, it offers an opportunity for broader lessons and a longer time perspective, as well as reflection on the sustainability of policy reform. Finally, the report draws lessons to inform future operations of this nature in other countries.

Following standard IEG procedures, a copy of the draft PPAR was sent to the relevant government officials and agencies for their review and feedback, and comments received from the Government of the Former Yugoslav Republic of Macedonia have been included in Appendix E.

Summary

This Project Performance Assessment Report (PPAR) assesses the policy-based guarantee (PBG) to FYR Macedonia, which was approved on November 10, 2011.

The PPAR provides an in-depth look at this operation four years after the completion of the reform program. It reviews the existing program and uncovers new evidence on the operation based on additional country-specific and comparative data, information on institutional reforms, international metrics, as well as insights from over 30 semi-structured interviews with stakeholders in the country and the World Bank. This PPAR is part of the Independent Evaluation Group's (IEG) effort to gain greater insights into the impact of budget support development policy operations (DPO). According to the Operations Policy and Country Services Vice Presidency's (OPCS) rules at the time, a country was eligible for a PBG if it met three criteria: (i) a strong track record of performance with a satisfactory structural, social, and macroeconomic policy package, (ii) a sustainable external financing plan, and (iii) a coherent borrowing strategy, which would enable it to become a borrower in its own name without a guarantee in the medium term. FYR Macedonia scored well on these criteria.¹

The objectives of the operation were to: (i) improve the government's access to international financial markets, (ii) fortify the sustainability of public finance and the functioning of labor markets, (iii) strengthen social safety nets, and (iv) support the resilience of the financial sector (FYR Macedonia Policy Based Guarantee 2011, p. ii and Annex 2, Policy Matrix).

The relevance, design, and results of the PBG met the expectations of financial and policy reform objectives set at the outset. The World Bank took informed risks with the new instrument to respond to the client's request for a much larger volume of financing than would have been available under a development policy loan (DPL).

The government showed commitment to and ownership of the reform agenda. The World Bank and the government had a good working relationship and policy dialogue. The operation featured good design and moderate outcomes, despite a difficult external environment in the Eurozone, a second regional recession in the Western Balkans, and the escalation of the Greek debt crisis. The reform agenda showed moderate achievements and sustainability.

The relevance of objectives was high. Objectives were closely aligned with the World Bank's strategy in two out of three country partnership strategy (CPS) pillars on economic growth and competitiveness, and inclusive growth. The objectives were highly relevant to country conditions, the country's main European Union (EU)-related

¹ OP/BP 14.25, Guarantees. It was retired in 2013/14 and policy based guarantees were incorporated into OP/BP 8.60, Development Policy Lending (renamed Development Policy Financing). The program document (FYR Macedonia Policy Based Guarantee 2011) contains a detailed section documenting the evidence of the country meeting the eligibility criteria before Board approval. Also, this evidence and eventual judgement was subject of discussion during the review process.

accession documents, and the context, and remained relevant at the time of this review. Policy reform areas were identified based on prior analytical work: Economic Memorandum (CEM), Poverty Assessment, FSAP, and a Public Expenditure Review (PER).

Design was substantially relevant to country conditions, given the protracted market turbulence and regional and Eurozone risks at the time. The country was especially vulnerable to the contagion from Greece because of its large exposure to trade, financial, and transport links.

The objectives were well linked to the design of the PBG as well as the desired outcome of the country eventually accessing markets independently. Policy reform objectives were appropriate based on a track record of solid macroeconomic and fiscal management characterized by low fiscal deficits and moderate public debt levels, good policy dialogue, extensive consultation, and past analytical work. Prior actions were linked to objectives, limited in numbers, relevant, and concrete.

Achievement of financial objectives was substantial. The government managed to raise the required funds, and extend maturity of external borrowing using the PBG. This subsequently led to FYR Macedonia independently accessing international markets on favorable terms. Policy reform objectives showed mixed achievement. Critical actions and outcomes in the financial sector were substantially achieved. The achievement in the areas of strengthening public finances and in the functioning of labor markets and in strengthening of the social safety net were modest. The emergence of health sector arrears and other payment arrears during implementation and supervision undermined the overall achievement.

This moderate achievement took place in the context of adverse economic conditions of a triple recession in the Western Balkan region (2009, 2012, and 2014) and unemployment in FYR Macedonia of about 30 percent, which made policy implementation politically challenging. There was no International Monetary Fund (IMF) program in place at the time, and there was a perception that the country was highly vulnerable to external shocks. Reforms supported by the PBG proved important to the resilience of the budget and the banking sector, allowing it to absorb adverse economic and external shocks.

World Bank performance was satisfactory. Given very difficult economic and external conditions and risks that the World Bank took with a new type of operation, the World Bank performance was solid. As the first PBG in FYR Macedonia and only the second in the world in a decade, the operation required additional effort from the World Bank team than is usually required in developing a DPL. The team built on the experience of the previous PBG in Serbia approved six months prior. The good relationship with the government and a broad policy dialogue helped. The World Bank also closely coordinated with the IMF. But because there was no IMF program in place, the World Bank team appropriately engaged in more intensive monitoring and assessment of macroeconomic developments and policies.

Borrower performance was satisfactory. The government's interest, commitment, and ownership was substantial. The quality of reporting, cooperation, dialogue, and

engagement of technical counterparts was strong. Key government agencies, the Ministry of Finance, National Bank of Republic of Macedonia (NBRM), Ministry of Labor and Social Policy, and the Health Insurance Fund, were cooperative. Coordination with the Ministry of Finance was solid. Government agencies worked closely with the World Bank team on a tight schedule to ensure the timely completion of many complex details of the financial architecture of the operation, which was new to the government and the external commercial underwriting banks.

The M&E framework was rated substantial. It featured clear objectives and prior actions with indicators and linkages among them. The majority of indicators were quantitative and most were identifiable, clear, and measurable. The use of some critical indicators informed policy adjustments and improvements, especially in the areas of public expenditure policy and financial sector reform.

Lessons

This moderately successful operation offers several lessons for the future design of PBGs. Some may be of broad interest on the use of the instrument, and some are more project specific.

Regarding broader lessons on the use of PBGs:

- First, PBG remains a fairly unknown and underused instrument globally requiring the Bank's team to provide considerable information and informal technical assistance to the client before and during the preparation. Recent regulatory reform by OPCS, which brought PBGs under the umbrella of DPO policy regulation is an important step in the direction of mainstreaming PBGs as a specific type of DPO and making it more known to clients.
- Second, PBG appears to be a useful type of budget support, especially during international market turbulence. PBG could be particularly relevant, for example, to many small, vulnerable economies with substantial external financing needs, but with a solid track record of macroeconomic performance, debt management, and policy reform and a good dialogue with the World Bank.
- Third, PBGs have the potential to leverage and increase turnover of World Bank capital. In FYR Macedonia, the International Bank for Reconstruction and Development guaranteed €100 million of the total principal of €130 million.

Several project-specific lessons emerge as well, which may be of broader interest for the future design of PBGs.

- First, PBGs provide potential benefits and risks to the clients, which should be clearly identified and discussed with the Borrower. Although direct financial benefits of PBGs for improving market access and terms of external borrowing can be substantial, there are other benefits: the borrower is able to establish itself in the eyes of international investors and broaden the investor base. Also, by providing substantial external financing to the budget at the right time, PBGs can

support both macroeconomic stability and the reform program. On the risk side, as with any large loans, especially with a guaranteed component, PBGs are associated with the risk of debt repayment and, potentially, a “moral hazard,” in terms of reduced incentives for the borrower to exercise caution in borrowing and implementing reform. To guard against “moral hazard” whereby large financing is used to postpone rather than implement the reforms, a strong policy reform program, prior actions, and results frameworks are essential.

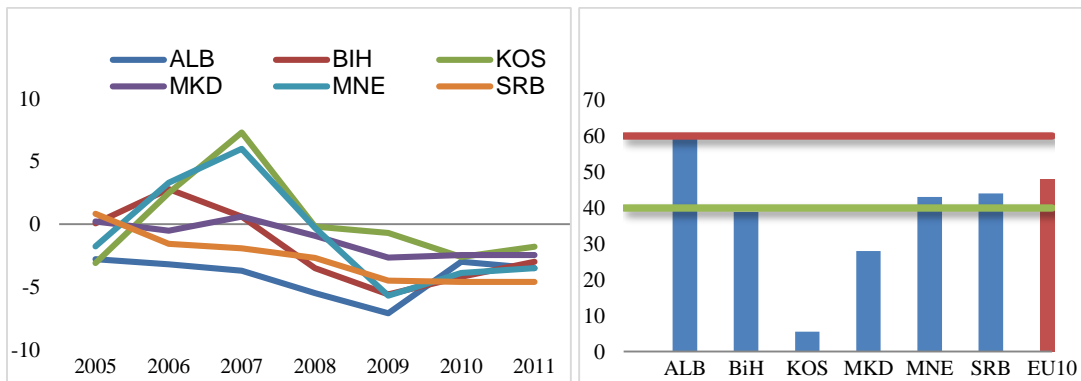
- Second, strong and relevant design and achievement is much more likely when the operation’s design is informed by relevant knowledge work, intensive and longer-term World Bank engagement and dialogue, and, a relationship of trust between the World Bank and the borrower.
- Third, this operation shows that the World Bank can be more effective when it promotes country-to-country learning during the preparation of similar projects in different countries. This is especially the case when the Bank is testing a relatively new instrument as was the case with PBGs.

Nick York
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Human Development and Economic Management
Independent Evaluation Group

1. Background and Context

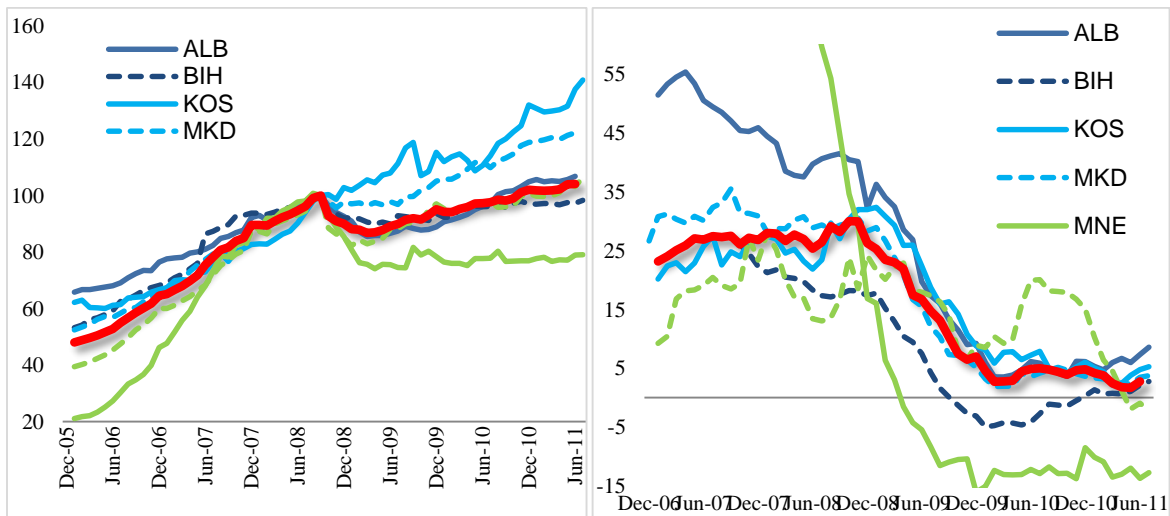
1.1 In 2010-11, when the policy-based guarantee (PBG) operation was prepared for the Former Yugoslav Republic (FYR) of Macedonia, the country's external and regional context was particularly difficult. The Western Balkans region was recovering very slowly from a deep regional and global recession. The escalation of the Greek crisis in 2009 led to renewed market turbulence and international capital "flight to quality." This meant that international markets were effectively closed for many small, vulnerable countries. Because of its proximity to Greece and linkages with trade, transport, and the financial sector, FYR Macedonia was viewed as especially vulnerable to the Greek contagion. Sovereign spreads for many European countries escalated, including in FYR Macedonia.

