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Report No: PGD400

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

FOR A

PROPOSED IDA SHORTER-MATURITY LOAN

OF EUR 90.3 MILLION (EQUIVALENT TO US$100 MILLION)

OF WHICH EUR 76.7 MILLION (EQUIVALENT TO US$85 MILLION)

FROM THE IDA SCALE-UP WINDOW

TO THE REPUBLIC OF KOSOVO

FOR THE

FIRST FISCAL EFFECTIVENESS, COMPETITIVENESS AND GREEN GROWTH

DEVELOPMENT POLICY FINANCING

February 20, 2024

Macroeconomics, Trade and Investment Global Practice
Europe And Central Asia Region

Republic of Kosovo

GOVERNMENT FISCAL YEAR

January 1st - December 31st

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of December 31st, 2023)

Currency Unit = Euro (EUR)

US$1.00=EUR 0.9028

ABBREVIATIONS AND ACRONYMS

AI	Administrative Instruction
CAD	Current Account Deficit
CBK	Central Bank of Kosovo
CC	Climate Change
CD	Concept Document
CEFTA	Central European Free Trade Agreement
CEM	Country Economic Memorandum
CIT	Corporate Income Tax
CPF	Country Partnership Framework
DeM	Debt Management
DPF	Development Policy Financing
EBRD	European Bank for Reconstruction and Development
ECE	Early Childhood Education
EIA	Environmental Impact Assessment
EPC	Energy Performance Certificates
ERP	Economic Reform Program
EU	European Union
FCV	Fragility, Conflict, and Violence
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GHG	Greenhouse Gas
GIZ	German International Cooperation Agency
GoK	Government of Kosovo
GRID	Green, Resilient and Inclusive Development
GRS	Grievance Redress Service
HBS	Household Budget Survey
ICT	Information and Communication Technologies
IDA	International Development Association
IFC	International Finance Corporation
IMF	International Monetary Fund
IT	Information Technology
LFS	Labor Force Survey
MESPI	Ministry of Environment, Spatial Planning, and Infrastructure
MFLT	Ministry of Finance, Labor, and Transfers
MTDS	Medium Term Debt Strategy
MTEF	Medium Term Expenditure Framework
NAO	National Audit Office
NDS	National Development Strategy
NSW	National Single Window
NECP	National Energy and Climate Plan
OECD	Organization for Economic Cooperation and Development
PA	Prior Action
PC	Policy Commitment
PCE	Private Capital Enabling
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PP	Percentage Points
PPG	Public and Publicly Guaranteed
PISA	Program for International Student Assessment
PIT	Personal Income Tax
PPRC	Public Procurement Regulatory Commission
RES	Renewable Energy Sources
RI	Results Indicator
RRA	Risk and Resilience Assessment
RSF	Resilience and Sustainability Facility
SAS	Social Assistance Scheme
SBA	Stand-by Arrangement
SCD	Systematic Country Diagnostic
SDR	Special Drawing Rights
SME	Small and Medium sized Enterprise
SML	Shorter-Maturity Loan
SOE	State Owned Enterprise
SUW	Scale-Up Window
TFA	Trade Facilitation Agreement
UNICEF	United Nations Children's Fund
USAID	US Agency for International Development
VAT	Value-Added Tax
WBG	World Bank Group
WTO	World Trade Organization

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REPUBLIC OF KOSOVO

Kosovo Fiscal Effectiveness, Competitiveness and Green Growth DPF

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SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Operation ID	Programmatic	If programmatic, position in series
P179944	Yes	1st in a series of 2

Proposed Development Objective(s)

To enhance the effectiveness of fiscal policy, strengthen the investment climate and lay the foundations for greener growth

Organizations

Borrower:	Republic of Kosovo
Implementing Agency:	Ministry of Finance, Labor and Transfers

PROJECT FINANCING DATA (US$, Millions)

Maximizing Finance for Development

Is this an MFD-Enabling Project (MFD-EP)? Yes

Is this project Private Capital Enabling (PCE)? Yes

SUMMARY

Total Financing	**100.00**

DETAILS

World Bank Group Financing

International Development Association (IDA)	100.00
IDA Shorter Maturity Loan (SML)	100.00

IDA Resources (US$, Millions)

	Credit Amount	Grant Amount	SML Amount	Guarantee Amount	Total Amount
National Performance-Based Allocations (PBA)	0.00	0.00	15.00	0.00	15.00
Scale-Up Window (SUW)	0.00	0.00	85.00	0.00	85.00
Total	**0.00**	**0.00**	**100.00**	**0.00**	**100.00**

PRACTICE AREA(S)

Practice Area (Lead)

Macroeconomics, Trade and Investment

Contributing Practice Areas

Energy & Extractives; Environment, Natural Resources & the Blue Economy; Finance, Competitiveness and Innovation

CLIMATE

Climate Change and Disaster Screening

Yes, it has been screened and the results are discussed in the Operation Document

OVERALL RISK RATING

Overall Risk	Moderate

RESULTS		
Indicator Name	Baseline	Target (*circa end-2025*)
1. Tax revenue as a share of GDP	23.5[1] percent (average)	26 percent
2a. Public expenditure on ECE as a share of spending on education 2b. Number of new children registered in ECE institutions	4.6 percent 0	6.1 percent 1,800
3. PEFA Indicators PI-1 (aggregate expenditure outturn) and PI-2 (expenditure composition outturn)	PEFA indicators: PI-1: B PI-2: D+	PEFA indicators: PI-1: A PI-2: C
4. Number of qualified investors' expressions of interest in the territory of Kosovo	0	10
5a. Number of institutions integrated into the national single window 5b. Number of inspectorates implementing risk-based inspections	0 0	6 3 or more
6. Number of priority cadastral zones reconstructed based on the provisions of the new Cadastre Law	0	30
7. Number of household beneficiaries of the Program for the Protection of Vulnerable Consumers in the Electricity Sector	0	50,000
8. Number of buildings with energy performance certificates (EPCs)	0	50
9. Megawatts of new renewable energy sources (RES) committed for electricity generation	0	175MW
10. Annual average usage number of lightweight plastic carrier bags per capita	222	180
11. Annual GHG inventory report published according to the new monitoring and evaluation criteria[2]	No	Yes

[1] The baseline for this indicator is calculated as the average tax revenue (in percentage of GDP) between 2015-2022.
[2] Sectoral coverage of the annual GHG inventory report according to the new methodology will be dependent on data availability.

IDA PROGRAM DOCUMENT FOR A PROPOSED CREDIT TO THE REPUBLIC OF KOSOVO

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The objective of the proposed Fiscal Policy, Competitiveness and Green Growth Development Policy Financing (DPF) series is to support the Government of Kosovo (GoK) in its efforts to enhance the effectiveness of fiscal policy, strengthen the investment climate, and lay the foundations for greener growth in the post-COVID era.** This programmatic DPF operation in the amount of EUR 90.3 million (US$100 million equivalent)[3] supports selective priorities of the Government Program 2021–2025 and of its structural reform agenda. The proposed program is aligned with the World Bank Group's (WBG) mission of ending extreme poverty and boosting shared prosperity in a livable planet. It is at the center of the WBG Country Partnership Framework (CPF) for FY2023-2027 and supports actions that cut across all the three focus areas of the CPF, namely strengthening public service delivery efficiency and quality, enhancing conditions for more formal private sector jobs and increasing environmental resilience[4]. The proposed DPF follows the Public Finances and Sustainable Growth DPF (P170113), delivered in FY2022, which provided financing of EUR 50.6 million (US$56.4 million equivalent) in support of important structural reforms to improve fiscal transparency, private sector development and environmental sustainability. The DPF has been a core reform anchor for Kosovo and serves as a platform for the adoption of important structural reform measures by the Government, thanks to strong ownership and multi-donor partnership. Based on an assessment of the prior actions, the proposed DPF is aligned with the goals of the Paris Agreement.

2. **Kosovo has experienced steady economic progress since its independence in 2008 in the context of its ambition to integrate into the European economy, allowing its transition to upper-middle-income status in 2018.** In the decade leading up to the pandemic (2010–19), Kosovo's economy grew by an average of 4.6 percent a year, which translated into an almost 50 percent increase in per capita income and a 35 percent reduction in the poverty rate[5]. During this period, Kosovo's economic growth was mainly driven by private consumption, fueled by remittances inflows, higher social protection spending and continued financial deepening. Public and private investment also supported growth, but with weak returns. In 2020, the economy was heavily affected by the COVID-19 crisis and the GDP contracted by 5.3 percent. Between 2021 and 2023, the GDP grew at an average of 6.3 percent and the economy marked a shift to more export- and investment-driven growth, and significant job formalization. The country continues to record high trade deficit levels, financed primarily through significant diaspora-driven inflows, including through real estate foreign direct investment. On the production side, services have historically led growth, while industry – excluding construction – and agriculture provided more limited contributions to growth. Outdated, unreliable, and highly polluting coal-based energy production capacities remain a significant binding constraint for growth. High inactivity rates among women, with only one in five women participating in the labor market, represent a constraint to inclusive development.

3. **To sustain growth and accelerate poverty reduction, the country needs to transition to a more competitive growth model that creates more and higher quality jobs, supports firm growth and is driven by higher productivity.** Carefully leveraged, Kosovo's strengths—a young population, proximity to a large and affluent market, good digital connectivity, low labor costs, a resilient and liquid financial sector, and strong ties with its diaspora— provide an opportunity for growth. Yet, the country continues to face structural, social, economic, and political vulnerabilities as described in the 2021 Risk and Resilience Assessment (RRA).

4. **The recent crises reaffirmed the urgency of structural reforms to enhance the effectiveness of fiscal policy to mitigate the impact of shocks in a unilaterally euroized economy without market access.** Before the pandemic, Kosovo maintained a good track record of sustainable headline fiscal policy, anchored by a set of fiscal rules and prudent policy

[3] Kosovo is eligible for IDA Scale-Up Window Shorter-Maturity Loan (SUW-SML) financing in FY24. Out of total EUR 90.3 million (US$100 million equivalent), EUR 13.6 million (US$15 million) will be provided by Kosovo's Performance Based Allocation (PBA) and EUR 76.7 million (US$85 million) will be provided from SUW-SML.
[4] The proposed operation is aligned with the WBG Evolution Roadmap, its Crisis Response Framework, IDA20's Policy Commitments (PC) in the areas of FCV, Climate Change, Human Capital, Jobs and Economic Transformation and Gender and Development and is private capital enabling (PCE).
[5] In 2022, the poverty rate reached 25 percent measured using the upper-middle income poverty line (US$6.85/person/day in 2017 PPP).

management. The country was able to significantly increase public spending in the pre-COVID period while maintaining fiscal discipline, thanks to strong economic growth. However, the effectiveness and efficiency of public spending remains low. For instance, between 2017 and 2023 the share of current spending in total expenditure increased to more than 75 percent of total expenditures, driven by increases in transfers and employee compensation. The quality and composition of spending has also experienced a deterioration driven by the proliferation of untargeted social protection benefits and transfers. Moving forward, it will be important for authorities to strengthen fiscal policy to ensure adequate space to address sizable developmental gaps and be able to mitigate shocks. Against this background, the DPF, through its first pillar, supports measures aimed at improving public financial management (PFM), expenditure prioritization with a focus on human capital spending and strengthening revenue mobilization, with a view to enhancing fiscal policy effectiveness in the medium term.

5. **Supporting a stronger enabling environment for the private sector is critical to fulfill Kosovo's aspirations for higher productivity growth, job creation and faster poverty reduction.** Kosovo remains a country in transition. Despite efforts to promote domestic private sector growth, attract foreign direct investment (FDI), and formalize private sector employment, the structure of the economy continues to rely on micro, small, and medium-sized enterprises. The private sector shows limited productivity growth, firm dynamism, investment attraction and employment creation. While there have been notable improvements in the business-enabling environment, significant barriers to private sector development and investment attraction persist. These constraints include weak investor protections and contract enforcement, an unreliable energy supply, limited regional integration, an uncertain regulatory framework for businesses, difficulties in establishing property rights, and lack of full contract enforcement. The DPF, through its second pillar, supports a series of measures to encourage investment attraction, strengthen trade facilitation, reduce compliance costs associated with doing business, and strengthen property rights.

6. **Kosovo is at an early stage in its decarbonization pathway towards a carbon neutral economy.** The majority of greenhouse gas (GHG) emissions in the country (87 percent) are generated by the combustion of fossil fuels in the energy sector. Therefore, a key objective for Kosovo is to promote a transition to low-carbon technologies in the energy sector by increasing the use of renewable energy sources (RES), supporting energy efficiency, while gradually phasing out the use of fossil fuels. The energy sector is currently under significant pressure due to limited and unreliable generation capacity in the context of increasing demand. The sector continues to rely predominantly on inefficient and highly polluting coal-fired energy generation, despite some recent investments in RES. Managing growing demand with imports, especially during the winter, has turned into an acute short- and medium-term challenge, considering the elevated international energy prices. In addition, Kosovo's high fossil fuel dependency leaves the country vulnerable to the impacts of the European Union's (EU) Carbon Border Adjustment Mechanism, which is expected to be introduced permanently in 2026. Key policy priorities for the energy sector are, in the short term, a more efficient use of electricity that can contribute to reducing demand and balancing the system; and, in the medium to long-term, boosting energy efficiency and renewable generation, and diversification. This requires improving the enabling environment and introducing market-based support mechanisms for renewables and rendering the electricity system more flexible and able to respond to needs. At the same time, environmental degradation and climate change pose a substantial risk to Kosovo's development progress. The proposed DPF, through its third pillar, supports critical reforms for the energy transition in sustainable power generation, energy efficiency, environmental sustainability, and climate change policy.

7. **Given Kosovo's vulnerable institutional and political context, the operation complements technical and financial support provided by other development partners in support of the GoK's wider structural reform agenda**. In line with the WBG's Fragility Conflict and Violence (FCV) strategy, the operation leverages strong collaboration and implementation support from international partners, including the EU, the International Monetary Fund (IMF), the German International Co-operation Agency (GIZ), the United Nations Children's Fund (UNICEF) and United States Agency for International Development (USAID), as well as other WBG operations and advisory services. The reforms are well-aligned with the Economic Reform Program (ERP) 2022–25, an important reform anchor for Kosovo's EU accession

process.

8. **The overall risk of the proposed operation is assessed as Moderate.** Among the risk categories, institutional capacity for implementation and sustainability risks, as well as political and governance risks are assessed as Substantial. All other risk categories are assessed as Moderate. Risks are mitigated by the Government's strong commitment to the policies being supported by the DPF series, close coordination and consultation with authorities, and development partners together with strong analytical foundations. The WBG and other development partners are expected to continue providing technical assistance through the DPF program to support the timely implementation of reforms.

2. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS

9. **In 2021 and 2022 Kosovo experienced a strong post-pandemic economic recovery.** After contracting by 5.3 percent in 2020, driven by plunging diaspora-related tourism exports and investment, economic growth recovered in 2021 by reaching an exceptional rate of almost 11 percent, driven by large diaspora inflows, mobility normalization, and improved consumer confidence[6]. In 2022, the post-pandemic growth momentum of 2021 was constrained by the negative terms-of-trade shock resulting from Russia's invasion of Ukraine and associated price pressures, which weighed on private demand, a key growth driver in 2021. In the first half (H1) of 2023 amid a challenging global context and high volatility, growth further decelerated, but remains resilient. GDP growth reached 3 percent in H1 2023, driven primarily by a robust export growth (10.3 percent, year-on-year[7]) – particularly of service exports (19 percent) – and private consumption (2.3 percent). After contracting in 2022, investment has been on a positive trajectory, reaching 1.5 percent growth in H1 2023. On the production side, services provided the highest contribution to growth.

10. **Employment formalization is on the rise, but the labor market continues to face critical challenges.** According to recent administrative data, formal employment increased by 4.3 percent between September 2022 and September 2023. The latest Labor Force Survey (LFS) for 2022 revealed that the working age population shrank during 2022, likely due to migration, while the employment-to-population ratio experienced an increase, from 31.1 percent in 2021 to 33.8 percent in 2022. Notably, the unemployment rate has been on a downward trajectory, falling to 12.6 percent in 2022; but inactivity rates remain high. The LFS data further highlight prominent gender disparities within the labor market, encompassing significant differences in employment rates (49.4 percent for males and 18.4 percent for females in 2022), inactivity rates (45 percent for males and 78 percent for females), as well as high levels of youth unemployment (21.4 percent).

11. **Kosovo has a good track record of fiscal management supported by well-defined fiscal rules[8] and a prudent fiscal stance**[9]. Fiscal consolidation efforts that started in 2021 are continuing. In 2022, the combination of tax revenue growth and capital underspending compensated for the increase in expenditures associated with crisis-response measures, leading to an improvement in the fiscal position with the fiscal deficit reaching 0.5 percent of GDP. By end-August 2023, the overall budget balance recorded a surplus of EUR 243 million (or 2.5 percent of GDP) on the back of continued revenue growth (14 percent) and prudent spending. Tax revenue growth reached 12 percent, driven primarily by increased collection of direct taxes (20 percent) and domestic Value-Added Tax (VAT, 20 percent). Strong revenue performance, particularly for direct taxes, reflected continued efforts to strengthen the tax administration and reduce informality, including through more frequent risk-based audits and inspections[10]. Expenditures increased by 15 percent until September 2023. Implementation

[6] In 2021, GDP returned to pre-pandemic levels.
[7] All references hereon refer to year-on-year comparison unless otherwise indicated.
[8] Kosovo's fiscal deficit rule caps the overall fiscal deficit at 2 percent of GDP, excluding investment financed with privatization receipts and donor financing, as well as Privatization Agency of Kosovo-related current expenditures.
[9] As a unilaterally euroized economy, fiscal policy is Kosovo's sole macroeconomic management tool. The decision to adopt the euro has generated a number of benefits, including a stable exchange regime, limited domestic price pressures, and a more predictable environment for private sector development.
[10] In recent years, other measures the GoK has adopted to formalize workers include incentives that are conditional on work formalization, and labor market policies aimed at supporting employment opportunities for youth.

of the new legislation on public wages led to a 19 percent increase of the monthly wage bill, while expenditures for subsidies and transfers declined following the discontinuation of crisis-related measures. Capital expenditure increased by 67 percent by September 2023, albeit from a relatively low base in 2022. Despite the significant pick-up in spending, implementation of externally financed capital projects continues to lag. Given the availability of adequate levels of budget reserves, the Government has cancelled plans to issue new domestic debt by end-2023. Public and publicly guaranteed (PPG) debt reached 16.7 percent of GDP in September 2023, down from 20 percent of GDP at end-2022[11].

