

# PROJECT INFORMATION DOCUMENT (PID) CONCEPT STAGE

Report No.: PIDC19292

<b>Project Name</b>	Road Upgrading and Development Project (P149955)
<b>Region</b>	EUROPE AND CENTRAL ASIA
<b>Country</b>	Macedonia, former Yugoslav Republic of
<b>Sector(s)</b>	Rural and Inter-Urban Roads and Highways (90%), General public administration sector (10%)
<b>Theme(s)</b>	Regional integration (50%), Trade facilitation and market access (50%)
<b>Lending Instrument</b>	Investment Project Financing
<b>Project ID</b>	P149955
<b>Borrower(s)</b>	Public Enterprise for State Roads
<b>Implementing Agency</b>	Public Enterprise for State Roads
<b>Environmental Category</b>	A-Full Assessment
<b>Date PID Prepared/ Updated</b>	20-Apr-2015
<b>Date PID Approved/ Disclosed</b>	21-Apr-2015
<b>Estimated Date of Appraisal Completion</b>	15-Jun-2015
<b>Estimated Date of Board Approval</b>	29-Sep-2015
<b>Concept Review Decision</b>	Track II - The review did authorize the preparation to continue

## I. Introduction and Context

### Country Context

FYR Macedonia has a trade-dependent economy with exports accounting for 43 percent of GDP in 2013. Currently, low value added products dominate the export mix; however, foreign direct investment (FDI) related exports are increasingly changing the export composition. Industry currently accounts for around 22 percent of GDP and agriculture for around 9 percent. The economic recovery in the Eurozone, which is the key market for Macedonian export, is expected to lead to an increase in Macedonian exports. To promote its exports and FDI, the Government has focused on the development of infrastructure and particularly transport infrastructure to enhance connectivity.

Macedonia experienced sustained economic growth for most of the last decade, but poverty reduction still needs continued efforts. While GDP per capita increased by 45 percent in the 2002-2011 period (in PPP terms), the national poverty rate remained unchanged at around 30 percent with equally high poverty levels observed in urban and rural areas. Moreover, income

inequality worsened in the 2002-2008 period, with an increase from 0.38 to 0.44 in the Gini coefficient, supporting the hypothesis that growth has not been evenly spread among income groups. Similarly, when comparing poverty trends with other countries in the sub-region, Macedonia has consistently lagged behind some of its neighbors. The extreme poverty headcount, measured as US\$2.50 or less a day, amounted to 9 percent in 2008, against 2 percent in Montenegro, 2.4 percent in Serbia, and 13 percent in Albania.

Well-developed road and rail networks and access to deep-sea ports are existential to the landlocked country for its economic and social development. Key elements of these networks are also part of the Trans-European Transport network (TEN-T) and the South East Europe Transport Observatory (SEETO) Comprehensive Network (Corridor X, which connects Austria to Turkey, and Corridor VIII, which connects Albania to the Black Sea ports in Bulgaria). Since independence, the main challenges facing the country have been to reduce the economic distance to markets and to further develop the SEETO Comprehensive Network and integrate it in the European Union's transport network. Additionally, uninterrupted access to deep-sea ports has been considered a priority due to the difficult experiences during the trade embargos of the '90s.

Inadequate supply of infrastructure is the second most problematic factor for doing business according to the Global Competitiveness Report 2013 thus restraining the country's competitiveness and growth. Investment in transport infrastructure should also provide connection to regional markets, with roads presenting a particular priority since most of the goods, including exports, are transported by road (in the first three quarters of 2014, 93 percent of freight was carried on roads). Roads are also crucial for local competitiveness and development of tourism and also reduce the relative isolation of some regions. Better regional connectivity is important to enhance transport communication between local communities and regional and foreign markets and social services, promoting more balanced and sustainable economic development.

### **Sectoral and Institutional Context**

Road Network. The current road network in Macedonia is about 14,100km long, of which, 1,100km are national roads, 3,700km are regional roads, and 9,300km are local roads. The sections of Corridors X and VIII in FYR Macedonia are 176km and 307km respectively. The condition of the road network varies depending on the road category. According to PESR data from 2013, the national roads and motorways have a length of 1,112km, of which 85 percent is paved and 91 percent in good or fair condition. The regional roads have an overall length of 3,721km, of which 3,021 are paved and 75 percent are in good or fair condition. Starting in 2008, the Government's Regional and Local Roads Program included wide rehabilitation of the regional and local road network, with financial support from the World Bank and EBRD. This resulted in the condition improvement of about 450km of regional roads and 600km of local roads. Regional roads have lower traffic levels, but are of particular importance to smaller and more isolated communities and to the poorer segments of society, typically located in rural areas.

