CREATING FUTURE TOGETHER
NDS 2022–2042

INNOVATIVE MECHANISMS AND INSTRUMENTS FOR FINANCING STRATEGIC NATIONAL DOCUMENTS

Skopje, November 2022

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1. INTRODUCTION

The term "innovative financing for development" was first used at the beginning of the new millennium (UNDP, 2012). Innovative financing refers to all mechanisms and initiatives that provide finances for the fulfilment of the Agenda for Sustainable Development 2030. Innovative financing is also defined as non-traditional (non-conventional) applications of “solidarity, public-private partnerships, and catalytic mechanisms that (i) support fundraising by tapping new sources and engaging investors beyond the financial dimension of transactions, as partners and stakeholders in development; or (ii) deliver financial solutions to development problems on the ground” (World Bank 2009).

What does innovative financing cover? Innovative financing typically includes (1) new financial instruments to support sustainable development; (2) a new combination of already existing financial instruments; (3) inclusion of new development partners (for example, new venture capital funds); (4) innovations in the ways in which the collected funds are used; (5) new focus and new complementary areas of projects. Innovative financing of development should provide a supplement (sometimes even a replacement) of traditional sources and mechanisms of financing.

Different perspectives of innovation. In a global economy moving at different speeds, what is considered a *traditional* financial instrument in developed market economies may still be considered *innovative* in transition and developing economies. For example, municipal bonds are a conventional financial instrument in many developed economies, although they still have not been used as a financing instrument by the municipalities in North Macedonia. A similar argument could be used for underused financial instruments, such as factoring. It is present in practice, but its application is extremely small.

The objectives of innovative financing. The main goals of innovative financing are to generate additional funds for development by using new sources of financing, to improve the efficiency of financial inflows, and to make finance more result oriented. When assessing the importance of innovative financing, one must consider not only the absolute amount of financial support but also - more importantly – the multiplier effects or leverage effects. Thus, for example, the Juncker plan for Europe (launched by the European Commission during the mandate of Jean-Claude Juncker) provided financial support for economically justified projects through guarantees worth 16 billion euros from the EU and 5 billion euros from the European Investment Bank (EIB). By mobilizing additional private capital, the plan envisaged total investments in the amount of 315 billion euros. The multiplier effect or leverage effect consists in the fact that each euro of invested public money generates a total investment of 15 euros or leverage of 15.[1]

Innovative and blended finance. Innovative financing largely overlaps with the concept of blended finance, which envisages different combinations of public and private sources of financing investment projects in priority areas. Blended financing is the use of catalytic (accelerating) capital from public or philanthropic sources in order to increase private and public investments and achieve the goals of sustainable development. In this way, governments,

[1] One more conservative assessment of Société Générale has found leverage between 5 and 7.

international institutions, philanthropic investors and other stakeholders seek to (i) reduce investment risk or (ii) improve risk-adjusted returns. Given the increasing focus on sustainability, innovative finance is increasingly associated with the concept of sustainable finance, which is growing into a major trend in credit markets.

Chart No. 1. The power of leverage of national and foreign financing sources

Source: European Council and European Investment Bank (2022).

In terms of the level of use of the financing instruments, one can distinguish between:

- traditional i.e. conventional instruments: traditional taxes and non-tax revenues, grants, budget support credits, project credits, classic government bonds, treasury bills.
- innovative financial instruments: innovative taxes (for example, carbon tax), green bonds, gender bonds, social bonds, hybrid funds to support strategic investments, a wide range of options for blended financing, etc.

A huge gap in financing to achieve the goals of sustainable development. The United Nations estimate that the annual funding needed to meet the Sustainable Development Goals (SDGs) by 2030 is almost US$ 2.9 trillion, or 2.8 times the estimated current funding for the goals in the amount of 1.4 trillion US dollars, from domestic and foreign sources. Agenda 2030 includes 17 Sustainable Development Goals and 230 precisely determined targets, which should be financed by public entities and private investors.

Innovative finance has the potential to reduce the financial gap. UN member states reached a consensus on the importance of deploying public funds to attract private investment at the Third International Conference on Development Financing in 2015 in Addis Ababa (Addis Ababa Action Agenda, AAAA). Not only governments but also businesses, the non-governmental sector, and individuals are invited to get involved in the implementation of the Action Plan from this conference. A similar initiative, called *Maximizing Finance for Development*, has already grown into a new World Bank approach that systematically combines and multiplies all sources of finance, expertise, and solutions to support sustainable development in developing countries and transition economies.

At the same time, it is of particular importance to emphasize that innovative financing mechanisms and instruments in no way exclude traditional financing sources and instruments. Thus, for example, innovative financial instruments cannot be a substitute for the insufficient capacity to apply for and receive grants from the European Union, available through the Instrument for Pre-Accession Assistance (IPA), the Instrument for Pre-Accession Assistance and Rural Development (IPARD), Competitiveness of Small and medium-sized enterprises (COSME), Creative Europe, Erasmus+, Horizon 2020 and many others. Innovative financing can sometimes provide replacement of traditional sources and mechanisms of financing. For example, the issuance of a green government bond reduces the need for financing through a traditional bond, the proceeds of which are used for general purposes.

The redirection of financing sources to long-term and sustainable investments is essential to support the transition to a climate-neutral, climate-resistant, efficient and fair economy and, of course, to the priorities of sustainable development (European Commission, 2022).

In the next section, the relevant aspects of the macroeconomic context in the adoption of the National Development Strategy will be reflected, and in the third section, the sources of financing, innovative mechanisms and instruments, which are used to finance sustainable development around the world, will be elaborated. The fourth section focuses on experiences from the region, and the fifth section is dedicated to the next steps.

2. CONTEXT

2.1. Limited budget resources and reduced fiscal space

Innovative financing should support investments, real economic convergence, and sustainable development. The financial needs of the Western Balkans (WB6) to encourage investment and sustainable development are enormous. Governments face limited budgetary resources, especially for capital expenditures and especially in periods of multidimensional or multifaceted crisis, as in 2022) with tight fiscal space and rising levels of public debt. Access to finance is still a problem for many micro, small, and medium enterprises. Hence, innovative financing is considered as one of the most significant mechanisms for raising investments in favour of sustainable development (Lukšić et al. 2022).

GDP per capita is only 42% of the average GDP per capita of the EU-27 in 2021 (Chart No. 2) and real economic convergence should be accelerated with stronger investment activity (Chart No. 3). Gross investments are projected at a high level, which can be realized with innovative tools and sources of financing.

Chart No. 2. GDP per capita as a percentage of the European average (EU-27), according to the purchasing power parity (2010-2021)

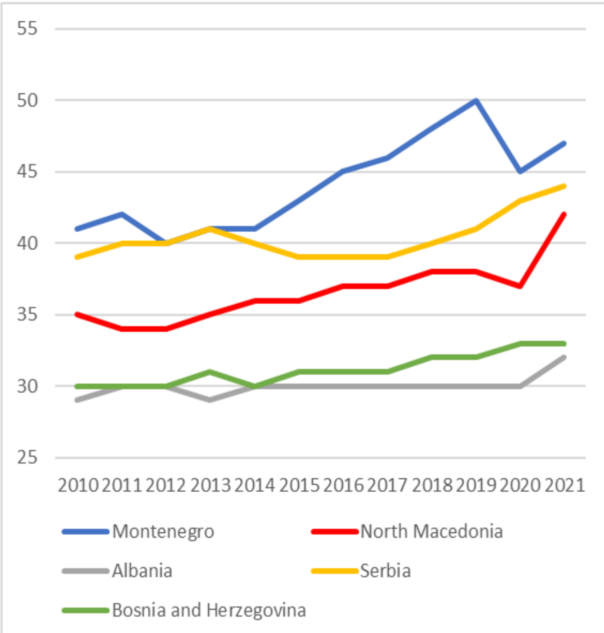
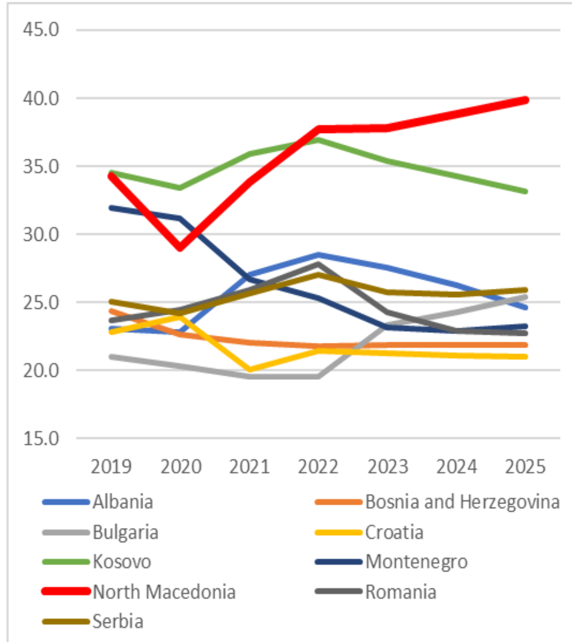


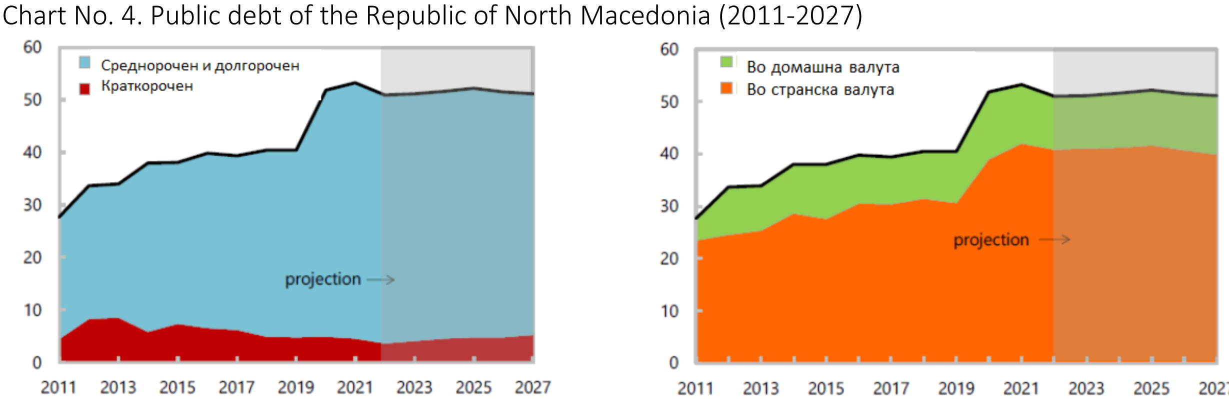
Chart No. 3. Gross investments in South East Europe (as a percentage of GDP, 2019-2025)



Source: IMF (October 2022).

At the same time, the fiscal space and the space for further borrowings are narrowed (Chart No. 4). Hence, the idea of more efficient use of public money and the introduction of innovative tools and mechanisms for financing sustainable development.

Chart No. 4. Public debt of the Republic of North Macedonia (2011-2027)



(*Text on charts: Medium-term and long-term; Short-term; In national currency, In foreign currency*)
Source: IMF (2022).

In terms of the average fulfilment of the Sustainable Development Goals, the least progress is observed in goal 13 Climate action and the greatest in goals 1 No poverty, 8 Decent work and economic growth, and 10 Reduced inequalities.

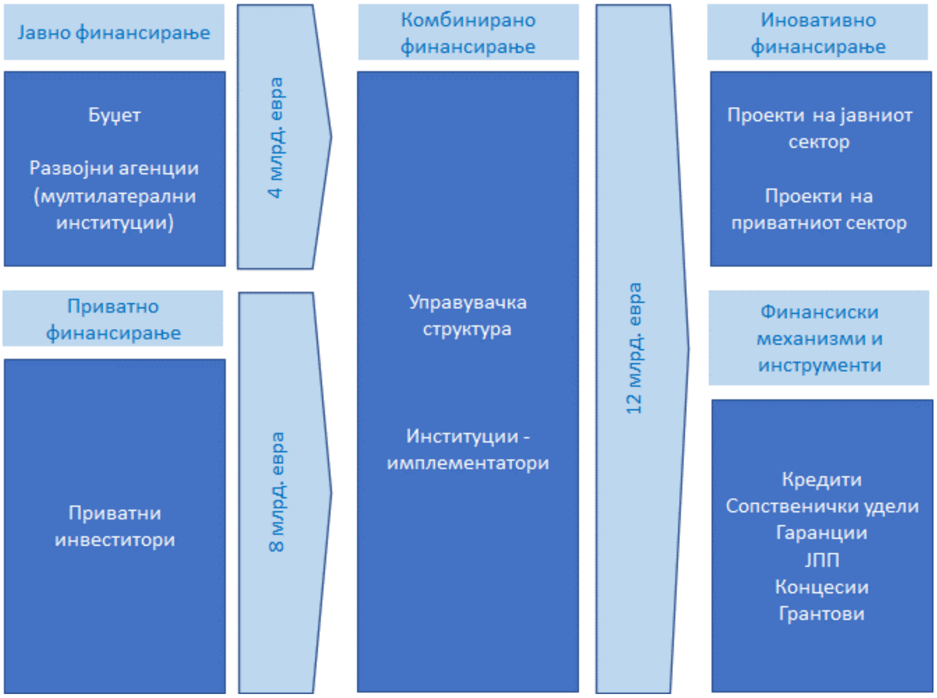
Chart No. 5. Challenges for the Republic of North Macedonia in meeting the Sustainable Development Goals

Source: Sustainable Development Report (2022).