Table 1: Key Macroeconomic Indicators

Indicator	2020	2021	2022^e	2023^f	2024^f	2025^f	2026^f
Nominal GDP (EUR million)	6,772	7,958	8,955	9,797	10,607	11,450	12,060
Real Sector							
Real GDP growth (percent)	-5.3	10.7	5.2	3.2	3.8	3.9	4.0
Contribution to GDP growth (in percentage points)							
Consumption	2.1	8.2	3.9	2.3	3.4	3.4	2.8
Investment	-2.8	5.0	-1.2	0.4	1.3	1.3	1.8
Exports	-8.3	16.4	6.4	3.8	2.2	2.3	2.6
Imports	-3.6	18.8	3.9	3.3	3.1	3.0	3.2
Monetary and external sector							
Consumer price inflation (percent, period average)	0.2	3.4	11.6	4.8	3.0	2.5	2.2
Goods exports (percent of GDP)	7.0	9.5	10.4	8.8	9.0	9.2	9.5
Goods imports (percent of GDP)	45.0	54.3	58.1	54.4	53.6	53.5	53.1
Net services exports (percent of GDP)	5.8	13.0	15.5	16.7	16.3	16.6	16.9
Trade balance (percent of GDP)	-32.2	-31.8	-32.4	-29.0	-28.4	-27.8	-26.6
Net remittance inflows (percent of GDP)	14.0	14.1	13.3	13.7	13.6	13.6	13.7
Current account balance (percent of GDP)	-7.0	-8.7	-10.5	-6.5	-6.0	-5.5	-5.1
Net foreign direct investment inflows (percent of GDP)	4.2	4.0	6.7	5.5	4.6	4.3	4.6
External debt (percent of GDP)	36.9	37.6	38.2	38.3	40.2	41.1	41.8
Fiscal sector							
Public revenues (percent of GDP)	25.4	27.4	27.8	28.7	28.2	28.3	28.8
Public expenditures (percent of GDP)	33.0	28.8	28.2	29.2	30.1	30.1	30.3
Fiscal balance (percent of GDP)	-7.6	-1.3	-0.5	-0.6	-1.9	-1.9	-1.7
Public debt (percent of GDP)	22.0	21.2	19.6	18.3	20.6	21.6	22.9
Public and publicly guaranteed debt (percent of GDP)	22.4	21.5	20	18.6	20.9	21.9	23.2
Of which: External (percent of GDP)	7.8	7.3	7.2	7.2	9.1	10	10.7

Source: World Bank staff calculations and projections based on data from the Kosovo Agency of Statistics, the Central Bank of Kosovo, and the Ministry of Finance.
Note: e=estimate, f = forecast. Figures are expressed on a cash basis.

12. **In 2022, against a deterioration of the terms-of-trade, the current account deficit (CAD) widened to 10.5 percent of GDP from 8.7 percent in 2021.** Kosovo's export competitiveness, particularly in goods, remains weak, with a dependence on commodities and a large trade deficit in goods (47 percent of GDP in 2022). The high trade deficit is partly offset by the surplus in services, supported by the Kosovar diaspora, among other factors. By August 2023, the CAD improved by 41 percent, reaching 2 percent of GDP, driven by lower value imports coupled with a continued growth in exports (9.4 percent), particularly in service exports, and secondary income inflows. Nominal merchandise exports dropped by 8 percent, while imports stagnated. The CAD continued to be financed by a combination of FDI and official external financing. Net portfolio investments showed net outflows of around 3 percent of GDP by August 2023[12]. Remittances recorded a cumulative growth rate of 12 percent. Foreign direct investment (FDI) continued to experience a positive performance with a cumulative increase of 4.7 percent by July 2023. Nonetheless, FDI remains highly concentrated in the construction and real estate sector, reflecting the demand of the Kosovar diaspora for real estate assets in Kosovo.

[11] The total stock of PPG debt comprises mostly domestic debt (59.5 percent of total public debt), and is held predominantly by the Kosovo Pension Savings Trust, commercial banks, and the Central Bank of Kosovo. External public debt is largely owed to multilaterals (IDA, IBRD, IMF, EBRD and EIB). Kosovo does not have market access and credit ratings.

[12] The level of portfolio investments is limited, and the country's portfolio of assets mainly include overseas investments by the Kosovo Pension Savings Trust and commercial banks.

Table 2: Key Fiscal Indicators (percent of GDP)

Indicator	2020	2021	2022	2023f	2024f	2025f	2026f
Total Revenue	25.4	27.4	27.8	28.7	28.2	28.2	28.8
1. Tax Revenue	**22.3**	**24.5**	**24.8**	**25.2**	**25.4**	**25.5**	**26.0**
a. Direct Taxes	3.9	4.3	4.6	4.8	4.8	4.9	5.1
Corporate Income Taxes	1.3	1.4	1.8	1.8	1.8	1.8	1.9
Personal Income Taxes	2.3	2.4	2.4	2.5	2.6	2.7	2.8
Property Taxes	0.3	0.5	0.4	0.4	0.4	0.4	0.5
Other Direct Taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Direct Tax Refunds	0.0	0.0	0.0	0.0	0.0	0.0	0.0
b. Indirect Taxes	18.4	20.2	20.2	20.4	20.6	20.7	20.9
VAT	11.4	13.0	13.6	13.6	13.7	13.8	14.0
Customs Revenues	1.5	1.6	1.5	1.5	1.5	1.5	1.5
Excise Revenues	5.9	6.3	5.8	5.8	5.9	5.9	5.9
Other Indirect Taxes	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Indirect Tax Refunds	-0.4	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7
2. Non-Tax Revenue	2.7	3.0	2.8	2.7	2.7	2.7	2.7
3. Grants	0.5	0.0	0.1	0.9	0.1	0.1	0.1
Total Government Expenditure	**33.0**	**28.8**	**28.2**	**29.2**	**30.1**	**30.1**	**30.3**
1. Current Expenditure (=a + b+ c)	27.4	23.5	23.6	23.7	23.9	23.5	23.6
a. Expenditure on Goods and Services	4.4	4.1	4.0	4.3	4.7	4.7	4.5
b. Compensation of Employees	9.8	8.4	7.3	7.8	7.4	7.5	7.5
c. Current Transfers	12.8	10.6	11.8	11.1	11.3	10.8	11.1
Social Assistance	0.7	0.7	0.5	0.4	0.4	0.4	0.4
Pensions	7.0	6.6	6.5	6.0	6.1	5.9	6.0
Other Current Transfers	5.1	3.3	4.8	4.7	4.9	4.7	4.8
2. Interest Payments	0.4	0.4	0.4	0.4	0.4	0.4	0.4
3. Capital expenditure	5.6	5.3	4.7	5.6	6.2	6.7	7.1
General Government Balance (GGB)	**-7.6**	**-1.3**	**-0.5**	**-0.6**	**-1.9**	**-1.9**	**-1.7**
GGB, Fiscal Rule Definition	**-4.8**	**-0.6**	**0.1**	**0.0**	**-1.1**	**-1.2**	**-1.5**

Source: World Bank staff calculations based on data from MoFLT, Central Bank and Kosovo Agency of Statistics. Note: Figures are expressed on a cash basis. F=forecast.

13. **Inflation has been steadily decreasing from its peak of 14.2 percent in July 2022, but price pressures remain elevated.** As a net importer of food and energy, Kosovo remains highly vulnerable to imported inflation. Consumer price inflation reached 4.2 percent in September and averaged 5.8 percent between January and September 2023. During this period, a significant contribution to inflation resulted from price increases of alcoholic beverages and tobacco (6.6 percent), household furnishing items and maintenance (5.5 percent), and food and non-alcoholic beverages (5.5 percent). Core inflation has, on average, declined more gradually and reached 3.9 percent in September.

14. **Despite the challenging external environment, the financial sector remains robust and supportive of economic activity.** During Q3 of 2023, credit growth remained positive (13.3 percent by September), despite higher financing costs as reflected in the increase in the interest rate on new loans since early 2022, from 5.7 percent to 6.5 percent in September 2023. In terms of the banking sector, capital buffers and asset quality remained adequate, with the ratio of regulatory capital to risk-weighted assets standing at 15.6 percent and the share of non-performing loans remaining stable at 2 percent in September 2023.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

15. **The macroeconomic outlook is positive but remains characterized by downside risks.** Assuming continued easing of international commodity prices, GDP growth is expected to reach 3.2 percent in 2023, mainly driven by continued positive export performance and higher private consumption. Higher services exports are expected to offset stalling merchandise exports, leading to a positive real contribution of the external balance to growth. At the same time, strong credit growth and higher net remittances, supported by elevated levels of public transfers, are expected to support private consumption. Higher public wage spending following the implementation of the new Law on Public Wages is expected to

contribute to public consumption growth. Likewise, after contracting in 2022, gross fixed investment is expected to add to growth, fueled by construction activity and a more predictable environment for input prices. Public capital expenditure is also expected to boost investment on the heels of recent efforts to eliminate implementation bottlenecks, including through price adjustments for public contracts. On the production side, services are expected to provide a higher contribution than manufacturing and agriculture combined.

16. The medium-term outlook remains positive within a context of high uncertainty. The contribution of investment to growth is expected to pick up in 2024–2025, supported by reforms to the business and investment climate, improved public financial management and increased investment in public infrastructure, including through enhanced utilization of external concessional financing. Higher public and private investments in energy supply and efficiency associated with the implementation of the new Energy Strategy for 2022-2031[13] and energy sector reforms, including a new framework for the scale-up of renewable energy generation through competitive auctions, are also expected to support investment activity. Kosovo has also a pipeline of ratified but slowly disbursing infrastructure projects financed by international financial institutions of close to 7 percent of GDP. Real estate development activity is expected to continue boosting investment in the medium term. Financial deepening and buoyant primary and secondary inflows are expected to support both consumption and investment. Export performance is expected to remain positive, supported by trade facilitation reforms, including through a renewed impetus to lower cross-border trade compliance costs in the context of GoK's commitment to establish the National Single Window. The recent positive trend in non-commodity export growth particularly for manufactured goods and information and communication technology (ICT) service exports is expected to continue supporting export diversification and growth.

17. The CAD is expected to improve over the medium term. In 2023, the CAD is expected to narrow to 6.5 percent of GDP owing to a deceleration in nominal imports, thanks also to a drop in the value of commodity imports, and further improvements in the services balance. Over the medium term, as international prices normalize, imports are expected to remain broadly stable. Export activity is expected to pick up, driven by positive performance of exports of goods, continued diversification into non-commodity goods exports, reforms to support trade facilitation and competitiveness, and resilient service exports[14]. Non-debt-creating FDI inflows are expected to continue providing the main source of financing for the CAD, but high levels of errors and omissions in the balance of payments remain a source of uncertainty[15]. Concentration of FDI in real estate activities is expected to continue over the medium term, but higher energy sector private investment and a more robust framework for investment attraction could potentially lead to greater diversification of FDI. A more robust policy framework for investment attraction coupled with lower compliance costs resulting from DPF-supported reforms, are expected to provide a further boost to FDI inflows.

18. Inflation is expected to decelerate, but price pressures remain high. While decreasing in line with international trends, consumer price inflation is projected to reach 4.8 percent in 2023 and further decelerate over 2024–2025, reflecting expectations on euro area inflation and international commodity price movements. A tighter labor market could, however, exert an upward pressure on inflation. At the same time, Kosovo's high dependency on imports continues to expose the country to international price fluctuations. Higher fuel and energy prices could lead to an inflation rebound and an energy supply shock, negatively impacting growth.

19. Over the medium term, the fiscal deficit is set to gradually increase, while remaining within the fiscal rule limit. The baseline projections assume (i) a positive fiscal stimulus driven by capital investment growth and further increases in public wage coefficients and operationalization of allowances, which will lead to an increase of the fiscal deficit to up to 1.9

[13] In early 2023, the Assembly approved a new Energy Strategy for 2022-2031 including commitments for public and private investments in the energy sector estimated at EUR 3.2 billion by 2030.

[14] The manufacturing sector is currently fairly undiversified in a few prominent sectors such as metals and processed food and beverages. In recent years, production of mattresses and plastic materials has emerged as a new driver of manufacturing output and exports. Services exports continue to be dominated by diaspora-related travel service exports, but information and communication services, as well as business process outsourcing services, have recently seen a significant increase.

[15] High errors and omissions reflect mainly informal flows of remittances, FDI and other forms of travel spending.

percent of GDP over the projection period; (ii) continued positive tax revenues performance supported by formalization gains and reforms to the tax policy and administration frameworks, which are expected to strengthen tax compliance and support domestic revenue mobilization; and (iii) adherence to the fiscal deficit rule and nominal wage growth rule. Moreover, PFM reforms are expected to support better expenditure management and budget execution, especially for capital spending. Further spending needs for energy subsidies could increase the deficit beyond what is expected, increasing pressures on the Government's balance sheet.

20. **Financial sector performance is expected to remain solid.** Following the COVID-19 crisis, the financial sector's performance has remained robust in the face of tighter euro area financial conditions, weakening economic activity in the EU and the war-induced terms-of-trade shock. While progress on these developments continues to be accompanied by high uncertainties, the financial system in Kosovo has adopted prudent operating approaches in relation to the circumstances, and accumulated adequate reserves of capital and liquidity to cope with increased risks. Nevertheless, further strengthening credit risk monitoring and improving the surveillance remain important[16]. Moving forward, the Central Bank of Kosovo is finalizing the draft Banking Law, which would improve the licensing criteria for banks, and refine standards for their operations, organization and management, while strengthening consumer protection and the bank resolution framework[17].

21. **Kosovo's PPG debt-to-GDP ratio will increase over the projection period, but it remains sustainable both in the baseline and stress test scenarios.** Gross financing needs are expected to remain below the vulnerability threshold of 15 percent for emerging market economies. After peaking at almost 12 percent in 2020, financing needs moderated to 3.5 percent in end-2022. Financing needs are expected to average 4.4 percent of GDP between 2023 and 2026. Under the baseline scenario, PPG debt-to-GDP will remain below the debt ceiling of 40 percent of GDP. Driven by lower fiscal deficits, starting in 2021 the Government decided to reduce medium-term plans for the issuance of new domestic debt from above 2.5 percent of GDP to an average of 1.2 percent of GDP per year, reducing the pressure on domestic markets.

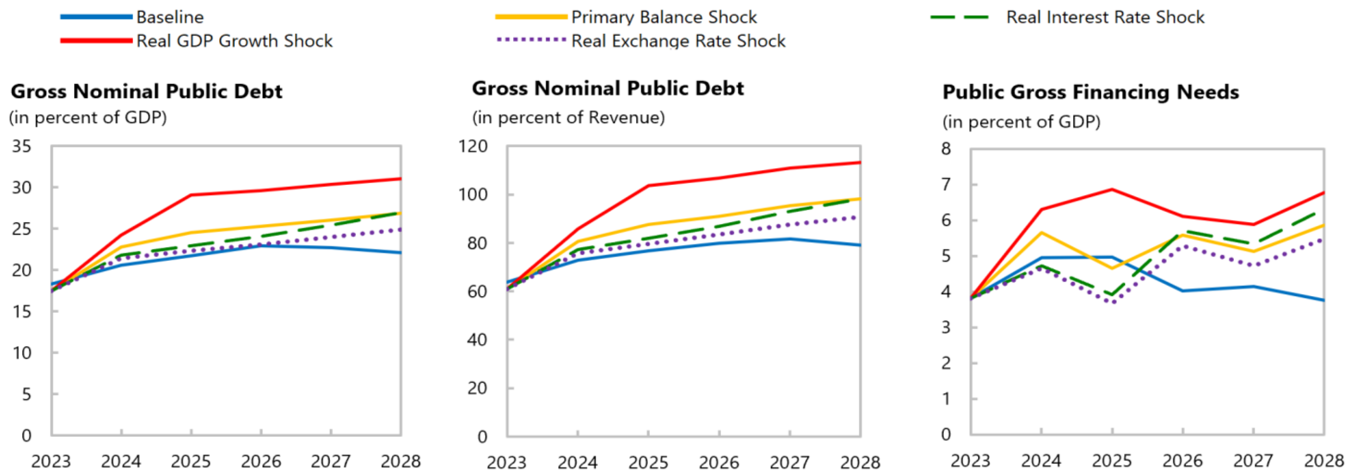
22. **Standardized stress tests indicate that the public debt-to-GDP ratio will remain at manageable levels over the forecast horizon.** Standardized GDP growth shocks result in the public debt ratio reaching 31 percent of GDP by 2028, and financing needs that peak at 6.9 percent of GDP in 2025. Under a combined macro-fiscal shock scenario (real GDP growth, primary balance, real exchange rate, and real interest rate shocks), the public debt ratio reaches 33 percent of GDP in 2028, whereas the financing needs peak at 7.8 percent in 2028. A stress test scenario where the budget absorbs a contingent liability shock (modeled at 5 percent of GDP) would have a large impact on the debt profile, but public debt would not breach the high-risk threshold of 65 percent of GDP. An alternative stress test scenario where – without readjustments to revenues or expenditures — the budget absorbs additional spending for the implementation of a) the Energy Strategy 2022-2031, b) higher pension costs, and c) increased health spending shows that public debt will increase significantly but remain below the fiscal rule threshold of 40 percent of GDP. In all the stress test scenarios, the public debt level does not breach the high-risk threshold of 65 percent. In the context of Kosovo's existing fiscal rules, if the debt-to-GDP ratio hits the debt ceiling, the rule would require the adoption of a fiscal consolidation path to bring the ratio below the debt ceiling.

