The World Bank in FYR Macedonia

# Country Snapshot

*An overview of the World Bank's work in FYR Macedonia* **April 2018**

| FYR MACEDONIA | 2017 |
|---|---|
| Population, million | 2.08 |
| GDP, current US$ billion | 11.3 |
| GDP per capita, current US$ | 5.2 |
| School Enrollment, primary (% gross) | 93.2 |
| Life Expectancy at birth, years (2017) | 75.5 |

## At a Glance

- The political turmoil of 2015–17 slowed real GDP growth in 2017 from 2.9% in 2016 to 0% in 2017, driven by a fall in investments.
- The Government focuses on major economic reforms to accelerate economic growth, job creation, fair taxation, private sector expansion, and protection of the most vulnerable.
- For the remaining current Country Partnership Strategy cycle ending in December 2018, the World Bank plans to support the implementation of public financial management and reform of social services.
- The World Bank is preparing a Systematic Country Diagnostic and a new Country Partnership Framework for FYR Macedonia in close consultation with national authorities and other stakeholders.

## Country Context

After two years of political turmoil and delays in establishing a parliamentary majority following the early parliamentary elections in December 2016, a new coalition Government was formed in May 2017, consisting of the Social Democratic Union of Macedonia (SDSM) and two ethnic Albanian parties (the Democratic Union for Integration and Alliance for Albanians).

The reform agenda outlined in the new Government's Program 2017–2020 focuses on economic growth, job creation, fair taxation, support to small and medium enterprises, reform of social protection programs for the most vulnerable, and public administration reform. In addition, the Government has adopted a set of measures aimed at accelerating the process of European Union (EU) and NATO accession.

Finally, the Government has taken steps to resolve pending issues with neighboring countries, including a friendship agreement with Bulgaria, and intensified diplomatic relations with Greece in an attempt to resolve the long-standing dispute over country's name.

The political turmoil of 2015–17 slowed economic growth in 2017. Real GDP growth dropped from 2.9% in 2016 to 0% in 2017. The slowdown is mostly explained by a fall in investment by 4.5%. The inauguration of the new Government in June 2017 reduced political uncertainties, as evidenced by businesses' improved production outlook. Private consumption was the only contributor to growth in 2017, supported by higher employment and wages.

## The World Bank and FYR Macedonia

The 2015–18 Country Partnership Strategy (CPS), approved in October 2014, focuses on two areas:

- Growth and Competitiveness. Improvements in the business climate and trade regime are essential to attracting private investment and enhancing export performance in order to achieve sustained private sector–led growth and job creation.
- Skills and Inclusion. Interventions that increase skills and improve inclusion are crucial to ensuring that all segments of society benefit from economic growth through greater employability and more efficient public and municipal services.

Since the country aspires to EU membership, the strategy of the World Bank Group (WBG) supports progress on the accession agenda as a cross-cutting theme. Bank resources are used to complement and improve the absorption of the EU's Instrument of Pre-Accession (IPA) funds. Overall, the WBG is supporting the Government with a full range of financial, knowledge, and convening services in several sectors, including competitiveness, transport, public financial management, education, and social protection.

A Performance and Learning Review (PLR) found that the implementation of the country program is largely on track, with notable progress on improving the transparency of public financial management and the efficiency of the social protection system. World Bank interventions have also made satisfactory progress on creating better conditions for private sector investments and links to foreign direct investments (FDIs).

Overall, by the end of the current CPS cycle, which was extended to December 2018 by the PLR, the World Bank plans to provide approximately US$135 million in new lending in FY19. This is expected to bring the overall Bank lending and trust fund program to about US$360 million for the current CPS period. In addition, the International Finance Corporation (IFC), a member of the WBG that supports the private sector, will target a lending volume of US$40–60 million until the end of the CPS cycle.

A new partnership framework for the period 2019–22 will be discussed and agreed with the Government in the second half of 2018.

### WORLD BANK PORTFOLIO

No. of Projects: 7

Lending: $348.9 Million

IBRD: $312 Million

EU IPA: $37.18 Million

## Key Engagement

### Public Finance Review

The World Bank continues to support the Public Finance Management (PFM) reform agenda in FYR Macedonia through just-in-time analytic work. The Bank is currently working with the Ministry of Finance on a Public Finance Review (PFR) update aimed at identifying policy options to enhance fiscal sustainability, improve the transparency and accountability of public finances, and improve the efficiency of public spending.

PFR policy recommendations will support the development of a potential Public Finance Policy-Based Guarantee to further strengthen public finance management in FYR Macedonia.

### Systematic Country Diagnostic (SCD)

The WBG is preparing a Systematic Country Diagnostic (SCD) for FYR Macedonia. The SCD aims to identify the most critical constraints to ending extreme poverty and promoting shared prosperity in a sustainable manner. This diagnostic will assess barriers to and opportunities for inclusive and sustainable growth in the country and identify policy reform priorities.