Figure 1.1. Fiscal Balance and Public Debt in FYR Macedonia and Comparator Countries (percent of GDP)



Note: ALB=Albania, BiH=Bosnia and Herzegovina, EU10=EU10 countries, KOS= Kosovo, MKD=FYR Macedonia, MNE=Montenegro, and SRB=Serbia. The red horizontal line is the Maastricht 60 percent debt limit. The green line is the 40 percent debt limit advocated in recent International Monetary Fund publications (Gupta and Baldacci).

Figure 1.2. Bank Deposits and Growth of Real Credit to the Private Sector in FYR Macedonia and Regional Comparators



Source: South East Europe Regular Economic Report, 2012.

1.2 Against this backdrop, the government has run generally prudent macroeconomic monetary policy that helped maintain the exchange rate peg. Prudent fiscal policy kept fiscal deficits in check. The public debt level was moderate compared to regional comparator countries (Figure 1.1), but deficits and government debt increased in recent years. Central government debt increased from 27.7 percent of gross domestic product (GDP) in 2011 to 35.9 percent in 2015 (IMF 2015). Active supervision and regulation by the national bank helped limit risks to the financial system; there were fewer non-performing loans, they were lower than in the other countries, and provisions were substantial. Liquidity and capital adequacy ratios remained solid. Confidence in the banking system was preserved. Bank deposits recovered quickly following the global crisis. The credit boom and bust was less pronounced than in other countries in the region and the growth of real credit to the private sector did not turn negative (Figure 1.2). As a result, the impact of the Greek crisis was relatively muted compared to some other small European countries, and there were no major bank failures.

1.3 On the structural reform front, FYR Macedonia has been pursuing investment climate reforms as part of the country's strategy to improve competitiveness and attract foreign investments. The country became a regional champion in the legal and regulatory aspects of investment climate and related reforms as measured by the World Bank/European Bank for Reconstruction and Development Doing Business Indicators. In 2010, it ranked 38th in the world, an exceptional improvement from 92nd position in 2006. It continued to improve its ranking and achieved the 12th rank in the world in 2016, the highest in the Western Balkans. FYR Macedonia's credit rating, according to Standard and Poor's, has been BB for several years, the highest in the Western Balkans (World Bank 2015). Also, in contrast to other Western Balkans countries, a large share of FYR Macedonia's foreign direct investments consisted of green-field investments in the tradable sector, enabling it to boost exports and diversify its export structures. As a result, the country was viewed as a regionally competitive destination for foreign investment, because of the low cost of labor and adequate local skills available. FYR Macedonia attracted some quality foreign direct investments in manufacturing, including in the auto parts industry, linking it into the value chain of the vast European automobile industry.

1.4 However, despite these achievements, other structural constraints such as the small size of the market, landlocked position, infrastructure quality, and labor market rigidities contributed to only moderate growth and persistent unemployment of about 30 percent; about a fifth of the population continued living in poverty. This and underlying ethnic tensions makes many fiscal and structural reforms politically sensitive. Labor Force Survey (LFS) data, indicate that unemployment dropped from 37 percent in 2004 to 32 percent in 2009 and further to 26 percent in 2015. Youth unemployment, however, remains above 30 percent.

1.5 Against this backdrop, the World Bank had a good economic policy dialogue with FYR Macedonia. Despite major shocks during the global recession, sound macroeconomic management helped the country avoid a major banking crisis that engulfed some European countries. And there was a continuum of structural reforms, reflected in FYR Macedonia's sound macroeconomic policy, highest credit rating, and ratings of the business climate in the region (World Bank 2015 and 2013). This solid track record and the continuity of policy

dialogue with the World Bank were important prerequisites for the country to access financing using a PBG.

1.6 The World Bank had supported FYR Macedonia's reforms through a development policy operation (DPO) and a number of projects. The World Bank approved the first development policy loan (DPL) in 2009, originally part of a two-operation DPL series. The series was terminated and the second DPL was converted to a standalone PBG at the request of the government. The policy framework and the policy matrix remained largely unchanged with some modifications. The PBG has, therefore, helped maintain continuity of major reforms.

2. Objectives, Design, and their Relevance

2.1 At the outset, it is important to recognize that the PBG was an operation combining the characteristics of: a DPO and a financial guarantee.

2.2 As a result, it featured multiple objectives, targeting financial benefits arising from the financial guarantee as well as policy reform objectives. Also, the PBG required a third player in preparation of the operation beyond the government and the World Bank—the commercial banks which provided the funding. This made the preparation and design of the operation more demanding than otherwise would have been the case. Also, it was the first such operation in the country and only second one in the world in a decade, following the Serbia PBG.

2.3 The financial objectives of the operation were to improve FYR Macedonia's access to international markets and assist the country in the achievement of favorable terms on its external commercial loans. The policy reform objectives were to: (i) strengthen sustainability of public finances and the functioning of labor markets, (ii) strengthen social safety nets, and (iii) strengthen resilience of the financial sector.

2.4 The financial objectives of the operation featured in the policy matrix along with results indicators, but not in the development objectives. At the same time, the program document clearly makes references (for example on pages, p.ii and 54, and in Annex 2 Policy Matrix) that indicate that this was an important objective of the operation.²

Relevance of Objectives

Relevance of objectives is rated **high**.

2.5 The objectives were highly relevant to country conditions. FYR Macedonia as a small, landlocked country with strong trade and financial linkages to Greece faced considerable challenges in maintaining macroeconomic stability and continuing structural

² “The guarantee is expected to lead to improvements in pricing and tenor, and to contribute to enhancing the country's access to international capital/financial markets.” (Program Document, p. ii). And the in the program document in Annex 2 in the Policy Matrix explicitly states under objectives: “The IBRD guarantee will improve access to international financial/capital markets.”

reforms aimed at improving long-term growth, employment, and poverty reduction prospects. The country has had a strong track record on macroeconomic management and reforms. This was especially the case in the area of investment climate and attraction of quality FDIs in the form of green-field investments (World Bank 2015). But the country environment was challenging in the context of international market turbulence and uncertainty (and the country's budget financing needs). Financial objectives of improving access and terms to external borrowing were directly targeting those urgent needs. Policy reform objectives were highly relevant. They targeted critical improvements in macroeconomic stability and structural reforms in fiscal management, labor and financial markets, and social protection. Maintenance of macro-stability was an essential condition for a small open economy facing major regional shocks. Very high unemployment was a major structural problem, partly related to the institutional constraints and incentives targeted by the operation. And financial sector stability was of critical importance for the country to weather the international and regional market turbulence. Given the prolonged Eurozone financial and growth problems, and the difficult regional environment, these objectives remained highly relevant when the operational phase of the project closed in 2012 and remained relevant at the time of review. The external conditions and the country context remained broadly similar to the time of approval in 2011.

2.6 By emphasizing policy reform to strengthen macroeconomic stability and advance structural reforms for growth, resilience of the financial sector, and social safety nets, the operation's policy objectives were closely aligned to the government's strategic documents related to the European Union (EU) accession, including the Stabilization and Association Agreement (European Commission 2011), National Plan on Adoption of the Acquis and the Pre-Accession Economic Program, and the 2011 and 2012 budgets. Because the reform program was in line with efforts to build lasting confidence within the public and domestic and foreign investors, the objectives were also aligned with the Ohrid Framework Agreement (2001) on the relationship with the minority community and the subsequent, related legal reforms, which ended the previous civil hostilities in the country. These programs and treaties, and their relevance, were current in 2012 when the financing and operational part of the project closed, as well as in 2015 when this assessment was prepared.³

2.7 The objectives were also highly relevant to the World Bank's Country Partnership Strategy (CPS) (October 2010) and remained relevant at the time of review. The key pillars of the CPS were: (i) faster growth—competitiveness (including continued macroeconomic stability); (ii) more inclusive growth—employability and social protection; and (iii) greener growth—environmental sustainability and climate action (CPS 2010). The PBG, with its emphasis on fiscal stability and labor market reforms, social protection, and financial sector resilience, directly aligned with the first two pillars of the CPS.

2.8 The government's motivation to use the PBG in pursuit of financial objectives was based on the desire for improved access to international financial markets at lower cost and longer maturities, and continued budget support to policy reforms addressing fiscal, labor

3

http://ec.europa.eu/enlargement/pdf/the_former_yugoslav_republic_of_macedonia/framework_agreement_ohrid_130801_en.pdf

market, social safety net, and financial sector issues in the context of a difficult external environment.

Relevance of Design

2.9 Relevance of design was rated **substantial**.

2.10 The financial objective of improving the country's access to international markets was highly relevant to country conditions. Financial markets were penalizing even well performing countries at the time with very high sovereign spreads. For many smaller countries such as FYR Macedonia, that had record of solid economic management, markets were effectively closed because of global risk aversion and uncertainty. PBGs—by reducing the risk to commercial lenders—had the potential to induce commercial lenders to overcome this international market failure problem and consider and potentially provide external funding to the country. In any event, the operation worked as intended, providing the country with a timely and sufficient volume of external funding at more favorable terms than would have been possible in its absence. The operation was well linked to the design of the PBG—given the country context and needs—as well as the country ambition of eventually accessing markets independently. The other, related financial objective of improving terms of external commercial borrowing was especially important in the context of elevated sovereign spreads. The financial objectives were closely linked with the expected results in terms of the government independently accessing markets in 2012 and the government raising euro loan and bond funding with a maturity of at least five years and at an interest rate below Euribor plus 500 basis points.

2.11 Policy reform objectives were clear and appropriately linked with reform activities. The policy reform objective of strengthening public finances and the functioning of labor markets was linked with key activities—which were also designed as prior actions.