23. **Risk indicators associated to Kosovo's debt have further improved since 2020.** Refinancing risks have improved over recent years. The share of domestic debt to be refinanced within the year has decreased to 2.5 percent of GDP from 2.9 percent of GDP in 2020. The issuance of longer maturity 10-year bonds in 2021 and 2022 has contributed to this trend. By June 2023, the average time to maturity of domestic debt reached 2.7 years, while the average time to maturity of external debt stood at 8.1 years. Indicators of interest risk have undergone positive changes, with less than 5 percent of the debt portfolio tied to variable interest rates. The exchange rate risk has further declined and is minimal with 95 percent of the public debt issued in euros.

[16] Central Bank of Kosovo (CBK), Financial Stability Report (2023): https://bqk-kos.org/wp-content/uploads/2023/08/CBK_FSR_19.pdf
[17] IMF Country Report No. 23/200

24. External debt is sustainable in the medium term. Between 2020 and 2021, external debt increased by 6 percentage points (pp), of which public external debt increased by 2 pp of GDP in 2020 (given external budget support disbursements during the pandemic), and private external debt increased by 4 pp of GDP (in the form of long-term debt to the energy sector). The external debt-to-GDP ratio is expected to moderately increase over the projection horizon, with public external debt increasing to around 10.5 percent of GDP by 2026, and private external debt remaining broadly stable as the CAD narrows and need for external debt financing declines.

Figure 1: Public and Publicly Guaranteed Debt ratios under different scenarios



Source: World Bank staff calculations

Table 3: External Financing Requirements and Sources 2020-2026 (% of GDP)

	2020	2021	2022	2023f	2024f	2025f	2026f
Gross External Financing Requirements	**10.6**	**8.4**	**9.1**	**6.1**	**5.7**	**5.5**	**5.0**
Current Account Deficit	7	8.7	10.5	6.5	6	5.5	5.1
Debt Amortization (public)	1.3	1	0.5	0.6	0.7	0.5	0.4
Change in gross reserves (increase=+)	0.7	2.1	0.8	1.5	1	1	1
Adjustment for errors and omissions	1.6	-3.4	-2.7	-2.5	-2	-1.5	-1.5
Gross External Financing Sources	**10.6**	**8.5**	**9**	**6.1**	**5.7**	**5.5**	**5.0**
FDI (net)	4.2	4	6.7	5.5	4.6	4.3	4.6
Portfolio Investments (net)	1.2	-3.5	-1.5	-3.1	-3.2	-2.3	-2.6
Capital grants	0.3	0.8	0.4	0.5	0.1	0.1	0.1
Net other financial investment	4.9	7.2	3.4	3.2	4.2	3.4	2.9
of which: debt disbursements (public)	3.2	1.5	1.2	1.2	3.2	2.0	1.6

Source: World Bank staff calculations based on data from Central Bank of Kosovo

25. Uncertainty remains high and risks to the outlook are tilted to the downside. High uncertainties associated with the evolution of Russia's invasion of Ukraine and its effects on economic activity and prices could have negative repercussions on growth and inflation. Given Kosovo's status of net importer of food and energy, higher electricity prices and lower domestic energy generation may result in a significant stress for the energy sector, thus representing a substantial risk to the outlook. A rebound in energy prices could lead to significant fiscal and external sector pressures, negatively impacting growth and private demand, increasing the output gap and fiscal financing needs. A further slowdown in EU growth could lead to an erosion of income of the diaspora, with detrimental impacts on remittances, investment, and diaspora inflows. Similarly, a deterioration of the domestic political context or an intensification of emigration trends entail significant risks. On the upside, an acceleration of public investment execution, a stronger than expected growth performance in the EU, accelerated gains in boosting female labor force participation, and timely implementation of the new energy strategy could benefit growth.

26. **The macroeconomic policy framework is considered adequate for the purposes of development policy lending.** The medium-term outlook is favorable with growth expected to reach around 4 percent, driven by consumption, exports and a pickup in investment. Kosovo has a good track record of maintaining sustainable and prudent headline fiscal policy, anchored by a rules-based fiscal framework. Reforms supported by this DPF are expected to support fiscal sustainability through enhanced domestic revenue mobilization and expenditure management. In addition, reforms to strengthen the investment and business climate are expected to contribute to growth over the medium term, while energy sector reforms are expected to support the green transition and a more sustainable growth pathway.

2.3. IMF RELATIONS

27. **In May 2023, the IMF Board approved a 24-month precautionary Stand-By Arrangement (SBA) of SDR 80.12 million and an arrangement under the Resilience and Sustainability Facility (RSF) of SDR 61.95 million**. The SBA is expected to be precautionary and will provide liquidity in case downside risks materialize. The RSF will provide financing to support Kosovo's climate change mitigation and adaptation efforts, including through greener electricity production and more efficient energy use. On November 15, 2023, the IMF Executive Board completed the First Reviews of Kosovo's SBA and RSF arrangement, making available an additional SDR 20.0 million (EUR 24.8 million) under the SBA and SDR 30.9 million (about EUR 38.4 million) under the RSF arrangement.

3. GOVERNMENT PROGRAM

28. **Approved in 2023, the National Development Strategy (NDS) 2030 defines a vision for Kosovo's long-term development, focused on sustainable economic development and effective institutions.** It reiterates the key role of the EU integration process in the country's development. The NDS 2030 is articulated around four pillars: (i) sustainable economic development; (ii) equitable human development; (iii) safety and the rule of law; and (iv) good governance. The first pillar prioritizes a circular and competitive economy, supported by high-quality infrastructure and by an efficient use of natural resources. The second pillar highlights the need to strengthen early childhood education, improve access to health services, and promote the cultural heritage. The third pillar focuses on readiness for peace and security, protection of property rights and supporting an effective justice system. The fourth pillar aims to promote effective and accountable fiscal governance and a stronger regional and global role for Kosovo, its citizens, and the diaspora. The Government Program for 2021-2025 supports sustainability of public finances while promoting economic growth and job creation. Among the key strategic areas are: (i) improving the rule of law; (ii) strengthening governance, promoting human rights and gender equality; (iii) promoting comprehensive economic growth by ensuring sustainability of public finances; (iv) re-designing fiscal policies and formalizing the economy; (v) supporting industry, entrepreneurship, and trade; (vi) developing information and communication technologies and (vii) strengthening environmental policies.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

29. **The proposed operation supports the Government's efforts to tackle longstanding structural bottlenecks that impede higher, more inclusive and sustainable growth in Kosovo.** The operation is organized around three interrelated pillars, with a total of ten prior actions (PAs) and indicative triggers. Through its first pillar, the operation aims to improve fiscal policy effectiveness with a view to increasing returns and equity of fiscal policy in the medium term. It supports reforms that: (i) strengthen PFM systems; (ii) improve spending prioritization with a focus on human capital spending; and (iii) enhance domestic revenue mobilization through reducing costs associated with tax compliance and strengthening the tax policy framework. Through its second pillar, the operation supports reforms to enable private sector development by: (i) improving the legal framework for FDI attraction; (ii) supporting trade facilitation and reducing compliance costs associated with business inspections; and (iii) strengthening property rights and land administration. Through its third pillar, the operation supports reforms that promote greener and sustainable growth while supporting the poor by: (i)

establishing a program for vulnerable consumers in the electricity sector; (ii) improving energy efficiency by streamlining the process and enforcement of energy performance certifications for buildings; (iii) establishing a legal framework for the transition to market-based support mechanisms in the renewable power generation sector to diversify the energy supply mix towards renewables and phasing out coal; and (iv) discouraging the use of lightweight plastic carrier bags that contribute to environmental degradation. The pillars of the proposed DPF share strong interlinkages. Reforms under pillar I on tax administration and policy are expected to reinforce policy measures supported under pillar II through their expected positive impact on the business and investment climate. Similarly, reforms under pillar II aimed at improving trade facilitation can lead to higher domestic revenues. Energy policy reforms supported under pillar III have the potential to generate higher trade and unlock investment, supporting pillars I and II of the DPF.

30. The design of the operation incorporates both general and country-specific lessons from past operations in the country. The proposed operation builds on the reforms supported by the previous Public Finances and Sustainable Growth DPF (P170113) to improve fiscal transparency, enhance private sector development and strengthen environmental sustainability. Lessons from past operations emphasize the need to ensure: (i) strong government ownership and leadership of the reform program; (ii) systems and institutional arrangements are in place to support consistent implementation of the reform program over the medium term; and (iii) strong technical and advisory support systems to support the implementation of the reform program. Key lessons from past operations, including the Public Finances and Sustainable Growth DPF, also highlight that the programmatic nature of an operation is a key factor in supporting the reform momentum and the Government's commitment to the structural reform agenda; and that the operation should be anchored to robust analytical underpinnings.

31. This operation is aligned with the goals of the Paris Agreement. First, the DPF reform program is consistent with Kosovo's Climate Change Strategy 2019-2028[18] and it addresses some of the main mitigation and adaptation priorities of the country. Second, regarding mitigation, GHG emissions in Kosovo are largely driven by the energy sector (86 percent of total GHG emission), with overall low energy efficiency. Prior actions are not likely to cause a significant increase in GHG emissions or any persistent barriers to transition to low-GHG emissions, and the reforms supported by the third pillar will address the energy sector and contribute to climate change mitigation. Third, regarding adaptation and climate resilience, the anticipated climate hazards are not likely to have an adverse effect on the prior actions' contribution to the PDO for all prior actions. Specifically, Kosovo's industry and agriculture are vulnerable to the anticipated impacts of climate change, primarily to changes in precipitation causing water shortages, drought, and flooding. Raising temperatures and heat waves, together with partly destructed infrastructure, inadequate sewage and high concentrations of atmospheric pollutants increase the vulnerability of the population. The reforms in the third pillar are supporting green growth by addressing several country-specific climate action priorities, contributing to mitigation and adaptation and strengthening resilience to the anticipated impacts of climate change. Therefore, all prior actions of the proposed DPF program are aligned with the adaptation and resilience goals of the Paris Agreement.

32. In addition, the DPF series contributes to attracting private investment, including in support of Kosovo's green transition, **and is aligned with the Maximizing Finance for Development approach**. The operation is private capital enabling (PCE) as measured by specific non-monetary indicators (Results Indicators [RI]4 and RI9). In the energy sector, private investment is enhanced by establishing a consistent framework to attract private capital into the renewable energy sector through competitive auctions (PA9). Private investment flows are also expected to be mobilized through a clearer and more predictable investment policy framework and institutions.

[18] https://gzk.rks-gov.net/ActDocumentDetail.aspx?ActID=29356

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS[19]

Pillar I: Enhancing the effectiveness of fiscal policy

Prior Action #1: *To strengthen tax compliance and enhance domestic revenue mobilization, the Recipient has enacted the* ***Law on the Administration of Tax Procedures*** *to: (i) simplify rules for taxpayers' registration; (ii) introduce requirements for digital payment transactions; and (iii) improve the accuracy of the taxpayers' registry, as evidenced through Law No. 8/L-257 and published in the Recipient's Official Gazette on January 12, 2024.*
Indicative trigger #1: *To strengthen the equity of the tax system and improve domestic revenue mobilization, the Recipient has enacted: (i)* ***the Law on Personal Income Tax;*** *(ii)* ***the Law on Corporate Income Tax;*** *and (iii) the* ***Law on Value-Added Tax****.*

33. Rationale, background and objectives: At 27.6 percent of GDP in 2022, Kosovo has one of the lowest revenue-to-GDP ratios among regional and structural peers, and well below the European Union's average. The tax efficiency, as measured against comparator countries, is low. The GoK relies on tax collection for more than 85 percent of its revenues, and it does not collect social contributions to finance health spending or pensions. Historically, indirect taxes, particularly value-added tax (VAT) and excise taxes levied on imports, have been Kosovo's main source of revenue, with income taxes playing a more limited role. The personal income tax (PIT) structure has low rates resulting in low revenues and limited progressivity. Business taxation is fragmented among the Corporate Income Tax (CIT) and PIT regimes with a negative impact on tax compliance. The low tax-to-GDP ratio reflects a combination of high informality in economic activity, low tax rates and lack of social security contributions. Accordingly, increasing formalization and tax compliance has become a policy priority in recent years, as it would contribute to larger fiscal space and to a more equitable and efficient tax system[20]. While domestic revenue mobilization is an important goal, the GoK is also interested in improving the quality of the tax system with important spillovers on improving the business climate.

34. Substance of the prior action: The new Law on the Administration of Tax Procedures approved by the GoK introduces measures to encourage formalization and support tax compliance. The law will support the GoK's efforts in reducing informality and improving taxpayer compliance. Specifically, the new law: (i) supports digital transactions by imposing a limit on cash transactions and introducing requirements for digital payments; (ii) introduces penalties for lack of compliance with fiscal electronic devices requirements; (iii) simplifies rules for taxpayers' registration; and (iv) improves the accuracy of the taxpayers' register by strengthening provisions for de-registration of inactive taxpayers. The reform is an important step in modernizing the tax administration system, improving tax collection, and ensuring the tax administration authority can operate effectively in the evolving structure of the economy. As an indicative trigger for the second operation the DPF series supports the adoption of revised Personal Income Tax, Corporate Income Tax and Value-Added Tax Laws with the goal to improve the quality of the tax policy framework and further align it with the EU *acquis*. With these reforms, the GoK intends to strengthen the progressivity of the PIT structure and streamline selected tax allowances and deductions that distort the CIT and VAT structures. The GoK is also considering enhancing the existing legal provision for capital gains taxation.

35. Expected results: The measures supported by the DPF are expected to lead to an improvement in tax collection with the tax revenue-to-GDP ratio increasing to 26 percent of GDP by end-2025.

Prior Action #2: *To strengthen public expenditure effectiveness and improve the returns to public spending in education, the Recipient has enacted the* ***Early Childhood Education (ECE) Law*** *to provide legal grounds for: (i) diverse forms of ECE provision and (ii) new financing schemes to support service delivery, as evidenced through Law No. 08/L-153 published in the Recipient's Official Gazette on August 3, 2023.*
Indicative trigger #2: *To define mechanisms to access public funding for ECE by different service providers, the Recipient has adopted the* ***Administrative Instruction(s)*** *that will regulate quality standards for accessing public funding for ECE service provision.*

[19] See Annex 6 for analytical underpinnings for the DPF prior actions.
[20] At the tax administration level, this has been reflected in more frequent, risk-based audits and inspections, enhanced digitalization of processes, centralization of tax debt collection, and at the budgetary level through incentives to formalize workers.

36. Rationale, background, and objectives: Kosovo's level of education spending, particularly in ECE, relative to GDP is on par with peers, but significantly lags peers in terms of outcomes. Low levels of foundational literacy and numeracy skills in Kosovo limit the ability of young adults to develop the skills required for the labor market. Low access to ECE negatively impacts the development of school readiness and the establishment of foundational skills[21]. These trends have long-term negative implications for young people's employability, evidenced by the high rates of youth unemployment, especially among women[22]. Low levels of spending are considered an obstacle for human capital development and therefore, improved fiscal management of ECE spending is a key priority for improving fiscal policy effectiveness. Moreover, the current legal framework for ECE is scattered among different legislations and lacks a clear definition of norms on funding management for ECE services. At the same time, lack of access to ECE hampers women's participation in the labor market, which at 22 percent is extremely low. A body of research has documented that government policy around childcare strongly correlates with women's labor market outcomes[23]. Considering the challenges above, increasing the level and quality of ECE spending is a key fiscal policy priority for GoK to increase fiscal policy effectiveness. The high return to investing in the early years of life provides Kosovo an opportunity to make a meaningful impact in growing its human capital and foster women's economic empowerment and labor market participation.

37. Substance of the prior action: The Law on Early Childhood Education (ECE) aims to address the above challenges by defining the rules for management of budgetary funds in ECE institutions and increasing expenditure in human capital, thus strengthening the legal framework for fiscal expenditure allocation in the education sector and fiscal policy effectiveness. The law regulates the provision of comprehensive quality education in all forms for 0-6 years old children, and its adoption will support the expansion of new service delivery models by setting the foundations for financing and defining alternative forms of service provision, including private sector provision. Specifically, the enactment of the ECE law will: (i) define norms and provide legal grounds for ECE provision, including on management of budgetary funds in Kosovo; (ii) allow to develop financing schemes to support such forms of provision and (iii) advance public-private, private, and community-based provision of services. Such expansion will increase public spending in ECE services. The additional allocation to the education budget for the implementation of the new law is expected to be EUR 31.5 million between 2023-2024. Of these, EUR 6.3 million will be capital expenditures. Moreover, the implementation of the law is expected to strengthen the provision of alternative ECE service provision models, including private and public-private models. Over the medium to long term, the implementation of the law is expected to contribute to gains in women's employment. As a *trigger* for the second operation, the DPF series will support the administration instruction to define mechanisms to access public funding for ECE by different service providers.

38. Expected result: In the long run, the adoption of the ECE law is expected to increase returns on human capital spending through improved outcomes in education, health, employment and social behavior. In the medium term, the adoption of the ECE law is expected to lead to an increase in the share of public expenditure in ECE within the total spending on education to 6.1 percent, from 4.6 percent in 2022. Moreover, the policy measure is expected to contribute to the direct employment of women in ECE services, and indirectly by providing childcare services to families, thus increasing the opportunities for women to participate in the labor market.