## Recent Economic Developments

The political turmoil of 2015–17 slowed real GDP growth in 2017 from 2.9% in 2016 to 0% in 2017, driven by a fall in investments. The inauguration of the new government in June 2017 reduced political uncertainties, as evidenced by businesses' improved production outlook. Investment fell by 4.5% year-on-year (y-o-y) in 2017 but started recovering by year-end, with improved investor confidence.

Private consumption was the only contributor to growth in 2017, supported by higher employment and wages. Net exports contributed negatively to growth (-0.7 percentage points). Solid exports growth was propelled by the recovery in the euro area but was not enough to compensate for rising imports of energy, iron, and steel, as well as FDI-related imports.

Despite slower growth, there were improvements in the labor market. Employment grew by 2.4% y-o-y in 2017, helped in part by employment subsidies in the first part of the year, through which almost 60% of the net new jobs were created. The employment rate has been constantly improving but remains low at 44%, meaning that more than half of the working-age population is either unemployed or outside of the labor force.

Poverty (at US$5.5/day at 2011 purchasing power parity) is projected to have fallen to 21% in 2017, driven by employment growth and salary increases, especially in the labor intensive sectors, continuing a decreasing trend since 2009. Pensions, which played a role in the 2009–14 decrease, are unlikely to have played a relevant role in recent poverty dynamics.

Revenue gains in 2017 were offset by increases in spending, resulting in an unchanged fiscal deficit at 2.7% of GDP. Revenues increased on the back of the solid value added tax (VAT) and the collection of social security contributions, while expenditures increased due to higher spending for health, pensions, and subsidies.

Capital spending once again remained under-executed, reflecting a slowdown in project implementation. Public and publicly guaranteed debt declined to 47.5% in 2017 from 48.4% in 2016 due to a drawdown on accumulated deposits to reduce new borrowing.

The current account deficit narrowed to 1.1% of GDP in 2017. Solid export performance of FDIs, iron and steel, furniture, and tobacco helped to reduce the goods and services deficit to 13.9% of GDP (from 15% in 2016). Net private transfer inflows increased slightly to 15.8% of GDP, while the primary income deficit widened further to 4.2% of GDP as foreign investors kept repatriating profits amid the political turmoil.

FDIs declined in 2017 to only 2.3% of GDP compared to 3.2% in 2016. At end-2017, foreign reserves stood at 4.4 months of imports and were further replenished in January 2018 as the Government issued a seven-year €500 million Eurobond at 2.75% that fully covers government borrowing requirements for 2018.

## Economic Outlook

The economic outlook is positive, with growth bouncing back in 2018. Construction activity is expected to recover, as the construction of two highways is resumed.

The manufacturing sector is also expected to recover, a process that began in late 2017, propelled by improved foreign demand from the EU. Private consumption is projected to rise, supported by higher employment and an increase in social transfers.

Poverty is likely to continue its downward trend in 2018–20 with the improved economic outlook. Public investment in infrastructure should sustain employment creation. Increases in social transfers should also translate into further poverty reductions, if properly designed and means tested. The fiscal deficit is planned to remain unchanged in 2018, leading to a rise in public debt to 50% of GDP.

## Project Spotlight

### "Yes You Can": Socio-Emotional Skills Curriculum

Students at primary school "Dane Krapchev" in Skopje

A growing body of literature points to the key role of socio-emotional skills, such as grit and perseverance, in predicting educational success.

The World Bank recently implemented **"Yes You Can"** in FYR Macedonia, its first large-scale test of a socio-emotional skills curriculum.

The project, implemented in 2016–17, was delivered to 6th and 7th graders in public schools (for a total of 23,421 students), using three groups: two grit-building treatment groups and a control group. The curriculum encouraged students to identify their learning weaknesses, persevere in the face of difficulty, seek critical feedback, and approach work with full concentration. Crucially, the intervention also aimed to change negative beliefs—such as stereotypes—that hold students back from investing a full effort in school.

The results show that the curriculum was successful in improving students' self-reported levels of socio-emotional skills up to 13% of the "typical" deviation from the average. Students showing higher levels of grit work harder for a longer period of time in order to achieve their goals. Both treatment groups showed positive results. Although the evaluation did not capture notable changes in the overall academic achievement of the treated students, the curriculum increased academic achievement among disadvantaged minority students, particularly Roma students, with higher impacts among Roma girls than Roma boys.

These students also increased their socio-emotional skills at a level higher than the Macedonian or Albanian students. The difference in their grades was the equivalent of an additional three weeks of school (the duration of remedial education for low-performing students in FYR Macedonia). The results were driven by the teacher-delivered treatment arm, where teachers were trained to deliver the curriculum, avoid stereotyping students, and recognize effort. The observed results among Roma students are similar to those from programs that provide information on the benefits of schooling to either students or parents.

The intervention was very cost effective at about US$18 per student in the short term (including design costs) to US$10 per student in the long term for improvements in grades, and less than half that for changes in negative views.

The "Country Snapshot" is a bi-annual update, highlighting the country's recent developments, economic outlook and major overview of the World Bank's partnership with the country. You can find the latest updates at http://www.worldbank.org/en/country/macedonia

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