2.2. Growth Acceleration Plan (2022-2026)

The limited budget resources and the reduced fiscal space motivated the Government of North Macedonia to design a Growth Acceleration Plan (GAP). By introducing innovative financing mechanisms and mobilizing private capital, the ultimate goal is to increase the pool of sustainable finance, support overall investment, and accelerate economic growth in the medium term. It enables coordinated and blended financing from public and private entities in traditional innovative ways to encourage business initiatives. In addition, it also aims to improve the business environment, encourage regulatory and administrative reforms, and impose higher standards for project selection, management, and evaluation. During 2022-2026, the Growth Acceleration Plan intends to combine public sources totalling EUR 4 billion, with mobilized private capital of EUR 8 billion. The two sources (private and public) are planned to be merged into a defined management framework and a network of institutions and implementing agencies (such as the Development Bank, the Fund for Innovation and Technological Development, the Directorate for Technological and Industrial Development Zones, etc.). The transmission mechanism in the Growth Acceleration Plan 2022-2026 is shown in Chart No. 6.

Chart No. 6. The transmission mechanism in the Growth Acceleration Plan 2022-2026



(Text on chart: Public finance, Budget, Development agencies (multilateral institutions), Private financing, Private investors, 4 billion euros, 8 billion euros; Blended finance, Management structure, Implementing institutions, 12 billion euros; Innovative finance, Public sector projects, Private sector projects, Financing mechanisms and instruments, Credits, Ownership shares, Guarantees, PPP, Concessions, Grants)

The main instruments of the Growth Acceleration Plan 2022-26 are as follows:

- Budget revenues and borrowing:
  - CAPEF mechanism (mechanism for increasing the efficiency of capital expenditures)
  - Development bond
  - Green bond
  - Bond indexed to inflation
  - Better management of public funds
- Public-private partnerships
- Concessions
- Blended finance
  - Guarantee fund
  - Fund for energy efficiency
  - Fund for local and regional development
  - Research and Development Fund
  - Green financing instrument
  - Hybrid Fund for Green and Digital Transformation for SMEs (FITR)
  - Hybrid Strategic Fund for Green Investments (TIDZ)
  - Fund for entrepreneurial (venture) capital
  - Fund for increasing financial assets (Fund of Funds)
  - Crowdfunding platforms.

To ensure the effective implementation of the investment plan, a management structure is expected to be established, which will monitor the entire project management process, including a feedback system to accelerate effectiveness in terms of time. The management structure builds on the existing institutional elements with some new elements to be created in separate phases of the project cycle, where there is an institutional vacuum. Government ministries and agencies are expected to play a leading role in the implementation with support from international development partners where needed.

The state of capital funds per inhabitant of the country indicates a gap of almost 50 percent in relation to the newly admitted EU member states (IMF, 2022). The country lags behind the EU also in terms of infrastructure quality. Therefore, if implemented properly, the Growth Acceleration Plan could encourage stronger investment activity and boost medium-term economic growth. However, there are a number of risks associated with its implementation: (1) a multifaceted crisis in 2022 (ongoing pandemic, energy crisis and double-digit inflation, fuelled by much higher food and energy prices), security crisis in Europe; (2) weakened administrative capacities due to the outflow of quality personnel from the public sector; (3) lack of a supporting institutional structure to coordinate financing.

2.3. From the Growth Acceleration Plan to the National Development Strategy

The Growth Acceleration Plan (2022-2026) is an excellent initial basis for the operationalization of the financing instruments and mechanisms of the development priorities defined in the first decade of the National Development Strategy. The Growth Acceleration Plan could be upgraded in terms of:

- more detailed elaboration of the separate types of financing mechanisms and instruments, with a clearly defined institutional structure, which will introduce and support them, with precise deadlines and expected results;
- defining the sequence of phased introduction of innovative sources, mechanisms, and instruments;
- the degree of available budget support for specific priority areas of sustainable development; and
- establishing a mechanism for monitoring and evaluating the results of the implementation.

3. INNOVATIVE FINANCING SOURCES AND MECHANISMS FOR SUSTAINABLE DEVELOPMENT

The financial landscape is becoming increasingly complex, in terms of new and more complex instruments, mechanisms, and participants. Funding sources are becoming more diversified, which adds a new dimension of complexity. For those reasons, it is useful to systematize and present the innovative instruments and mechanisms available to governments.

3.1. Modern reclassification of finance

In addition to the traditional focus on economic goals, modern finance is classified, according to its purpose, into finance aimed at:

- environmental protection, i.e. green finance (climate change, sustainable use of water and materials, control of pollution and waste, conservation of biodiversity);
- social sphere, i.e. inclusive finance (working conditions, health and safety, employee training, human rights, relations between communities;
- governance or governance finance (corporate governance, business ethics, anti-corruption practices, tax ethics, privacy, and data security).

The last three categories or areas are amalgamated in the English term "ESG financing" or good environmental, social and governance financing.

Decarbonisation finance, adaptation finance, climate finance, green finance, and sustainable finance are overlapping and strongly related concepts, which include numerous traditional and innovative mechanisms and instruments for financing the Sustainable Development Goals. New financial instruments provide a more efficient and effective way for governments, international development partners, the private sector, and philanthropic institutions to work together to de-risk certain projects, improve risk-return ratios and mobilize additional private capital.

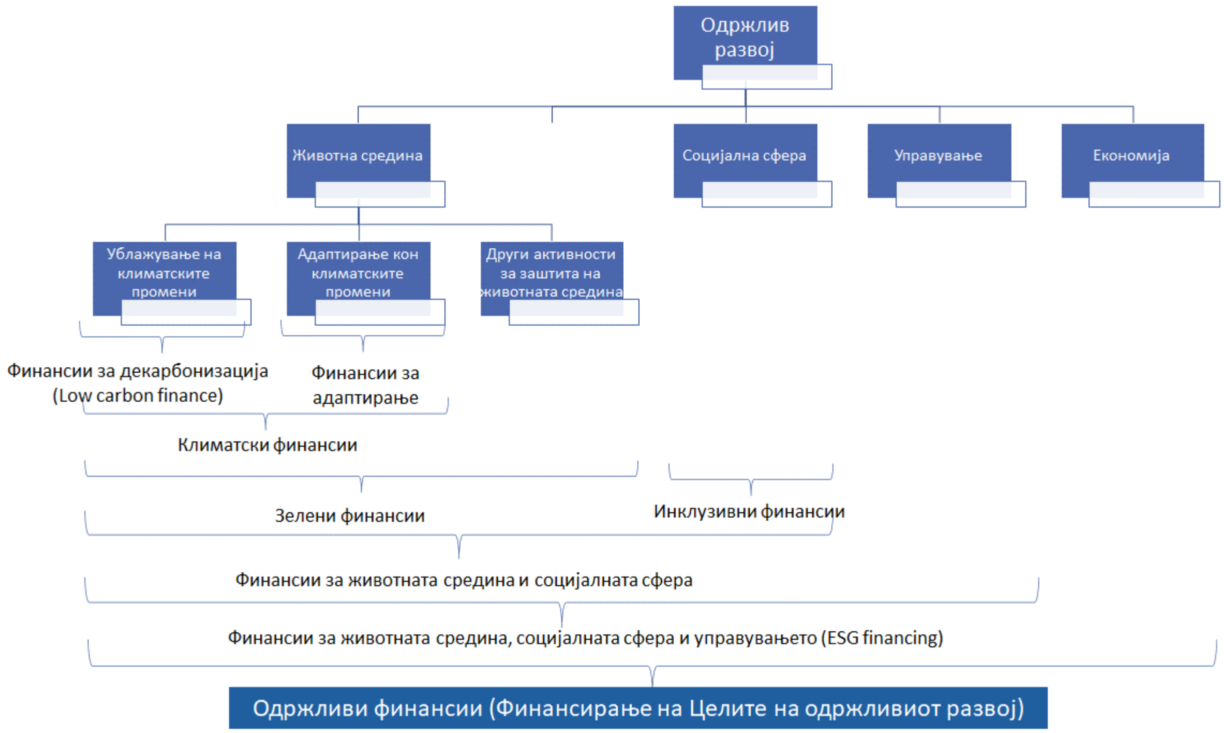
Chart no. 8 gives a better idea of the different scopes of the separate financial concepts.

Green finance consists of finance for decarbonisation or the low-carbon economy, finance for adaptation, and finance for other aspects of environmental protection. *Finance for decarbonisation* or "low-carbon" economy consists of financial support for the transition of energy systems towards lower CO_2 emissions. *Adaptation finance* includes financial support for adaptation solutions and the implementation of activities in response to the impact of climate change that is still occurring, but also to prepare for future changes (UNEP Adaptation Gap Report, 2022). *Climate finance* is aimed at "efforts to reduce greenhouse gas emissions and aim to reduce vulnerability while ensuring and increasing the resilience of human systems and ecosystems to the negative impact of climate change."

Inclusive finance is financial services and products intended to help the low-income population, that is, the vulnerable categories of citizens.

Sustainable finance refers to the inclusion of economic, environmental, social, and governance aspects in making long-term investment decisions in sustainable economic activities and projects.

Chart No. 7. Defining key terms



(Text on chart: Sustainable development, Environmental, Social, Governance, Economic, Climate change mitigation, Climate change adaptation, Other environmental, Low-carbon finance, Adaptation finance, Climate, Green, Inclusive, Socioenvironmental, ESG financing)
Source: UNEP (2016).

It is also worth noting the EU Taxonomy of Sustainable Investments (Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 introducing a framework to facilitate sustainable investments, and Supplementing Regulation (EU) 2019/2088). The new Taxonomy covers six areas:

- climate change mitigation
- adapting to climate change
- sustainable use and protection of water and water resources
- transition to a circular economy
- prevention and control of pollution and
- protection and restoration of biodiversity and ecosystems.

3.2. Financing sources

The sources for financing sustainable development can be divided according to several criteria:

- Depending on the resident status of the entities that provide sources of financing, we distinguish between domestic and foreign sources of financing. It is obvious that a small economy in transition is inevitably directed towards the use of external sources of financing to encourage investment and real economic convergence.
- Depending on whether the entities providing the sources of financing are controlled by the state (or states), we distinguish sources of financing from *public and private entities*. Public entities are governments, government agencies, international financial institutions (including multilateral development banks), development banks and other international development partners, while private entities providing financing are commercial banks, investment funds, pension fund management companies, hedge funds capital, etc.
- Depending on the use of financing instruments, we distinguish (1) traditional or conventional instruments: traditional taxes and non-tax revenues, grants, credits for budget support, project credits, classic government bonds, treasury bills. (2) Innovative financial instruments: innovative taxes (for example, carbon tax), green bonds, gender bonds, social bonds, hybrid funds to support strategic investments, a range of blended financing options, etc.
- Depending on the conditions under which financing sources are approved, we distinguish (1) development funding, that is, funding sources provided by public institutions and philanthropic organizations from the private or non-governmental sector. Driven primarily by efforts to achieve sustainable development, they provide financing on more favourable terms (concessional financing); (2) private capital, primarily driven by the profit motive, which usually insists on securing funding sources under market conditions.

Table 1. Basic typology of funding sources

Types of entities Resident status	Public	Private
Domestic	For example, Grant from the Innovation and Technological Development Fund	For example, credit from Komercijalna Banka AD from Skopje
Foreign	For example, a loan from the World Bank	For example, investment by the European Fund for Southeast Europe

According to the UN (2021), 76.7% of the financing sources of the Sustainable Development Goals were domestic public sources, international private sources provided 12.5%, domestic private sources of financing provided 6.3%, and international private sources contributed with 4.5%. The various sources of financing and financial flows in the economy are illustrated in Chart No. 8.

Chart No. 8. Overview of financing sources and financing flows

(Text on chart: Multilateral and bilateral international institutions, Official development aid, Government, Portfolio and other investments, Non-resident financial sector, Public revenues, Public revenues, Public expenditures, Portfolio and other investments; Remittances, Households, Public sector, Companies; Non-resident households and individuals, Domestic savings, Domestic financial sector, Credits for investments, Foreign direct and portfolio investments, Non-resident companies)
Source: Adapted based on OECD (2020).

3.2.1. Domestic public financing sources

Budget revenues. Domestic public or budgetary resources are the most abundant source of financing sustainable development. Comparative analyses of international financial institutions unequivocally indicate the low level of budget revenues as a percentage of GDP in North Macedonia and recommend a gradual increase in the total fiscal burden. The increase is justified by the need to improve the quality and range of public services, the necessary investments in physical infrastructure and human capital, the increased need for servicing the debt and others.

In addition to increasing tax rates, expanding the tax base and introducing a progressive system for some of the traditional taxes, new taxes such as a carbon tax, a tax on drinks or products with high sugar content ("sugar tax"), tax on financial transactions, tax on digital services (so-called digital taxation) could be introduced in the next two decades.

In the short term, options for a temporary progressive tax on profits are also being considered. It is also highly likely that the proportional rate of personal income tax will not survive the next decade and will give way to a progressive taxation system.