- Under the program, the law on payment of wages was amended to put in place a wage freeze for an extended period, until September 2012. Given the rigidity of the budget and the large share of the wage bill, and very low single-digit inflation, a nominal wage freeze was considered an essential element of controlling budget deficits in a fiscally and socially sustainable manner. It also helped avoid worsening of the composition of public expenditures towards public consumption. This prior action was linked to the target indicator that the government would maintain the wage bill at below 32 percent of general government revenues in 2011.
- Another prior action under this objective was the enactment of the amendments of the law on pensions and disability insurance that reduced pension expenditures through a lower “valorization coefficient” and tighter eligibility criteria for survivor pensions. Again, given the importance of pensions in the budget expenditure, this was linked to the target indicator that aimed to maintain pension spending at less than 9 percent of GDP in 2011. While the chain of causation is broadly clear, a more specific formulation of the fiscal objective in terms of the control of public expenditures (rather than “strengthening public finances,” which

is much broader) would have strengthened the link between the objective, policies, and the target indicator.

2.12 Under the second objective of strengthening social safety nets, an important prior action was that the Ministry of Labor and Social Policy had developed a functional cash benefits management information system (MIS) to the testing stage, and established a network between social welfare centers and the Ministry of Labor and Social Policy. This reform continued on the heels of the conditional cash transfer (CCT) Project which was designed to contribute to social protection and human capital by conditioning cash benefits on secondary school enrollment and expanding primary and pre-primary, as well as health care and adult training programs (CPS 2010, p.29). The MIS has been identified as a critical weak link that undermined the efficiency and targeting of the social safety nets (see, for example, the Implementation Completion Report Review of the earlier social protection project). This action was well linked to the target indicator that aimed to reduce the processing time for the social financial assistance application from a baseline of 30 days in 2011.

2.13 Under the third objective of strengthening resilience of the financial sector, a key prior action was to establish the Financial Stability Committee (FSC) and adopt rules of procedures for its operation. Creation of the committee was in line with international practice. Field interviews and discussions with different agencies indicate that such a committee was important in bringing together different parts of the government to discuss and coordinate macro-financial policy in the context of extreme external financial uncertainty. A related target indicator was that financial soundness indicators are regularly reported and monitored, and the Financial Stability Report discussed and acted upon by FSC and policy responses are coordinated among the NBRM, Ministry of Finance, and Deposit Insurance Fund (DIF). Broadly, the implicit causal chain between these objectives and outcomes appears to be that (1) key government agencies such as NBRM, the Ministry of Finance, and DIF, that play important role in overall financial stability must closely coordinate the strategy and tactics of potential responses and jointly assess risks, (2) such enhanced coordination, risk assessment, and specific actions stand a better chance of the country absorbing major external and financial shocks and responding in a timely manner, and (3) that this institutional strengthening will provide greater confidence within the financial system, helping to reduce the risk of systemic bank failures. This chain of causation seems clear and convincing; it also rests on the prior analytical and diagnostic work and policy dialogue that identified key activities and measurable indicators in support of the objectives (for example, IMF 2015). At the same time, a more concrete formulation of the objective emphasizing strengthening of monetary and regulatory institutions and reporting for greater financial stability would have tightened the chain of causation.

2.14 The prior actions were completed as envisaged (Table 2.1). The Independent Evaluation Group (IEG) mission interviews and visits document that behind each prior action there has been a process of intensive policy dialogue, some analytical work, and continuity of reforms. Considered within the context of broader policy reforms and previous reforms supported under DPL 1, these actions were appropriately limited in numbers, concrete, significant within the country context, and measurable. Legislative reforms in prior actions are also significant (for example, passing modern laws on the National Bank, adopting amendments to the law on wages and putting in place public sector wage freeze, and

developing a cash benefits MIS.) The PPAR mission visit also found that most of the reforms supported by these prior actions have been sustained in key areas as of mid-2015.

2.15 The main exogenous factor that affected the operation was the continued turbulence in the Eurozone and international financial markets in 2012 and, relatedly, the second regional recession in the Western Balkans. This made the achievement of the financial objectives more difficult. By putting downward pressure on the demand for FYR Macedonia's exports, it also dampened its growth trajectory and made subsequent policy reform harder to implement.

2.16 Finally, the design of the operation was underpinned by analytical work in key areas. This included the FYR Macedonia Country Economic Memorandum (CEM), poverty assessment, FSAP, and public expenditure review (PER). This and the solid monitoring of economic policy reforms and developments helped tailor the operation's design to the complex country context. Economic monitoring and comparative analysis was strengthened and put in the wider regional context when the World Bank launched its regular regional economic report in 2011.

Table 2.1. PBG Prior Actions

Objective	Prior Actions	Status
Strengthening the sustainability of public finances and the functioning of labor markets	The member country has, through enactment of the Law on Amendments to the Law on Payment of Wages of July 20, 2010 (“Official Gazette of the Republic of Macedonia” – OGRM - 97/2010) froze nominal government wages until September 2012.	Completed.
	The member country has, through enactment of the Law on Amendments to the Law on Contributions from Compulsory Social Insurance of December 25, 2009 (OGRM 156/2009) reduced the social insurance contribution rates, and has, through enactment of the Laws on Amendments to the Law on Pension and Disability Insurance of December 25, 2009 and of December 6, 2010 (OGRM 156/2009 and 156/2010, respectively), reduced pension expenditures through reduced valorization coefficients and tightened eligibility criteria for survivor pensions.	Completed.
	The member country has, through enactment of the Law on Amendments to the Law on Contributions from Compulsory	Completed.
	The member country has adopted a program to improve the efficiency and sustainability of the health sector.	Completed.
	The Health Insurance Fund has adopted by-laws and a rulebook regulating the operations of the new Health Single Treasury Account covering all public health institutions.	Completed.
Strengthening social safety nets	The Ministry of Labor and Social Policy has developed a functional cash benefits MIS to the testing stage, and has established a network between social welfare centers and the Ministry of Labor and Social Policy.	Completed.
	The member country has adopted the Program on Subsidizing Energy Consumption in 2011 (OGRM 6/2011) which introduces a mechanism for providing support to the poor and vulnerable against electricity price increases.	Completed.
Strengthening the resilience of the financial sector	The member country has, through enactment of the Law on the National Bank of Republic of Macedonia on December 12, 2010 (OGRM 158/2010), increased the accountability and independence of the Central Bank to EU standards.	Completed.
	The member country has established the FSC and this committee has adopted rules of procedure for its operations.	Completed.

Source: World Bank 2013 (ICR), and 2011 (program document).

3. Implementation

3.1 The PBG was the first such operation in FYR Macedonia and only second approved by the World Bank globally in more than a decade, following the pioneering Serbia Private and Financial Sector Policy-Based Guarantee (February 2011). The World Bank team was learning from experience and building substantially on the positive experience with the Serbia operation. This was helped by the fact that both operations were managed by the same World Bank management team with some overlap in team members, which ensured seamless transfer of knowledge and lessons from one country to the other.

3.2 Importantly, as documented during the PPAR mission and interviews, there was considerable country-to-country consultation and learning, which was encouraged and facilitated by the World Bank. The Ministry of Finance of the government of FYR Macedonia, especially the debt management department, consulted closely with the Finance Ministry of Serbia before and during the preparation of the FYR Macedonia PBG. It actively sought to learn from the past and use the lessons from the Serbia operation to improve the design and implementation of FYR Macedonia's PBG.

3.3 Nevertheless, because the FYR Macedonia PBG was the first such operation in the country, the World Bank team had to engage the government and the World Bank's internal structures in intensive consultations, over and above a typical effort required in preparing a DPL. This was the case for three reasons. First, the team had to ensure that the government made an informed choice on a new instrument. Second, it had to help with the government's preparation and dialogue with the international commercial banks, something that is usually absent in a DPL. And third, the operation needed to be fully in compliance with World Bank regulations and internal processes that had been tested only on one such operation in a neighboring country. Preparation of the operation also required several parts of the World Bank working together in concert under the direction of the country director: task management and the PBG team, the broader country team, the Poverty Reduction and Economic Management Network (PREM) (lead network), the Human Development Network (HD), Finance and Private Sector Development (FPD), Treasury, and FINCR.

3.4 The implementing agency representing the government was the Ministry of Finance, which played a key coordinating role. Closely involved were the NBRM, Ministry of Labor and Social Policy and Health Insurance Fund (HIF). There were no co-financers. By design of the PBG, financing for the budget was provided by the underwriting banks, Deutsche Bank and Citibank, with the World Bank providing a partial guarantee for the principal. Since the World Bank guaranteed €100 million of the total €130 million provided by the commercial banks, the World Bank capital was leveraged, effectively "crowding in" private commercial funding for the client government.

3.5 No safeguard policies were triggered by the operation. Based on the inspection of prior actions, no major adverse distributional effects are anticipated from policies in the operation. Poverty and social impact analysis of the previous DPL1 informed the design of the PBG. A public sector wage freeze in the context of low inflation was not expected to lead to a poverty impact because the real impact on public sector wages was limited and the minimum public sector wage substantially exceeded the national poverty line. Maintaining

control of pension expenditures was needed for fiscal sustainability and this could have adversely affected poverty because about a quarter of pensioners lived in poverty. However, ensuring fiscal sustainability of pension expenditures helped ensure timely payment of pensions, avoiding pension arrears, which would have been even more damaging from the poverty standpoint. This measure was supplemented by tightening eligibility criteria and reducing fraud, which also helped maintain timely payments of pensions. Further, the operation is not expected to result in major direct adverse, or irreversible, environmental impacts in the short term.⁴

4. Achievement of the Objectives

4.1 The achievement of objectives was satisfactory. Achievement was high for four out of five objectives, with substantial achievement of one objective. Two out of ten outcome indicators were not achieved. This should be viewed in the country context of a second regional recession and difficult external and internal economic environment.

Objective 1: Improving access to international financial and capital markets: Substantial

4.2 The financial objective of the operation was to improve access to international financial and capital markets. This implies achieving independent access in the aftermath of the operation as well as improving the terms (maturity and interest) on its commercial external borrowing.

4.3 The operation helped the country (i) achieve access to the needed volume of external financing, (ii) obtain favorable terms, establishing a benchmark for subsequent international commercial borrowing *in the context of the PBG*, and, (iii) access *subsequent* international commercial borrowing on reasonable terms.

4.4 Two outcome indicators were appropriately chosen. The first was that the government would raise funding independently from international markets in 2012. The second was that the government would obtain Euro loan funding with maturity of at least five years and at an interest rate below Euribor plus 500 basis points, which was considered as not adding significantly to the debt service burden.

4.5 Both outcome indicators were *substantially achieved*. Following the completion of the operation, in 2012, the government accessed the international markets independently by borrowing €75 million from Deutsche Bank at five years maturity and interest slightly above 500 basis points above Euribor. While the 500 basis points mark was slightly missed, it should be seen in the context of renewed market turbulence. As a result, the second indicator is also considered substantially achieved.