Prior Action #3: *To enhance the effectiveness of public expenditures and strengthen budget credibility, the Recipient has adopted the **Concept Document on Public Financial Management** that initiates the required regulatory and legal changes to the current legal and policy framework, as evidenced by Government Decision No. 15/102 published in the Recipient's Official Gazette on October 26, 2022*.
Indicative trigger #3: *To enhance the effectiveness of public expenditure and improve fiscal governance, the Recipient has enacted the **Law on Public Financial Management.***

[21] Kosovo Country Economic Memorandum (2021) – Background Paper on Enhancing Human Capital by Improving Education.
[22] A study by the Kosovo Women's Network conducted on a household survey of unemployed women found that nearly all women surveyed would like to work in a paid position, with 88% of them saying that they would use childcare services if they had an affordable option available.
[23] For example: https://openknowledge.worldbank.org/server/api/core/bitstreams/37738d35-c782-50bc-91d5-0bb06360a972/content and https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/publication/wcms_838653.pdf

39. **Rationale, background and objectives:** PFM is one of the two pillars of Kosovo's Public Administration Reform and a priority policy area in the EU enlargement agenda. According to the latest Public Expenditure and Financial Accountability (PEFA, 2022)[24], Kosovo has good PFM systems when compared to regional standards and its strengths include: (i) a transparent set of rules regulating the budget cycle; (ii) a budget classification system that is consistent with international standards; and (iii) a system of electronic data management that produces accurate data processing, supervision, and monitoring, with appropriate authority level and control. Despite the progress in PFM reforms, several elements of the PFM system have room for further improvements. These include improving budget reliability, strengthening public investment management and budgeting, ensuring alignment of strategic planning with expenditure budgeting, and strengthening fiscal risks monitoring and management.

40. **Substance of the prior action:** The Concept Document (CD) on Public Financial Management is a policy instrument that initiates the legal reform of Kosovo's PFM system. In Kosovo, the CD is enshrined in Law No. 08/L-117 and is integrated in the Regulation No. 09/2011 on Rules of Procedure of the Government, as a critical and mandatory step in the policy and institutional reform process and is subject to significant analysis and public consultation before it can be adopted. As such, a CD holds a specific legal status in Kosovo and requires approval by the Cabinet. The CD on PFM is a mandatory first step that sets out in detail the required regulatory and legal changes as well as the strategic reform directions of the new Law on PFM. It carries a substantive weight in terms of content, providing a detailed description of the reform content. It is aligned with EU and OECD quality requirements. Furthermore, it requires a budget impact assessment analyzing the expected impact of the reform measures. The PFM reform aims at strengthening budget credibility and some of the key issues that will be addressed include: (i) strengthening the legal basis for strategic planning and resource allocation; (ii) enhancing capital budgeting and management; and (iii) streamlining the regulation of fiscal rules, which is now scattered among different existing legislations. Moreover, authorities have expressed interest in preparing a new PFM Law that is climate informed. As a *trigger* for the second operation, the DPF series will support the adoption of the Law on PFM with the aim of strengthening the effectiveness of public expenditure, improve financial management and enhance public service delivery.

41. **Expected results:** The results indicator is the improvement in PEFA Indicators PI-1 (aggregate expenditure outturn) and PI-2 (expenditure composition outturn) to A and C, respectively, indicators for budget credibility and execution control[25].

Pillar II: Strengthening the investment climate

Indicative trigger #4: *To establish a consistent framework for the protection of investors and enhance the investment climate and to fully establish and mandate the lead organization tasked with promoting investments into Kosovo, the Recipient has (i) enacted the* ***Law on Sustainable Investments*** *and (ii) adopted the* ***Administrative Instruction on the Establishment of the Investment and Export Agency.***

42. **Rationale, background and objectives:** For a young and small economy where domestic capital is scarce, additional FDI can be transformational for generating more and better jobs and a more resilient growth[26]. FDI has so far been concentrated in low-productivity sectors such as real estate, with limited spillovers to the rest of the economy. Investment opportunities in agriculture, manufacturing and natural resources have not been tapped. Investor confidence has been hampered by perceived risks related to investing in Kosovo, weak protection of investor rights and weak investment-related institutions. Since its independence, Kosovo has made advancements in modernizing its investment policy framework. However, more needs to be done to enhance the existing framework to ensure it supports attracting quality investments. The adoption of a new investment law, addressing the investment environment constraints, including weaknesses in the legal framework, and making its investment promotion institutions more effective, is

[24] https://www.pefa.org/node/5026
[25] Should a new PEFA Update not be available by the target date the WB will use the PEFA methodology to calculate the respective indicators.
[26] Country Economic Memorandum (2021): Gearing up for a more productive future.

therefore a crucial reform priority for Kosovo to attract more and higher quality FDIs.

43. Substance of the trigger: To establish a consistent framework for the protection of investors and to strengthen the investment promotion institutions, the GoK has enacted the Law on Sustainable Investments. The GoK has merged the Law on Investment and the Law on Strategic Investments into one new Law on Sustainable Investments. This is in line with international good practice as the Law provides for protection guarantees that are critically important to foreign and domestic investors, including non-discrimination, the right to transfer funds, and effective protection against expropriation. The Law will also support climate action as it explicitly recognizes environmental sustainability as a key principle in the list of objectives it aims to achieve as part of its investment promotion agenda and a critical feature of the strategic investments it aims to prioritize. Furthermore, the Law provides a strong legal basis for Kosovo's emerging institutional framework for investment policy and promotion, including the establishment of the Investment and Export Agency as a new investment promotion agency and the Investment Council of the Republic of Kosovo as a high-level body tasked with several investment policy and promotion functions[27]. The DPF series will also support the Administrative Instruction on the Establishment of the Investment and Export Agency to further stipulate the functions and institutional structure of the newly established institution.

44. Expected results: The indicator for this prior action will measure the qualified investors' expressions of interest generated after the Investment and Export Agency is established, which is expected to reach 10 by end 2025[28].

Prior Action #4: *To support regulatory simplification and reduce the compliance costs associated with trading across borders, the Recipient has approved: (i) the establishment of the* ***National Single Window*** *to introduce an electronic platform that will make possible the online application and processing of regulatory authorizations for trade, as evidenced by Government Decision No. 08/162, dated September 27, 2023 and published on the Recipient's' Official Gazette on September 27, 2023 and (ii) the* ***Regulation on the Internal Organization of Jobs in the Office of the General Inspector****, to define the organization of jobs and set responsibilities, as evidenced by Prime Minister's Office Regulation No. 06/2023 approved by the Decision No. 540/2023, dated July 3, 2023 and published in the Recipient's Official Gazette on July 5, 2023.*
Indicative trigger #5: *The Recipient has (i) approved a package of necessary legislation, including subsidiary legislation and/or bylaws to establish and functionalize the National Single Window; and (ii) has published the regulatory requirements to comply with inspections legislation to reduce compliance costs associated with business inspections.*

45. Rationale, background and objectives: In a small economy like Kosovo trade integration can play a critical role for growth and is essential to achieving economies of scale, strengthening competitiveness, supporting productivity growth and job creation. High compliance costs associated with trade and inspections regimes impose a significant regulatory burden and create uncertainty for businesses. Analysis shows that time required to discharge all the regulatory obligations to trade across borders remain high,[29] and that there are opportunities for process automatization. Businesses in Kosovo report that the burdensome regulatory framework contributes to high levels of informality and anticompetitive behaviors, resulting in a weak business enabling environment. The GoK has approved the decision to establish the National Single Window (NSW) as an important first step in the reform process, facilitating regional economic integration and international trade, in line with the agenda of the new EU Growth Plan for the Western Balkans and the World Bank (WB)-supported Trade and Transport Facilitation Project. Additionally, the GoK, through the Law on Inspections (entered into force in January 2022 and supported under the previous DPF), aims to improve the inspection system by improving coordination, and efficiency, and introducing risk-based business inspections. One of the key requirements to functionalize the Law on Inspections is the establishment of Office of the General Inspector, which is mandated to lead

[27] The Law further foresees the establishment of a Complaints Panel, which has the potential to improve the retention of existing FDI in Kosovo.
[28] Qualified means expressions of interest by investors in a specific location in Kosovo, as evidenced by the successful conclusion of a first site visit, the signing of a memorandum of understanding related to the scope of the investment, or the application for any permits or procedures required as part of the investment process in the location. The investor leads generated are directly linked to additional private investment (FDI) expected from these investors, of which a portion should be expected within 3 years of project closure.
[29] IFC (2021). Kosovo Time Release Study

the inspection reform program, coordinate and support the activities of inspection bodies with the ultimate objective of reducing the administrative burden on inspections and protecting the public interest, including public health, public safety, and the environment.

46. Substance of the prior action: The GoK has approved the decision to establish an NSW to support an ambitious trade facilitation reform, informed by a detailed blueprint that sets out the main components of the NSW implementation, including the legal and regulatory changes needed to integrate the NSW into Kosovo's institutional framework, the functional and technical architecture, and the financial model. The introduction of an NSW is encouraged by the World Trade Organization's (WTO) Trade Facilitation Agreement (TFA). As a member of the Central European Free Trade Agreement (CEFTA), Kosovo committed to aligning with TFA measures. Furthermore, the development of the NSW is also an ongoing initiative of the EU, including among other Western Balkans countries. The NSW is an electronic platform that will make possible the online application and processing of regulatory authorizations for international trade through a single entry point, thereby increasing efficiency, effectiveness, transparency predictability of the trade regulatory process, and reducing trade costs. Given the importance of trade in Kosovo's economy and the need to deepen regional trade integration, the NSW has the potential to play a critical role in supporting trade flows, productivity, and growth. In the area of inspection reform, following the adoption of the Law on Inspections in December 2021, the Government has appointed an acting General Inspector, and is aiming to further functionalize the Office of the General Inspector. The proposed DPF will support the adoption of the Regulation on the Internal Organization and Systematization of the Office of the General Inspector to further advance the reform agenda on inspections[30]. As *trigger* for the second operation, the DPF series supports the adoption of amendments needed to operationalize the NSW. In addition, the DPF will support the publication of the regulatory requirements to comply with the inspection legislation.

47. Expected Results: The results indicator for this prior action will measure the number of agencies and institutions integrated in the NSW. The number is expected to be six by end-2025, including Customs Agency, Food and Veterinary Agency, Ministry of Industry, Entrepreneurship and Trade, Ministry of Environment, Spatial Planning, and Infrastructure, Ministry of Internal Affairs, and Kosovo Medicines Agency. On inspection reform, the results indicator will target at least 3 inspectorates implementing risk-based inspections[31].

***Prior Action #5:** To strengthen property rights and improve land administration, the Recipient has enacted the **Law on Cadastre** to update the procedures to allow cadastre reconstruction, as evidenced by Law No. 8/L-237, published in the Recipient's Official Gazette on January 9, 2024.*
***Indicative trigger #6:** To enable the reconstruction of land records information, the Recipient has adopted the **Administrative Instruction on Procedures for Reconstruction of Cadastre**.*

48. Rationale, background and objectives: Secure land tenure is considered a cornerstone of private sector development, as having clarity of legally backed use and ownership rights on the ground helps to foster, among other things, investor confidence, citizens' access to loans and mortgages, and enhanced access to public services. In Kosovo, informality in the land and property sector is widespread, and the Government is actively working to clarify and register land and property throughout the country in order to unlock private sector development and job growth. After 1999, Kosovo's cadastral records covering the period from 1983 to 1999 were destroyed, lost or relocated, giving rise to a significant number of unresolved property claims. Through a process called cadastre reconstruction which refers to the process of rectifying and improving the spatial data (records and maps) of a cadastre system, the Kosovo Cadastral Agency (KCA) is systematically surveying and registering land and property and, to date, has completed approximately 15 percent of Kosovo's national territory, which required extensive time due to high population densities and the large number of

[30] The regulation will (i) define the internal organization and systematization of jobs in the General Inspector Office; b) set duties and responsibilities of the Office and its staff; and c) define rules on the organizational structure of the Office.
[31] The Office of the General Inspector is responsible for leading the business inspection system reform, ensuring that risk-based inspections are carried out according to international standards. This Office is also responsible for publishing information on inspectorates implementing risk-based inspections.

land parcels in these areas. KCA is targeting "priority cadastral zones", or areas where economic output is greatest, and the largest concentrations of the country's population reside[32]. While major advances in the clarification of ownership and use rights have been made, the cadastre reconstruction process is not empowered with the ability to recognize informal transactions or resolve inheritance and other legal issues, resulting in many properties not being officially registered and leaving many Kosovars with insecure land tenure. The GoK is considering updates to the current legal framework to address these issues in order to ensure long-term land tenure security for the benefit of Kosovo's socio-economic development.

49. Substance of the prior action: The objectives of the Law on Cadastre are to regulate the administration of the cadastre, the registration of immovable property and the organization of responsible institutions. The Law will (i) update the procedures to allow cadastre reconstruction commissions to address informal transactions and land disputes during the process and (ii) establish of a "vertical structure" that brings the country's Municipal Cadastre Offices under the responsibility of KCA as a means of generating additional revenue streams via transaction fees to foster a sustainable business model for KCA. The implementation of the Law will enable progress in the cadastral reconstruction process, by introducing a modernized land administration system and securing property rights which have an immense effect improving the business environment in the country. As a *trigger* for the second operation, the DPF series will support the Administrative Instruction on the procedures for cadastre reconstruction needed to implement the Law on Cadastre.

50. Expected Results: The results indicator for this prior action will measure the number of priority cadastre zones reconstructed based on the provisions of the new Law on Cadastre, which are expected to increase from 0 to 30.

Pillar III: Laying the foundations for greener growth

Prior action #6: *To provide the first targeted support program to vulnerable electricity consumers, the Recipient has adopted the* ***National Program for the Protection of Vulnerable Consumers in the Electricity Sector****, as evidenced by Government Decision No. 1/158 dated September 5, 2023 published in the Recipient's Official Gazette on September 6, 2023 and Ministerial Decision No. 52/2023.*
Indicative trigger #7: *To establish a multi-annual framework for the National Program for the Protection of Vulnerable Consumers in the Electricity Sector, consistent with the Law on Electricity, the Recipient has adopted the* ***Administrative Instruction on the Law on Electricity****.*

51. Rationale, background, and objectives: Energy affordability is an increasing concern in the context of the forthcoming energy sector reforms and liberalization of energy prices. According to the data from the 2017 Kosovo Household Budget Survey (HBS), electricity expenditures represented about 7.9 percent of total household expenditures, reflecting the high dependency of households on electricity. Depending on their individual circumstances, households faced by rising prices may under-heat their homes, or reduce consumption on other essential goods and services, or fall into debt to meet their electricity needs. The GoK recognizes these risks and has established a legal commitment to protect those who cannot afford to meet their energy needs.

52. Substance of the prior action: The GoK adopted the National Program for the Protection of Vulnerable Consumers in the Electricity Sector, which will significantly expand the coverage of support to vulnerable consumers. Having a strong program for the protection of vulnerable consumers facilitates the implementation of the clean energy transition by mitigating adverse social impacts on affordability of energy poor. This program will provide direct financial support through the subsidization of electricity bills for vulnerable consumers identified through a means test approach[33]. Beneficiaries will be able to submit their application through an electronic platform or in Social Services Centers. The program is approved for years 2023-2024, recognizing the unique situation in 2023 in the energy sector and the need to

[32] The total number of cadastral zones in Kosovo is 1,305. Of these, 450 are priority cadastral zones. The DPO results indicator has a target of 30 new cadastral zones reconstructed.
[33] Based on preliminary analysis, the design of the Program demonstrates efficacy in including poor households, irrespective of the poverty line chosen.

provide support to vulnerable customers, and the GoK plans to convert this into a multi-annual program in 2024. The approval of the program for the period 2023-2024 will allow the GoK to test and evaluate the effectiveness of the design and implementation arrangements and ensure that lessons learned from the initial phase of implementation of the program as well as current analysis of household survey data are incorporated in the design of the multi-annual program, thereby improving its effectiveness. As a *trigger* for the second operation, the DPF series will support the secondary legislation that will establish the multi-annual program providing more adequate support to customers in need, than in 2022. Compared to the program supported under DPF-1, the multi-annual program will be grounded in primary legislation and will support Kosovo during its energy transition. It will have an enhanced design, including a more effective and sustainable targeting system, and will have foundations in primary legislation, hence a more robust legal base. Establishing this legal basis for a multi-annual framework will provide the Government with an important tool to respond to increases in energy prices, as the program could expand or contract to reach more or less households, with varying amounts, as needed.[34] The proposal is for the multi-annual program to use the targeting mechanism that will be introduced through the Social Assistance Scheme (SAS) pilot (and later on, through the SAS Reform), which provides a means of assessing both formal and informal incomes. Given the importance of the informal sector in Kosovo, accounting for informal incomes when determining the eligibility criteria (in addition to formal incomes), has the potential to significantly improve the targeting efficiency. The feasibility of this proposal is dependent on the timely and successful implementation of the SAS pilot or SAS Reform.

53. Expected Results: With the adoption of this government program, the coverage of vulnerable electricity consumers will expand. The results indicator is the number of beneficiaries covered by the program by end-2025.

Prior Action #7: *To improve energy efficiency, the Recipient has adopted and submitted to Parliament the* ***Law on Energy Performance of Buildings*** *to (i) streamline the process for energy performance certifications (EPCs) and (ii) establish enforceable minimum energy standards for buildings, as evidenced by Government Decision No. 06/148 dated June 29, 2023 and published in the Recipient's Official Gazette on June 30, 2023.*
Indicative trigger #8: *To introduce the minimum energy performance requirements for buildings based on National Calculation Methodology, the Ministry of Environment, Spatial Planning and Infrastructure has adopted the* ***National Calculation Methodology.***

54. Rationale, Background, and Objectives: Kosovo is at an early stage in its efforts of greening the economy and supporting the energy transition. Energy efficiency is considered by the GoK as an essential component of the strategic and economic planning and the development of Kosovo. The recently published Energy Strategy 2022-2031 outlines strategic objectives and targets for the energy sector, and energy efficiency is expected to play a central role in the implementation of the strategy[35]. Kosovo has made good progress in meeting EU energy efficiency requirements. The minimum energy performance requirements for buildings are set out in the Law on Energy Performance of Buildings (No. 05/L-188), adopted in December 2016. The law sets out the requirements for energy performance for new and existing buildings, including the issuance of Energy Performance Certificates (EPCs), which determine the level of energy efficiency of a building. However, EPCs have not been issued yet on any buildings due to lack of enforcement (penalties) as well as lack of clarity in the roles of various institutions involved in the process. Furthermore, the initial law did not include any provisions on incentives for energy efficiency improvements in buildings; and did not include the provisions of the amendments of the EU Directive on Energy Performance of Buildings through the EU directive 2018/844.