The tax policy should, of course, introduce a series of tax exemptions and benefits for taxpayers, whose activities are in the priority areas of sustainable development. Tax credit (reduction of taxes depending on the amount of sustainable investment), accelerated depreciation (faster write-off), exemptions from indirect taxes, i.e. duties on import inputs, zero per cent value-added tax for solar panels, etc., are just some of the potential tax reliefs and exemptions.

The newly adopted Law on Budgets (September 2022) for the first time introduces fiscal rules and a Fiscal Council, promotion of medium-term budget planning, better management of state and municipal funds, monitoring of the financial results of public enterprises and commercial companies, established by the state and municipalities, as well as the establishment of an integrated information system for the management of public finances (IFMIS).[2] It is extremely important that this integrated information system has a module for special budgeting and reporting on the goals and targets of sustainable development (SDG budget tagging), as well as a special module for financing and reporting on the realization of development priorities and programs, defined in the National Development Strategy.

Borrowing. Expansion of the offer (range) of debt instruments will be elaborated on in the section related to innovative financial instruments.

3.2.2. Foreign public financing sources

The Republic of North Macedonia has many years of experience with the financial sources provided by international financial institutions, such as the IMF, the World Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the Council of Europe Development Bank, the German Investment and Development Bank "KfW" and other multilateral or bilateral official creditors.

The support through grants and technical assistance from the United Nations (the United Nations Development Program and other organizations under the UN umbrella), the European Commission, the United States Agency for International Development (USAID) and other bilateral official donors (for example, the governments of the Netherlands, Great Britain, Slovakia, FR Germany, Japan, etc.) is also of high importance.

[2] Particularly important innovations in the new Budget Law are fiscal rules and the Fiscal Council. The new fiscal rules stipulate a legal obligation that the deficit of the general government does not exceed a level of 3% of nominal GDP, the total debt of the general government does not exceed 60% of GDP, and the guaranteed public debt does not exceed 15% of GDP. If the debt exceeds the level, it is necessary to adopt a strategy with measures and activities for its reduction. The introduction of numerical fiscal rules is expected to ensure long-term stability, predictability and transparency of public finances. Deviations in the budget deficit are also possible, but not more than 0.5% of GDP on an annual level for the implementation of investment projects, or in cases where there are crises and natural disasters. The Fiscal Council will be a new independent body, which will be accountable to the Parliament and will be responsible for: (1) providing independent and professional advice on issues related to fiscal policy and the budget, as well as (2) providing analyses and opinions on the fiscal strategy, the republic's budget, the semi-annual budget implementation report, the final budget implementation report and other documentation submitted to the Parliament. Expectations from the Fiscal Council are that it will contribute to strengthening the responsibility, transparency and accountability of fiscal policymakers.

In the next decade, it is desirable to renew the cooperation with the Multilateral Investment Guarantee Agency (MIGA) and the International Finance Corporation, organisations within the World Bank Group.

During the period in which the Republic of North Macedonia will continue to be a candidate for EU membership, part of the pre-accession funds from the EU budget will be available to it. In the period until 2042, it is expected that the pre-accession funds will be institutionalised within the framework of the IPA IV, IPA V, etc. programs.

The potential membership in the Union will also mean that the Republic of North Macedonia will be a net beneficiary of funds from the EU budget. Funds between the EU budget and an EU member state move in two directions – in and out of the member state. On one side, there are cash flows from the EU budget to EU member states. The flows consist of funds coming primarily in the fields of agriculture, cohesion and competitiveness (Mrak, 2019). On the other side, there are flows of funds from the national budgets of EU member states to the EU budget. Member States' contributions to the financing of the EU budget consist of three types: (i) traditional own resources, primarily customs duties, (ii) resources based on VAT and (iii) resources based on gross national income. If the Republic of North Macedonia shall become a member of the EU in the next 20 years, additional inflows will come from the Structural and Cohesion Funds, as a significant financial instrument of the EU's regional policy.

3.2.3. Domestic private sources

Domestic private financing sources consist of the following:

- credits from commercial banks, as one of the most significant sources
- funds of institutional investors (for example, capital funded pension insurance companies)
- funds of investment funds
- retained earnings of the domestic non-financial (corporate) sector.

In a bank-centric financial system like the Macedonian one, where the assets of the banks account for 79% of the assets of the total financial system, it is especially important to involve the banks as development partners. It is worth noting that there is also financial disintermediation, that is, significant cash outside the official financial flows. The high share of cash in circulation is one of the indicators of the informal (grey) economy. The use of these funds is not reflected in official statistics. Hence, the fight to suppress the grey economy and tax evasion can bring an extremely large addition to domestic public sources.

3.2.4. International private sources

Due to the limited domestic savings, the Republic of North Macedonia, as a small and open economy, is directed to the import of capital. Foreign private capital enters the Macedonian economy in the form of foreign direct and foreign portfolio investments, foreign loans from private entities (for example, a loan from Deutsche Bank), trade loans and advances, etc. Although they do not have the accounting treatment of capital import, but of transactions in the current account of the balance of payments, remittances are also a significant international private inflow of funds, which can be used not only for consumption, but also for investments.

Foreign direct investments (FDIs) are aimed at managing new production facilities (de novo financial investments or Greenfield investment) or buying a majority shares package (usually over 10%) with decisive influence in existing companies. The inflow of FDI into the Macedonian economy is encouraged by improving the business environment, as well as by abundant state aid (tax benefits and exemptions, as well as subsidies for foreign investors) through the technological-industrial development zones. Given that a policy of non-targeted access has been implemented for three decades, one of the big challenges is to assess whether a more favourable treatment is needed for foreign investments aimed at priority areas of sustainable development.

Chart No. 9. Net inflows of foreign direct and portfolio investments (as a percentage of GDP), 2003-2021

(Text on chart: Foreign direct investments (net, percentage of GDP); Foreign portfolio investments (net, percentage of GDP)

Source: National Bank (November 2022).

Foreign portfolio investments of the private sector are investments primarily motivated by the return, with no particular interest in managing the business entity. Their participation is reduced to inflows on the basis of issued Euro-bonds on the international capital market, with very small investments of foreign investment funds and funds of entrepreneurial capital (Chart No. 9).

Remittances abroad or private transfers are an extremely significant foreign exchange inflow for the domestic economy, which is primarily directed towards personal consumption. According to the estimates of the National Bank (2020), which are made according to an international methodology harmonized with the IMF, the amount of these remittances, from

2009 onwards, exceeds one billion euros per year, that is, it amounts to about 16% of the GDP, on average.[3]

3.3. Traditional and innovative financing mechanisms and structures

According to the type of financing structures and mechanisms, one can distinguish between simple and combined mechanisms:

- Simple financing mechanisms and structures are those in which one financial instrument is used (for example, only a loan from the World Bank, with a potential obligation for national co-financing)
- Combined financing mechanisms and structures are those in which a combination of several financial instruments is made.

Innovative financing mechanisms and structures are related to new combinations of several or few financial instruments from different public and private funding sources (Table No. 2).

Table No. 2. Four most frequently used combined financing structures

Combined financing structures	Illustration
1. Public entities or philanthropic organizations, which provide funds under market conditions within the capital structure to reduce the total costs of the capital or to provide a first layer of protection to private investors (first-loss capital)	Надреден долг или капитал Прв слој на заштита Subordinated debt or capital First protection layer
2. Public entities or philanthropic investors who augment the available funds through guarantees or issuing at prices lower than the market	Гаранции Долг Капитал Guarantees, Debt, Capital
3. Technical assistance grants that can be used before or after the investment to enhance commercial success or development impact	Долг Капитал Грантови за техн. помош Debt, Capital, Technical assistance grants
4. Providing grants (including for project preparation or design) to attract institutional investors	Долг Грантови → Капитал Grants, Debt, Capital

The first capital protection layer or more commonly, the Catalytic First Loss Capital (CFLC) is a loan or security that is (are) subordinated to other loans or securities in relation to asset claims or from the profit. In the event of bankruptcy or liquidation, subordinated debt creditors will not be paid until the subordinated debt is paid in full. Subordinated debt is riskier than unsubordinated debt.

[3] https://www.nbrm.mk/ns-newsarticle-soopstenie-05082020.nspx.

3.4. Innovative financing instruments

Innovative instruments for financing sustainable development apply to both the public and private sectors. They include many stakeholders: the public and private sectors, the civil sector, the academic community, independent researchers and social innovators, etc.).

3.4.1. Innovative taxes

A *carbon tax* is an innovative, non-traditional tax imposed on users of carbon fuels to compensate for environmental pollution. The carbon content of every fossil fuel, from lignite to heating oil and natural gas, is almost precisely established. A carbon tax would therefore impose a greater burden on the use of coal compared to the use of natural gas. A carbon tax is a direct tax levied on large industrial corporations for greenhouse gas emissions in order to encourage them to move towards cleaner and more efficient production. The carbon tax in Europe is applied by Sweden, Denmark, the United Kingdom and the EU itself. The European Union's "carbon tax" is essentially the EU's Emissions Trading System. Entry into the EU also implies participation in the EU emissions trading system.

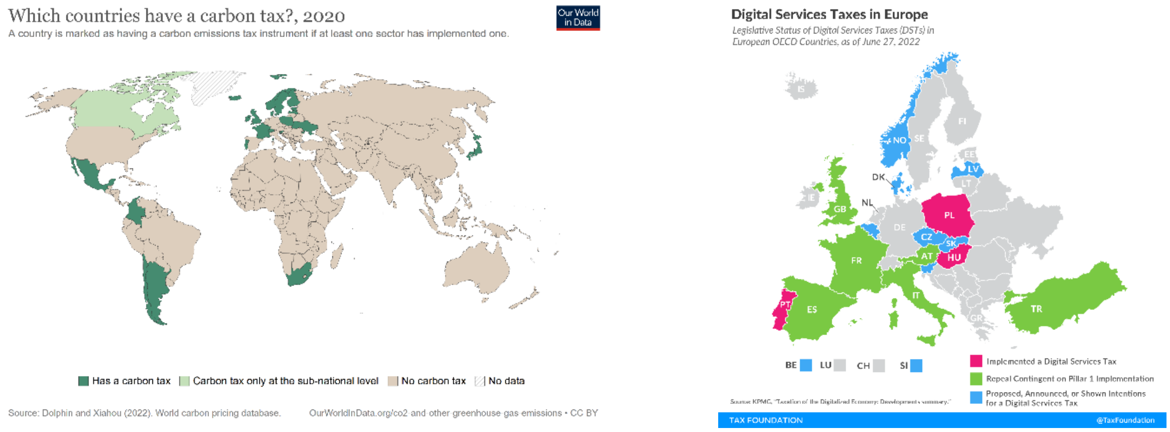
Tax on sugary drinks and products with a high sugar content (the so-called "Sugar Tax"). Belgium, Finland, France, Hungary, Ireland, Latvia, Monaco, Norway and Portugal are among the first EU members which have already introduced a tax on sugary drinks. The idea is to discourage the consumption of beverages, the continuous consumption of which almost inevitably leads to diabetes and obesity.

Tax on financial transactions. This tax is recommended for certain types of transactions, such as the purchase of stocks and bonds. The financial transaction tax is applied in Spain, France, Great Britain, Belgium, Switzerland, Poland, Finland, and Italy. Thus, for example, Italy levies a tax on financial transactions of 0.1% and 0.2%, financial investments in stocks and shares, and the purchase of financial derivatives. The Kingdom of Spain levies a 0.2% financial transaction tax on the purchase of shares in companies whose market capitalization exceeds 1 billion euros.

Digital Services Tax (Digital Taxation). According to the current system of taxation of digital services, multinational companies pay profit tax at the location of production, but not where the consumers of digital services are located. The principle of taxation of digital services according to the location of consumers is incorporated in the first pillar (Pillar One) of the initiative of the Organization for Economic Cooperation and Development (OECD), which is coordinated in 130 countries. By the end of 2023, a new solution for taxing digital services (for example, the use of Netflix services) according to the location of consumers is also expected.

Although it is not a classic tax but a non-taxable income, in this category we will also mention the *charge for traffic congestion in the city centre* (city congestion charge). Vehicle entry into central London is subject to a daily charge of £15 Monday to Friday 7 am to 6 pm and 12 pm to 6 pm on weekends and holidays. If the vehicle does not meet the ultra-low harmful gas emission standards, an additional fee is paid. In this way, traffic jams and ambient air pollution in the central city area are prevented.