⁴ This is, in part, due to the legislative and institutional nature of many prior actions and because none of the actions relate to issues of forestry, agriculture, and mining that might have direct environmental and social repercussions.

4.6 The context is important to understanding these achievements. Before the operation, in 2009, the government issued a Eurobond at very unfavorable terms (3.5 years and 9.875 percent interest). It also attempted to access the bond market in 2010, but it had to cancel this effort after the country road show because the terms became prohibitive with renewed escalation of spreads due to the Greek crisis. These two experiences illustrate the difficulty the country had in accessing international markets during those difficult times in the international financial environment, despite the country's strong macroeconomic management, creditworthiness, and a track record of structural reforms.

4.7 By contrast, the PBG provided the international commercial loan from Deutsche Bank and Citibank, with a World Bank guarantee, of €130 million for five years, at an interest rate of 234 basis points above the Euribor. The World Bank provided a partial guarantee of the principal, covering €100 million of the total loan amount, leveraging the World Bank's capital. The country benefitted from substantial lengthening of maturity and lowering of yields, which provided a cost saving of at least 300-400 basis points compared to what may have been possible in the international commercial markets at the time (Najdov 2013).

4.8 Financial benefits of the operation also helped broader fiscal and macroeconomic stability and domestic economic activity. By providing more than half of the financing needed to cover the budget deficit without adding to current debt service because of the bullet repayment design, the PBG temporarily relieved pressure from government borrowing on the domestic markets. Nevertheless, it is important to recognize that the bullet repayment feature is not a "free lunch." It is essential for the borrower to make periodic provisions or to build reserves for the repayment of bullet repayment to reduce repayment risk later on.

4.9 Furthermore, by establishing a relatively favorable benchmark at an especially turbulent time in the international markets, the operation provided a positive signal to the markets that this creditworthy country was, indeed, able to borrow at those terms from major international banks. Also, the operation helped introduce the country to the international commercial bank markets for the first time, and it helped broaden FYR Macedonia's investor base, making it more known and potentially attractive to investors in the future. This potentially reduced the perception of the country's sovereign risk at a time of heightened sovereign spreads. As noted previously, subsequent to the PBG, the government of FYR Macedonia successfully accessed international bank markets independently by borrowing €75 million from the Deutsche Bank for five years at slightly above 500 basis points. While the cost was slightly above the target, this reflected the market conditions at the time. Two years later—and following the second PBG operation—the country managed to borrow at even longer maturity and historically much lower interest rate (Table 4.1).⁵

⁵ In 2013, the government used the subsequent, second PBG (public expenditure PBG—PEPBG, see IEG PPAR on this operation 2016) to borrow €250 million at a low, 3.915 percent interest rate, in two tranches of five and seven years of maturity.

Table 4.1. FYR Macedonia External Borrowing (Eurobonds and bank loans)

Year	Amount	Maturity	Interest
2014	500	7	3.975
2012*	75	5	6.35
2009	175	3.5	9.875
2005	150	10	4.625

Source: FYR Macedonia Ministry of Finance Annual Debt Management Report 2006, 2009, 2014.

* Loan from Deutsche Bank.

Objective 2: Strengthening public finances and functioning of labor markets: Modest

4.10 The following outcome indicators monitored progress under the objective of strengthening the sustainability of public finances and functioning of labor markets: (i) The general government wage bill was maintained at below 32 percent of general government revenues in 2011; (ii) an increase in the number of formal workers with paid social insurance contributions from 407,887 in 2009 to 420,000 in 2011; (iii) pension spending was maintained at less than nine percent of GDP in 2011; (iv) arrears in the public health sector (Health Insurance Fund and health care institutions) did not exceed 1.7 billion denars (0.4 percent of GDP) in 2011; and (v) comprehensive financial reports on public health institutions were available publicly on a monthly basis in 2011. The outcome indicators broadly corresponded to the prior actions under this objective. Achievement of each indicator is discussed below.

4.11 The general government wage bill maintained at below 32 percent of general government revenues in 2011. *Achieved.*

4.12 The relevant prior action was that the government froze government wages in nominal terms September 2012 by enacting the Law on the Amendments to the Law on Payment of Wages. The government maintained the nominal wage freeze as envisaged. As a result, the government wage bill control was maintained. The wage freeze was more than a temporary measure in the context of very low annual inflation. The government extended the nominal wage freeze through December 2013, beyond the horizon of the original program. This resulted in the overall wage bill remaining broadly flat in the 2010-13 period. As a share of total government revenues, the wage bill was maintained well below the target (Table 4.2). It should be noted, however, the ceiling (32 percent) on wages as a percent of general government revenue appears high.

Table 4.2. FYR Macedonia Wages Bill and Government Revenues

	2010	2011	2012	2013	2014	2015
<i>In Billions of Denar</i>						
Wages and salaries	22.6	23.1	22.7	22.6	23.4	24.5
Revenue	131.6	136.4	137.4	139.7	149.8	16.1
GDP	437.0	464.0	467.0	499.6	525.8	549.2
Wages / Revenue (%)	17.2	16.9	16.5	16.2	15.4	15.2

Source: IMF Country Report No. 15/18 (2015). Former Yugoslav Republic of Macedonia: Staff Report for Program Post-Monitoring and Press Release (Table 2, p. 23). <http://www.imf.org/external/pubs/ft/scr/2015/cr1518.pdf>.

4.13 Increase the number of formal workers with paid social insurance contributions from 407,887 in 2009 to 420,000 in 2011. Achieved.

4.14 A prior action associated with this indicator was the reduction of social insurance contribution rates through the adoption of the Law on Modifications and the Amendments of the Law on Compulsory Social Insurance. It was a part of the longer-term government policy. Social insurance contributions were reduced from 28.4 to 27 percent. Viewed in a longer perspective since 2008, social contributions were reduced from 32 to 27 percent; as of mid-2015, the 27 percent rate was unchanged. The objective of this measure was to further reduce the “tax wedge” and incentives for employment. Relatedly, the law separated the right to mandatory health insurance from the requirement for registration for the unemployed, which had in the past resulted in incentives to over-report unemployment. The government also introduced other measures to improve incentives for employment in the private sector. This strengthened incentives for payment of contributions in the formal sector. The enactment of the law resulted in a substantial reduction in the number of improperly registered unemployed persons and a reduction in the overall number of unemployed; from there on, the latter figure better reflected the actual number of unemployed. Subsequent to the law, there was an increase in the number of workers in the formal sector with paid social insurance contributions from 407,887 in 2009 to 467,609 in 2012, substantially exceeding the target. The PPAR mission was informed that the latest figure available for 2015 exceeded 500,000.

4.15 Pension spending is maintained at less than nine percent of GDP in 2011. Not Achieved.

The prior action related to this indicator was that the government has improved control over pension expenditures by adopting amendments of the Law on Pension and Disability Insurance (OGRM, no. 156/2009) which reduced the valorization coefficient (which adjusts the salaries of previous years for determining the amount of pension), thus having a cost-reducing effect on the pension system. Additionally, the reform aimed to equalize conditions for exercising the right to survival pension for both men and women. These actions were expected to contribute to the control of pension spending. In any event, pension spending for 2011-13 was maintained below 9 percent of GDP (Table 4.3). In 2014, pensions exceeded the 9 percent benchmark as a result of an ad-hoc increase in pensions indicating difficulty in sustaining this achievement. Importance of prudent approach to pension spending should be

seen in the context of the rapid aging of the population and, in particular, baby boomer, post-World War II generation retirement. Currently, about 18 percent of the Macedonian population (total of 1.06 million) are over 60, and 17 percent are under 14 years of age. The total fertility rate is below the replacement level (1.5), which means the population is projected to decline and age in coming years. By 2050, the population is projected to be only 1.8 million, and 35 percent of it will be over 60 (World Bank 2015).

Table 4.3. FYR Macedonia Pensions as Percent of GDP

2010	2011	2011	2013	2014	2015
8.6	8.5	8.8	9.2	9.1	9.1

Source: IMF September 2015. <http://www.imf.org/external/pubs/ft/scr/2015/cr15242.pdf> (Table 2b).

4.16 Arrears in the public health sector (Health Insurance Fund and Health Care Institutions) do not exceed 1.7 billion denars (0.4 percent of GDP) in 2011. *Not achieved.*

4.17 The prior action here was that the government adopted a program to improve the efficiency and sustainability of the health sector. This program and a number of actions were expected to lead to multiple improvements. One important improvement was the introduction of the Single Treasury Account for the Health Sector, which substantially improved monitoring, controls, and transparency of expenditures in the entire health sector. This system allows tracking of revenues, expenditures, debt, and other financial indicators. This information is regularly published on the Health Insurance Fund's website in quarterly reports. As a result of these and other measures, arrears in the health sector were kept within the 1.7 billion denar limit and then eliminated by 2013. However, by November 2015, these arrears resurfaced and stood at 0.7 percent of GDP, exceeding the target. It is of interest in this context that in the subsequent policy dialogue in 2012, it emerged that there were other payment arrears, which were subsequently cleared. (PPAR of Public Expenditure Policy Based Guarantee, May 2016, p.8). These arrears were building up during the preparation and supervision of the present operation, but that information only became known later in 2012 in the context of the subsequent policy based guarantee. If it was not for this issue, the overall assessment of this objective would have been substantial.

4.18 Comprehensive financial reports on public health institutions were available publicly on a monthly basis in 2011. *Achieved.*

4.19 The prior action was that the HIF adopted by-laws and a rulebook regulating the operations of the new Health Single Treasury Account covering all public health institutions. Following the reforms, HIF began publishing annual financial reports with detailed financial information on public health institutions. These reports and other detailed information on the health sector are published regularly on the HIF website: <http://www.fzo.org.mk/default-mk.asp>.

Objective 3: Strengthening social safety nets: Modest

4.20 Two outcome indicators measured expected results under the objective of strengthening social safety nets: (i) processing time for social financial assistance application

reduced from a baseline of 30 days in 2011, and (ii) the percentage of cash benefits going to the poorest quintile increased from 37 percent in 2009 to 40 percent in 2011, and increased further thereafter.

4.21 Processing time for social financial assistance application reduced from a baseline of 30 days in 2011. *Mostly achieved.*

4.22 Under this objective, the first prior action was that the Ministry of Labor and Social Policy developed a functional cash benefits MIS to the testing stage, and established a network between social welfare centers and the Ministry of Labor and Social Policy. This is an important achievement in the management of information, reporting, transparency, and inter-agency interconnectivity for the administration of cash benefits. The Ministry of Labor and Social Policy developed a new, fully functional cash based MIS, including a virtual private network between the Ministry of Labor and Social Policy and the social welfare centers, ensuring the security of data, and functionality and access to the system for all social welfare centers and the Ministry of Labor and Social Policy. Additional interconnectivities are under consideration. In terms of outcome indicator achievement, although the system was in a startup stage in 2011, the expected reduction in processing time in 2011 could not be documented. However, in 2012, the average processing time for new applications for social financial assistance benefits was reported at 19 days. Average processing time for social financial assistance for the existing beneficiary households, which registered change in their households, was 13 days.