Investments in the transport sector in support of economic and social development historically focused on rehabilitation and are now expanded to road construction. In the period 2008-2012, total road sector investment expenditures showed a gradual decrease in real terms, with annual amounts dropping from EUR 45 million in 2008 to EUR 28 million in 2012. This was relatively low by regional and international standards. The 2013 restructuring of Public Enterprise for State Roads (PESR) from a ministerial agency to a public enterprise allowed for better road planning and led to an increase in expenditures for road construction and rehabilitation reaching three times the 2008 level in 2014, with an annual amount of about EUR 142 million. The increase was enabled to a large extent by significant support from international financial institutions (IFIs). In the case of the

Bank, this support has included significant financial assistance for priority road rehabilitation and maintenance, and perhaps more importantly support to the institutional transformation of PESR and to sound road management policies. As a result, the focus of the Ministry of Transport and Communications (MOTC), as policy maker and PESR, as the network manager, has evolved and now includes increased attention to improving road management practices and planning, road safety and climate resilience. This proposed project will build on the recently-launched National and Regional Roads Rehabilitation project (NRRRP) and further support the relevant institutions in the sector, and primarily PESR, as the Borrower, to ensure that the road network is managed sustainably and with proper consideration of safety.

Institutional Context. MOTC is in charge of developing and implementing transport strategies and policies. In the road sector, under MOTC, there are two main bodies directly responsible for the road sector: PESR and Public Enterprise Makedonija Pat (road maintenance contractor). PESR is mandated to plan, construct, rehabilitate, manage and protect national and regional roads (state roads) and is responsible for implementing MOTC's policy directives. PESR presently has 320 employees, of which 260 are dedicated to toll collection processes. Fifteen of the remaining 60 employees are civil engineers managing the road network. PESR took advantage of the ongoing Regional and Local Roads project (RLRPSP) to (i) introduce a road asset management system (RAMS) for better planning and programming of works, (ii) increase the operational capacity of its staff to manage the increased contract load effectively and (iii) improve its financial management system. Project implementation shows an improved consideration of road safety elements in rehabilitation practices and also prioritization of climate resilience measures, primarily through protection against land erosion. This is to a large extent a result of the regular guidance from, and cooperation with the Bank team. To help institutionalize these good practices in PESR operations, the focus of the technical assistance component of the recently approved NRRRP is on ensuring the continuous operation of RAMS in the first five years of its existence and on the establishment of a sound internal organizational structure with the necessary technical knowledge to ensure the integration of road safety practices in project designs and implementation.

PESR also manages the toll collection in the country. It is responsible for the preparation of road development programs and financing plans. PESR receives financing from the central budget, fuel excise tax, annual motor vehicle registration fees, motorway tolls, and loan financing from IFIs. As per the projections of PESR's Annual Program, the first two sources of revenues for PESR will continue to be: (i) no less than 20 percent of the excise tax on oil derivatives to be transferred from the State Budget at least on a quarterly basis, and (ii) road tolls. Recently toll rates were increased by 30 percent and vehicle tax rates were also increased. Despite the increased revenues, substantial obligations by PESR require a close look at the financial sustainability of PESR's operations. Financial ratios are regularly monitored in agreement with the Bank as an integral element of the ongoing projects and sector dialogue. In order to safeguard the enterprise's financial sustainability the Bank, PESR and Ministry of Finance (MOF) have agreed on a minimum debt service ratio and current ratio to be maintained by PESR. For PESR's first two years of operation as a public enterprise the financial indicators are positive and the financial covenant requirements have been met.

Makedonija Pat is the public enterprise responsible for the regular and winter maintenance of the national and regional road networks, installation and maintenance of signalization and traffic counting. It currently employs about 900 workers, of whom 30 are engineers. It is responsible for the maintenance of 4,100km of paved roads, and a small share of road construction. Makedonija Pat

is responsible for two major kinds of road maintenance: 1) periodic maintenance; and 2) routine maintenance. As the future maintenance of Corridors VIII and X is planned to be financed under the Instrument for Pre-Accession (IPA) and under future concessions respectively, Makedonija Pat will focus on the remaining sections of national roads and all regional roads. The budget allocated to Makedonija Pat for regular and winter road maintenance of the state roads in 2015 is about US\$14 million or US\$2,850 per km, which is relatively low by regional standards. The 2015 planned investments of PESR amount to about EUR 159 million. Annual maintenance contracts are established between Makedonija Pat and PESR. The quality of maintenance is not satisfactory, a result of limited budgets available to Makedonija Pat and limited staff capacity and equipment. Under NRRRP, PESR aims to develop new maintenance standards which could eventually evolve into performance-based contracts in the medium term. The latest discussions with MOTC suggest greater receptivity in government to the initiatives of increased commercialization of maintenance operations and the proposed project will provide technical assistance to support these initiatives.