Chart No. 10. Countries with introduced carbon tax in the world and digital services tax in Europe



3.4.2. Innovative support for entrepreneurship

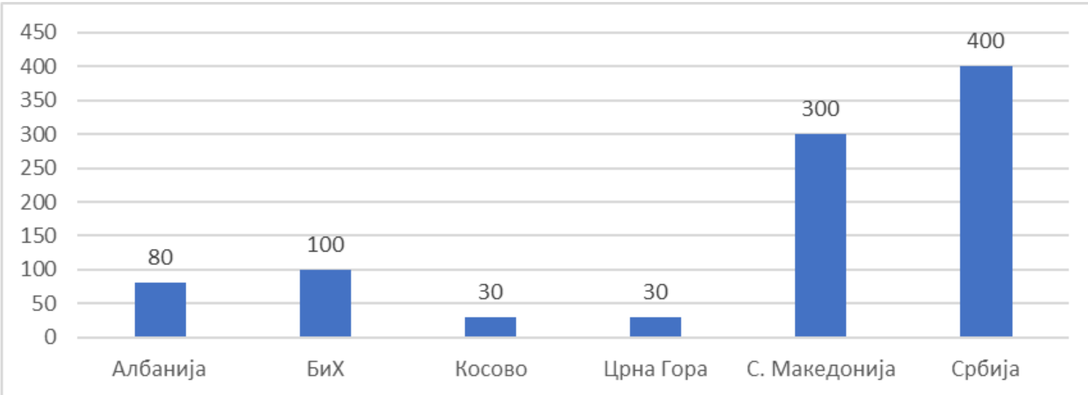
Many European countries practice state support for the so-called sustainable entrepreneurship. Thereby, a distinction is made between environmentally responsible entrepreneurship ("Ecopreneurship") and social entrepreneurship ("Social entrepreneurship").[4] The newly-established company or "startup" is defined as a business venture, which has: (1) at least one team member who is full-time dedicated to the development of the startup; (2) promising product/service with exponential growth potential and ambition to develop in the global market; (3) revenue of at least US$ 10,000 and/or US$ 10,000 received from external funding sources (Startup Genome, 2020).

One of the market failures associated with the development of sustainable entrepreneurship is limited access to financing. The banking sector is cautious in financing startups, due to the impression that it refers to too risky projects or credit applications with inadequately prepared analysis. Other obstacles to the development of entrepreneurship are the lack of knowledge and start-up culture. Many startups lack sufficient funding, although they have the potential to expand into business ventures outside the business entity ("spinoffs") or grow into dynamic companies with rapid sales growth ("scaleups"). It is precisely the innovative mechanisms and instruments of support that are perceived as a way of supplementing the support with traditional instruments.

The eco-system of startups in the Republic of North Macedonia is in its infancy, and venture capital investors and angel investors state that local startups are not ready for global competition. Currently, it is estimated that there are around 300 startups in the Macedonian economy (Chart No. 10), which is still relatively high compared to other Western Balkan countries (World Bank, 2021).

[4] Startups that introduce technological innovations in the finance sector are also known as fintech (fintech = finance + technology) industry, and those in the insurance sector are also known as insurtech startups (insurtech = insurance + technology).

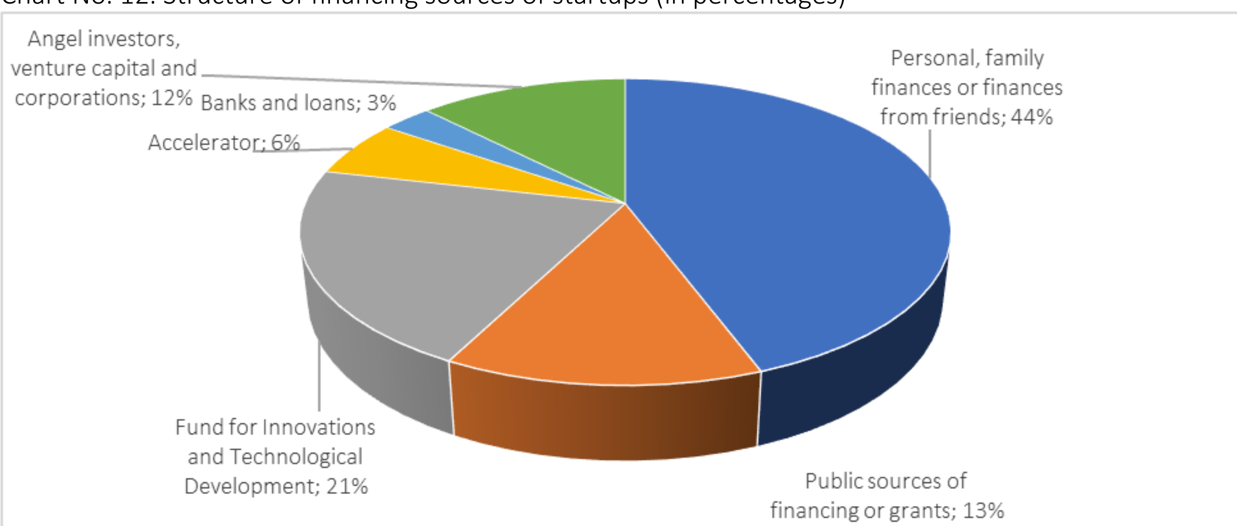
Chart No. 11. Number of startups in the Western Balkan region



(Text on chart: Albania, BiH, Kosovo, Montenegro, N. Macedonia, Serbia)
Source: PwC and the World Bank (2021).

As illustrated in Chart No. 12, startups provide most of their financing needs through personal, family or friend finance (44%), grants through the Fund for Innovation and Technological Development (FITR) (21%) and other public sources of funding and grants (13%).

Chart No. 12. Structure of financing sources of startups (in percentages)



Source: World Bank (2021).

Untapped potential of European venture capital funds. There is a large unused financial potential of international (global, European and regional) funds to support Macedonian startups. For a large part of them, the Macedonian economy is still an unknown country (*terra incognita*). FITR (especially in the context of the announced Hybrid Fund for Green and Digital Transformation for small and medium-sized enterprises) and the Directorate for Technological Industrial Development Zones (through the announced Hybrid Strategic Fund for Green Investments) should approach with concrete initiatives. European venture capital funds are backed by governments or the private sector and are led by professional fund management companies that combine public and private funding. Considering that it is a small market, these funds can easily be included in the financing of national and regional business initiatives.

Table No. 3. Examples of funds for supporting micro, small and medium enterprises

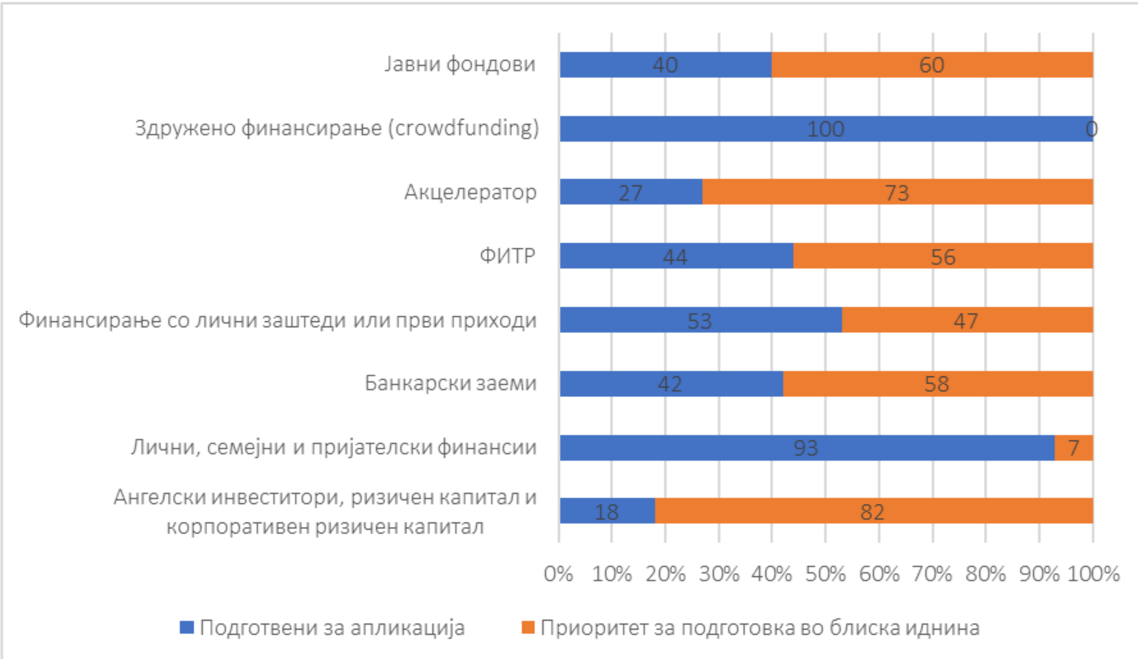
Founders	Funds	Budget or available fund
The Republic of Cyprus and the EIB	Cyprus Entrepreneurship Fund (CYPEF)	410 million euros
EIB Group (EIB + European Investment Fund)	Pan-European Guarantee Fund (EGF)	/
NORDEA (Nordic Universal Bank) and EIB	Green financing for SMEs in Europe	1,8 billion euros
Fund of the European Innovation Council (European Commission)	Direct equity investments	From 500.000 to 15 million euros
South Central Ventures	investments in startups, small and medium globally oriented technology companies in SE Europe	/

Table No. 4. An example of a fund that combines venture capital, private equity and mezzanine investments

Founders	Funds	Budget or available fund
European Investment Fund (EIF)	Central Europe Fund of Funds (CEFoF)	97 million euros

The banking sector remains convinced that the demand for loans is insufficiently supported by quality investment projects and business plans from SMEs. This market failure needs to be corrected: (1) in the short term, by subsidizing better development of business plans and investment projects (expert support and verification), and (2) in the medium- and long-term by extensive training in entrepreneurship, marketing and management. This is indeed confirmed in the answers to the survey of the startups, where 58% of respondents stated that in the near future, they will prepare better for credit applications to banks (Chart No. 13).

Chart No. 13. Degree of readiness to apply now and in the near future



(Text on chart: Public funds, Crowdfunding, Accelerator, FITR, Financing with personal savings or first income, Bank loans, Personal, family loans and loans from friends, Angel investors, venture capital and corporate venture capital, Ready for application, Priority for preparation in the near future)
Source: World Bank (2021).

Stronger support from the public sector. In terms of the *business environment*, a greater engagement of the public sector is needed in the domain of approximation of the national legislation with the EU legislation, acceleration and increasing the efficiency of judicial processes for the protection of private interests and suppressing the high level of corruption. In terms of *direct financial support*, the proposals for greater reliance on external sources for awarding grants through the Fund for Innovation and Technological Development and for subsidizing interest rates through the MBPR are fully justified, considering that they reduce the risk for financial institutions of misallocation of credits towards riskier SMEs. Those two measures should be the main pillars of the government's policy to improve the access to financing for the SMEs, that is, to allocate more budget funds for both institutions. The awarding of innovation grants should be performed with increased participation of foreign experts, preferably from the World Bank Group and other independent foreign experts.

Panel No 1. Factoring and leasing: Traditional or innovative instruments?

Factoring (also known as debt factoring or invoice factoring) is a traditional form of invoice financing in developed economies but is still underutilized in transition economies. It is designed to help businesses improve their cash flow.

The factoring industry plays an important role in supplying liquidity to businesses. Factoring is a service that enables the sale of products and services on deferred payment, whereby (part of) the amount specified in the invoice is received in a timely manner. Factoring combines credit protection, debt collection and financing for companies that sell products and services with deferred payment shorter than a specified period (for example, 180 days).

Late payments have been a long-standing problem for small and medium-sized enterprises in the Republic of North Macedonia, especially for the successful ones. According to the report on the financial stability of the National Bank, the average days for the collection of receivables have slightly improved from 118 days in 2015 to 103 in 2021. Factoring is in its initial phase and is provided by the Development Bank. The Law on Financial Companies contains only a general definition of factoring, in the sense of a financial activity in which, on the basis of an agreement concluded in writing, the financial company (factor) purchases the outstanding claims of another domestic or foreign legal entity (creditor), with or without the recourse right. Beyond this, there are no rules that are specific to the factoring agreement itself, that is, to its special content, and according to its special legal and economic characteristics.

Regarding the regulation of leasing, the legal text is non-transparent due to its numerous amendments and supplements. There are also pronounced ambiguities regarding the scope of the so-called operational leasing, which is understood differently in comparative practice. In this sense, relevant for SMEs is the so-called financial leasing, and therefore, reforms should be focused in this direction. The legal text does not have adequate protective mechanisms for users of financial leasing, especially in cases of late payment of the leasing fee. Finally, all this results in additional negative consequences on the level of leasing use.

Crowdfunding is the practice of financing a business venture or investment project by raising small amounts from a large number of people. Crowdfunding brings together companies that intend to mobilize funds and investors looking for opportunities to invest in early-stage companies. Potential users of this platform are legal entities that are not established as joint-stock companies, but as limited liability companies (LLC) or one-person limited liability companies (DOOEL). The establishment of this type of instrument will require technical assistance to evaluate the existing regulation whether it is in favour of the concept of group investment and the preparation of a potential legal framework and organizational requirements for the establishment of this concept.

3.4.3. Innovative guarantee funds

Guarantee funds are a traditional financing instrument, but with insufficient utilization and huge potential. The main challenge is strengthening the existing, and introducing new, guarantee funds within the framework of the Development Bank, simplifying the procedures and comprehensively informing the private sector. In addition, close cooperation with commercial banks is expected in the domain of improving the design, structure and terms of use of the guarantee funds. The reluctance of banks to offer credit lines to riskier borrowers or without adequate collateral is a "lesson" learned from the risky credit placements made in the past. However, by using the guarantee fund, a part of the principal can be guaranteed (even up to 80%), which significantly reduces the risk for the banks.