4.23 Percentage of cash benefits going to the poorest quintile will increase from 37 percent in 2009 to 40 percent in 2011, with further increases thereafter. *Not achieved.*

4.24 According to the household consumption survey, which is conducted every year by the State Statistical Office of the Republic of Macedonia, the percentage of cash benefits going to the poorest quintile was 37.4 percent in 2009. In 2011, the percentage of cash benefits intended for the poorest quintile was 34.5 percent.⁶

4.25 In a related move, the government adopted its Program on Subsidizing Energy Consumption in 2011 (OGRM 6/2011), which introduced a mechanism for providing assistance to the poor and vulnerable against electricity price increases. This program provided additional, top-up payments through the same administration as the improved targeting pool of beneficiaries under the social financial assistance program. As such, it increased benefit generosity while maintaining targeting of the poor and vulnerable. The program has been extended by the decision of the government in each year. It contains elements of self-enforcement in that it paid a reimbursement for the paid bills to the electricity company. Therefore, it may have contributed on the margin to the payment and financial discipline of the electricity company.

⁶ Website of the State Statistics Office:
http://www.stat.gov.mk/PrikaziPublikacija_en.aspx?id=2&rbr=545.

Objective 4: Strengthening resilience of the financial sector: Substantial

4.26 Financial soundness indicators (FSI) were regularly reported and monitored and the Financial Stability Report discussed and acted upon by the FSC, and policy responses were coordinated among the NBRM, Ministry of Finance, and Deposit Insurance Fund. *Achieved.*

4.27 NBRM publishes regular annual financial stability reports.⁷ Reports contain a comprehensive picture of the financial stability issues and indicators in the country. Extensive financial soundness indicators are also available and downloadable into spreadsheet. It contains data from 2007, updated to the first quarter of 2015.

4.28 Importantly, the PBG also supported the establishment of the FSC in September 2011 based on good international practice. Since then, there are regular FSC meetings monitoring and reviewing financial stability. Coordination across agencies on issues of financial stability improved. The establishment of the FSC was a learning process and it set into motion subsequent measures. The FSC is chaired by the governor of the NBRM with 10 members, equally split between NBRM and the Ministry of Finance. In crisis situations, requiring the commitment of public financial resources, chairmanship shifts to the Minister of Finance. The FSC structure and functionality has been stable since inception. The FSC has a wide mandate to discuss various issues not only related to the crisis, including Basel II, and fit and proper criteria, for example. As a result, it developed an important knowledge function. Finally, outside the narrow FSC mandate, formal and informal communication channels were established and strengthened with other regulators and agencies. This has helped improve sector-wide communication, sharing of information, and coordination (for example, between the Agency for Insurance Supervision, Agency for Pension Fund Supervision, and the Securities Commission).

5. Ratings

Outcome: Moderately Satisfactory

5.1 The objectives were highly relevant, both in terms of the government's strategic priorities and the World Bank's strategy, especially considering the international financial context and the country's borrowing needs and continuum of reforms. The design was substantially relevant, combining the objectives of improving access to international markets with policy reform objectives in the areas of public finance and labor markets, safety nets, and the financial sector. Each of these policy areas represented a continuum of reforms and dialogue from the previous DPL1. Associated policy actions were also rooted in prior analytical work and policy dialogue that informed the operation's design. Moreover, these achievements were made in the particularly complex external economic environment.

5.2 The PBG was an innovative instrument that met the government's need for larger budgetary financing than would have been possible under a standard DPL, while helping

⁷ NBRM website: <http://www.nbrm.mk/?ItemID=E93CE394DF9E684F9356289B19564FD5>.

advance policy reform in key areas. The absence of the IMF program put an additional burden of proof on the World Bank team that the macroeconomic framework and debt sustainability were adequate for the purpose of the PBG. The country's strong track record on macroeconomic policies and structural reforms ensured that the country met the PBG eligibility criteria.

5.3 Efficacy was mixed. The critical indicators under objectives 1 (improving access to international markets), and 4 (strengthening resilience of financial sector) were substantially achieved. However, the issue of arrears in the health sector, in the context of other payment arrears that were building at the time and became subject of the subsequent policy based guarantee undermined the otherwise solid achievement of the second objective of strengthening public finances and functioning labor markets. The achievement of the third objective (strengthening social safety net) was also modest with one target achieved but the other not.

5.4 The PPAR mission discussion with the stakeholders and the information collected indicates that the broad reforms under the PBG were sustained and, in several areas, deepened, as noted previously. The achievement and sustainability of these reforms and outcomes should also be seen in the context of particularly difficult external and domestic environment that prevailed from 2011 through mid-2015, which included a triple regional recession and weather-related supply shocks (See South East Europe Regular Economic Reports, World Bank, 2012-14).

5.5 Finally, beyond the outcome indicator achievements, the PBG contributed to broader macroeconomic stability and economic activity, among other things, by providing timely budget financing, relieving pressure on the domestic banking system, and giving more room of maneuver to monetary and fiscal authorities, and to the government to pursue a broad reform agenda. The Central Bank would have likely had to reduce monetary accommodation in the absence of the PBG, with attendant effects on economic activity. And the government would have had to borrow from the domestic banking system or at higher commercial rates abroad. Also, by broadening the investor base and confidence, the operation has contributed to strengthening the country's standing in the commercial markets and has eased future external financing constraints. Reforms supported under the operation were sustained, and continued under the follow up, 2013 PBG, which focused on public expenditures. That operation is the subject of a separate PPAR currently under way.

Risk to Development Outcome: Moderate

5.6 As noted previously, reform actions and outcomes under the operation were broadly sustained over the past four years under difficult external and domestic conditions. Yet, FYR Macedonia's economy faces substantial external and, potentially, political and policy implementation risks. The PPAR team's assessment is that those risks are moderated by the government's solid track record and the quality of key economic ministries, learning from the past global recession, and improved capacity of the government to deal with macroeconomic and external risks. As a result, risk to outcomes is rated moderate.

5.7 On the external-macroeconomic side, while the banking system remains well capitalized and provisions are adequate, non-performing loans continue to pose a threat under conditions of new major shocks. This risk is mitigated by continuous, close monitoring of the banking sector risks and stronger capacity in the NBRM and FSC to deal with banking sector shocks than four years ago. While the country's debt increased, it remains moderate, and given constrained growth prospects, there is limited fiscal space for further increases in indebtedness. As a result, fiscal prudence will continue to depend on the government's ability to maintain control over public sector wages and pensions, something that may prove difficult in the context of the heightened political uncertainty and tensions in recent months. External risks, including from the new spillovers from the Greek crisis or other vulnerable European economies, remain. But the government's monetary and fiscal tools and capacity to cushion these impacts are now stronger than four years ago, in large part because of the intervening reforms. Finally, recent political tensions in FYR Macedonia underscore the difficulty of maintaining political consensus in the economic environment characterized by a weak regional economy, slow growth, and large unemployment; there is a risk that this may affect policy implementation in the future.

World Bank Performance: Satisfactory

Quality at Entry: Satisfactory

5.8 The PBG was an innovative operation, building on the pioneering PBG operation in Serbia six months earlier. It met the government's critical need to raise sufficient resources to finance its budget during difficult external conditions—and it did so in a timely fashion despite demanding preparation, which included coordination with third parties (commercial banks) and more intensive dialogue and informal technical assistance. It financed half of the projected fiscal deficit in 2012, providing four times larger resources than would have been possible under a standard DPO.

5.9 World Bank management and the team learned from the previous operation in several ways. This includes keeping the operation and its policy framework from becoming too complex and limiting the number of outcome indicators, as well as providing timely informal technical assistance to the government in what was a new type of operation for the borrower. This additional investment of World Bank time and resources was above what would have been required under a standard DPO. The team also invested additional efforts to navigate the World Bank's internal processes in preparing what was still a new instrument. The PPAR interviews and field visits indicate that the World Bank's regulatory framework guiding PBGs was still relatively untested and there were questions about the interpretation of some of its elements (for example, the track record used as a criterion of eligibility, the World Bank's country headroom borrowing limit, the definition of World Bank capital leverage, and so on). As a result, the World Bank team and the borrower spent considerable time on clarifications to apply and comply with the regulatory framework for PBGs on a tight schedule. However, there is no evidence that this has affected the expeditious preparation of the operation.

5.10 PPAR interviews indicate a very good working relationship of trust between the World Bank and the borrower. They indicate wide appreciation of the World Bank staff's

intensive engagement with the client, including ensuring that the operation was prepared in a timely fashion to meet the budget cycle of the government. The World Bank closely coordinated with the IMF even though the IMF did not have a program with the country at the time. The World Bank and IMF teams had a clear division of labor and complementarity of focus with the IMF concentrated on macroeconomic policies and macro-critical issues, and the World Bank on structural reforms. Because there was no IMF program at the time, the World Bank team appropriately invested more effort in monitoring and assessing macroeconomic policies.

5.11 Preparation of the operation started a year before approval but was delayed because of the intervening elections in May 2011. Following the elections, the World Bank team moved rapidly and completed the operation within several months. Despite interruptions and the speed of preparation following the elections, the World Bank maintained high-quality dialogue and engagement. Finally, the operation built on the previous DPL1 as well as analytical work focused on aspects of growth and investment climate, public expenditures, and the financial sector.

Quality of supervision: Satisfactory

5.12 The World Bank team remained engaged following the operation's approval. It provided continued monitoring of the reform program and dialogue with the government in the context of several missions combined with other project preparations and analytical work. The World Bank has also stepped up monitoring of macroeconomic and structural reforms and developments in the context of the regular regional economic report. With the absence of the IMF program, the World Bank continued to play an important role in maintaining a broad macroeconomic and structural policy dialogue. It is in this context of continued dialogue and reforms—but also continuing uncertainties stemming from the Eurozone and international financial markets—that the second PBG was developed later in 2013, building on the achievements in financial and policy reform objectives of this PBG.

Borrower Performance: Satisfactory

5.13 The government showed strong commitment and ownership of the PBG policy reform and the financial objectives of improving access to international markets. The borrower's trust in the World Bank's ability to deliver was apparently strong. That trust was strengthened in the course of developing the operation as the World Bank team delivered on the client request with a timely and large volume of financing using a new instrument.

5.14 The government's main ministries and agencies—the Ministry of Finance, NBRM, Ministry of Labor and Social Welfare, and the Health Insurance Fund—were closely engaged in the policy dialogue. Technical-level staff engagement, communication, and reporting with the World Bank team were very good. The Ministry of Finance played very well the key coordinating role. And NBRM engagement was critical on the financial sector agenda.