55. Substance of the prior action: The Law on Energy Performance in Buildings aims to streamline the process of issuing EPCs, establishing enforceable minimum energy standards for buildings, while introducing financial incentives for

[34] This is more effective than establishing a new program in response to each energy crisis because it not only saves time (as no dedicated Government Decisions are required), but it also ensures the use of established systems and procedures, with improves program performance and transparency.
[35] By 2031, Kosovo has a target to limit the final energy consumption to the level of 1877 kilotonnes of oil equivalent (ktoe), achieve cumulative energy savings of 266.4 ktoe in buildings including public, private, and commercial by 2031 and to certify 150 Near Zero Energy Buildings.

energy efficiency improvements[36]. According to the provisions of the Law, the Ministry for Environment, Spatial Planning and Infrastructure (MESPI) will determine the minimum energy performance requirements. It will also have key responsibilities for implementation, monitoring, and issuance of EPCs, which will enable the streamlining of the relevant processes for issuing EPCs. With the support of German development agency (GIZ)[37], MESPI has already drafted the necessary bylaws and regulations that are needed to operationalize the issuance of EPCs once the law is ratified by Parliament. Furthermore, the Law includes specific penalties for building owners that do not comply with the requirements to have an EPC issued for buildings. The Law also envisages financial incentives programs to be developed by the Ministry in charge of the energy sector, and to be implemented by the Kosovo Energy Efficiency Fund. The implementation of the law is supported by international partners including GIZ and KfW. As a *trigger* for the second operation, the DPF series will support the adoption of the National Calculation Methodology, which is used to calculate the annual energy required to meet the different needs of a building associated with its typical used. The National Calculation Methodology provides the framework and all applicable formulas for calculating the efficiency performance of buildings based on local circumstances (for example climate conditions, existing regulations for minimum standards). It serves as guidance for the implementation of energy efficiency requirements, preventing deviations from current rules. The National Calculation Methodology will define the framework for energy performance measurement and monitoring, it will underpin the issuance of EPCs aligned with European Directives. The National Calculation Methodology is currently being developed by the Ministry.

56. Expected Results: The result indicator for this prior action is the number of buildings with EPCs, which is expected to increase from zero to 50 by end-2025.

Prior Action #8: *To scale up the decarbonization of the power sector, the Recipient has adopted the* ***Administrative Instruction No. 02/2023 on the Target of Electricity from Renewable Energy Sources*** *to increase institutional mandatory targets for renewable energy, as evidenced by the Ministry of Economy Decision published in the Recipient's Official Gazette on September 29, 2023.*

Indicative trigger #9: *To establish a consistent framework for the promotion of the use of renewable energy, the Recipient has enacted the* ***Law on the Promotion of Renewable Energy Sources****.*

57. Rationale, Background, and Objectives: Kosovo continues to rely on indigenous coal for power generation with more than 93 percent of domestic generation coming from its two outdated, inefficient and highly polluting coal-fired power plants. With the new Energy Strategy for 2022-2031, Kosovo's government plans to displace most of the generation from the older coal power plant (Kosovo A) by investing in about 1.3 GW of new renewable energy capacity, mainly solar and wind[38]. Furthermore, the Government will receive a US$200 million grant from the Millennium Challenge Corporation, which would facilitate the balancing of the intermittency of these renewable energy sources. To promote private investments in renewable energy through institutional support schemes, the GoK will need to formally increase the renewable targets that would set the legal basis for providing competitive and market-based support schemes for attracting renewable energy investments.

58. Substance of the prior action: The Administrative Instruction (AI) will mandate institutions in the energy sector (for example the Energy Regulator) to implement policies and programs in line with the new Renewable Energy Sources (RES) targets. Hence, in order to meet new energy demand while adhering to new RE targets set in the AI, Kosovo will need to increase use of RES displacing coal consumption. The AI determines the annual and long-term targets for gross final electricity consumption until 2030 and mandates Kosovo's institutions to introduce various support schemes for

[36] The Law will transpose the Directive 2010/31/EU on the Energy Performance of Buildings and Directive (EU) 2018/844 amending Directive 2010/31/EU on the energy performance of buildings. The Law was approved by the Assembly in first reading and is expected to be approved in final reading in early 2024.
[37] GIZ also provided support for the Kosovo Energy Efficiency Agency to utilize the Monitoring and Verification Platform.
[38] By 2031, the new strategy foresees: (i) that 35 percent of total electricity consumption will be covered by RES, with total installed RES capacity reaching 1600 MW; (ii) a reduction of GHG emissions in the power sector by 32 percent; (iii) improving energy efficiency and achieving a reduction in final energy consumption; and (iv) advancing regional market integration.

renewable energy investments based on competitive procedures (i.e., auctions). The 2030 target for the share of renewable energy is 32 percent of gross final electricity consumption. This means that the renewable energy share would increase from around 7 percent today to 32 percent by 2030, reducing coal from 93 percent to 66 percent or less of total gross electricity consumed, which will be partly supported by the phase-down of Kosovo A coal-fired power plant. As a *trigger* for the second operation, the DPF series will support the adoption of the Law on the Promotion of Renewable Energy Sources to establish a consistent framework for the promotion of the use of renewable energy, introducing market-based support schemes, mainly auctions, for renewable energy investments, which will be used instead of the outdated feed-in tariffs schemes used in the past. The law will (i) define responsibility and procedures of key actors in the RE sector; (ii) define rights and obligations regarding the construction of new RES capacities and establish competitive mechanisms for supporting the development of new RES capacities; (iii) set principles for the support scheme for the generation of electricity; and (iv) define principles for network access for RES. The enactment of the Law is expected to transpose energy commitments with the EU and define the general framework to attract private capital into the renewable energy sector using competitive auction schemes. Together with reforms to enhance the investment policy framework under Pillar II of the DPF, the law is expected to create more favorable conditions for private investment attraction in Kosovo.

59. **Expected Results:** The result indicator targets the megawatts of new renewable energy source committed for electricity generation to reach 175MW by end-2025. It is expected that a large share of the investment will derive from private investments. The total investment cost for new RES generation capacities is expected to be approximately EUR 183 million, and part of which will come from private sector sources.

Prior action #9: *To reduce the adverse impact of plastic waste on the environment, the Recipient has introduced a tax on the consumption of plastic bags, as evidenced by the adoption of the* ***Administrative Instruction on Packaging and Packaging Waste No. 07/2023,*** *published in the Recipient's Official Gazette on August 9, 2023.*

60. **Rationale, Background, and Objectives**: Kosovo has been actively working towards improving its services to build stronger climate resilience. Current solid waste management practices and systems are polluting for the environment and unsustainable. According to the ERP 2023-2025, only 10 percent of municipal waste is recycled compared to a potential level of 90 percent. Landfilling, including illegal landfilling, remains the predominant form of waste management and, separate collection remains scarce. The waste sector contributes to around 5 percent of GHG emission in the country. Plastic packaging introduced into the environment is anticipated to never fully degrade, therefore causing significant damage to Kosovo's environment. These damages are significant and affect numerous ecosystems in the territory of Kosovo. Limiting the use of plastic and promoting sustainable waste management practices is therefore a priority.

61. **Substance of the prior action:** The DPF will support the AI on Packaging and Packaging Waste, incentivizing the reduction of plastic use and reducing pollution. The AI aims at discouraging the use of lightweight plastic carrier bags above 25 microns by introducing a mandatory selling price of EUR 0.05 per plastic bag[39]. Moreover, the AI on Packaging and Packaging Waste determines the conditions, procedures, responsibilities and obligations for producers, importers, and sellers for the management of packaging and packaging waste in Kosovo.

62. **Expected results**: The results indicator for this prior action is the reduction of the annual average usage number of lightweight plastic carrier bags to 180 per capita.

Prior action #10: *To establish a framework for the promotion, planning and monitoring of climate change policies the Recipient has enacted the* ***Law on Climate Change,*** *as evidenced through Law No. 8/L-250, published in the Recipient's Official Gazette on January 5, 2024.*

[39] Of the total of EUR 0.05, EUR 0.02 goes to the budget of the Republic of Kosovo.

Indicative trigger #10: *To strengthen the monitoring framework for GHG emissions, the Recipient has adopted* ***the Administrative Instruction on Monitoring GHG Emissions.***

63. Rationale, Background, and Objectives: Despite recent progress, Kosovo is at the early stages in developing its climate change legislation framework. Currently, the country lacks a comprehensive legal framework for the promotion and planning of the climate agenda, and the Climate Change Strategy (2018-2028) is the only policy document that gives orientation to Kosovo's climate agenda.

64. Substance of the prior action: The DPF will support the adoption of Kosovo's first Law on Climate Change (CC). The objectives of the Law on CC are to define the framework for planning climate change policies and monitor their implementation and strengthen and coordinate activities of authorities in planning mitigation and adaptation measures. The Law also defines roles and responsibilities of relevant institutions responsible for the climate change policies and regulates the monitoring, reporting, and verification of GHG emissions. The implementation of the Law will set the legal basis for the National Energy and Climate Plan (NECP) as required by the Energy Community, contribute to the mitigation of GHG emissions and set the grounds for additional secondary legislation and climate policies such as the Climate Change Adaptation Strategy and Long Term Decarbonization Strategy. As a *trigger* for the second operation, the DPF series will support the adoption of the secondary legislation to the CC Law aimed at regulating monitoring and evaluation of GHG emissions.

65. Expected results: The results indicator for this prior action is the publication of Kosovo's annual GHG inventory report according to the new monitoring and evaluation criteria[40]. The GHG annual inventory report will be a critical tool for measuring, managing, and mitigating GHG emissions. Specific uses include regulatory compliance, policy development, and risk management.

4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

66. The proposed Fiscal Policy, Competitiveness and Green Growth DPF series is a key pillar of the WBG's engagement in Kosovo. The program is closely aligned with the WBG active portfolio and has served as a platform for coordinated policy dialogue by the WBG and other development partners in support of Kosovo's reform efforts. Actions on Early Childhood Education spending, and particularly the adoption of the Law on Early Childhood Education (ECE) will support activities under the Early Childhood Development for Kosovo's Human Capital Project (P179656) under preparation. The trade facilitation reforms are supported through the *Western Balkans Trade Facilitation Advisory Project* (P179241) and the *Western Balkans Trade and Transport Facilitation* (P173620) project, while inspection reform is supported through the *Competitiveness and Export Readiness Project* (P152881) and the new IFC Investment Climate Project commenced in 2023. The adoption of the Law on Cadastre is expected to unlock investments under the Real Estate and Geospatial Infrastructure Project (P164555). The introduction of the first program for the protection of vulnerable electricity consumers is expected to be complemented by the Social Assistance Project (P171098). The operation also complements the *Energy Efficiency and Renewable Energy Project* (P143055) by introducing the Energy Performance Certificates (EPC) for public buildings that are being renovated under the Project.

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

67. Kosovo's policy making process is broadly consultative and inclusive, as reflected in a consolidated legislative framework for public consultations and regulatory reforms. Since 2011, all legislation (primary and secondary), strategies, and concept documents are subject to mandatory public consultations based on the Regulation No. 09/2011 on the Rules and Procedures of the Government.[41] In 2016, the Government also approved the Regulation No. 05/2016

[40] Sectoral coverage of the annual GHG inventory report according to the new methodology will be dependent on data availability.

[41] Regulation No. 09/2011 on the Rules and Procedures of the Government requires a mandatory use of prior consultations and public consultations (article 7 and article 32) for draft laws, secondary legislation, strategies, and concept documents.

on the minimum standards for public consultation process. A public consultation is conducted systematically through an online consultation platform for at least 15 working days (or 3 weeks). As a result of these changes, more than 90 percent of policies and legislation were finalized following public consultations in 2022. The GoK has conducted extensive consultations on most of the prior actions supported by the DPF. These included the Law on Early Childhood Education (ECE), the Law on the Administration of Tax Procedures, the Law on Cadastre, the Law on Energy Performance in Buildings and the Law on Climate Change.

68. **The World Bank has maintained close collaboration with development partners and key stakeholders.** Key stakeholders driving the reform agenda include the Ministry of Finance, Labor, and Transfers (MFLT), the Office of the Prime Minister, the Ministry of Economy, Ministry of Education, Science and Technology and the Ministry of Environment and Spatial Planning. The measures supported by the DPF enjoy a strong consensus among Kosovo's development partners community. PAs are closely aligned with the reforms supported by the IMF in the areas of tax policy and administration; the EU in the areas of PFM and public procurement; UNICEF in the areas of Early Childhood Education (ECE) and GIZ and UNDP in the areas of waste management and climate change. Similarly, there is close alignment between the DPF and support provided by USAID in the area of energy sector reform.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

69. **The DPF program is expected to have broadly positive or neutral social and distributional effects.** The policy actions supported by the DPF program are expected to enhance the effectiveness of fiscal policy, to strengthen the investment climate, and lay the foundations for greener growth in the post-COVID era, which are key development goals for Kosovo and also outlined in the 2022 SCD update. This section provides a discussion by pillar.

70. **PAs supported under Pillars I and II of the DPF are expected to have positive or neutral impacts on the poor.** To the extent that tax policy and administration reforms hinge on careful policy design and comprehensive strategies that prioritize the well-being of poor and vulnerable households, and that additional revenues are effectively targeted to reach those in need, the impact of **PA#1** is expected to be positive or neutral. **PA#2** is expected to have a positive impact on the poor and vulnerable by increasing and diversifying forms of ECE service provision and helping to bridge the gap in access to educational services. By building stronger and more effective PFM systems prioritizing the needs of the most vulnerable, and to the extent that reforms will affect investment in social expenditures, such as healthcare, education, and social safety nets, **PA#3** is expected to have a positive impact on the poor and vulnerable. **PA#4** and **PA#5** are also expected to have neutral or positive impacts on the poor by improving the investment climate and reducing the costs of business operations, thereby supporting private sector investment and job creation. As a result of **PA#6**, updated procedures for cadaster reconstruction can help establish clear property rights and boundaries and enhance land tenure security for vulnerable populations. As a result, having secure rights to land can result in better access to credit, investment opportunities, and the ability to use land as collateral.

71. **PAs supported by Pillar III of the DPF are expected to have positive or neutral impacts on the poor.** By establishing a National Program for the Protection of Vulnerable Consumers in the Electricity Sector, **PA#7** is poised to benefit poor households by increasing the income of the poorest and reducing inequality. A careful design is needed to include energy-vulnerable households while preventing the inclusion of groups that may not need support. Other prior actions under Pillar III are expected to have a positive impact on the poor and vulnerable people in Kosovo. By improving energy efficiency in buildings and supporting renewable energy use, **PA#8** and **PA#9** can reduce energy costs, which could be particularly beneficial for low-income families, who spend a larger portion of their income on energy expenses. However, while the potential benefits are significant, there may also be costs associated with the implementation of energy efficiency programs and increase in renewable energy, particularly in low-income and vulnerable neighborhoods. These challenges could include initial costs of upgrades, lack of awareness or access to resources, and potential disruption

during renovations. Therefore, a comprehensive and inclusive approach that addresses vulnerable populations' specific needs and circumstances is crucial to realize the benefits of new energy efficiency and renewable energy programs. **PA#10** is similarly expected to have a positive impact on the poor and vulnerable by reducing harmful risks associated with the impacts of climate change and plastic waste management, which tend to disproportionately impact the vulnerable.

5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

72. **The DPF is envisaged to have mostly positive environmental impacts, and no significant adverse impacts on the environment, forests, and natural resources are expected.** Positive environmental impacts are expected under the proposed PAs under the third pillar of the DPF. The PAs will contribute to reductions in Greenhouse Gas (GHG) emissions and climate change adaptation and mitigation through reforms that support reduced plastic waste, energy efficiency, and the shift towards renewable energy generation. More indirect, but similarly positive environmental effects are expected under the private sector pillar, with a reduced environmental footprint through the shift to modern and more efficient ICT solutions to support compliance with regulatory obligations associated with trade activity and the adoption of a new legislative framework for investment attraction, which promotes sustainable investments in the environmental sector. Property rights and land reforms supported under the second pillar are not expected to have any negative impact on the environment as reforms will serve to improve the effectiveness and efficiency of the regulatory framework rather than eliminating obligations associated with environmental protection.

73. **Kosovo's existing policy framework is considered to be adequate for addressing environmental protection and ensuring sustainable implementation of projects.** The Ministry of Environment, Spatial Planning, and Infrastructure (MESPI) is the responsible authority for developing policies and issuing environmental and construction permits, based on the conditions and requirements under the Law on Environmental Impact Assessment, conducting inspections and controls for compliance with legal requirements and environmental conditions. The Environmental Impact Assessment (EIA) and Strategic Environmental Assessment ensure that environmental implications are taken into consideration before public policy decisions are made.[42] Both procedures ensure that plans, program, and projects that are likely to have significant effects on the environment are subject to an environmental assessment, before their approval or authorization.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

74. **Kosovo has made substantial progress in improving PFM over the last 5 years, as noted by various reviews**[43]. Despite this remarkable progress, several elements of the PFM system still have room for improvement, including: (i) enhancing alignment of strategic plans with medium term budgets; (ii) strengthening fiscal risk management; (iii) improving public investment and asset management; (iv) upgrading the procurement framework; (v) raising the effectiveness of financial management control and audits; and (vi) improving follow up on external audit findings. The Government's efforts to address these gaps are anchored in the current PFM Strategy (2022-2026) and a monitoring framework for its implementation. The proposed DPF is aligned with the Government's PFM reform efforts and supports the strengthening of PFM systems. While the operation's fiduciary risk is primarily driven by the current PFM environment, the shortcomings in this area do not indicate major fiduciary risk given the nature and content of the program. The fiduciary risk for this operation is assessed as Moderate.