The existing Guarantee Fund in the Development Bank guarantees loans of up to 500,000 euros for micro, small and medium-sized enterprises (MSMEs), as well as large traders whose revenues based on exports account for at least 30% of the total revenues. The guarantees guarantee the principal of newly-approved loans for current and fixed assets given by banks and savings banks to the private sector.[5] Guarantees for MSME guarantee loans from 300,000 to 30,750,000 denars, with a repayment period of 1 to 8 years with a grace period of up to 1 year for fixed assets, and with a repayment period of 1 to 3 years with a grace period of up to 1 year for current assets. The amount of guarantees is up to 80% of loans for current assets and up to 50% of loans for fixed assets. For individual guarantees relating to large traders whose revenues based on exports account for at least 30% of the total realized revenues, a maximum of 50% of the principal amount of the loan is guaranteed.

In the next two decades, there is a huge potential to enrich the supply of guarantee funds. Following the example of the European Guarantee Fund, several sub-products or segments related to sustainable development should be distinguished:

- Guarantees to improve the competitiveness of the SMEs (better conditions, longer repayment period, lower acceptable mortgage value, recapitalization, etc.)
- Sustainability guarantees, which would support the green and sustainable transition of SMEs in accordance with the EU Taxonomy for sustainable investments
- Guarantees for innovation and digitization, as follows:
    - for innovation: significantly improved products, processes, services, investments in new intellectual property rights or a new organizational approach, with a focus on fast-growing enterprises or enterprises focused on research and development
    - for digitization: digitization of business models, supply chain management, customer relations management, business development, cyber security, training, upgrading, etc.
- Guarantees to support culture and creative industries
- Guarantees for micro-enterprises and social enterprises
    - microfinancing: to ensure sustainable employment and social inclusion, especially for vulnerable groups
    - social enterprises: to support active participation in the labour market and job creation for enterprises that increase inclusivity.
- Guarantees for upgrading of skills and education, mainly for financing students, pupils, enterprises investing in new skills; educational service providers to better respond to new skills needs.

The development of new guarantee funds will lead to an increase in private financing, which is also a priority in the EU, as well as to greater credit activity of banks.

With prospective membership in the EU, domestic business entities and individuals could also apply directly for the use of funds from the European Guarantee Fund.

3.4.4. Innovative banking products and services

The banking sector is increasingly aware of the new trend of lending in accordance with sustainable development (SDG lending). The expansion of the offer of banking products and

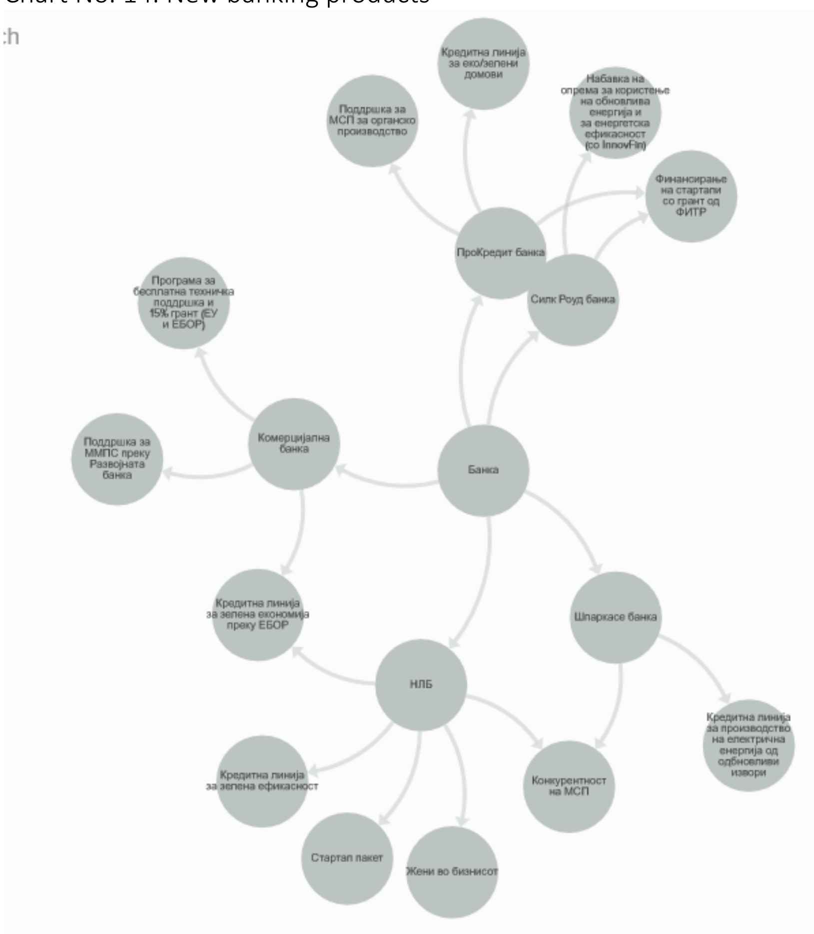
[5] In order to cooperate with the Guarantee Fund, banks and savings banks should have a capital adequacy of at least 12%, a positive financial result in the last year, and a credit portfolio of which at least 70% is classified in A and B category.

services is reflected in the newly launched banking products (Chart No. 14), such as loans intended for:

- support of startups with a grant from FITR
- energy efficiency and eco-homes (green homes)
- production from renewable energy sources
- organic production
- increased competitiveness of SMEs.

Banking in the service of the Sustainable Development Goals should be more strongly encouraged. The central bank may impose an obligation to reclassify the loan portfolio according to the area of approved loans. Thus, a greater insight will be gained about which commercial banks are more active in supporting sustainable development, which should be interpreted as greater social responsibility and potentially greater market capitalization.

Chart No. 14. New banking products



(Text on chart: Support for SMEs for organic production, Credit line for eco/green homes, Procurement of equipment for use of renewable energy and for energy efficiency (co InnovFin), Financing start-ups with FITR grants, ProKredit Bank, Silk Road Bank, Program for free technical support and 15% grant (EU and EBRD), Support for MSMEs through the Development Bank, Komercijalna Banka, Bank, Credit line for green economy and through EBRD, NLB, Sparkasse

Bank, Credit line for green efficiency, Start-up package, Women in business, SME competitiveness, Credit line for production of electricity from renewable sources)

According to the European Banking Federation (2021), European banks mostly lent to projects aimed at the eighth goal of sustainable development *decent work and economic growth* (83%), namely for the promotion of savings deposits, increasing financial literacy, promotion of entrepreneurship and development of SMEs and towards the *thirteenth goal of climate action* (75%), that is, a greater share of credits that support the Green Agenda, as well as the mitigation of, and adaptation to, climate change (Chart No. 15).

Through the regulation of the banking sector, an obligation to report (classify) a part of the credit portfolio of commercial banks can be imposed according to the Sustainable Development Goals. In addition, the commercial banks themselves should strive to introduce innovative credit products, especially in the area of project lending in the priority areas of sustainable development. In order not to wait too long, the National Bank can also introduce an annual award for innovative credit products in function of sustainable development.

Chart No. 15. Connection of credit activities of European banks with the Sustainable Development Goals (2030)

Source: European Banking Federation (2021).

3.4.5. Innovative stock market approaches

Stock exchanges, as organized markets of long-term securities, can help finance sustainable development, through a special innovative approach to listed joint-stock companies.

The Sustainable Stock Exchange Initiative is also in that direction. As many as 66% of the 120 stock exchanges involved in this initiative have already issued Reporting Guidelines for the purposes of environmental protection, social sphere and management (ESG financing). Listed companies that invest in sustainable development have special reporting obligations (a separate report on the Sustainable Development Goals or an integral part of the annual report), which are expected to have a positive impact on their market capitalization. An important international development partner in this domain is the European Bank for Reconstruction and Development (EBRD), which supports the process. The activities of this plan are still at an early stage.

3.4.6. Innovative banking regulation

The European Central Bank (ECB) is already integrating climate risks into monetary policy. The idea is that through banking regulation, commercial banks can be encouraged to restructure their loan portfolio towards projects in the priority areas of sustainable development. The instruments that the ECB will use are as follows:

(1) preference for the purchase of corporate bonds from companies that have a responsible attitude towards sustainable development;

(2) demand for higher collateral from companies that have a stronger carbon footprint;

(3) accepting only marketable assets and credit claims from companies and borrowers that comply with the Corporate Sustainability Reporting Directive (CSRD) as collateral in the Eurosystem credit operations.

The awareness of commercial banks is also raised through the so-called stress testing of climate change, in order to evaluate their exposure to risks and resilience to climate change.

The option that is being debated in the academic environment is to introduce lending certificates for the Sustainable Development Goals. Namely, central banks would establish a mandatory percentage for lending to priority sectors for the banking sector (for example, sustainable agriculture, education and environment). For example, a minimum of 10% of the loan portfolio should be allocated to loans to support environmental protection projects. In that way, commercial banks would be more responsible towards the Green Transition and the Green Agenda. If a bank is below the established minimum for lending to sustainable development, it could buy a loan certificate from another bank that has already exceeded the required minimum and can trade with the excess.

Alternatively, targeting could put a limit (ceiling) on the financing of the so-called "brown" funds, i.e. investment projects that do not consider pollution). And in this way, banks would reduce the carbon footprint of their loan portfolio.

In that direction, the National Bank introduced climate change and environmentally responsible behaviour of banks in the by-laws in the field of lending. In September 2022, the National Bank made a Decision on changes to the mandatory reserve instrument, through which the crediting of projects related to the domestic production of electricity from renewable sources is encouraged. In the third quarter of 2022, the share of "green" loans in total loans increased from 2.7% to 3.1%, a level which is still extremely low and which should still increase.

3.4.7. Innovations in attracting FDIs

The principle of a non-targeted approach ("every euro is welcome") to foreign direct investments should be reassessed. There is an opportunity for a targeted approach, which will offer more favourable treatment and greater incentives for foreign investors, who will invest in the priority areas of sustainable development. A serious shortcoming of the FDI policy is the absence of a thorough independent analysis of the costs and benefits of FDI to date. It should incorporate the granted state aid (tax exemptions and subsidies), benefits in the form of new employment and new added value, as well as the environmental impact of FDI. The analysis should be part of the continuous monitoring and evaluation of the effects of FDI.

A possible approach to better targeting of FDIs is their "greening", i.e. the concept of green FDIs. Green FDIs play a positive role in achieving all 17 Sustainable Development Goals, but they have the greatest impact on the eighth goal "decent work and economic growth" and the ninth goal "industry, innovation and infrastructure". According to the theory of environmental awareness ("Pollution Halo Effect Theory"), FDIs can bring three favourable effects on the environment: (1) transfer of clean technologies, which are more efficient and less harmful than domestic technologies; (2) technological spillover, i.e. the transfer of technologies that reduce pollution and (3) positive spillover effects on domestic companies through the transfer of best practices in the field of environmental protection (for example, Gallagher and Zarsky, 2007).

The following are among the more important measures to attract green FDIs:

- targeted FDI stimulations
    - guaranteed tariffs (feed-in tariff, FIT) are a tool for encouraging investments in renewable energy sources, through long-term contracts with fixed prices higher than market prices and guaranteed access to the electricity grid;
    - renewable energy certificates are a market instrument to encourage the production of energy from renewable energy. The production of 1 MWh of electricity from renewable energy sources is confirmed by a certificate, which can be traded, that is, sold to companies that pollute excessively.

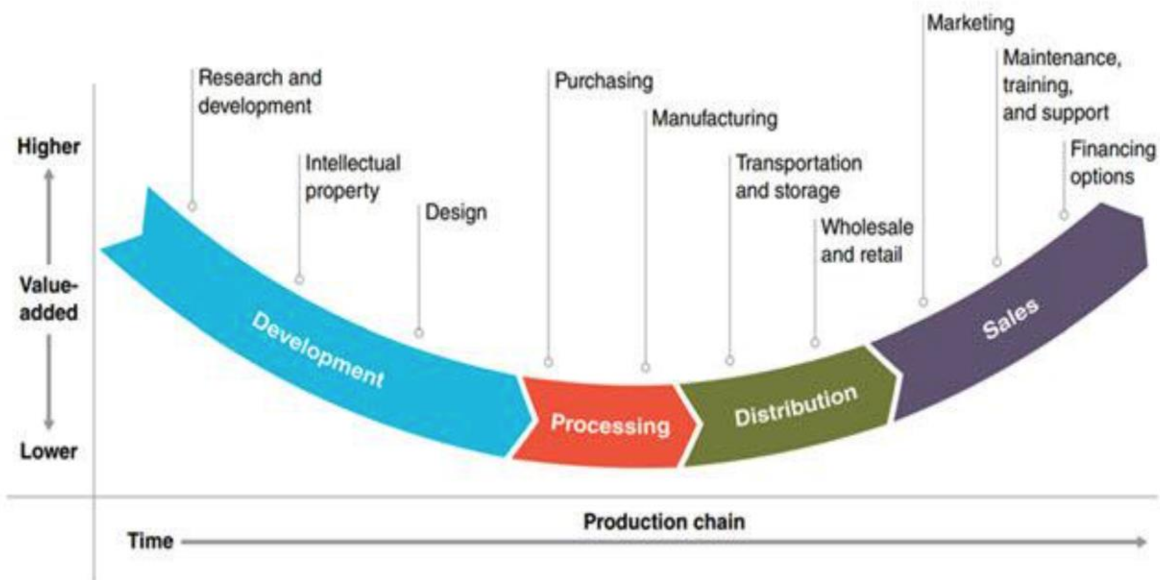
- more favourable taxation of the produced energy from renewable sources (tax credit to support innovations)

- financial support (subsidies) for decarbonisation

- targeted public expenditures for research and development in renewable technologies (OECD, 2017).