5.15 The government actively sought to learn from the previous PBG experience in Serbia. It consulted that country's Ministry of Finance and its Public Debt Administration extensively in the course of preparation for the operation. This country-to-country learning

and collaboration is an important feature of operation preparation, and the World Bank actively encouraged it.

5.16 The borrower's reporting and provision of information to World Bank staff was satisfactory. Cooperation with the World Bank team was strong and featured a frank dialogue, including on politically difficult issues. Productive and direct virtual communications with the World Bank's technical counterparts were frequent and helped maintain the continuity of dialogue between missions. All prior actions were met as well as non-prior actions which were part of the policy matrix and the achievement of outcomes was high. PPAR field visits indicated that in most policy areas, reforms continued, indicating the sustainability of the policy reform agenda under the PBG. Building on the experience of this PBG, the next stage of reforms was supported by the second PBG in 2013.

Monitoring and Evaluation: Substantial

5.17 **Design.** The M&E framework was solid. Objectives were clearly defined and linked to actions and outcome indicators. Indicators were more limited than is often the case in DPLs, a welcome element of design. They were generally measurable, quantitative, and identifiable with some institutional indicators. Of the 11 indicators, eight were quantitative, making their assessment relatively straightforward. Several were more in the nature of output indicators, but were important to monitor to maintain control of the government budget (for example, pension expenditures as percent of GDP, and wage bills). The other three were identifiable events or institutional actions (for example, the government raising funding independently in the international markets and regular reporting of financial soundness indicators). In most cases, the same or related indicators and information could be tracked and updated three and a half years after operation approval, which made it possible to obtain a sense of sustainability of reform actions and outcomes. In a few cases (pension expenditures and wage bills) target indicators could have been more ambitious, but this should be understood in the context of structural constraints on public sector employment partly related to the Ohrid Agreement.

5.18 Data required were generally available from the government's public sources from the relevant ministries and agencies (for example, the Ministry of Finance, NBRM, Ministry of Labor and Social Welfare, and National Health Foundation) and comparative macroeconomic indicators (for example, IMF macroeconomic data, and so on). Quantitative indicators had clear baselines.

5.19 **Implementation.** Most indicators were quantitative and measured. There was considerable prior consultation and agreement with the borrower on the choice of the indicators. There was also adequate consultation with the IMF on macroeconomic and fiscal issues. The Ministry of Finance had a coordinating role with other agencies which monitored and reported indicators in their domains. This arrangement worked effectively.

5.20 **Utilization.** Indicators were used to inform the direction of reforms. Tracking wage bill and pension spending, for example, were used to monitor the success of expenditure control and implementation of the budget. And processing time for applications for social financial assistance was monitored to assess the efficiency of implementation of the cash

benefits MIS. Financial soundness indicators are continuously used by the NBRM and the FSC to monitor the health of the banking system and they are regularly reported on the NBRM website and available for download by the public.

6. Lessons

6.1 This operation offers several lessons for the future design of PBGs. Some may be of broader interest for the use of the instrument, while others are more project specific.

6.2 Regarding broader lessons for the *use of the PBGs*, the following three could be considered.

6.3 First, The PBG remains a fairly unknown and underutilized instrument globally, despite its potential. Therefore, the World Bank could usefully and systematically inform the borrowers of the PBG option and discuss its benefits and risks. Recent regulatory reform by OPCS, which brought PBGs under the umbrella of DPO policy regulation, is an important step in the direction of mainstreaming PBGs as a specific type of DPO.

6.4 Second, PBGs appear to be a suitable instrument of providing financing for the budget for other countries, expanding the World Bank's toolkit of DPO varieties. PBGs could potentially have wide applicability, especially, for example, in many small, vulnerable economies with substantial external financing needs and with a solid track record of macroeconomic performance, debt management, and policy reform and a good dialogue with the World Bank. But PBGs could also be relevant to larger World Bank borrowers with large, temporary financing needs combined with strong macro management and reforms. Demand for PBGs is likely to increase during periods of elevated market risks and worsened access and terms of sovereign borrowing. Anticipating these conditions and changes in demand for PBGs could be factored into the Bank's regional lending strategies.

6.5 Third, PBGs have the potential to leverage and increase the turnover of World Bank capital on the margin from the perspective of the country lending allocation. IBRD guaranteed €100 million of the total principal of €130 million. And with the PBGs, World Bank capital is released and available for existing and new client borrowers much earlier (after the five to seven years that PBG maturities typically have) compared with traditional DPOs (over 20 years).

6.6 It is important to recognize the potential risk to World Bank capital and, indeed, its financial standing associated with a potential default on one or more guarantees in the future. There is a risk of contagion to other PBG borrowers and consequent downgrading of World Bank client sovereign ratings. While this risk is currently small because of the small number of PBG operations, greater use of the instrument will require close monitoring and continuous risk assessments at the regional and global levels.

6.7 Several *project-specific lessons* have emerged, which may be of broader interest for the future design of PBGs.

6.8 First, while the direct financial benefits of PBGs to improve market access and terms of external borrowing, and the ability of a country to borrow more than under a traditional DPO, are substantial, there are other, indirect benefits. Those benefits could be usefully highlighted and explained to potential future borrowers based on the early PBG experience. For example, the borrower is able to establish itself in the eyes of international investors and broaden the investor base, which can be very useful for small countries that are not well known to international lenders. Also, by providing substantial external financing to the budget at the right time, PBGs can help temporarily both macroeconomic stability and economic activity by relieving pressure on the domestic banking system and allowing domestic banks to provide more credit to the private sector.

6.9 Second, strong and relevant design and high achievement is much more likely when the operation's design is informed by considerable knowledge work, intensive and longer-term World Bank engagement and dialogue, and, especially important, a relationship of trust between the World Bank and the Borrower.

6.10 Third, it is important to recognize that a PBG is no free lunch. The substantial financing it provides should not be used by clients to postpone but to facilitate reforms and necessary adjustments. Hence, a strong reform program is essential. Also, while the bullet repayment feature temporarily relieves repayment and fiscal pressure, it could add to borrower risk of repayment *in the future* unless it is accompanied by ex-ante provisions equal to the amount required under a standard annual repayment schedule. Repayment options and their pros and cons should, therefore, be discussed at length with the client. Standard repayment schedules should normally be preferred and bullet repayments should be accompanied by a World Bank recommendation (or requirement) to the Borrower to make annual provisions.

6.11 Fourth, this operation shows that the World Bank is particularly effective when it promotes the regional and global public good of country-to-country learning during preparation of similar projects in different countries. This is especially the case when testing relatively new instruments as was the case with PBGs. The FYR Macedonia PBG benefitted from consultations the FYR Macedonia government held with the government of Serbia on the costs and benefits and technical details of the operation. The World Bank took an active part in these consultations and encouraged this productive learning. The World Bank team itself has shown that the lessons from the first PBG in the region on Serbia were absorbed and integrated into the design of the FYR Macedonia operation.

6.12 Fifth, financial sector supervision and regulation can help preserve macroeconomic and financial stability in the face of substantial external shocks and adverse local conditions. At a time when many a country in Europe faced bankruptcy or major interventions of systemic banks, FYR Macedonia's fiscal and monetary authorities managed to maintain stability by a combination of active monitoring, a focus on stability, and anticipation of the impact of regional shocks.

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Appendix A. Basic Data Sheet

POLICY BASED GUARANTEE (G-2080-MK, P125837)

Key Project Data (amounts in US\$ million)

	Appraisal estimate	Actual or current estimate	Actual as % of appraisal estimate
Total project costs	134.90	134.90	100
Loan amount	134.90	134.90	100

Cumulative Estimated and Actual Disbursements

	FY 11
Appraisal estimate (US\$M)	134.90
Actual (US\$M)	134.90
Actual as % of appraisal	100

Project Dates

	Original	Actual
Concept Review	02/18/2011	02/18/2011
Appraisal	09/16/2011	09/16/2011
Board approval	11/10/2011	11/10/2011
Signing	11/22/2011	11/22/2011
Effectiveness	12/07/2011	12/07/2011
Closing	12/31/2012	12/31/2012

Task Team members

Name	Responsibility/Specialty	Unit
Lending and Supervision		
Evgenij Najdov	Task Team Leader	ECSP2
Marina Wes	Lead Economist	ECSP2
Rajna Cemerska	Operations Officer	ECSH3
Rekha Menon	Senior Economist	EASH1
Ronald Hendriks	Consultant	
Johannes Koettl	Senior Economist	ECSHD
Martin Melecky	Sr Financial Sector Spec.	ECSF2
Aurora Ferrari	Manager	ECSF1

<i>Name</i>	<i>Responsibility/Specialty</i>	<i>Unit</i>
Daniel Bruncic	Consultant	
Snjezana Plevko	Senior Economist	ECSH3
Bojana Naceva	Senior Education Specialist	ECSH2
Lewis Hawke	Senior Financial Management Specialist	ECSC3
Julie Rieger	Senior Counsel	LEGLE
Nikolai Soubotin	Lead Counsel	LEGEM
Thomas A. Duvall	Chief Counsel	LEGCF
Neil Ashar	Counsel	LEGCF
Pilar Gonzalez	Counsel	LEGCF
Jose C. Janeiro	Senior Finance Officer	CTRFC

Staff Time and Cost

<i>Stage of Project Cycle</i>	<i>Staff Time and Cost (Bank Budget Only)</i>	
	<i>No. of staff weeks</i>	<i>US\$ Thousands (including travel and consultant costs)</i>
Lending		
FY11	24.5	98,570.83
Supervision		
	7.02	52,277.58

Appendix B. The Bank's Experience with Policy-Based Guarantees

Although the World Bank introduced the policy-based guarantee (PBG) in 1975 and has completed eight operations, very little independent evaluative evidence exists on the instrument's effectiveness and development impact.⁸ Between 1975 and 2015, the World Bank implemented PBGs in Côte d'Ivoire (1975); Argentina (1999); Colombia (2001); Serbia (2001); the Former Yugoslav Republic of Macedonia (2012, 2013); Montenegro (2012); and Albania (2015) (see table B.1). The \$5.6 million Côte d'Ivoire operation was evaluated in 1985 and its development outcome was rated as Unsatisfactory.⁹ The \$250 million PBG for Argentina, which was an innovative use of the guarantee instrument, was called, but the Implementation Complement Report (ICR) does not seem to be publicly available.¹⁰ There is, however, a brief ICR Review for the Argentina Special Structural Adjustment Loan (SSAL), in which part of the 2nd tranche was cancelled and allocated to a separate \$1.1 billion PBG. The Independent Evaluation Group (IEG) rated this operation's development outcome as well as borrower performance, as Unsatisfactory.¹¹ A more extensive discussion of the Argentine experience can be found in IEG's evaluation of the guarantee instrument at the World Bank Group.¹² No Project Performance Assessment

⁸ For a list of policy-based guarantees, see

<http://www.worldbank.org/projects/search?lang=en&searchTerm=Policy-Based%20Guarantee>.