[42] These procedures are in line with the amended EU Directive 2014/52/EU on the Environmental Impact Assessment as well as with the EIA 2011/92/EU. Kosovo's legislation regarding EIA consists of the following legislation: 1) Law on Environmental Protection No. 03/L-025; 2) Law on Integrated Prevention Pollution Control No. 03/L-043; 3) Law on Environmental Impact Assessment No. 03/L-214; 4) Law on Strategic Environmental Assessment No. 03/L-230; 5) Administrative Instruction on licensing individuals and entities for conducting Environmental Impact Assessment Report; 6) Administrative Instruction on issuing of Environmental Permit; 7) Administrative Instruction on licensing compliers of environmental impact assessment reports; 8) Administrative Instruction on information, public participation and interested parties in the Environmental Impact Assessment procedures; 9) Administrative Instruction to determine the amount of the fee for services relating to the Environmental Impact Assessment.

[43] These include five PEFA assessments (between 2016 and 2021); annual EU-SIGMA reviews; and other analyses by the World Bank, IMF, EC, and other organizations.

75. **A medium-term perspective to budgeting has been established and budgeting practices conform with the criteria for good performance.** The Government publishes its statement of priorities each year in the Medium-Term Expenditure Framework (MTEF), from which the annual budget document is prepared. The MTEF has improved in both substance and process, although the MTEF process still faces some issues that reduce its role as an important three-year planning document, mainly due to gaps in legal framework. These result in a lack of full alignment with strategic plans and inconsistency with prior year estimates. Better procedures for budget preparation have been established and compliance with authorized procedures has improved. Lack of registrations for multi-year commitments undermines the budget planning and monitoring process. Despite recent improvements on reporting fiscal risks, the Government also remains vulnerable to fiscal shocks, considering the practices to monitor and manage fiscal risks, such as the quasi-fiscal activities of public companies or other explicit contingent liabilities, are still at their infancy.

76. **There have been improvements in the area of predictability and control in budget execution as evidenced in the latest PEFA assessment, yet, challenges remain, especially in the area of commitment management and public procurement**. The budget execution, cash management, accounting, and reporting are enabled by a unified Treasury-operated system. The system enables accurate data processing, supervision, and monitoring with appropriate authority level and control. However, better integration with other PFM systems is needed to address shortcomings in the recording for multi-annual commitments and arrears, which reduces efficiency of commitment controls, planning, and public investment management. The internal control framework is reasonably effective and has become stronger as the internal audit practice develops. Further efforts are required to implement the concept of decentralized managerial accountability and risk assessment, which remains poorly understood, and extend the coverage of the internal audit function to all aspects of budget organization. The PFM Law supported under the DPF series will contribute to improving budget credibility and further strengthening the PFM system. The Public Procurement Law, adopted in 2011, aims to ensure the cost-efficient, transparent, and fair use of public funds. All public funds are procured through the e-procurement system. The public procurement transparency has increased with the introduction of two new e-procurement modules, enabling contractor performance evaluation and contract monitoring. However, the procurement framework needs updating to include environmental and social aspects when awarding contracts and to encourage life cycle criteria. Besides, public procurement remains prone to irregularities and is vulnerable to corruption[44].

77. **Comprehensive fiscal information is available to the public.** The budget classification system is consistent with international Government Financial Statistics/Classifications of the Functions of Government standards, and most of the budget documentation is published online, including budget proposals and the annual budget law. The Treasury prepares and publishes online in-year budget execution reports and annual financial statements, which are consistent with budget coverage and classification to allow monitoring of budget performance. The financial statements are complete, prepared based on international accounting standards and submitted for external audit within the three months after year-end. There has been notable progress in external audit. The National Audit Office (NAO) fully meets its audit mandate by completing a regular audit of all budget organizations and the consolidated government financial statement, in compliance with international standards. The Assembly uses the NAO's annual audit reports to scrutinize the Executive, and generally, supports the audit recommendations, however their implementation rate is still low.

78. **Improvements have been noted in the Central Bank of Kosovo's (CBK) governance and internal control framework.** The functioning of the CBK Board was restored in 2022. Further efforts are required to strengthen the CBK's governance framework. The CBK Act protects the autonomy of the central bank, and the audit mechanisms and financial reporting practices continue to be aligned with international standards. The implementation of the risk management

[44] Authorities are working on a new public procurement law which aims to address these limitations, modernize and simplify procurement procedures, promote sustainability, and increase opportunities for small and medium-sized enterprises (SMEs) and innovation. The new law is expected to draw on good international practices and enhances policies and procedures. It will introduce new procurement procedures aimed at simplifying the procurement process to increase efficiency and effectiveness in procurement (e.g. dynamic purchasing systems, reverse auctions, and an electronic catalog), contributing to support stronger budget execution.

framework is advancing. During the last three years, the CBK has received unqualified audit opinions from the appointed auditor[45]. Since the unilateral adoption of the euro, this currency is a legal tender in Kosovo and circulates freely.

79. Disbursement will be made upon declaration of credit effectiveness and submission of respective withdrawal applications to the WBG. The financing proceeds will be transferred to the existing Treasury account maintained at the CBK. The MFLT shall ensure that upon receipt of the deposited amount, an equivalent amount is accounted and reflected in the Kosovo Financial Management Information System. The financing and disbursement currency would be the same as the country currency (euro). If financing proceeds are used for Excluded Expenditures, the WBG will require the Government to refund the amount directly to the WBG. No additional fiduciary arrangements are required. The WBG will not require an audit of the deposit account, but will request the Government to provide a confirmation to the WBG for each disbursement, in an official letter from the MFLT on the amounts deposited within 30 days of receiving the funds.

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

80. The MFLT is the lead organization responsible for coordinating the proposed operation. It is the main counterpart for this operation and coordinates the preparation and implementation of the supported reforms with all line ministries and institutions involved in the DPF. The line ministries and institutions report on the prior actions and result indicators to the MFLT and the WBG as and when requested. The results framework presented in Annex 1 will be used as a monitoring tool by both the Government and the WBG. Data availability and quality are appropriate to monitor progress towards the achievement of the results indicators. The Macroeconomic Policy and International Financial Cooperation Department, or any successors, is responsible for monitoring of the reform program supported by the DPF. The Department will provide information to the WBG, as required, to monitor outcomes in the results framework.

81. ***Grievance Redress.*** Communities and individuals who believe that they are adversely affected by specific country policies supported as Prior Actions or tranche release conditions under a World Bank Development Policy Financing may submit complaints to the responsible country authorities, appropriate local/national grievance mechanisms, or the Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Project affected communities and individuals may submit their complaint to the Bank's independent Accountability Mechanism (AM). The AM houses the Inspection Panel, which determines whether harm occurred, or could occur, as a result of Bank non-compliance with its policies and procedures, and the Dispute Resolution Service, which provides communities and borrowers with the opportunity to address complaints through dispute resolution. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the Bank's Accountability Mechanism, please visit https://accountability.worldbank.org.

6. SUMMARY OF RISKS AND MITIGATION

82. The risk of the proposed operation is assessed as Moderate. The institutional capacity for implementation and sustainability risk is rated at Substantial, reflecting Kosovo's young institutions, as well as limited inter-ministerial coordination, particularly for reforms that are supported under the second and the third pillars. This risk is mitigated through close coordination with the Government, and parliamentary commissions, and the strong consensus among Kosovo's development partners. Technical assistance is being provided across all three pillars to support implementation of the proposed reforms by the WBG and other development partners, including the EU, GIZ, and USAID, on a continuous basis. Moreover, relying on the WBG's convening power and the frequent and close monitoring of progress in the delivery of technical assistance activities and needs are envisaged to further mitigate institutional

[45] Central Bank of Kosovo, 2019, 2020, 2021.

capacity risks.

83. Political and governance risks are substantial. The outcome of Kosovo's parliamentary elections in 2021 has ensured political stability and provided the conditions for the DPF implementation. Disruptions related to the legislative process associated to the dialogue between the Government and opposition parties remain a risk for program implementation and ratification of international agreements by the National Assembly. The WBG will continue to engage with relevant stakeholders and will update risk assessment in response to political economy shifts, if warranted. Frequent consultations with national authorities on program design, robust engagement with other development partners, close collaboration and assistance from the EU in the context of the Stabilization and Association Agreement, particularly in the context of key structural reforms, strong analytical foundations, anchoring the program in international commitments and in government priorities, and political commitment to the prior actions are expected to help mitigate political and governance risks. All other risk categories are assessed as Moderate.

Table 4: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	Substantial
2. Macroeconomic	Moderate
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Moderate
7. Environment and Social	Moderate
8. Stakeholders	Moderate
9. Other	
Overall	Moderate

ANNEX 1: POLICY AND RESULTS MATRIX

DETAILED RESULTS FRAMEWORK

Prior actions and Triggers		Results		
Prior Actions under DPF 1	**Triggers for DPF 2**	**Indicator Name**	**Baseline**	**Target**
Pillar I: Enhancing the effectiveness of fiscal policy				
Prior Action #1: To strengthen tax compliance and enhance domestic revenue mobilization, the Recipient has enacted the **Law on the Administration of Tax Procedures** to: (i) simplify rules for taxpayers' registration; (ii) introduce requirements for digital payment transactions; and (iii) improve the accuracy of the taxpayers' registry, as evidenced through Law No. 8/L-257, published in the Recipient's Official Gazette on January 12, 2024.	**Indicative trigger #1:** To strengthen the equity of the tax system and improve domestic revenue mobilization, the Recipient has enacted (i) **the Law on Personal Income Tax;** (ii) **the Law on Corporate Income Tax** and (iii) the **Law on Value Added Tax**.	Tax revenue as a share of GDP	23.5[46] percent (average)	26 percent
Prior Action #2: To strengthen public expenditure effectiveness and improve the returns to public spending in education, the Recipient has enacted the **Early Childhood Education (ECE) Law** to provide legal grounds for: (i) diverse forms of ECE provision and (ii) new financing schemes to support service delivery, as evidenced through Law No. 08/L-153, published in the Recipient's Official Gazette on August 3, 2023.	**Indicative trigger #2:** To define mechanisms to access public funding for ECE by different service providers, the Recipient has adopted **Administrative Instruction(s)** acts that will regulate quality standards for accessing public funding for ECE service provision.	Public expenditure on ECE as a share of spending on education Number of new children registered in ECE institutions	4.6 percent 0	6.1 percent 1,800
Prior Action #3: To enhance the effectiveness of public expenditures and strengthen budget	**Indicative trigger #3:** To enhance the effectiveness of public expenditure and improve	PEFA Indicators PI-1 (aggregate expenditure outturn) and PI-2	PEFA indicators::	PEFA indicators:

[46] The baseline for this indicator is calculated as the average tax revenue (in percentage of GDP) between 2015-2022.

Prior actions and Triggers		Results		
credibility, the Recipient has adopted the **Concept Document on Public Financial Management** that initiates the required regulatory and legal changes to the current legal and policy framework, as evidenced by Government Decision No. 15/102, published in the Recipient's Official Gazette on October 26, 2022.	fiscal governance, the Recipient has enacted the **Law on Public Financial Management**.	(expenditure composition outturn)	PI-1: B PI-2: D+	PI-1: A PI-2: C
Pillar II: Strengthening the investment climate				
	Indicative trigger #4: To establish a consistent framework for the protection of investors and enhance the investment climate and to fully establish and mandate the lead organization tasked with promoting investments into Kosovo, the Recipient has (i) enacted the **Law on Sustainable Investments** and (ii) adopted the **Administrative Instruction on the Establishment of the Investment and Export Agency.**	Number of qualified investors' expressions of interest in the territory of Kosovo	0	10
Prior Action #4: To support regulatory simplification and reduce the compliance costs associated with trading across borders, the Recipient has approved: (i) the establishment of the **National Single Window** to introduce an electronic platform that will make possible the online application and processing of regulatory authorizations for trade, as evidenced by Government Decision No. 08/162 dated September 27, 2023 and published in the Recipient's Official Gazette on September 27, 2023; and (ii) the **Regulation on the Internal Organization of Jobs in the Office of the General Inspector,** to define the organization of jobs and set responsibilities, as evidenced by Prime	**Indicative trigger #5:** The Recipient has (i) approved a package of necessary legislation, including subsidiary legislation and/or bylaws to establish and functionalize the National Single Window and (ii) has published the regulatory requirements to comply with inspections legislation to reduce compliance costs associated with business inspections.	Number of institutions integrated into the national single window Number of inspectorates implementing risk-based inspections	0 0	6 3 or more

Prior actions and Triggers		Results		
Minister's Office Regulation No. 06/2023 approved by the Decision No. 540/2023, dated July 3, 2023 and published in the Official Gazette on July 5, 2023.				
Prior Action #5: To strengthen property rights and improve land administration, the Recipient has enacted the **Law on Cadastre** to update the procedures to allow cadastre reconstruction, as evidenced by Law No. 8/L-237, published on the Recipient's Official Gazette on January 9, 2024.	**Indicative trigger #6:** To enable the reconstruction of land records information, the Recipient has adopted the **Administrative Instruction on Procedures for Reconstruction of Cadastre.**	Number of priority cadastral zones reconstructed based on the provisions of the new Cadastre Law	0	30
Pillar III: Laying the foundations for greener growth				
Prior Action #6: To provide the first targeted support program to vulnerable electricity consumers, the Recipient has adopted the **National Program for the Protection of Vulnerable Consumers in the Electricity Sector**, as evidenced by Government Decision No. 1/158 dated September 5, 2023, and published in the Recipient's Official Gazette on September 6, 2023 and Ministerial Decision No. 52/2023.	**Indicative trigger #7:** To establish a multi-annual framework for the National Program for the Protection of Vulnerable Consumers in the Electricity Sector, consistent with the Law on Electricity, the Recipient has adopted the **Administrative Instruction on the Law on Electricity**.	Number of households beneficiaries of the Program the Protection of Vulnerable Consumers in the Electricity Sector	0	50,000
Prior Action #7: To improve energy efficiency, the Recipient has adopted and submitted to Parliament the **Law on Energy Performance of Buildings** to (i) streamline the process for energy performance certifications (EPCs) and (ii) establish enforceable minimum energy standards for buildings, as evidenced by Government Decision No. 06/148 dated June 29, 2023 and published in the Recipient's Official Gazette on June 30, 2023.	**Indicative trigger #8:** To introduce the minimum energy performance requirements for buildings, based on National Calculation Methodology, the Ministry of Environment, Spatial Planning and Infrastructure has adopted the **National Calculation Methodology**.	Number of buildings with energy performance certificates (EPCs)	0	50
Prior Action #8: To scale up the decarbonization of the power sector, the Recipient has adopted the **Administrative Instruction No. 02/2023 on**	**Indicative trigger #9:** To establish a consistent framework for the promotion of the use of renewable energy, the Recipient has enacted the	Megawatts of new renewable energy sources (RES) committed	0	175MW

Prior actions and Triggers		Results		
the Target of Electricity from Renewable Energy Sources to increase institutional mandatory targets for renewable energy, as evidenced by the Ministry of Economy Decision published in the Recipient's Official Gazette on September 29, 2023.	**Law on the Promotion of Renewable Energy Sources**.	for electricity generation		
Prior Action #9: To reduce the adverse impact of plastic waste on the environment, the Recipient has introduced a tax on the consumption of plastic bags, as evidenced by the adoption of the **Administrative Instruction on Packaging and Packaging Waste No. 07/2023,** published in the Recipient's Official Gazette on August 9, 2023**.**		Annual average usage number of lightweight plastic carrier bags per capita	222	180
Prior Action #10: To establish a framework for the promotion, planning and monitoring of climate change policies the Recipient has enacted the **Law on Climate Change,** as evidenced through Law No. 8/L-250, published in the Recipient's Official Gazette on January 5, 2024.	**Indicative trigger #10:** To strengthen the monitoring framework for GHG emissions, the Recipient has adopted **the Administrative Instruction on Monitoring GHG Emissions.**	Annual GHG inventory report published according to the new monitoring and evaluation criteria	No	Yes

RESULTS INDICATORS BY PILLAR

Baseline	Closing Period
Enhancing the effectiveness of fiscal policy	
Tax revenue, as a share of GDP (Percentage)	
Dec/2022	Dec/2025
23.5	26
Public expenditure on ECE as a share of spending on education (Percentage)	
Jan/2023	Dec/2025
4.6	6.1

Number of new children registered in ECE institutions (Number)	
Dec/2022	Dec/2025
0	1800
PEFA indicators PI-1 (aggregate expenditure outturn) and PI-2 (expenditure composition outturn) (Text)	
March/2022	Dec/2025
B and D+	A and C
Strengthening the investment climate	
Number of qualified investors' expressions of interest in the territory of Kosovo (Number)	
Dec/2022	Dec/2025
0	10
Number of institutions integrated into the national single window (Number)	
Dec/2022	Dec/2025
0	6
Number of inspectorates implementing risk-based inspections (Number)	
Dec/2022	Dec/2025
0	3 or more
Number of priority cadastral zones reconstructed based on the provisions of the new Cadastre Law (Number)	
Dec/2022	Dec/2025
0	30
Laying the foundations for greener growth	
Number of households beneficiaries of the Program for the Protection of Vulnerable Consumers in the Electricity sector (Number)	
Dec/2022	Dec/2025
0	50000
Number of buildings with energy performance certificates (EPCs) (Number)	
Dec/2023	Dec/2025
0	50
Megawatts of new renewable energy sources (RES) committed for electricity generation (Megawatt)	
Dec/2022	Dec/2025
0	175
Annual average usage number of lightweight plastic carrier bags per capita (Number)	
Dec/2022	Dec/2025
222	180
Annual GHG inventory report published according to the new monitoring and evaluation criteria (Yes/No)	
Dec/2022	Dec/2025
No	Yes

ANNEX 2: FUND RELATIONS ANNEX

IMF Executive Board Completes the First Reviews of Kosovo's Stand-By and Resilience and Sustainability Facility Arrangements

November 16, 2023

- The IMF Executive Board completed on November 15, 2023, the first reviews of Kosovo's Stand-By Arrangement (SBA) and Resilience and Sustainability Facility (RSF) arrangement, making available SDR 20.031 million (about €24.8 million) and SDR 30.976 million (about €38.4 million), of budget support under each facility, respectively.
- The authorities are making very good progress in implementing their policy agenda under the Fund-supported arrangements. The SBA continues to provide a key policy anchor, and the RSF continues to support Kosovo's climate change mitigation and adaptation efforts including by catalyzing additional climate financing.