The concept of "The Smiling Curve" also indicates that targeting investments in the initial and final stages of the production chain is associated with the highest added value (Chart No. 16). For example, the value added in FDI directed at research and development or marketing is, on average, higher than the value added of FDI in manufacturing or processing industry.

Chart No. 16. “The Smiling Curve” concept

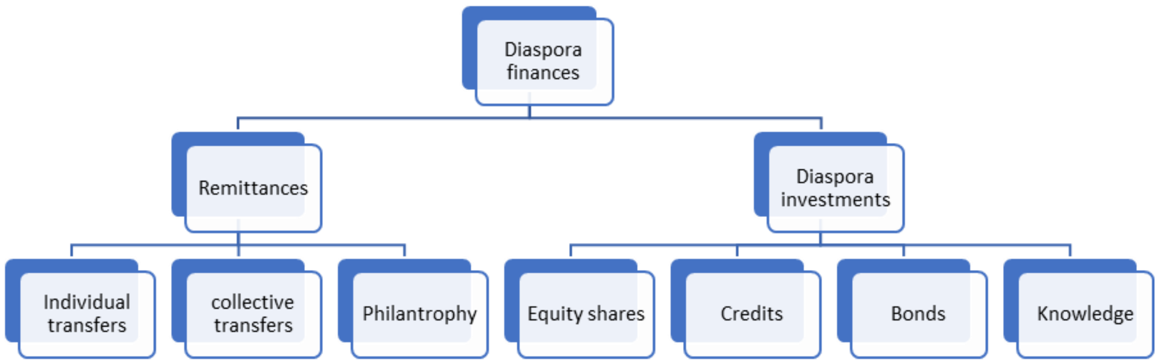


Source: Freudenberg (2020).

3.4.8. Innovative use of finances of the diaspora

Depending on the specified purpose, diaspora finances can be divided into two groups: (1) remittances, primarily intended for personal consumption, and (2) diaspora investments. Given that the annual amount of remittances, on average, is about 16% of GDP, the impression is inevitable that they have not been given sufficient attention by the policy-makers. The implicit conclusion is that as long as they are spent in formal economic activities, their favourable effect will be felt through the increased income of the recipient family and through greater personal consumption, that is, the sale of goods and services on the domestic market.

Chart No. 17. Diaspora finances



Source: Gelb et al. (2021).

Equity shares (direct and portfolio investments). There are expats who have founded and are successfully running a business in the Republic of North Macedonia (for example, "Taskforce BPO"). The current state support for companies founded by expatriates is 15% of the recognized costs of the investment, but not more than 1 million euros.[6] One option is to raise the state support to 30%, but set the maximum at 200,000 euros, for example, to increase the scope of potential investors. Determining different percentages of state support for individual regions, according to the degree of their economic development (GDP per capita), is another possibility for encouraging more balanced regional development.

Credits. Even when expatriates make deposits, the available pool of loanable funds in the domestic financial sector increases. Another option is to earmark remittances for housing loans (remittance-linked housing loans). For example, the inflow of remittances to be used to repay this type of bank loans.

Bonds for the diaspora. Appealing to patriotic feelings, many governments and municipalities issue specialized bonds intended for the diaspora. In order to maximize participation and responsiveness, the purpose, that is, the use of bond proceeds, is usually also determined. For example, bonds for the diaspora to finance the reconstruction and modernization of the Tetovo-Gostivar regional road. Because of the sensitive patriotic moment, the coupon interest rate on these bonds is usually lower than that of traditional government

[6] https://narodenglas.com/iselenicite-koi-sto-ke-investiraat-vo-firmi-i-rabotni-mesta-ke-dobijat-15-posto-drzavna-poddrska-bekteshi/

bonds of the same maturity, thus reducing the government's costs. Israel and India already have a tradition of issuing diaspora bonds.[7]

Knowledge. The knowledge (skills) of the diaspora are extremely important. A Kosovar expatriate returns to his home country and establishes a private Finnish international school, which follows the best practices and curricula from Finland.

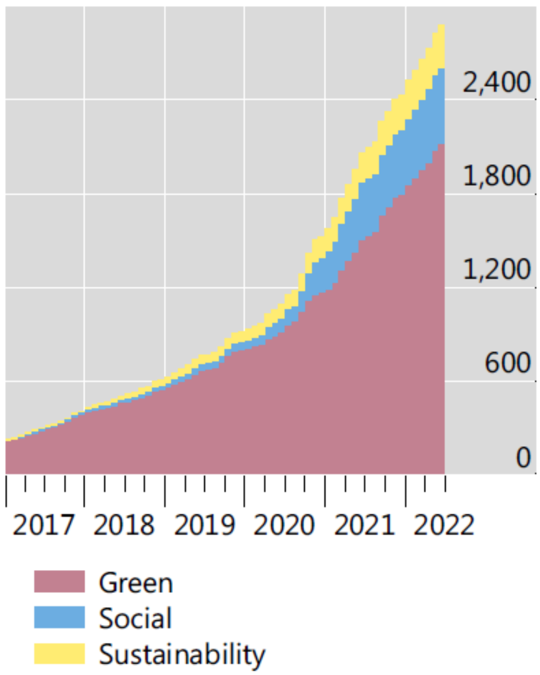
3.4.9. Innovative bonds

The market for innovative bonds, also known as bonds to finance the Sustainable Development Goals, is developing very quickly (Chart No. 17), reaching about 2.9 trillion USD at the end of June 2022 (Chong et al. 2022). An important feature of the development of the innovative bond market is the late entry of states as issuers. Many European Union (EU) member states have committed to increased budget expenditures to accelerate the green transition and sustainability. This market is still under-regulated; for example, as many as one-fifth of corporate green bonds are self-labelled as green by the issuer, without any external evaluation.

Unlike conventional bonds whose proceeds are used for general purposes, the proceeds of these thematic bonds (innovative bonds; "impact" bonds) are used to finance projects with an environmental, social or sustainability impact (Chart No. 18). The euro and the dollar are the main world (reserve) currencies in which these bonds are denominated. Innovative (thematic) bonds: (1) can provide lower financing costs (lower interest rate) compared to conventional bonds; (2) attract socially responsible investors; (3) more transparently present the use of funds in priority areas.

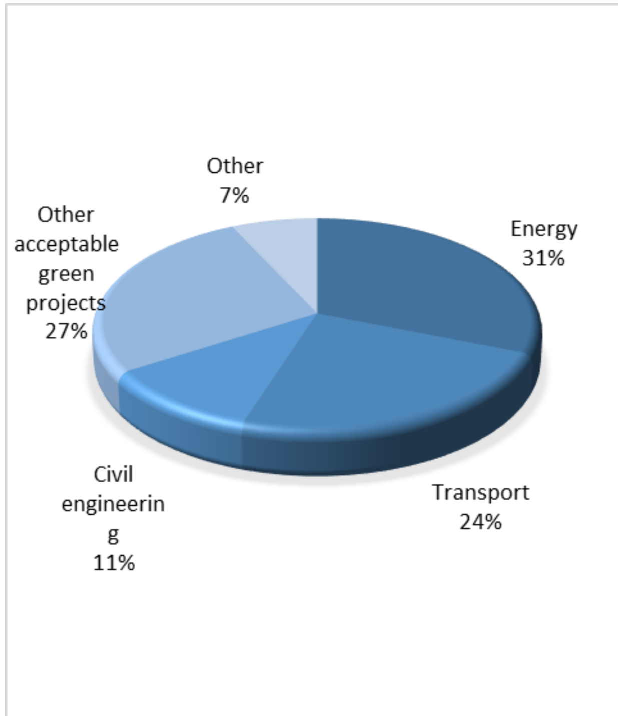
[7] Former Israeli Prime Minister, Golda Meir, addressed expatriates with the words: "You have a stake in every drop of water we use in our country, in every mile of road built, in every kilowatt of power, in every field, in every factory."

Chart No. 18. Green Bond Market Growth (2017-2022, in USD billion)



Source: Cheng, Ehlers, and Packer (2022).

Chart No. 19. Different sectors in which green bonds are issued (2013-2021)



Various participants are involved in the design and launch of innovative bonds:

- financiers: international financial institutions (IFIs); foundations; philanthropic organizations; governments; non-profit organizations; corporations, investment funds.
- investors: foundations or philanthropists; multilateral, bilateral or intergovernmental financial institutions (IFIs); impact on investing companies; banks; investment funds; institutional investors
- service providers: non-profit organizations, international organizations, non-governmental organizations; development organizations, charitable organizations, etc.
- intermediaries: Consulting organizations or consulting companies.
- technical assistance providers: consulting organizations, law firms, think tanks, universities.
- evaluators: Research institutes, academics, professional service companies.

The great success of thematic bonds is due to the focus on impact reporting, increased disclosure requirements and increased transparency. In addition, there is also some evidence that thematic bonds provide lower financing costs (slightly lower interest rates) compared to conventional bonds (e.g., Zerbib, 2016).

There are two approaches to issuing green bonds, social bonds and sustainability bonds:

- (1) a use-of-proceeds approach, which requires issuers to use bond proceeds to implement pre-identified projects. The use of income is strictly limited for specific purposes and projects.
- (2) a performance-based approach, which includes key performance indicators to assess impact, at a specified critical date.

Green bonds

Green bonds are offered to encourage projects that support the Green Agenda and the Green Transition.

The acceptable areas for issuing green bonds include the following:

- Renewable energy sources (including generation, transmission, appliances and products);
- Energy efficiency (such as in new or refurbished buildings, energy storage, central heating, smart grids, appliances and products);
- Pollution prevention and control (including air emissions reduction, greenhouse gas control, soil remediation, waste prevention, waste reduction, waste recycling and energy/emission-efficient waste-to-energy);
- Environmentally sustainable management of living natural resources and land use (including environmentally sustainable agriculture; environmentally sustainable animal husbandry; climate-smart farm inputs such as biological crop protection or drip irrigation; environmentally sustainable fisheries and aquaculture; environmentally sustainable forestry, including afforestation or afforestation and conservation or restoration of natural landscapes)
- Conservation of terrestrial and aquatic biodiversity (including protection of riparian, lake and watershed environments)
- Clean transport (such as electric, hybrid, public, rail, non-motorized, multimodal transport, infrastructure for clean energy vehicles and reducing harmful emissions)
- Sustainable water and wastewater management (including sustainable clean and/or drinking water infrastructure, wastewater treatment, sustainable urban drainage systems and other forms of flood mitigation);

	Q3 2022		2022 YTD		Cumulative since 2006	
	USDbn	% total	USDbn	% total	USDbn	% total
Green	79.4	52.1	332.5	52.3	2008.1	57.2
Social	23.1	15.2	94.2	14.8	617.0	17.6
Sustainability	34.4	22.6	142.1	22.4	678.9	19.3
SLB	14.7	9.6	63.5	10.0	192.9	5.5
Transition	0.7	0.5	3.4	0.4	12.7	0.4
Total	152.3	100	635.7	100	3509.6	100

- Climate change adaptation (including efforts to make infrastructure more resilient to climate change impacts, as well as information support systems, such as climate observation and early warning systems);
- Products, production technologies and processes adapted to the circular economy (such as the design and introduction of reusable, recycled and renewed

materials, components and products; circular tools and services); and/or certified eco-efficient products;
- Green buildings, which meet regional, national or internationally recognized environmental performance standards or certificates."

Types of issuers include companies (corporations), utilities, municipalities, sovereign issuers (governments), and multilateral development institutions.

Table 5. Examples of green bonds

Type of bond	Short description
Green sovereign bond	The first sovereign green bonds were issued by Poland and France in early 2017. In October 2017, Fiji issued the first sovereign green bond from a developing country, raising 100 million Fijian dollars, equivalent to about $50 million.
Green utility bond	In May 2021, the Pakistan Water and Power Development Authority issued a US$ 500 million green bond to finance a hydroelectric project. The ten-year bond has an interest rate of 7.5% per year and matures in 2031.
Corporate bond	CTP B.V. Group, one of the five largest European logistics companies in the real estate market and the largest logistics company in Central and Eastern Europe, headquartered in the Czech Republic, successfully issued the first green bond in the amount of EUR 650 million on October 1, 2020.

Social bonds

Social bonds (social impact bonds; social benefit or social purpose bonds) are designed to respond to a wide range of social needs. Their role is to provide capital for projects that contribute to socio-economic progress and empowerment - such as: basic infrastructure (for example, clean drinking water, sanitation, sewage, transport, energy); access to basic services (for example, health, education and vocational training, health care, financing and financial services); allocation of social housing; job creation and programs designed to prevent and/or reduce unemployment resulting from economic downturns, including through the potential effect of SME financing and microfinance; food security and sustainable food systems (for example, physical, social and economic access to safe and sufficient food that meets dietary needs and requirements; flexible agricultural practices; reduction of food loss and waste; and improved productivity of smallholder producers) ; socio-economic progress and empowerment (for example, equitable access to and control over assets, services, resources and opportunities; equitable participation and integration in the market and society, including reducing income inequality). Existing issues of social bonds range from 300 million euros to 1 billion.