⁹ <http://www.worldbank.org/projects/P001113/small-scale-enterprise-project?lang=en>. Neither the ICR Review nor the PPAR for that operation are publicly available.

¹⁰ <http://www.worldbank.org/projects/P068845/argentina-policy-based-guarantee-operation?lang=en>

¹¹ IEG ICR Review – AR Special SAL (SSL), 2003,

<http://lnweb90.worldbank.org/oed/oeddoclib.nsf/DocUNIDViewForJavaSearch/8525682E0068603785256C54006BA2D0?OpenDocument>

¹² http://siteresources.worldbank.org/EXTGUARANTE/Resources/guarantees_eval_full.pdf.

According to this IEG evaluation (2009), in the case of the two PBGs for Argentina and Colombia, the guarantees exerted considerable leverage—generating financing of 4.7 times the value of the PBG in Argentina and 6.3 times its value in Colombia. The Colombia operation achieved investment grade status which enabled the country to reestablish access to international capital markets at a time when investor interest was low or nonexistent. In Argentina, although the country was able to access both U.S. and non-U.S. capital markets at similar terms, the PBG enabled it to issue a significantly larger bond (\$1.2 billion) than would otherwise have been possible at the time. In Argentina and Colombia, although both countries had previously accessed international capital markets, the PBGs effectively reintroduced their large bond issues to international markets at a time when they were either closed to emerging market economies or constrained to small volumes. Following the collapse of the Argentinean financial system, the country's adjustment program went off track, and reforms that were intended to be supported by a World Bank adjustment loan as well as the PBG financing were not achieved. In Colombia, when the PBG was issued, the government had been implementing a broad reform program supported by a World Bank Financial Sector Adjustment Loan. The World Bank's self-evaluation of the project noted that in this context, hybrid policy loan/guarantee operations might provide more policy leverage and better sequencing than standalone policy guarantee operations. The World Bank's decision to extend repayment terms on the called PBG in Argentina effectively ended its ability to use rolling, reinstatable PCGs. [[AQ: Do you mean PBG or is this a new abbreviation

Report (PPAR) seem to have been prepared for this very complex and large operation which was large to fill the financing gap in the International Monetary Fund program defending Argentina's peg to the dollar (through its currency board). For Colombia PBG (\$230.3 million), there is an ICR Review¹³ which rates the development outcome as Moderately Satisfactory and is critical of the guarantee operation, arguing that "international capital market inefficiencies were not in Colombia's favor despite the PBG (mainly because of the collateral damage from the Argentine guarantee debacle which resulted immediate downgrading of Colombia's bonds (backed by the World Bank guarantee, see fn. 6). The PPAR for the Colombia FSAL rates the overall operation (FSAL) as Satisfactory but does not evaluate the PBG portion of the financing operation.¹⁴ ICRs were conducted for the Serbia PBG operation, the two Macedonia operations, and the operation for Montenegro (the Albanian PBG is too recent to have been reviewed).

Table B.1. World Bank Policy Based Guarantee, 1975 - 2015

<i>Project title</i>	<i>Country</i>	<i>Project ID</i>	<i>Commitment (US\$ millions)</i>	<i>Status as of September 2015</i>	<i>Approval date</i>
Albania Public Finance Policy-Based Guarantee	Albania	P149765	226.7	Active	March 27, 2015
FYR Macedonia Public Expenditure Policy-Based Guarantee	Macedonia, FYR	P133791	201.5	Active	January 8, 2013

that needs to be introduced?]]The Rolling Reinstatable Guarantee (RRG) mechanism for PCGs was introduced on a pilot basis in 1999, and three PCGs [[AQ: PBG or a different instrument?]] were issued using it between 1999 and 2001—in Thailand, Argentina, and Colombia. However, according to IEG's 2009 evaluation of the World Bank Group instrument, given difficulties in modeling and valuing the credit enhancement, RRGs were seen as being penalized by the market. This in turn was seen as affecting the value placed on direct World Bank bond issues, thereby potentially raising the cost of borrowing for the World Bank. In this context, in 2000 the World Bank adopted a very cautious approach to future transactions using the RRG structure. Then in 2002, the PBG in Argentina was called when Argentina failed to service the outstanding bond. Rather than enforce the 60-day period in which Argentina had to repay the World Bank for the guarantee to roll over, the World Bank rescheduled the loan, causing the guarantee to lapse. The market immediately downgraded the issue and also downgraded the RRGs in Thailand and Colombia.

¹³ Implementation Completion Report (ICR) Review for Colombia FSAL (2003): <http://lnweb90.worldbank.org/oed/oeddoclib.nsf/DocUNIDViewForJavaSearch/8525682E0068603785256C54006BA2D0?OpenDocument>

¹⁴ The PPAR for the FSAL simply mentions that "most of the resources of the FSAL second tranche were used to fund a PBG in March and May 2001" and then goes on to indicate that "this assessment does not cover the outcomes (nor Bank and borrower performance) under the PBG, as the PBG has not yet closed and remains active today." http://ieg.worldbankgroup.org/Data/reports/PPAR-40139-P006884-Colombia_Financial_SALs.pdf

<i>Project title</i>	<i>Country</i>	<i>Project ID</i>	<i>Commitment (US\$ millions)</i>	<i>Status as of September 2015</i>	<i>Approval date</i>
Montenegro Financial Sector Policy-Based Guarantee	Montenegro	P130157	79.2	Active	June 28, 2012
FYR Macedonia Policy-Based Guarantee	Macedonia, Former YR	P125837	134.9	Active	November 10, 2011
Private and Financial Sector Policy-Based Guarantee	Serbia	P102651	400.0	Active	February 10, 2011
Colombia Policy-Based Guarantee	Colombia	P072723	220.3	Closed	March 8, 2001
Argentina Policy-Based Guarantee Operation	Argentina	P068845	250.0	Closed	September 16, 1999
Small-Scale Enterprise Project	Côte d'Ivoire	P001113	5.6	Closed	August 21, 1975

Source: World Bank (<http://www.worldbank.org/projects/search?lang=en&searchTerm=Policy-based%20guarantee>).

Note: For active and closed projects, the commitment amount at Board approval is shown in US dollars. These figures do not reflect any cancellations.

Appendix C. List of Persons Met

Government

Mr. H.E. Dime Spasov, Minister, Ministry of Labor and Social Policy
 Ms. Jasmina Ivanova, CCT project director, Ministry of Labor and Social Policy
 Ms. Elizabeta Kunovska, Ministry of Labor and Social Policy
 Ms. Irena Risteska, Head of Pension Department, Ministry of Labor and Social Policy
 Ms. Verica Prokovic, Head of Budget Department, Ministry of Finance
 Ms. Violeta Stojanovska, State Advisor, Financial Systems, Ministry of Finance
 Ms. Natasa Stojmanovska, Financial Systems, Ministry of Finance
 Mr. Dejan Nikolovski, Public Debt Department, Ministry of Finance
 Ms. Lence Tagasovska, Financial Systems, Ministry of Finance
 Ms. Suzana Peneva, State Advisor, Ministry of Finance
 Ms. Hristina Trajkovska, Ministry of Finance
 Ms. Ana Todorovska, Ministry of Finance
 Ms. Andrea Lazarevska, Ministry of Finance
 Ms. Vesna Svetanova, Macro Department, Ministry of Finance
 Mr. Jordan Trajkovski, Ministry of Finance
 Ms. Tanja Tripunova, Assistant Head, Budget Department
 Mr. Toshe Panovski, Head of Unit, Budget and Budget Policy
 Ms. Biljana Trajkovska, former Chief of Cabinet Ministry of Labor, Ministry of Education & Science
 Mr. Jovan Grpovski, Minister's advisor & former Director Health Insurance Fund, Ministry of Health

National Bank

Mr. Dimitar Bogoev, Governor, National Bank of the Republic of FYR Macedonia
 Ms. Milica Arnaudova, Director, Sector for Supervision, Banking Regulation and Financial Stability

Health Insurance Fund

Ms. Tatjana Lukanovska, Health Insurance Fund
 Mr. Vladimir Dimkovski, Health Insurance Fund

International Monetary Fund

Mr. Patrick Gitton, Resident Representative, IMF

World Bank Group

Ms. Jane Armitage, former Country Director, Western Balkans
 Ms. Marina Wess, lead economist, Western Balkans
 Mr. Evgenij Najdov, Senior Economist, TTL
 Mr. Goran Tinjic, Senior Operations Officer
 Mr. Gianfranco Bertozzi, Lead financial specialist, TRE
 Ms. Satu Kahkonen, former Sector Manager, PREM
 Ms. Aurora Ferrari, former Sector Manager, FPD
 Mr. Bojana Naceva, TTL for the CCT and focal point for social protection