Washington, DC: The Executive Board of the International Monetary Fund (IMF) completed today the first reviews of Kosovo's 24-month Stand-By Arrangement (SBA) and of Resilience and Sustainability Facility (RSF) Arrangement. Completion of these reviews makes available SDR 20.031 million (about €24.8 million) under the SBA and SDR 30.976 million (about €38.4 million) under the RSF arrangement.

Following the Executive Board's discussion, Mr. Okamura, Deputy Managing Director, and Acting Chair of the Board, issued the following statement:

The Kosovo authorities have made significant progress in the implementation of their economic reform agenda. Growth has been strong despite global and regional headwinds and geopolitical tensions. Inflation is on a strong downward trend. Program performance under both the Stand-By Arrangement (SBA) and the Resilience and Sustainability Facility (RSF) has been strong.

Fiscal targets for June and September 2023 under the SBA were met comfortably, and all structural benchmarks have been implemented. The 2024 budget is in line with program targets and with Kosovo's rules-based fiscal framework. Reforms implemented in the context of the SBA have aimed to make the tax system more equitable, enhance tax compliance, improve fiscal risk assessment, and strengthen public investment management, fiscal transparency, and accountability.

The appointment of a new central bank governor in August has brought about renewed momentum for reform implementation. A new banking sector law is expected to be sent to the National Assembly early in 2024. The Central Bank of Kosovo is also working to strengthen its governance structures, with Fund support.

The RSF has been instrumental in supporting Kosovo's ambitious climate change mitigation and adaptation efforts. All RSF-supported reform measures have been implemented as expected. RSF reform measures will reduce emissions and improve air quality by increasing the share of renewables in the energy mix, improving energy efficiency, and strengthening the functioning and regional integration of Kosovo's energy system and energy markets. A new law on renewable energy sources has been sent to the National Assembly and will pave the way for the attraction of private financing for green energy. Ongoing efforts to assess the potential impact of the European Union's forthcoming carbon border adjustment mechanism (CBAM) are commendable. Implementation of C-PIMA recommendations will facilitate, in time, public investment becoming more targeted, efficient, and climate resilient. The medium-term impact of these measures is expected to be positive and large, underscoring the benefits of RSF resources for Kosovo.

Kosovo: Selected Economic Indicators, 2019–24

(Percent, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024
				Est.	*Proj.*	
Real GDP growth 1/	4.8	-5.3	10.7	3.5	3.8	4.2
Contribution to growth (percentage points of GDP)						
Consumption	5.8	2.3	7.7	3.3	4.4	3.3
Private	4.6	2.0	6.5	3.5	2.6	2.7
Public	1.2	0.3	1.2	-0.2	1.8	0.6
Investment	-0.1	-2.3	3.6	-2.5	1.9	1.1
Net Exports	-0.3	-5.3	-0.2	2.7	-2.5	-0.2
Exports	2.2	-8.6	17.0	6.1	3.6	2.3
Imports	-2.5	3.3	-17.2	-3.4	-6.1	-2.5
Real growth rate (percent)						
Consumption	6.2	2.4	7.6	3.3	4.4	3.3
Private	5.6	2.5	7.3	4.0	3.0	3.2
Public	10.1	2.1	9.0	-1.5	14.2	3.9
Investment	2.9	-7.6	13.0	-6.8	2.5	4.0
Exports	7.6	-29.1	76.8	17.2	9.0	5.5
Imports	4.5	-6.0	31.4	4.9	9.2	3.6
Official unemployment (percent of workforce)	25.7	26.0	21.3	…	…	…
Price changes						
CPI, period average	2.7	0.2	3.3	11.7	5.0	3.5
GDP deflator	1.0	1.4	6.1	8.5	5.6	3.5
General government budget (percent of GDP)						
Revenues and grants	27.0	25.6	27.8	28.0	28.7	28.1
Expenditures	29.9	33.5	29.0	28.6	29.9	29.5
Of which: Wages and salaries	8.7	9.8	8.4	7.3	7.8	7.7
Subsidies and transfers	8.9	12.8	10.6	11.9	11.1	10.6
Capital expenditure	7.6	5.6	5.3	4.7	6.0	6.1
Overall Balance (Fiscal rule) 2/	-0.8	-6.5	-0.9	-0.4	-0.7	-0.7
Overall balance	-2.9	-7.8	-1.2	-0.6	-1.2	-1.4
Stock of freely available government bank balances	5.1	3.4	3.8	3.2	3.1	3.4
Total public debt 3/	17.7	22.5	21.6	20.0	19.9	20.6
Balance of Payments (percent of GDP)						
Current account balance, incl. official transfers	-5.7	-7.0	-8.7	-10.5	-8.1	-7.0
Of which: Official transfers 4/	3.4	4.1	2.9	3.3	3.6	3.1
Of which: Remittance inflows	12.1	14.5	14.5	13.7	13.6	13.5
Financial account	-2.3	-8.3	-4.6	-7.4	-5.8	-4.7
Of which: Direct investment, net	-2.7	-4.2	-4.0	-6.7	-5.1	-4.9
Portfolio investment, net	0.8	-1.2	3.5	1.5	0.1	1.1
Other investment, net	-1.8	-3.5	-6.2	-2.9	-1.8	-2.3
Reserve change	1.3	0.7	2.1	0.8	1.0	1.3
Errors and Omissions	3.5	-1.6	3.4	2.7	1.6	1.6
Savings-investment balances (percent of GDP)						
National savings	28.9	26.4	27.2	24.3	24.9	25.7

Public savings	4.4	-2.8	3.9	3.9	4.0	4.6
Private savings	24.5	29.3	23.3	20.4	20.9	21.1
Investment	34.6	33.4	36.0	34.8	33.0	32.7
Public investment	7.6	5.6	5.3	4.7	6.0	6.1
Private investment	27.0	27.8	30.6	30.2	27.0	26.6
Current account, including. official transfers	-5.7	-7.0	-8.7	-10.5	-8.1	-7.0
Financial Sector						
Non-performing loans (percent of total loans)	1.9	2.5	2.1	2.0	…	…
Bank credit to the private sector (percent change)	10.0	7.0	15.6	16.0	12.1	9.2
Deposits of the private sector (percent change)	15.6	10.9	12.4	12.8	10.4	8.6
Regulatory capital to risk weighted assets	15.9	16.5	16.1	14.8	…	…
Memorandum items:						
Foreign Reserves (millions of euros, IMF Definition)	1,142	1,149	1,293	1,370	1,478	1,623
Foreign Reserves (% of ARA metric)	126	120	107	96	95	95
GDP (millions of euros)	7,056	6,772	7,958	8,936	9,794	10,563
GDP per capita (euros)	3,959	3,766	4,499	5,049	5,531	5,963
Real GDP growth per capita	5.6	-6.2	12.6	3.5	3.7	4.1
Output gap (% of GDP)	1.2	-6.2	-0.5	-0.5	-0.5	-0.3
Population (million)	1.8	1.8	1.8	1.8	1.8	1.8

Sources: Kosovo authorities; and IMF staff estimates and projections.

1/ While quarterly and annual national account data for 2022 report the same nominal GDP, the use of different deflators in the two sets of data result in different annual real growth rates (3.5 percent in quarterly data, 5.2 percent in annual data). Pending final 2022 data (expected for December 2023), the table reports real growth in quarterly data.

2/ The “fiscal rule” caps the overall fiscal deficit at 2 percent of GDP, excluding investment financed with privatization receipts and donor financing contracted after 2015, as well as PAK-related current expenditure; the IMF calculates expenditures from carried-forward own-source revenue (OSR) as the difference in the municipal OSR stock.

3/ It does not include contingent debt of former Yugoslavia. Beginning in 2020, it includes Euro 120 million of debt with KPST.

4/ Total foreign assistance excluding capital transfers.

ANNEX 3: LETTER OF DEVELOPMENT POLICY

REPUBLIKA E KOSOVËS/REPUBLIKA KOSOVA/REPUBLIC OF KOSOVO
Qeveria e Kosovës / Vlada Kosova / Government of Kosova
Ministria e Financave / Ministarstvo za Finansije
Ministry of Finance
Arkiva - Arhiva - Archive
Njësia Org. / Org. Jedin. / Org. Unit: 01/481
Nr. Prot. / Br. Prot. / Prot. No.: 3030/2023
Nr. i faqeve / Broj stranica / No. pages: 1
Data / Datum / Date: 29/12/2023

Republika e Kosovës
Republika Kosova - Republic of Kosovo
Qeveria - Vlada - Government
Ministria e Financave, Punës dhe Transfereve - Ministarstvo Finansija, Rada i Trasfera - Ministry of Finance, Labor and Transfers

Prishtinë 29 dhjetor, 2023

Mr. Ajay Banga
President
The World Bank
1818 H Street NW
Washington, DC 20433
USA

Subject: Letter of Development Policy for the Kosovo Fiscal Effectiveness, Competitiveness and Green Growth Development Policy Financing (P179944)

Dear President Banga,

On behalf of the Government of Kosovo, I have the pleasure to submit to you this Letter of Development Policy for the First Fiscal Effectiveness, Competitiveness and Green Growth Development Policy Financing in the amount of US$ 100 million, the first program of a programmatic DPF series.

This letter presents the macroeconomic context for this operation and summarizes critical reforms of the program that we are committed to undertake. The design and implementation of such reforms will further strengthen the effectiveness of our public finances in the medium term, reinforce the business climate for private sector development, and strengthen our energy and climate change policies.

The Government of Kosovo appreciates the long-standing partnership and cooperation with the World Bank, and the support received for critical reforms and investments that have contributed to accelerate the convergence of living standards with the European Union, reduce poverty, and strengthen investors' confidence in the economy. We look forward to further enhancing our cooperation in the future.

Macroeconomic Framework and Key Structural Reforms

Our main objective over the medium term is to promote robust, inclusive, and sustainable economic growth, which leads to an improvement in the living standards of our citizens. To this end, we adopted our Government's program in May 2021 to lay out our Government's vision and the respective pillars of reforms we believe are needed in order to achieve the aforementioned objective.

Simultaneously, we are committed to reform the pension system to ensure its long-term sustainability both socially and fiscally. As part of the previous DPF, we improved the legal framework for costing pensions and other social protection programs, and we shall continue to strengthen our pension analysis capacities.

As part of the above mentioned efforts we will also review the existing social assistance system to ensure better targeting and that our social safety net is more equitable and adaptable. To this end, we are working together with the World Bank on an Investment Project Financing to support the reform of the Social Assistance Scheme (SAS). One of the key components of this project is the establishment of a poverty targeting system, which will help us better identify households in need. Additionally, the project involves the creation of a social registry that will provide comprehensive information on the type and extent of social benefits received by households.

In regards to the energy sector, we are committed to the prudent implementation of the new Energy Strategy, which aims to phase down coal-fired power generation and replace that capacity with renewable energy sources. Furthermore, the energy strategy includes ambitious energy efficiency targets to reduce energy consumption, especially in the building sector. To address the issue of energy affordability and provide targeted support to vulnerable consumers in the electricity sector we adopted the Program for Vulnerable Consumers in the Electricity Sector for 2023. We are committed to reviewing the program and enhancing its design by learning from the lessons of the 2023 program's implementation.

Moreover, we remain committed to ensuring debt sustainability and improving debt management practices and transparency. As the Ministry of Finance, Labor, and Transfers we continue to publish our medium-term debt management strategy as part of our State debt program, as well as the annual and quarterly debt bulletins. We are committed to finalize the preparation of sub-legal acts that are needed to implement the new Law on State Debt. In line with requirements of the new Law, we will report to the Parliament on the implementation of the state debt strategy.

Simultaneously, we are working on the design and implementation of various structural reforms. The objectives of these reforms include improving the regulatory environment for the private sector through reducing administrative burden, improving the efficiency and coordination of business inspections, strengthening the legal framework to attract FDI, supporting access to financial services and digitalization, and strengthening trade facilitation, including through the DPF. Another core pillar of our reform agenda is to raise the quality of human capital and increase the ability of the private sector to generate employment opportunities and raise earnings. The reform agenda is also responsive to reducing environmental degradation, protecting ecosystems, enhancing waste management, controlling air pollution and improving administrative procedures for addressing climate change.

Reforms supported by the Fiscal Effectiveness, Competitiveness and Green Growth DPF

The proposed Fiscal Effectiveness, Competitiveness and Green Growth DPF supports our efforts to (i) enhance the effectiveness of fiscal policy; (ii) strengthen the investment climate; and (iii) lay the foundations for greener growth.

Starting in 2021 Kosovo's economy experienced a strong growth post-pandemic recovery. The Government's policy actions that focused on managing the health emergency, providing targeted support to those mostly affected by the COVID-19 pandemic and the trust of citizens on our long-term vision for an economic and social transformation contributed to such results. By end-2021, the energy crisis that hit Europe resulted in a rapid increase in energy costs and heightened volatility. The crisis reaffirmed the need of a profound transformation of the energy system towards greater resiliency, flexibility and diversification. In December 2022, we approved a new Energy Strategy for 2022-2031 which aims to ensure a just transformation towards a greener and more diversified energy supply, considering the energy sector as a key precondition to sustainable growth and development.

Russia's unjustified invasion of Ukraine has caused a major shock to the global and European economies, including Kosovo, where the impact has been unprecedented. This impact, coupled with the ensuing energy crisis, resulted in an increase in inflation throughout 2022, subsequently having adverse effects on household real disposable income and private demand.

The rise in input prices also caused delays in the implementation of our public investment program and leading to a re-evaluation of project costs. However, our prudent fiscal management, which prioritized mitigating the impact of the crisis on the more vulnerable segments of our population and supporting economic recovery, played a crucial role to maintaining overall macroeconomic stability and rebuilding the necessary fiscal space. Throughout 2022, we have implemented measures, accounting for around 4 percent of the GDP, to alleviate the crisis. These measures included direct support for vulnerable households and businesses, offering pension bonuses and subsidizing the energy and agricultural sectors.

We affirm our strong commitment to maintaining and further enhancing macro-fiscal management over the medium term, also supported by the programmatic DPF. Since 2014, we have consistently improved our rules-based macro-fiscal framework and have demonstrated our dedication by adhering strictly to it. Commencing in 2021, robust tax revenue performance, driven by Government's measures to recover the economy and enhanced formalization, combined with prudent expenditure management, has allowed us to maintain the fiscal deficit, as per the fiscal rule definition, below 2 percent. This prudent approach has bolstered our fiscal buffers, enhancing the government's capacity to respond to potential downside risks. As of June 2023, our public and publicly guaranteed debt to GDP ratio stands at 17.3 percent, on a declining trajectory since 2021, and remains well below the legal ceiling of 40 percent of GDP, reflecting adequate prioritization of borrowing requirements. Over the medium term, we are committed to adhere to the fiscal rule on public debt, public deficit, and the wage bill growth ceiling.

As part of our ongoing efforts to enhance fiscal sustainability, we remain dedicated to the prudent implementation of the recently enacted Law on Public Sector Wages within the broader context of public administration reform. In this regard, we recognize that responsible management of public compensation requires a delicate balance between employment growth, adjustments to the wage coefficient, and the phased introduction of allowances and compensation as outlined in the law.

(i) Enhancing fiscal effectiveness

We are committed to design and implement reforms aimed at enhancing the effectiveness of fiscal policy and increase its equity and returns over the medium term. Under Pillar I of the DPF:

- We have enacted a new Law on the Administration of Tax Procedures. This Law is set to modernize and simplify the tax administration system by (i) simplifying registration rules for tax payers; (ii) supporting digital transactions and (iii) improving the accuracy and integrity of the taxpayers' registry.
- We have enacted the Law on Early Childhood Education (ECE) to support the expansion of inclusive ECE service delivery models. Such expansion will help increase public spending in ECE, a critical factor for long term development of Kosovo's human capital. We will ensure that appropriate costing for the introduction of grade zero and the expansion of ECE services will be finalized before the Law is implemented.
- We adopted the Concept Document on Public Financial Management (PFM) which marks the initiation of legal reforms in Kosovo's PFM system. Through this Concept Document we have set in motion the process to define the reform path for the new PFM Law. The new PFM Law shall strengthen the legal basis for strategic planning and resource allocation, improve capital budgeting and management, and streamline the regulation of fiscal rules, which are currently scattered among various existing legislations.

(ii) Strengthening the investment climate

To support the transition to a competitive growth model that creates more and higher quality jobs, supports firm growth and is driven by increases in productivity we need to provide an enabling environment for firms through a more business friendly regulatory environment. To this end, under the Pillar II of the DPF:

- To support regulatory simplification and reduce compliance costs associated with doing business, we have approved the Government Decision to establish a National Single Window (NSW). This electronic platform enables online applications and processing of regulatory authorization for trade. Additionally, we have adopted the Regulation on the Internal Organization and Systematization of the Jobs in the General Inspector Office to further advance the implementation of the Law on Inspections, which was supported under the previous DPF.
- We have enacted the Law on Cadastre, a pivotal step to strengthen property rights and improve land administration. Implementation of this new law, among other improvements, provides guidance for cadastral reconstruction, including procedures for address challenges related to inheritance and boundary disputes.