When investors provide funds to service providers in advance, contingent on the achievement of desired social goals, social bonds are also called social impact bonds or pay-for-performance bonds. Service providers return to investors their principal plus an agreed return on investment. Impact bonds often also involve several other key players, such as evaluators. Because it is outside the service provider, she or he checks or evaluates whether the agreed results have been achieved.

Gender bonds

A special type of social bond is the gender-related bond, also known as a gender-focused bond, or simply, a gender bond. Its general goal is to reduce gender inequality and support women's participation in economic life. There are several types of gender bonds, for which (1) the sole purpose may be to promote gender equality; (2) bonds for which the promotion of gender equality is a goal together with other sustainable development goals; (3) a sustainable bond, for which the advancement of gender equality is a goal along with other goals; (4) Bond linked to performance targets related to gender equality.[8]

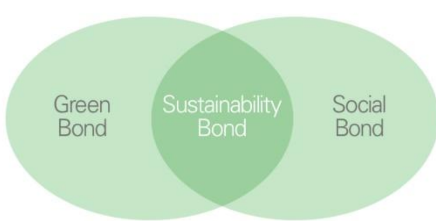
In October 2020 in Mexico, the Inter-American Development Bank (IADB) and the Funds for Rural Development (Fideicomisos Instituidos en Relación a la Agricultura, or FIRA) issued the first gender social bond worth 2.5 billion Mexican pesos (approximately 122 million US dollars) with a maturity of three years in Mexico. The bond finances projects aimed at promoting gender equality and empowering women, thus helping to advance Goal No. 5 of the United Nations, "Gender Equality". Proceeds from the issuance are used to (re)finance women-led projects in agriculture, fisheries, forestry, agri-food and rural sectors in three categories: (i) financial inclusion, targeting new borrowers; (ii) workforce and productive initiatives, to provide working capital financing for productive projects; and (iii) entrepreneurship, to provide long-term financing for capital investment in productive infrastructure.

The Asian Development Bank (ADB) on February 9, 2021, raised about USD 20 million from the first gender bond issued in Kazakhstan. Bond proceeds fund the Project to Advance Gender Equality in Housing Finance. The bond pays a semi-annual coupon interest rate of 10.15% and has a maturity of 10 years, i.e. it matures in December 2030.

On February 23, 2022, the Asian Development Bank issued the second gender bond in Kazakhstan in the amount of about 32 million USD with a coupon interest rate of 11%. The bond matures in December 2030. The inflows are expected to be used to expand the credit operations of the Housing and Construction Savings Bank of Kazakhstan, which in this way will provide housing mortgage loans to women (borrowers) in mainly rural areas.

Sustainability bonds

Sustainability bonds ("Sustainable" bonds; Sustainability-related bonds; Development bonds; Development impact bonds) are financial instruments with predefined targets for the Sustainable Development Goals, which the issuer has to achieve by a certain critical date ("critical date with potential penalty premium"). If the targets are not met, the issuer is obliged to pay a "penalty premium". This mechanism is absent in conventional green bonds. The coupon interest rate is increased by certain penalty percentage points (for example, 0.5 percentage points above the coupon interest rate).



[8] On November 16, 2021, the International Capital Markets Association ("ICMA"), together with the International Finance Corporation and UN Women, published a handbook on issuing gender bonds: *Bonds to Bridge the Gender Gap: A Practitioner's Guide to Using Sustainable Debt for Gender Equality*.

Catastrophe bonds (CAT Bonds)

Global economic losses from natural disasters (natural disasters) are estimated at over 300 billion US dollars annually, of which 75% are attributable to extreme weather events. In addition, disasters also force an estimated 26 million people below the poverty line each year, making this a key development challenge. A catastrophe bond (CAT bond) is a high-yield debt instrument designed to raise money for insurance companies in the event of a natural disaster.

Inflation-Indexed Bonds

In order to provide protection against loss of purchasing power, especially during periods of increased inflation rate, some governments also issue inflation-indexed bonds.

GDP-indexed bonds

GDP-linked bonds or bonds indexed to economic growth (Growth-Indexed Bonds, GIB) link government bond repayments to the rate of economic growth of the issuing country. They are focused on the economic dimension of sustainable financing and aim to reduce the procyclicality of fiscal policy and the likelihood of debt crises (Chamon and Mauro, 2006).

3.4.10. Innovative local finances

Better collection of own revenues is a traditional financial instrument, which has a huge unused potential at the local level. The innovative approaches in this part consist in updating the databases for the coverage and the real (market) value of the real estate in the territory of the municipalities, a more realistic picture of the tax lien for the property tax on bonds, etc.

There are also innovative approaches in the design of transfers from the central budget to LGUs, through their focus on (1) enhanced equalization of local fiscal disparities (enhanced equalization); (2) through their motivational component (performance grants) on the basis of an improved collection of own revenues, or (3) increased discretionary power in the spending of funds (free allocation of costs within the block grant for a certain competence).

There are also several innovative tools to strengthen local finances through borrowing for general purposes, to finance specific projects or to reduce municipal obligations and the obligations of local public enterprises.

Municipal bonds

The municipal bond is one of the modalities for long-term borrowing of municipalities. Its amount should be in accordance with the borrowing limits. The issuance procedure is regulated and depends on the prior consent of the Ministry of Finance and the Securities Commission. Inflows from municipal bonds can be used for general purposes or specific capital expenditures (local investments).

Interest-free municipal bond

The interest-free municipal bond is a financial instrument, which according to the Law on amending and supplementing the Law on Financing of Local Self-Government Units (LGUs) (173/2022 of 1.08.2022) can be issued by the municipality for a known buyer - the Ministry of Finance. The maturity period is a maximum of ten years, with the municipality having the obligation to pay equal annual instalments to the account of the Ministry of Finance every year. The interest-free municipal bond is issued according to a previously prepared prospectus and an adopted act for the approval of the securities issued by the Securities Commission.

Structural municipal bond

The structural municipal bond is an instrument, which includes the issuance of a structural bond by the Ministry of Finance at the request of the municipality. It also has a maximum maturity of up to ten years, with the municipality having the obligation to pay equal annual instalments to the account of the Ministry of Finance every year.

3.4.11. Innovative public private partnerships

Public Private Partnerships (PPPs) have the potential to accelerate the transition to a sustainable and inclusive economy. Although the impression is unequivocal that traditional PPPs have not yet come to life in Macedonian practice and that their potential remains almost unused, we will still briefly refer to innovative PPP models. PPPs have incredibly strong potential, which can be harnessed in an environment of good governance and satisfactory institutional capacity. This is especially true for large investments, for example, in the field of energy or health, where the mobilization of private capital can accelerate the process of modernization or upgrading of infrastructure. Opponents of PPP usually highlight the frequency of corrupt practices, the limited administrative capacity to assess the financial interest of the state, the limited capacity to monitor revenue generation, etc.

Panel No. 2. Risks related to public-private partnerships

In its thematic report from the audit of PPPs across the European Union, the European Court of Auditors came out with a study that indicates the risks and dangers associated with this type of financing. Some of the findings are listed below: "PPPs increase the risk of insufficient competition and thus put contracting authorities in a weaker negotiating position. Most of the PPPs that were audited indicate significant inefficiencies in the form of construction delays and large cost overruns. PPP analyses are based on overly optimistic scenarios regarding future demand and utilization of the planned infrastructure, resulting in project utilization rates of up to 69% (for ICT) and 35% (for highways) below projected amounts” (European Court of auditors, 2018).

Traditional PPPs (tPPPs) allow a private contracting party to provide a good or a service (usually public infrastructure) based on a long-term contract with the public sector.

Innovative PPPs (iPPPs) include the public sector, the private sector, civil society, municipalities, universities, research centres, multilateral institutions, social entrepreneurs and innovators.

Regarding the design of the reward system for participants from the private sector, two broad groups of PPPs are distinguished:

- User-fee PPPs give a private contractor the right to design, build (or renovate or expand), maintain, operate and finance infrastructure assets owned by the public sector

- Availability-based PPPs - The public sector institution – but not the end users – makes payments to the private party. These payments are usually made when the service becomes available

Numerous PPP projects can be facilitated and/or supported by international financial institutions, provision of grants and technical assistance (International Bank for Reconstruction and Development), political risk insurance (Multilateral Investment Guarantee Agency), mobilization of lenders offering support for the private sector (International Finance Corporation) and/or accelerating the green transition (European Bank for Reconstruction and Development), etc. The Department for PPP in North Macedonia is located in the Department of Legal Affairs in the Ministry of Economy and is regulated by the Law on Concessions and Public Private Partnership. At the same time, it must be emphasized that the new and modern proposal of the Law on Public Private Partnership has been "waiting" in the labyrinth of parliamentary procedures for 19 months. It ensures the transposition of Directive 2014/23/EU on the award of concession contracts and further aligns with the best standards and international practices in the field of PPP.

Panel No. 3. Innovative public-private partnerships

"University for all" (ProUni)

1.8 million full or partial scholarships for students from low-income families to access university education

Participants: Ministry of Education, Non-Governmental and Philanthropic Organizations, Caixa Economica Federal, Brazilian Banking Federation, Brazil (2005-2013)

Tax exemptions for 1304 private sector companies participating in this initiative

Improved and more cost-efficient street lighting and public security in the cities (2019)

PPP at municipal level for better and more cost-efficient street lighting (increased energy efficiency by 70%) (Bhubaneswar, Jaipur, Bengaluru in India)

Reducing gender inequality in Costa Rica, El Salvador, Peru and Panama

Cornell Institute for Public Administration in collaboration with the President of Panama

Training for public administration and students in the field of PPP, infrastructure, science, technology, sustainable development, social justice

Construction of a health complex

Construction of a hospital complex ("The Adana Health Complex") and two other huge hospitals in Elik and Kayseri through the PPP-funded Turkish Health Program. The aim is to modernize the Turkish healthcare system and improve service delivery. IBRD provided technical assistance to help manage PPP contracts. MIGA provided political risk insurance for 6 projects totalling US$ 848 million. IFC invested US$ 163 million in debt and helped mobilize an additional US$ 430 million from private sector lenders. The EBRD partnered with MIGA to provide credit enhancements for a €288 million green bond to build a modern hospital with 1550 hospital beds.

"The next 72 hours" (Nepal, 2015)

A PPP-funded program for quick and efficient response to help citizens affected by natural disasters within 72 hours

New building of "Fran Galovikj" high school and sports hall in Koprivnica (Croatia)

25-year contract for mandatory monthly compensation by the municipality.

Restoration of the Palace of the Varazhdin County (culture sector, Croatia)

20-year contract for the payment of a monthly fee.

Taishin Project in El Salvador (Japanese: Taishin, Earthquake Resistant)

A joint project of Mexico, Japan and two universities from El Salvador to help the citizens of El Salvador by "strengthening the technology to build popular earthquake-resistant housing structures." Houses made of reinforced bricks baked at a low temperature, with solar energy. This method is environmentally friendly and labour-intensive and has the advantage of local availability of basic building materials.

A significant addition to domestic public sources can also be brought about by the actual measurement of the amount of fees for the concession of certain natural resources. Currently, natural resources are ruthlessly exploited with an extremely modest fiscal contribution to public revenues. It imposes the need for a thorough and independent revision of the existing contracts and an innovative approach (by engaging independent experts and consultants of international development partners) when measuring the conditions of exploitation and the concession fee for the goods of general interest.

4. COMPARATIVE ANALYSIS OF THE FINANCING EXPERIENCES OF NATIONAL DEVELOPMENT STRATEGIES IN SOUTHEAST EUROPE

The general impression from the analysis of several national development strategies is that the section on their financing is quite general, with a taxative enumeration of potential domestic and external, public and private sources of financing. Financial issues are left for operationalization in medium-term fiscal strategies.

Republic of Croatia

The National Development Strategy 2030 of the Republic of Croatia is a national strategic action plan for the period from 2018 to 2030, which aims to support the dual digital and green transition of the Croatian society and economy. The strategy is not very explicit and specific in terms of financing. It points out that the availability of financial resources and the order of implementation of strategic interventions will be defined by four-year implementation programs at the national, regional and local levels, and will also depend on the consequences of the current crisis on the dynamics of budget revenues.

Innovative instruments	Short description
First fund for entrepreneurial (venture) capital	In July 2015, the World Bank approved a loan in the amount of 20 million euros for the establishment of the Venture Capital Project for Innovation and Entrepreneurship. This project aims to strengthen venture capital financing for innovative small and medium-sized enterprises (SMEs) and start-ups in Croatia and help the private sector become stronger, more productive and more competitive.
Technical assistance for research and innovation	In September 2021, an advisory agreement was signed under which the World Bank will provide technical assistance to support the Government of Croatia in improving the effectiveness and improving the institutional capacity to implement research and innovation policies. The advisory project provides long-term technical assistance and inputs for the design, implementation and monitoring and evaluation (M&E) of the research and development and innovation (RDI) policy during the EU programming period 2021-2027.

Corporate Green Bond (Performance-based Approach)	In August 2022, the M+ Group became the first company in Croatia to issue sustainability-related bonds worth almost EUR 40 million. It is a Zagreb-based provider of business process and technology outsourcing services with operations in 58 countries. Strategic partners in the issue of green bonds are Erste & Steiermärkische Bank and the European Bank for Reconstruction and Development (EBRD). If sustainability targets are not met, investors will be paid 0.75 percentage points above the nominal interest rate of 4.25%.