The 2013 European Union (EU) guidelines for the development of the trans-European transport network (TEN-T) confirmed that Corridors VIII and X continue to be considered an extension of the comprehensive network providing linkages to the neighboring countries and better integrating Europe. As a result, these corridors have received a significant share of the country's effort and financing in the past. On Corridor X, the completion of the construction works on the Demir Kapija-Smokvica section (started in 2013 with EBRD, EIB and EU grant assistance) will result in a full Corridor X motorway. The western section of Corridor VIII (to Albania) is currently being expanded to a motorway standard with financial assistance from the Chinese Exim Bank, with plans for completion by 2019. Consequently, the continuation of construction of eastern section of the Corridor VIII road link is considered a priority as well. The EU is supporting the rehabilitation of east Corridor VIII sections from the capital Skopje to Rankovce leaving the section from Rankovce toward the Bulgarian border as the only single carriageway with a lane for each direction.

The proposed Road Upgrading and Development Project is consistent with the National Transport Strategy (2007-2017), which sets out (1) the completion of motorway corridors, and (2) the efficient connection of the road network to the corridors as the short term priorities. The proposed focus on east Corridor VIII will enhance the country's connectivity and will assist the country to fulfil its EU commitments to strengthen and further develop the Trans-European networks. The technical assistance will build on the interventions under the current projects to improve maintenance and construction practices.

### **Relationship to CAS**

The World Bank Group's overarching country goals over the FY 2015-2018 Country Partnership Strategy (CPS) for FYR Macedonia is to reduce poverty and provide more and better jobs. To address this objective, one of the two CPS pillars is to foster growth and competitiveness since these are a prerequisite to achieve poverty reduction and increased shared prosperity. The CPS identifies the improvement of road infrastructure as necessary in order to overcome the disadvantages of the landlocked economy and support the country to become a more attractive destination for FDI. This proposed project is in direct response to the CPS in enhancing road connectivity to foreign markets and helping attract FDI. Development of transport infrastructure is one of the key Government Strategic Priorities 2014-2018, as a contributor to increased competitiveness of the national economy, stronger economic growth and a more equitable regional development within the country.

The CPS highlights the importance to strengthen the quality of the road investment program of the

country. This proposed Project will incorporate activities to update road construction standards and start the restructuring of the maintenance sector.

## II. Proposed Development Objective(s)

### Proposed Development Objective(s) (From PCN)

The Project Development Objective (PDO) is to increase transport connectivity along parts of east Corridor VIII, as well as other priority regional road corridors and to support improvements in road operations and asset management practices.

### Key Results (From PCN)

The key indicators to measure successful achievements of the PDO are as follows:

- a) Percentage of population connected to corridors to be improved by roads in good or fair conditions.
- b) Reduction of vehicle operating cost on the project sections (US \$/km).
- c) Revised design and maintenance standards applied by PESR.

## III. Preliminary Description

### Concept Description

Note: the PDO has been modified since the concept note meeting and will be reflected in the Appraisal stage PID

COMPONENT 1: Construction of Corridor VIII : Rankovce - Kriva Palanka (estimated cost of USD 80 million, of which USD 72 million will be financed by IBRD loan). This will finance the construction of the express road along the east section of road Corridor VIII which connects to Bulgaria. The new road sections will be 25 km long, with a width of 11.4m and 12.5m.

Component 2: Establishment of Bridge Management System (BMS) (estimated cost of USD 5 million, of which USD 4.5 million will be financed by IBRD loan). This component aims at strengthening the PESR's overall capacity to manage and maintain the country's bridge assets. The core focus of this activity would be to support PESR to introduce a bridge management system (BMS). This will entail: provision of equipment and software, diagnostic assessment of bridge condition, creation of a bridge maintenance and investment plan using BMS, and training for technical and administrative staff. Throughout the project implementation, additional activities focusing on technical capacity of PESR may be identified. It will also finance technical assistance, equipment, and operational costs associated with the implementation of the project. This would include: beneficiary satisfaction activities, as well as mid-term and impact evaluation surveys; strengthening the technical capacity of the PMT through the provision of technical assistance; and carrying out the annual financial audits of the Project.

## IV. Safeguard Policies that might apply

Safeguard Policies Triggered by the Project	Yes	No	TBD
Environmental Assessment OP/BP 4.01	×		
Natural Habitats OP/BP 4.04	×		
Forests OP/BP 4.36		×	
Pest Management OP 4.09		×	
Physical Cultural Resources OP/BP 4.11		×	

Indigenous Peoples OP/BP 4.10		x	
Involuntary Resettlement OP/BP 4.12	x		
Safety of Dams OP/BP 4.37		x	
Projects on International Waterways OP/BP 7.50		x	
Projects in Disputed Areas OP/BP 7.60		x	

## V. Financing (in USD Million)

Total Project Cost:	137.00	Total Bank Financing:	100.00
Financing Gap:	0.00		
<b>Financing Source</b>			<b>Amount</b>
Borrower			37.00
International Bank for Reconstruction and Development			100.00
Total			137.00

## VI. Contact point

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