(iii) Laying the foundations for greener growth

To enhance the sustainability and resilience of economic growth, we recognize the need to address pressing energy and climate change challenges, all while safeguarding the well-being of the poor and most vulnerable citizens. Kosovo has made good progress in laying the foundation for greener growth and supporting the transition to a more sustainable growth model. A key priority of our Government is to support scaling up the decarbonization of the power sector, increasing energy efficiency, strengthening environmental sustainability and instituting a robust legal framework for climate change policy. To this end under Pillar III of the DPF:

- We have adopted a National Program for the Protection of Vulnerable Consumers in the Electricity Sector that will significantly expand the coverage of support to vulnerable consumers starting in 2023. This program will provide direct financial support by subsidizing electricity bills for vulnerable consumers identified through a means test approach. We are committed to improving the program's design and targeting based on the lessons learned from its first year of implementation.
- We have approved the Law on Energy Performance of Buildings to streamline the process for energy performance certifications (EPCs) and establish enforceable minimum energy standards for buildings.
- We have approved the Administrative Instruction on the Target of Electricity from Renewable Energy Sources (RES) to increase institutional mandatory targets for renewable energy. The Administrative Instruction will mandate institutions in the energy sector to implement policies and programs in line with the new RES targets.
- We have enacted the Law on Climate Change to establish a framework for the promotion, planning and monitoring of climate change policies.
- To reduce the adverse impact of plastic waste on the environment and introduce a tax on the consumption of plastic bags we adopted the Administrative Instruction on Packaging and Packaging Wastes. In line with the agreed upon results indicator, we will publish the annual GHG inventory report according to the new monitoring and evaluation requirements.

We believe that this program of reforms will provide the foundations for sustainable growth in Kosovo, and are confident that the transformative nature of reforms meets the threshold to qualify for the IDA Scale Up Window (SUW).

Allow me to conclude by expressing our profound appreciation for the invaluable partnership we share with the World Bank. We extend our heartfelt gratitude to you for the steadfast support your organization has graciously offered to our nation.

Yours sincerely,

Hekuran Murati
Minister of Finance, Labor and Transfers
Republic of Kosovo

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Pillar I: Enhancing the effectiveness of fiscal policy		
Prior action #1: Strengthening tax compliance and enhancing domestic revenue mobilization	Positive/Neutral: This prior action is not likely to cause any adverse environmental effects and could generate positive effects as a result of increased digitalization of services.	Neutral/Positive
Prior action #2: Strengthening spending effectiveness and returns to public spending in education	Neutral: This prior action is expected to have overall neutral environmental impacts and some potential negative impacts. Potentially negative effects may derive from the construction of new pre-schools. These potentially negative impacts can be managed through adequate environmental impact assessment and appropriate mitigation strategies.	Positive
Prior action #3: Enhancing the effectiveness of public expenditures	Neutral: This prior action is likely to have neutral environmental effects.	Positive
Pillar II: Strengthening the investment climate		
Prior action #4: Improving trade facilitation and reducing costs associated with business inspections	Positive: By supporting the digitalization of trade services, this prior action is expected to have positive impacts in terms of reduced transport costs and emissions, lower consumption of scarce resources, and lower waste generation.	Neutral
Prior action #5: Strengthening property rights and land administration	Neutral: This prior action is likely to have neutral environmental effects.	Positive
Pillar III: Laying the foundations for greener growth		
Prior action #6: Providing the first targeted support program to vulnerable electricity consumers	Neutral: This prior action is likely to have neutral environmental effects.	Positive
Prior action #7: Streamlining the process for the energy performance certifications (EPC) and establish enforceable minimum energy standards for buildings	Positive: this prior action is expected to have positive environmental effects by supporting a reduction in energy demand and contributing to decarbonization efforts. Further positive environmental effects may derive from a reduction in GHG emissions, demand for energy imports and air and water pollution.	Positive

	However, to ensure a sustainable implementation of this policy measures, it will be important that adequate mitigation measures are considered, including handling of asbestos-containing material, and waste disposal, especially for special wastes like bulbs, fluorescent lamps, and electrical equipment.	
Prior action #8: Scaling up the decarbonization of the power sector and establish a consistent framework for the promotion of the use of RES	Positive: this prior action is expected to have positive environmental effects. By supporting renewable energy development, the prior action is expected to lay the foundations for greener and environmentally friendly growth. However, investments in renewable energy can result in negative impacts associated with land use, solid waste, bird and bat deaths due to collisions with wind turbines, and others. As mandated by Kosovo's environmental legislation, these impacts can be managed through adequate environmental impact assessment and appropriate mitigation measures.	Positive
Prior action #9: Reducing the adverse impact of plastic waste on the environment	Positive: This prior action is expected to have positive environmental effects by reducing waste, increasing the level of packaging reuse, recycling, as well reducing the final disposal of this waste, contributing to the transition towards a circular economy, saving energy, and reducing greenhouse gas emissions, which contribute towards mitigating climate change. This prior action will also help reduce resources spent on cleaning the rivers, and landscapes, which could be used for improved environmental management. The reform of banning single-use plastic bags will also promote positive behavior change toward the environment and the ecosystem's health.	Positive
Prior action #10: Establishing a framework for the promotion of climate change policies	Positive: This prior action is expected to have positive environmental effects. The law on Climate Change is expected to contribute to the mitigation of GHG emissions and the reduction of negative effects from climate change.	Positive

ANNEX 5: PARIS ALIGNMENT ASSESSMENT

Program Development Objective(s): To enhance the effectiveness of fiscal policy, strengthen the investment climate and lay the foundations for greener growth	
Step 1: Taking into account our climate analysis (e.g., Country Climate and Development Reports or CCDRs), is the operation consistent with the country climate commitments, including for instance, the NDC, NAP, LTS, and other relevant strategies?	**Yes.** The DPF reform program is consistent with Kosovo's Climate Change Strategy 2019-2028[47] and it addresses some of the main mitigation and adaptation priorities of the country.
Mitigation goals: assessing and reducing the risks	
Pillar I: Enhancing the effectiveness of fiscal policy Prior Actions 1,2 and 3.	The objective of Pillar I is to support domestic revenue mobilization, improving returns to spending in human capital and strengthening PFM, by supporting the Government **in enhancing fiscal policy effectiveness.**
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**No**. Three Prior Actions from Pillar I are enhancing fiscal policy effectiveness and will not cause significant increase of GHG emissions or introduce and persistent barriers to transition to the country's low GHG emissions development pathways.
Conclusion Pillar I (Prior Actions 1, 2 and 3): All three Prior Actions from Pillar I are aligned with the mitigation goals of the Paris Agreement.	
Pillar II: Strengthening the investment climate Prior Actions 4 and 5	The objective of Prior Actions in Pillar II is to **support to private sector development and growth by improving the investment climate**
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**No.** Two Prior Actions from Pillar II are aimed at supporting private sector development and growth. While growth can increase GHG emissions, not a significant increase is expected. Moreover, in the specific country context (middle-income country facing essential development needs, which has historically contributed very little to global GHG emissions) and given that there is no risk for creating significant and persistent barriers to low GHG emissions development pathways from these reforms, the risk for non-alignment in mitigation is low.
Conclusion Pillar II (Prior Actions 4 and 5): All two Prior Actions from Pillar II are aligned with the mitigation goals of the Paris Agreement.	
Pillar III: Laying foundations for greener growth Prior Actions 6, 7,8,9 and 10	The objective of Prior Actions in Pillar III is **laying stronger foundations for greener growth while protecting energy vulnerable households.**
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**No**. Five Prior Actions from Pillar III will not cause significant increase of GHG emissions or introduce and persistent barriers to transition to the country's low GHG emissions development pathways.
Conclusion Pillar III (Prior Actions 6, 7, 8, 9 and 10): All five Prior Actions from Pillar III are aligned with the mitigation goals of the Paris Agreement.	
Conclusion Mitigation Goals for the DPO: The operation is aligned with the mitigation goals of the Paris Agreement	
Adaptation and resilience goals: assessing and managing the risks	

[47] http://kepweb.org/documents_custom/climate-change-strategy-and-action-plan-2019-2028/

Pillar I: Enhancing the effectiveness of fiscal policy Prior Actions 1,2 and 3.	The objective of Pillar I is to support domestic revenue mobilization, improving returns to spending in human capital and strengthening PFM, by supporting the Government **in enhancing fiscal policy effectiveness.**
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	**No.** The anticipated risks from climate hazards in Kosovo are unlikely to significantly impact the effectiveness of the prior actions in Pillar I.
Conclusion Pillar I (Prior Actions 1, 2 and 3): All three Prior Actions from Pillar I are aligned with the adaptation and resilience goals of the Paris Agreement.	
Pillar II: Strengthening the investment climate Prior Actions 4 and 5	The objective of Prior Actions in Pillar II is **support to private sector development and growth by improving the investment climate.**
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	**No.** The anticipated risks from climate hazards in Kosovo are unlikely to significantly impact the effectiveness of the prior actions in Pillar II.
Pillar III: Laying foundations for greener growth Prior Actions 6, 7, 8 ,9 and 10	The objective of Prior Actions in Pillar III is **laying stronger foundations for greener growth while protecting energy vulnerable households.**
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	**No.** The anticipated risks from climate hazards in Kosovo are unlikely to significantly impact the effectiveness of the prior actions in Pillar III.
Conclusion Adaptation and Resilience Goals for the DPO: The operation is aligned with the adaptation and resilience goals of the Paris Agreement	
OVERALL CONCLUSION OF PARIS ALIGNMENT ASSESSEMENT: The operation is aligned with the goals of the Paris Agreement	

ANNEX 6: ANALYTICAL UNDERPINNINGS

Prior Actions	Analytical Underpinnings
	Operation Pillar I: Enhancing the effectiveness of fiscal policy
Prior action #1: Strengthening tax compliance and enhancing domestic revenue mobilization	*Documents*: WB (2021). Systematic Country Diagnostic Update, European Commission (2022). Country Report for Kosovo; WB (2022), Enhancing the Quality and Scope of Taxpayer Registration: A Tax Gap Analysis of the Republic of Kosovo; IMF (2022), TA Technical Report on Accelerating Tax Administration Reforms. *Description:* As domestic revenue mobilization is relatively low, Kosovo should strengthen the tax administration system and review its tax policy and intensify efforts to broaden the tax base. The credibility of the tax registry and information needs to be further strengthened, and efforts to further digitalize the delivery of tax services should intensify.
Prior action #2: Improving spending prioritization and returns to public spending in education	*Documents*: WB (2021), Systematic Country Diagnostic Update, WB (2021), Country Economic Memorandum, WB (2021), A Situational Analysis of Early Childhood Development (ECD) Services in Kosovo. WB (2021), Enhancing Human Capital by Improving Education (CEM Background paper). *Description:* Analysis show the need for Kosovo to ensure that children have the foundations for learning by the time they begin primary school. Increasing access to pre-school education requires expansion of alternative financing models for preschool (beyond public provision), providing incentives for private providers and hybrid public/private models, as well as ensuring minimum quality standards through licensing, monitoring, and training.
Prior action #3: Enhancing the effectiveness of public expenditures	*Documents*: WB (2021). Systematic Country Diagnostic Update, European Commission (2022). Country Report for Kosovo, Public Expenditure and Financial Accountability (PEFA, 2022). WB (2022), Public Expenditure Review. *Description:* An inadequate PFM system constraints public spending effectiveness. Despite the remarkable progress in PFM reforms, several elements of the PFM system have room for further strengthening. These include public investment management and procurement processes, alignment of strategic planning with expenditure budgeting, and fiscal risks monitoring and management.
	Operation Pillar II: Strengthening the investment climate
Prior action #4: Improving trade facilitation and reducing costs associated with business inspections	*Documents*: WB (2023), The Economic Effects of Market Integration in the Western Balkans. WB (2021), Systematic Country Diagnostic Update, WB (2021). Country Economic Memorandum. WB (2021), Boosting Export Performance (CEM Background paper). IFC (2021), Kosovo Time Release Study. IFC (2022), Blueprint for the National Single Window. *Description:* Non-tariff barriers and absence of a trade single-window constrain trade facilitation. The introduction of a NSW is encouraged under the World Trade Organization's Trade Facilitation Agreement (TFA). As a CEFTA member, Kosovo has committed to aligning with the Trade Facilitation Agreement (TFA) measures. Further, the development of a regional NSW is an ongoing initiative in the European Union.
Prior action #5: Strengthening property rights and land administration	*Documents*: WB (2021), Systematic Country Diagnostic Update, USAID (2016), Kosovo Property Rights Program (PRP) Report: Informality in the Land Sector, USAID (2015), USAID Kosovo Property Rights Program (PRP) Report: Gender, Property and Economic Opportunity in Kosovo. *Description:* Lack of clarity concerning ownership and use rights in Kosovo's land and property sector restricts investor confidence and private sector growth as part of the country's economic development. Moreover, insufficient mechanisms for addressing

	land disputes and other issues, such as those concerning property inheritance, remain persistent barriers to underserved communities' (e.g., women, ethnic minorities) access to tangible assets that can be leveraged for financial security and other opportunities for escaping poverty.
Operation Pillar III: Laying the foundations for greener growth	
Prior action #6: Providing the first targeted support program to vulnerable electricity consumers	*Documents*: WB (2019), Poverty and Distributional Analysis of Electricity Poverty and Protection of Vulnerable Customers in Kosovo, WB (2021), Program for protection of electricity vulnerable consumers in Kosovo; WB (2022), Kosovo Poverty Assessment. *Description:* Energy affordability has become an increasing concern in the context of forthcoming energy sector reforms. The existing electricity benefit scheme is not sufficient to protect electricity poor households. Together, these documents set out a proposal for the broad design of a program for energy vulnerable consumers based on analysis of electricity poverty and existing social protection coverage based on the 2017 HBS and prevailing norms from the European Union on energy poverty.
Prior action #7: Streamlining the process for the energy performance certifications (EPC) and establish enforceable minimum energy standards for buildings	*Documents*: WB (2021), Systematic Country Diagnostic Update; Energy Community (2022), Annual Implementation Report. World Bank (2013), Country Environmental Analysis. WB (2021), Western Balkan Countries Residential Energy Efficiency Market Assessment. *Description:* Investments in energy efficiency have recently picked up but remain limited. The country should speed up the implementation of energy efficiency investments in residential buildings and the private sector. The system for energy certification of buildings is not yet functional. A web-based platform; National Registry for Energy Certification of Buildings is the platform for processing energy certifications, the application process, and issuing the final EPC, but this platform is not yet functional. To date only one tool is used for pilot buildings to generate EPCs called iSBMxK.
Prior action #8: Scaling up the decarbonization of the power sector and establish a consistent framework for the promotion of the use of RES	*Documents*: WB (2021), Systematic Country Diagnostic Update; Energy Community (2022), Annual Implementation Report. Kosovo Ministry of Economy, (2020), Least Cost Renewable Energy Mix. *Description:* Despite increased renewable energy investment, the energy sector continues to rely on outdated, inefficient, and highly polluting energy generation. Although Kosovo came close to reaching its renewable energy 2020 targets, its energy mix should progressively rely more heavily on renewable sources, in line with the commitments to the Energy Community Treaty and EU Directives. The country should proceed with the adoption of its first renewable energy law to transpose and implement Directive (EU) 2018/2001 by the end of 2022.
Prior action #9: Reducing the adverse impact of plastic waste on the environment	*Documents*: European Commission (2022), Country Report for Kosovo; WB (2021), Systematic Country Diagnostic Update. World Bank (2013), Country Environmental Analysis. *Description:* Kosovo needs to increase its political commitment to address environmental degradation. It needs to support measures to reduce waste production, management, and the circular economy.
Prior action #10: Establishing a legislative framework for Climate change policies	*Documents*: European Commission (2022), Country Report for Kosovo; WB (2021), Systematic Country Diagnostic Update. Energy Community (2022), Annual Implementation Report. *Description:* Kosovo needs to increase its political commitment to address climate change challenges and substantially improve the implementation of its legislation, to align it with the Green Agenda for the Western Balkans' goals. On climate change, Kosovo needs to speed up the implementation of its Climate Change Strategy, including the adoption of the Law on Climate Change.

ANNEX 7: TECHNICAL ASSITANCE BY THE WORLD BANK AND OTHER PARTNERS

Policy Area	World Bank	Other development partners
PA1: Tax administration and policy	Enhancing the quality and scope of tax registration - (P173730) EU TF Strengthening Fiscal Governance in the Western Balkans - (P180191)	IMF Tax Administration Technical Assistance, GIZ
PA2: Early Childhood Education (ECE)	Early Childhood Development for Kosovo's Human Capital Project - (P179656)	UNICEF
PA3: Public Financial Management (PFM)	World Bank advisory World Bank Climate Support Facility (CSF) on Green PFM	European Union (EU), USAID
PA4: Sustainable Investment Law	Western Balkan's Common Regional Market Initiative (P178854) World Bank Climate Support Facility (CSF)	USAID, EBRD, GIZ.
PA5: National Single Window and Inspections Reform	WB6 Trade and Transport Facilitation Project (P173620) WB6 Trade Facilitation Advisory Project (P179241) Competitiveness and Export Readiness Project (P152881) IFC NSW Blueprint 2023	
PA6: Cadastre reconstruction	Kosovo Real Estate & Geospatial Infrastructure Project (REGIP) - P164555	USAID
PA7: Program for Vulnerable Consumers in the Electricity Sector	Social Assistance Project (P171098) Western Balkans Six Energy Crisis Response Programmatic ASA (P179826) Western Balkans Energy Transition Program (P169389)	IMF
PA8: Energy Performance	Western Balkans Energy Transition Program (P169389)	GIZ
PA9: Renewable Energy	Western Balkans Six Energy Crisis Response Programmatic ASA (P179826)	USAID, Energy Community Secretariat
PA10: Climate Change and environmental policy	World Bank Climate Support Facility (CSF)	UNDP, GIZ