Republic of Serbia

Serbia has numerous thematic strategic documents that make up the universe of the basic National Development Strategy:

Innovative instruments	Short description
Green sovereign bond	In September 2021, Serbia issued a EUR 1 billion green bond to finance the country's green agenda. The proceeds can only be used for financing and refinancing in the areas of renewable energy (with emissions up to 100 grams of CO_2 equivalent per kilowatt-hour), energy efficiency, sustainable water and wastewater management, pollution prevention and control and circular economy, conservation of the environment and biodiversity, and sustainable agriculture.
Building a super-cluster	"Serbia Innovates" is a 6 million USD activity (supported by USAID) to accelerate development, introduce new economic models that will strengthen Serbia's innovation-driven economy, and strengthen its sustainable development, competitiveness and export potential. The main goal of the project is the development of a supercluster, a business model that encourages intensive cooperation between small and medium-sized enterprises and newly-formed enterprises, investors, universities and relevant state institutions.

Republic of Montenegro

In July 2016, the Republic of Montenegro adopted the New Development Strategy until 2030 and the 15-year Action Plan. The Ministry of Sustainable Development and Tourism is the responsible entity for the process. One of the novelties announced in NDS is the establishment of a new eco-fund, in which all public fees and credits intended for environmental protection projects would be included. At the moment, there are no funds for entrepreneurial (venture) capital, and several start-ups have applied for financing in the "South Central Ventures Fund" in Belgrade (Serbia).

Innovative instruments	Short description

Joint investments in priority areas	Miami-based UGT Renewables (UGTR) has signed an agreement with the Montenegrin state electricity company “Elektroprivreda Crne Gore” (EPCG). The agreement is for the joint development of projects for the production of electricity from renewable sources as well as for energy storage. The company will expand its Solari 3000+ to 5000+ rooftop solar programs, aiming to install a total capacity of 70 MW. Hyundai Engineering hopes to provide green energy solutions in Montenegro and the Balkans together with UGT Renewables.
Green Economy Financing Fund	In March 2021, a new fund for financing the green economy and supporting green investments was launched in Montenegro

5. NEXT STEPS

Financing of development priorities. The success of the National Development Strategy (*to be financed*) depends on the capacity of the future governments to secure sufficient sources of financing in a timely manner (*how it will be financed and implemented*). In that context, only the national development strategy, for the realization of which sufficient budget funds have been set aside and additional private capital has been mobilized from domestic and foreign sources, can enable an inclusive and sustainable prosperity and can raise the quality of life of the citizens.

An integrated approach. The need for an integrated approach is also confirmed through the Addis Ababa Action Agenda (2015), which proposes the introduction of an integrated national funding framework in support of national development strategies (UN, 2019). The integrated financing framework provides an opportunity for synergies and for analysing the necessary trade-offs of certain policies. The operationalization of the Integrated Financing Framework consists of four building blocks: (1) assessment and diagnostics; (2) designing a financial strategy; (3) monitoring, review, and accountability mechanisms; (4) governance and coordination mechanisms.

National financing strategy. With all the risk of excessive production of strategies, it is recommended to also design a National strategy for financing development priorities, which can be an integral part or an annexe of the NDS. It would be specified and operationalized in the existing mid-term document – Fiscal Strategy for the next five years.

Innovative financing primarily as a complement to traditional financing. Innovative financing mechanisms and instruments in no way exclude traditional sources and instruments of financing. So, for example, innovative instruments cannot be a substitute for the insufficient capacity to apply for and receive grants from the European Union, available through the Instrument for Pre-Accession Assistance (IPA), the Instrument for Pre-Accession Assistance and Rural Development (IPARD), the programs for Competitiveness of Small and medium-sized enterprises (COSME), Creative Europe, Erasmus+, Horizon 2020 and many others. On the other side, innovative instruments can in certain cases be a substitute for traditional instruments. For example, financing through a green sovereign bond partially reduces the need for financing through the traditional general-purpose Eurobond.

Increased home ownership over innovative financing. Domestic ownership of innovative sources of development financing is of paramount importance to ensure long-term development results. As with other reforms, full reliance on international development partners with passive domestic involvement will not ensure continuity in the efforts to introduce innovative mechanisms and instruments for financing sustainable development.

Institutional prerequisites. A strong institutional structure is needed, which will have the mandate to coordinate and support the process, to monitor and evaluate the implemented activities and to implement corrective measures. That sector or department is to be preferably located either in the Office of the President of the Government or in the Ministry of Finance in order to have legitimate or hierarchical power. In addition, the institutional (administrative) capacities for the introduction and monitoring of innovative financing mechanisms and instruments must be continuously strengthened. One of the prerequisites for this is the decompression of the salary scale of the public sector, that is, the positions that require more expertise and responsibilities should be paid more. In that way, quality human capital will be retained in decision-making positions in the public sector.

A "living" or regularly updated document. In the interest of greater effectiveness, coherence and compliance, regular updating of the National Development Strategy is recommended. The modern age is characterized by great uncertainty, which can easily throw the economy off its development path. In that way, the necessary sources of financing will be determined more precisely in the near future.

Operationalization of the National Development Strategy. The NDS should be specified in subsequent medium-term plans with indicatively defined sources of financing development priorities (Medium-Term Expenditure Framework).

Exploiting complementarities. Wherever possible, it is desirable that an investment project affects several Sustainable Development Goals. The financing of energy-efficient apartments (buildings) for housing the socially vulnerable categories, for example, also affects the protection of the environment and the social sphere.

Improving coordination between stakeholders. New mechanisms and financial instruments should be introduced in coordination with international development partners and the private sector. Unlike international development partners who are fully committed to sustainable development, more attention should be paid to the involvement of the private sector in the financing of the Sustainable Development Goals (SDG financing). In developed European economies, practices have already been established for reporting (accountability) of the private sector in relation to activities aimed at meeting the Sustainable Development Goals.

A phased approach. Some instruments can be introduced continuously over the next two decades, while others require more time and experience. For example, innovative bonds should be introduced gradually. At first, according to the approach "use of the inflows" or publicly announced purpose of the inflows from Eurobonds, and later, you can also go according to the "performance approach". As an illustration, a green government bond could be issued in 2023 with a clearly defined use of the inflows to finance environmental projects. In 2030, a green bond could be issued with performance targets (for example, a 20% reduction in emissions of harmful gases at the end of 2035 compared to the level at the end of 2030.

Overcoming the handicap of a small economy. Many venture capital funds and many foreign (direct or portfolio) investors are not interested in a small economy. Small and open economies are susceptible to external shocks and fluctuations in economic activity. For those reasons, the way out is integration in a regional and European context. If the funds have the opportunity to operate within regional frameworks (Western Balkans), and investors continue to enjoy the benefits of the European market, more foreign capital can be attracted as a supplement to domestic savings.

Improving human capital. Almost identical to the administrative capacity of the public sector, foreign capital requires a skilled workforce with modern education and skills. Attracting foreign capital mainly because of cheap labour is a short-term strategy that is losing steam with accelerated emigration, an ageing population and declining unemployment. The success of the National Development Strategy, as well as the innovative mechanisms and instruments for its financing, will depend on the investment in human capital. The modernization of curricula, the strengthening of the system of accreditation and evaluation of higher education programs, the promotion of dual education, and the introduction of higher standards in the domain of scientific publications and innovative activity will certainly have a favourable impact.

Good governance. At the national level, the rule of law, improving the quality and implementation of regulation (keeping up with European supranational legislation), reducing the level of corruption, strengthening institutional and administrative capacity and abandoning the culture of impunity are also important ingredients for a successful introduction of innovative mechanisms and instruments and better use of traditional ones. At the corporate level, good corporate governance, corporate ethics and social responsibility, transparency, tax morality, and anti-corruption practices are no less important factors for the successful introduction of innovative tools and successful financing of sustainable development.

Innovation policy and innovation system. The former industrial policy is slowly fading into history, leaving more and more room for innovation policy. Innovation has the potential to increase productivity, which "may not be everything, but in the long run is *almost everything*" needed for inclusive progress and sustainable economic development. Any innovation, including the one introduced by startups, has the potential to cause tectonic changes in the socio-economic sphere. Innovative mechanisms and instruments will achieve the strongest effect and greatest synergy if they are complementary and support the innovation system. The economy is more in the phase of technological adaptation than creation and innovation (Freudenberg, 2020). Hence, the following is needed: (1) improvement of technological absorption by the companies; (2) strengthening the spillover effects from multinational companies to domestic suppliers and distributors; (3) modernization of existing production technologies and introduction of innovative technologies in traditional sectors.

Annexe No. 1. International and national financial institutions active in the region of the Western Balkans

Institution	Short description
United Nations (UN)	The Office of the UN Resident Coordinator encompasses all organizations in the UN system engaged in operational development activities, regardless of their formal presence. Working closely with the national government, the resident coordinator and the country team advocate for the interests and mandates of the UN system. Coordinating development operations promotes greater strategic support for the country's national plans and priorities, increases the efficiency of operations and reduces transaction costs for governments.
World Bank Group	The World Bank Group (WBG) offers support to developing countries and countries in transition through soft loans, policy advice, research and analysis, and technical assistance. Its portfolio includes sector development programs, as well as project preparation and implementation.
European Investment Bank (EIB) and related funds	European Investment Bank (EIB) The bank is the main lender on behalf of the European Union and the largest multilateral financial institution in the world. It is one of the largest providers of climate finance. The EIB is committed to helping economic development, creating new jobs, promoting equality and improving the lives of EU citizens and citizens of countries in transition and developing countries.
	European Investment Fund (EIF) The European Investment Fund is part of the EIB group. It is a specialized provider of slightly riskier financing to small and medium-sized enterprises (SMEs) across Europe. EIF designs and develops venture capital and growth capital, guarantees and microfinance instruments that specifically target this market segment. In this role, the EIF drives the EU's objectives to support innovation, research and development, entrepreneurship, growth and employment.
	Western Balkan Enterprise Development and Innovation Facility (WB EDIF) The European Investment Fund (EIF) and three subsidiaries of the ProCredit group have signed guarantee agreements for the support of small and medium-sized enterprises (SMEs) in Serbia, Kosovo and the Republic of North Macedonia. This was made possible through the Guarantee Mechanism for the Western Balkans, financed by the European Union within the Instrument for Enterprise Development and Innovation in the Western Balkans. It is a new initiative that aims to improve access to finance for SMEs in the Western Balkans, helping to develop the local economy as well as regional venture capital markets and at the same time to promote policy reforms to support access to finance through financial engineering instruments.
	Enterprise innovation fund In 2015, a EUR 40 million Venture Capital Fund was established in the Western Balkans to provide financing to SMEs starting up or which are in the early stages of expansion. It invests in SMEs ranging from seed stage to early growth stage, in innovative sectors that show high growth potential, with a particular focus on information and communication technology (ICT). The fund contains a special fund for initial capital ("seed"), which focuses exclusively on companies in the "pre-seed" or "seed" stage.
European Bank for Reconstruction and Development (EBRD)	The EBRD aims to develop a healthy investment climate and promote environmentally and socially sound and sustainable development. Its mandate is to encourage the transition to open market-oriented economies and to promote private and entrepreneurial initiatives. The EBRD is guided by the principle that a functioning market economy should be competitive, inclusive, well-governed, environmental, flexible and integrated. The EBRD invests in projects, most of them in the private sector, works on policy reforms and provides business advice, all of which fosters sustainable growth.
Council of Europe Development Bank (CEB)	The Council of Europe Development Bank (CEB) is a multilateral development bank with a social mandate. By providing funding and technical expertise for projects with a high social impact in its member countries, it actively promotes social cohesion and strengthens social integration in Europe. CEB is the main instrument of solidarity policy in Europe.
German Development Bank (Kreditanstalt für Wiederaufbau, KfW)	The German Development Bank (Kreditanstalt für Wiederaufbau, KfW) supports change and encourages advanced ideas in FR Germany, Europe and around the world. It has a long history of dealing with development needs in transition economies.
Western Balkans	The Western Balkans Investment Framework (WBIF) was established in 2009 as a joint initiative of the

Investment Framework (WBIF)	European Commission (EC), the Council of Europe Development Bank (CEB), the European Bank for Reconstruction and Development (EBRD) and the European Investment Bank (EIB). The KfW Development Bank (KfW) and the World Bank Group (WBG) subsequently joined the platform. In December 2018, the French Development Agency (AFD) became a new participating organization in WBIF. The WBIF is a regional instrument for blended finance, the purpose of which is to respond to the extensive investment needs in the infrastructure of the Western Balkans region and to support the EU accession process of the beneficiaries: Albania, Bosnia and Herzegovina, Kosovo, Montenegro, R. North Macedonia and Serbia. It provides financing and technical assistance for strategic investments in the following sectors: energy, environment, social, transport, private sector development and digital infrastructure.
Agence Française de Développement (AFD)	Agence Française de Développement (AFD) is an inclusive public financial institution and a major actor in the development policy of France.
United States Agency for International Development (USAID)	USAID leads the United States' international development and humanitarian efforts to save lives, reduce poverty, strengthen democratic governance, and help people thrive beyond aid. On behalf of the American people, it promotes and demonstrates democratic values abroad and advances a free, peaceful and prosperous world.

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