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Kosovo Public Finances and Sustainable Growth DPF (P170113)

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Report No: PGD104

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

FOR A

PROPOSED CREDIT IN THE AMOUNT OF

EUR 50.6 MILLION  
(EQUIVALENT TO US\$56.4 MILLION)

TO THE

REPUBLIC OF KOSOVO

FOR THE

PUBLIC FINANCES AND SUSTAINABLE GROWTH  
DEVELOPMENT POLICY FINANCING

February 18, 2022

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

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**REPUBLIC OF KOSOVO****GOVERNMENT FISCAL YEAR**

January 1 – December 31

**CURRENCY EQUIVALENTS**

(Exchange Rate Effective as of January 31, 2022)

Currency Unit = Euro (EUR)

US\$1.00 = EUR 0.896

**ABBREVIATIONS AND ACRONYMS**

AI	Administrative Instruction	IMF	International Monetary Fund
CAD	Current Account Deficit	IPSAS	International Public Sector Accounting Standards
CBK	Central Bank of Kosovo	IT	Information Technology
CEM	Country Economic Memorandum	LPFMA	Law on Public Financial Management
CPF	Country Partnership Framework	MAFRD	Ministry of Agriculture, Forestry and Rural Development
DeM	Debt Management	MESPI	Ministry of Environment, Spatial Planning, and Infrastructure
DEMPA	Debt Management Performance Assessment	MFLT	Ministry of Finance, Labor, and Transfers
DMF	Debt Management Facility	MTDS	Medium Term Debt Strategy
DPF	Development Policy Financing	MTEF	Medium-Term Expenditure Framework
DRS	Deposit Refund System	NAO	National Audit Office
EBRD	European Bank for Reconstruction and Development	NECP	National Energy and Climate Plan
EIA	Environmental Impact Assessment	OFID	OPEC Fund for International Development
e-ID	Electronic Identification	OPEC	Organization of Petroleum Exporting Countries
EPR	Extended Producer Responsibility	PA	Prior Action
ERP	Economic Reform Program	PFM	Public Financial Management
EU	European Union	PPG	Public and Publicly Guaranteed
FCV	Fragility, Conflict, and Violence	PPRC	Public Procurement Regulatory Commission
FDI	Foreign Direct Investment	PRO	Producer Responsibility Organization
GDP	Gross Domestic Product	RFI	Rapid Financing Instrument
GHG	Greenhouse Gas	SAS	Social Assistance Scheme
GIZ	German International Cooperation Agency	SCD	Systematic Country Diagnostic
GRID	Green, Resilient and Inclusive Development	SDR	Special Drawing Rights
GRS	Grievance Redress Service	SME	Small and Medium Sized Enterprise
ICT	Information Communications Technology	SOE	State Owned Enterprise
IDA	International Development Association	USAID	US Agency for International Development

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**REPUBLIC OF KOSOVO**

**PUBLIC FINANCES AND SUSTAINABLE GROWTH DEVELOPMENT POLICY FINANCING**

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**SUMMARY OF PROPOSED FINANCING AND PROGRAM**

**BASIC INFORMATION**

Project ID	Programmatic
P170113	No

**Proposed Development Objective(s)**

The objective of the proposed Public Finances and Sustainable Growth DPF is to support the Republic of Kosovo’s efforts to improve fiscal transparency, to enhance private sector development, and to strengthen environmental sustainability in the wake of the COVID-19 crisis.

**Organizations**

Borrower: REPUBLIC OF KOSOVO

Implementing Agency: MINISTRY OF FINANCE, LABOR AND TRANSFERS

**PROJECT FINANCING DATA (US\$, Millions)**

**SUMMARY**

<b>Total Financing</b>	<b>56.40</b>
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**DETAILS**

International Development Association (IDA)	56.40
IDA Credit	56.40

**INSTITUTIONAL DATA**

**Climate Change and Disaster Screening**

This operation has been screened for short and long-term climate change and disaster risks

