Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 19-May-2023| Report No: PIDC35005

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Kosovo	P179944	Kosovo Fiscal Effectiveness, Competitiveness and Green Growth DPF (P179944)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
EUROPE AND CENTRAL ASIA	Dec 15, 2023	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Republic of Kosovo	Ministry of Finance, Labor and Transfers		

Proposed Development Objective(s)

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

Financing (in US$, Millions)

SUMMARY

Total Financing	60.00

DETAILS

Total World Bank Group Financing	60.00
World Bank Lending	60.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

Country Context

1. **Kosovo needs to transition to a competitive growth model that creates more and higher quality jobs, supports firm growth and is driven by higher productivity.** In the decade leading up to the pandemic (2010–19), Kosovo 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. However, several structural weaknesses continue to impede higher growth, job creation and faster poverty reduction. Prior to the pandemic, Kosovo's economic growth was mainly driven by private consumption, fueled by remittances and higher social protection spending. Public and private investment also supported growth, but with weak returns as reflected by low productivity growth averaging 0.5 percent during 2012-2017. The

recent years marked significant job formalization, but growth did not translate into significant job creation limiting its impact on poverty reduction.

2. The recent crises reaffirmed the urgency of structural reforms to enhance the effectiveness of fiscal policy, support private sector development and strengthen foundations for greener growth. Before the pandemic, Kosovo maintained a good track record of sustainable headline fiscal policy anchored by a set of fiscal rules and prudent policy management. Kosovo 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. The pandemic weighed heavily on the government's fiscal position in 2020, driven by plunging revenues and deployment of economic and social response measures. 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. Supporting a stronger enabling environment for the private sector will be critical to fulfill Kosovo's aspirations for higher productivity growth, job creation and faster poverty reduction. Despite efforts to promote domestic private sector growth, attract FDI, and formalize private sector employment, the structure of the economy continues to rely on micro, small, and medium enterprises. The private sector shows limited productivity growth, firm dynamism, investment attraction and employment creation. Addressing Kosovo's energy sector and environmental challenges will be critical to achieve sustainable and inclusive growth over the medium and long term. The energy sector is 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 renewable energy sources (RES).

Relationship to CPF

3. The proposed program lays at the center of the World Bank Group Country Partnership Framework (CPF) for FY2023-2027. The proposed program is organized around three interrelated pillars and supports selected policies and institutional reforms that cut across all the three focus areas of the CPF for FY2023-2027, namely, strengthening public service delivery efficiency and quality, enhancing conditions for more formal private sector jobs and increasing environmental resilience.

C. Proposed Development Objective(s)

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

Key Results

4. The proposed Kosovo Fiscal Effectiveness, Competitiveness and Green Growth Development Policy Loan (DPL) aims to support policies and institutional reforms that enhance fiscal policy, strengthen the investment climate and support stronger foundations for green growth. The proposed DPL supports measures that strengthen domestic revenue mobilization, supporting the increase of the tax-to-GDP ratio over the medium-term, and improve public financial management (PFM) and spending management. Pillar 2 strengthens the investment climate by supporting stronger investors' protections, trade facilitation systems and the legal framework for land administration. Pillar 3 supports measures that will aim at increasing protection for vulnerable consumers in the electricity sector, increase energy performance certificates in public buildings and reduce usage of lightweight plastic carrier bags.

D. Concept Description

5. **The proposed operation supports the government's efforts to tackle longstanding structural bottlenecks that impede higher, more inclusive and sustainable growth in Kosovo.** Through its first pillar, the operation aims to improve fiscal policy effectiveness with a view to increase 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 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.

E. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

6. **Overall, the policy reforms supported by this operation are expected to have mostly positive or neutral effects on the welfare of Kosovar households.** Prior actions (PAs) under Pillar 1 are expected to have a positive or neutral effects on poverty reduction in the medium term. For example, PA2 is expected to lead to an increase in public expenditure on early childhood education (ECE) that can have a positive effect on poverty reduction. PAs under Pillar 2 are expected to have positive or neutral effects. Positive impacts are expected from the implementation of PA6 that is expected to strengthen property rights, providing individuals with greater security of tenure, which means that they are less likely to be evicted from their homes or land. Moreover, improved land administration and property rights can also facilitate access to credit. PAs under Pillar 3, are expected to have a neutral or positive social and distributional impacts.

Environmental, Forests, and Other Natural Resource Aspects

7. **The DPF is envisaged to have mostly positive environmental impacts and no significant adverse impacts on the environment, forests and natural resources are expected.** The environmental impacts from the DPF reforms are expected to be positive, except for PA2 which may have potentially negative effects as a result of the construction of new pre-schools for the expansion of ECE services. These potentially negative impacts can be managed through adequate environmental impact assessment and appropriate mitigation strategy. The direct positive environmental effects are expected under the proposed PAs in pillar three of the program. The proposed 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 foreign 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.

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APPROVAL

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