Appendix D. FYR Macedonia Macroeconomic Framework, 2011-2020

Table 1. FYR Macedonia: Macroeconomic Framework, 2011–2020
(Year-on-year change, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
					Proj.					
Real GDP	2.3	-0.5	2.7	3.8	3.2	3.2	3.3	3.4	3.6	3.8
Real domestic demand	0.4	3.5	-2.6	4.2	3.8	3.5	3.1	3.1	3.2	3.2
Private consumption	-5.4	1.2	2.1	2.3	2.0	2.1	2.2	2.4	2.6	2.6
Gross investment	17.9	10.2	-16.6	13.5	7.5	6.5	5.6	5.4	5.0	5.0
Exports (volume)	16.1	2.0	-2.7	17.0	7.7	6.7	8.8	8.2	7.6	6.9
Imports (volume)	8.0	8.2	-10.0	14.5	7.7	6.5	7.1	6.7	6.1	5.3
Contributions to growth 1/										
Domestic demand	0.5	4.0	-3.1	5.1	4.3	4.0	3.5	3.6	3.7	3.6
Net exports	1.7	-3.9	5.0	-0.9	-1.1	-0.8	-0.2	-0.2	-0.1	0.2
Output gap (percent of potential GDP)	1.1	-2.1	-2.2	-1.4	-1.1	-0.8	-0.5	0.0	0.7	1.7
General government operations (percent of GDP)										
Revenues	29.4	29.4	28.0	27.6	29.1	29.1	28.9	28.9	28.9	28.9
Expenditures	31.9	33.3	31.8	31.8	33.1	33.0	32.4	32.4	32.4	32.4
Of which: capital	3.8	4.0	3.3	3.4	3.9	4.1	3.9	3.9	3.9	3.9
Balance	-2.5	-3.8	-3.9	-4.2	-4.0	-3.8	-3.5	-3.5	-3.5	-3.5
Savings and investment (percent of GDP)										
Domestic saving	24.4	26.0	26.7	29.2	30.2	30.6	31.0	31.4	31.3	31.0
Public	2.5	0.2	-0.5	-0.9	-0.1	0.2	0.4	0.4	0.4	0.4
Private	19.2	25.8	27.2	30.1	30.3	30.4	30.6	31.0	30.9	30.6
Foreign saving	2.5	2.9	1.8	1.3	3.2	4.4	4.3	3.8	3.6	3.5
Gross investment	26.9	28.9	28.5	30.6	33.4	35.0	35.3	35.2	34.9	34.5
Consumer prices										
Period average	3.9	3.3	2.8	-0.3	0.1	1.3	1.8	1.9	2.0	2.0
End-period	2.8	4.7	1.4	-0.4	0.8	1.7	1.8	2.0	2.0	2.0
Private sector credit growth	7.7	5.2	6.3	9.8	7.6	6.4	7.5	7.4	7.3	7.1
Memorandum items:										
Current account balance (percent of GDP)	-2.5	-2.9	-1.8	-1.3	-3.2	-4.4	-4.3	-3.8	-3.6	-3.5
Gross official reserves (millions of euros)	2,069	2,193	1,993	2,434	2,277	2,476	2,704	2,789	2,859	2,998
in percent of ST debt	112	101	107	116	111	121	118	121	134	133
in months of prospective imports	4.9	5.3	4.3	4.9	4.1	4.0	4.0	3.8	3.5	3.7
Gross general government debt (percent of GDP)	27.7	33.7	34.1	38.1	37.0	39.5	41.0	42.5	43.8	44.8
Public and publicly guaranteed debt (percent of GDP) 2	30.1	36.3	38.2	43.5	44.2	48.3	50.9	52.9	53.8	54.1
Foreign direct investment (percent of GDP)	4.6	1.5	3.3	3.3	3.1	3.1	3.4	3.6	3.7	3.8
External debt (percent of GDP)	64.2	68.2	64.3	69.8	68.3	72.2	75.6	76.1	75.9	75.6
Nominal GDP (billions of denars)	464	467	500	526	549	574	602	633	668	708
Nominal GDP (millions of euros)	7,544	7,585	8,112	8,533	8,912	9,322	9,776	10,278	10,844	11,481
GDP per capita (PPP, constant USD 2005)	9,356	9,323	...	...	...	...	...	...	...	...
Gini coefficient	39.2	...	...	...	...	...	...	...	...	...

Sources: NBRM; SSO; MOF; World Bank; and IMF staff estimates and projections. National Accounts are revised by SSO, using ESA 2010 Methodology.

Note: 1/ The inconsistency between Real GDP growth and contributions to growth results from discrepancies in the official data on GDP and its components.
Note: 2/ Including general government and public sector non-financial enterprises.

Appendix E. Borrower Comments



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To:	The World Bank 1818 H Street N.W. Washington, D.C. 20433 U.S.A.	No.15- 9034/2 Skopje <u>30-06-2016</u>
Attn:	Mr. Mark Sundberg Manager, Economic Management and Country Programs, Independent Evaluation Group	Government of Republic of Macedonia Ministry of Finance St. Dame Gruev no.12 1000 Skopje, Republic of Macedonia Tel: ++ 389 2 3255 444 Fax: ++ 389 2 3255 724 e-mail: <i>Ivana.Popovska@finance.gov.mk</i> Web site: <i>www.finance.gov.mk</i>
Subject:	Policy Based Guarantee Project (IBRD-G-2080) and Public Policy Based Guarantee Project (IBRD-G-2170) Draft Project Performance Assessment Reports (PPARs)	

Dear Mr. Sundberg,

With reference to your letter dated 7th June 2016, transmitting the Project Performance Assessment Reports (PPARs) of the two Policy-Based Guarantee Projects prepared by the Independent Evaluation Group (IEG), please find below consolidated comments from all relevant national institutions included in the implementation of PBG loans.

Comments on the Project Performance Assessment Report for Macedonia Policy-Based Guarantee PPA Report (G-2080-MK, P125837), June 1, 2016

Chapter 1. Background and Context:

- *Section 1.3* The wording on Macedonia's ranking in the Doing Business Report: "In 2010, it ranked 38th in the world, an exceptional improvement from 92nd position in 2006. It continued to improve its ranking and achieved the 22nd rank in the world in 2012; as of 2015, it still ranked 30th in the world, which remains the highest in the Western Balkans." has to be updated with the rankings from Doing Business 2016 Report, ranking the Republic of Macedonia as 12th in the world.
- *Section 1.4* The sentence on unemployment "Labor Force Survey (LFS) data, indicate that unemployment dropped from 37 percent in 2004 to 32 percent in 2009 and further to 28 percent in 2014 (World Bank 2015), but youth unemployment at 35 percent remains very high." has to be updated with the data available for 2015 and/or Q1 2016 published by the State Statistical Office. Unemployment rate in Macedonia dropped to 26.1 percent in 2015, while the data for Q1 2016 show an unemployment rate of 24.5%.

Chapter 5. Ratings/Outcome: Moderately Satisfactory

- *Section 5.5* With reference to the sentence "The Central Bank would have likely had to tighten policy more in the absence of the PBG, with attendant effects on economic



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activity", we would like to emphasize that considering we were in a cycle of monetary accommodation, the more appropriate wording would be: "The Central Bank would have reduced the scope of monetary accommodation in the absence of the PBG, with attendant effects on economic activity".

General comments on the PPA Report (G-2080-MK, P1255837)

- We would like to emphasize that the reference "Former Yugoslav Republic of Macedonia" used throughout the Report should be replaced by the constitutional name of the country "Republic of Macedonia".

Comments on Project Performance Assessment Report for Macedonia Public Expenditure Policy-Based Guarantee PPA Report (G-2170-MK), June 1, 2016

Regarding the overall outcome of the Project, which is rated moderate satisfactory, we would like to stress out that the Republic of Macedonia ensured efficient and effective preparation and implementation of all covenants and achieved the development goals determined in the agreements. Main Project development objectives of the PEPBG were to improve the efficiency of public expenditures by strengthening public financial management practices; improving the efficiency of service provision in the health sector; and strengthening social protection and inclusion. All prior actions were completed prior to the Board presentation and all outcome targets were achieved well within the timeframe outlined in the Project document. The design of the operation was very well prepared based on ongoing Government reforms, focusing on three reform pillars, eight prior actions and eight measurable outcome indicators. This reflected Government's commitment to the Program, as well as the Bank's ability to rapidly respond to the request of the client by providing sound policy advice and leveraging support from other stakeholders. For all these reasons, and the fact that the MoF was in charge of monitoring, coordination and overall implementation of PBG, I strongly believe the Program should be rated as satisfactory and that this rating will be envisaged in the final Report.

Chapter 1. Background and Context/Section 1.4:

- Sentence on economic growth "In the years following the approval of the PEPBG, Macedonia experienced a resumption of economic growth aided by overall improvement in regional and global economies" should be supported by numerical evidence.
- The wording "50 percent" in the sentence "Public and publicly guaranteed debt (PPG) approached 50 percent of gross domestic product (GDP) by the end of 2015", should be replaced with the wording "46.5 percent". This is according to the preliminary debt data of the MoF.
- With respect to the sentence "Against the background of growing indebtedness, repetitive delays in fiscal consolidation, and political uncertainties, Macedonia saw an increase in the spreads on its international bonds by the end of 2015.", we would like to point out that the main driver of increase in the spreads of Macedonian bonds is the political situation and the uncertainty. FY 2015 ended with budget deficit of 3.5% of GDP, lower than the deficit projected in the Supplementary Budget, and growth of 3.7% of GDP. Having in mind these numbers, this sentence should be deleted, since the basis on which the Bank grounds this statement is not clear.

Chapter 4. Relevance of Design - Modest/Choice of the Instrument:

- *Section 4.2:* The wording "10 percent" in the sentence "Macedonia is the only country that



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has benefited from two PBGs under which €255 million of the Bank's guarantees leveraged €380 million of commercial loans, which comprised about 10 percent of Macedonia's outstanding public debt as of 2015" should be replaced with the wording "8.9 percent".

- *Section 4.5:* The sentence "This is an indication that the government's spending plan expanded toward the end of 2012 against the backdrop of available financing." should be deleted because budget financing in mid-2012 was used for budget financing needs and debt repayment in 2012. PBG2, contracted in January 2013, was used to cover budget needs and debt repayment throughout 2013 and half of 2014, having in mind that the next international borrowing of the country happened in mid-2014 by issuing the Eurobond in the amount of EUR 500 million. The Report, in particular this paragraph, contains conclusions based on lack of information. Making a statement that the Government spending plan expanded in 2012, due to new borrowing in the amount of additional EUR 250 million, without commenting on the financing needs and debt profile for the same period, as well as not indicating the period in which these proceeds were being used, is speculative, misleading and tendentious.

Chapter 6. Achievement of Objectives/Macroeconomic Developments in 2013-2015 (not rated), Fiscal Transparency and Efficiency of Public Expenditures:

- *Section 6.1* Text on the economic growth in Section 6.1 should be supported by numerical evidence, indicating the magnitude of its relative strength.
- *Section 6.3* The sentence "Macedonia PPG debt is estimated to exceed 48 percent of GDP by the end of 2015, which is 10 percent point higher than in 2012" should be replaced with the following sentence "Macedonia PPG debt accounted for 46.5 percent of GDP by the end of 2015, being by 8 percent points higher than in 2012".
- *Section 6.6* As regards the sentence "Macedonia went back to the international bond market in mid-2014 with an issuance of €500 million Eurobonds having a 10-year maturity and an interest rate of 3.95 percent (an estimated spread of around 3 percent against German 10-year bonds)", the Eurobond (notes due 2021) was issued with a 7-year tenor, so we would like to point out that the wording "10-year" should be replaced with the wording "7-year".
- *Section 6.13* The wording "10 percent of GDP" in the sentence "Implementation of PESR projects will add an estimated 10 percent of GDP on the country's debt stock over the medium term" should be replaced with the following wording "around 5 percent of GDP by the end of 2018".
- *Section 6.17* The sentence "The result has been the implementation of several controversial large investment projects such as the Skopje's urban beautification project (known as Skopje-2014 project), which reportedly cost hundreds of millions of euros." should be deleted.

Chapter 8. Risks to Development Outcomes/Section 8.4:

- As regards Section 8.4, we would like to point out a general comment that according to the latest 2016 - 2018 Fiscal Strategy, public debt, which includes both general government debt and PPG debt, will reach the level of 52.4 percent of GDP, which is lower than the ceiling of 60 percent of GDP. Additionally, MoF analyses show that public debt is



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sustainable over the medium term.

General comments on the PPA Report PBG (G-2170-MK)

- We would like to point out that the reference "Former Yugoslav Republic of Macedonia" used throughout the Report should be replaced by the constitutional name of the country "Republic of Macedonia".
- As regards the source of information in some of the tables, saying they are provided by the "Ministry of Social Protection", it should be replaced by "Ministry of Labor and Social Policy, since "Ministry of Social Protection" does not exist.

Sincerely yours,

Kiril Mimoski, MA
Minister of Finance