**Overall Risk Rating**

Moderate

**Results**

<b>Indicator Name</b>	<b>Baseline</b>	<b>Target</b>
1. Regular reports on the implementation of the State Debt Program, including all new borrowing and guarantee operations conducted by the Government during the previous fiscal period, are prepared and submitted to the Parliament	No (2021)	Yes (2023)
2. Number of long-term financial analyses for existing pension schemes and benefits completed and published online	0 (2021)	15 (2023)
3. Number of inspectorates affecting private sector operations	36 (2021)	20 (2023)
4. Percentage reduction in compliance costs for simplified licenses and permits in the agriculture and agribusiness sector	0 percent (2021)	25 percent (2023)
5a. Percentage of businesses using digital IDs as a share of total number of businesses	0 percent (2021)	15 percent (2023)
5b. Percentage of women-owned businesses using digital IDs as a share of total number of women-owned businesses	0 percent (2021)	20 percent (2023)
6. Establishment of a Producer Responsibility Organization that facilitates self-organization by industrial producers towards greater recycling	No (2021)	Yes (2023)
7. Number of auctions launched based on the new legal framework for market-based mechanisms to support renewable energy investments	0 (2021)	1 or more (2023)



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

### 1. INTRODUCTION AND COUNTRY CONTEXT

1. **The objective of the proposed Public Finances and Sustainable Growth Development Policy Financing (DPF) is to support the Republic of Kosovo’s efforts to improve fiscal transparency, to enhance private sector development, and to strengthen environmental sustainability in the wake of the COVID-19 crisis.** This stand-alone operation in the amount of EUR 50.6 million (US\$56.4 million equivalent) supports selective priorities of the Government Program 2021–2025 in an environment affected by Fragility, Conflict and Violence (FCV).<sup>1</sup> The operation is aligned with the World Bank Group (WBG) Country Partnership Framework (CPF) FY17–21 and supports actions that cut across all the three focus areas of the CPF, namely, enhancing conditions for accelerated private sector growth and employment, strengthening public service delivery and macro-fiscal management, and promoting reliable energy and stewardship of the environment. The DPF has been a reform anchor under consecutive governments since 2018, serving as a platform for the adoption of important structural measures by the current government, thanks to strong ownership. The reforms supported by the operation will also support the government in charting a recovery path from the COVID-19 recession.

2. **Kosovo needs faster and more resilient growth that creates jobs 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 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 demonstrated by low productivity growth averaging just 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. By 2019, 1 in 5 Kosovars continued to live on less than US\$5.5 per day in PPP terms and only 3 in 10 of the working-age population were employed. Furthermore, limited attention to the green transition puts the sustainability of long-term growth at risk.<sup>2</sup> The recent Country Economic Memorandum (CEM) shows that better leveraging the strong diaspora ties, harnessing the potential of a young workforce, enhancing the productivity of the private sector, and attracting higher and more productive foreign direct investment (FDI) can significantly accelerate convergence to higher living standards<sup>3</sup>. In this context, the new government has set out a reform agenda to ignite economic growth and ensure a sustainable and inclusive recovery from the COVID-19 pandemic, which plunged the country into its first-ever recession since independence.

3. **The COVID-19 crisis increased the urgency of structural reforms related to fiscal policy.** Before the pandemic, Kosovo maintained a good track record of sustainable headline fiscal policy anchored by fiscal rules. Nevertheless, the ratio of public and publicly guaranteed (PPG) debt to Gross Domestic Product (GDP), the lowest in the region, increased steadily over time even before the pandemic. In

<sup>1</sup> World Bank Group Strategy for Fragility, Conflict, and Violence 2020-2025, February 2020.

<sup>2</sup> Forthcoming Kosovo Systematic Country Diagnostic (SCD) Update, 2022.

<sup>3</sup> Kosovo Country Economic Memorandum, *Gearing up for a More Productive Future*, World Bank 2021.



addition, a proliferation of untargeted social protection benefits caused a deterioration in the composition of spending. The pandemic weighed heavily on the government's fiscal position in 2020, driven by plunging revenues and deployment of economic and social response measures. Hence, in 2020 alone, PPG debt increased by 4.8 percentage points, reaching 22.4 percent of GDP. Going forward, it will be important for the authorities to maintain and strengthen fiscal policy to ensure adequate space to address sizable developmental gaps and promote faster poverty reduction. Against this background, the DPF, through its first pillar, supports measures aimed at improving fiscal transparency with a view to enhancing fiscal sustainability in the medium term.

4. **The pandemic has increased the importance of providing an enabling environment for the private sector to fulfill Kosovo's aspirations for higher growth and faster poverty reduction.** The CEM documents that Kosovo's private sector shows limited dynamism in terms of net firm creation, employment creation, and productivity growth. Among the constraining factors are a burdensome and uncertain regulatory framework, with many licensing requirements and business inspections, inadequate energy supply, and an incomplete legal framework for e-commerce, including electronic identification (e-ID). The DPF, through its second pillar, supports a series of measures to improve the enabling environment for private sector development.

5. **Kosovo's pressing environmental and climate change challenges pose significant risks to the sustainability and inclusiveness of growth.** The main impacts of climate change in Kosovo, beyond the average temperature increase, are already tangible with more frequent and severe droughts and floods.<sup>4</sup> Energy production that is highly dependent on fossil fuels and inadequate waste management contribute to heavy air pollution and environmental degradation and negatively affect the health of the country's citizens, risking Kosovo's long-term growth prospects. Inadequate and uncertain reliability of energy supply challenge Kosovo's micro and small enterprise-dominated private sector. Although over 90 percent of municipal waste could be recycled, only 10 percent is currently recycled, with the rest ending up in landfills. A key priority of the new government is to lay the foundations of a green transition to incentivize and attract industry-led solutions that would create opportunities for new jobs and investment. In this context, the DPF, through its third pillar, supports environmental reforms in sustainable power generation and waste management sectors.

6. **The proposed operation is closely aligned with the IDA19 special themes on climate change and gender;<sup>5</sup> the WBG's COVID-19 Crisis Response;<sup>6</sup> and the Green, Resilient, and Inclusive Development (GRID) approach.<sup>7</sup>** In addition to exposure to climate change, the wide gender gap poses risks to the sustainability and inclusiveness of growth in Kosovo. Women in Kosovo are less likely to be employed or to become entrepreneurs, and women-led businesses have more limited access to finance and digital access.<sup>8</sup> Despite challenges, female entrepreneurs showed a higher level of digital readiness prior to the pandemic and saw faster adoption of digital technologies during the pandemic. Hence, the digitalization

<sup>4</sup> Climate Change Risk Profile Fact Sheet, United States Agency for International Development.

<sup>5</sup> World Bank, "IDA19: Ten Years to 2030: Growth, People, Resilience", World Bank Group, Washington DC, February 2020.

<sup>6</sup> World Bank, "Saving Lives, Scaling-up Impact and Getting Back on Track," COVID-19 Crisis Response Approach Paper, World Bank Group, Washington, DC, June 2020.

<sup>7</sup> From COVID-19 Crisis Response to Resilient Recovery – *Saving Lives and Livelihoods while Supporting Green, Resilient and Inclusive Development (GRID)*" World Bank, Washington, DC, March 2021.

<sup>8</sup> Kosovo Country Economic Memorandum, *Gearing up for a More Productive Future (CEM)*, World Bank 2021.



of businesses through e-IDs is expected to help close the gender gap in entrepreneurship by enabling women to more easily access digital services and economic opportunities through remote transactions.

7. **The overall risk to the proposed operation is assessed as Moderate.** Institutional capacity implementation and sustainability risks are assessed as Substantial, given Kosovo's young institutions and limited inter-ministerial coordination, particularly for reforms supported under the second and the third pillars of the DPF. All other risk categories are assessed as Moderate or Low. Risks are mitigated by close coordination with the government, parliamentary commissions, and development partners. The WBG and other development partners are expected to continue providing technical assistance across the DPF program to support timely implementation of reforms.

8. **The operation complements technical and financial support provided by other development partners in support of the government's wider structural reform agenda.** The proposed operation supports important but politically sensitive reforms in a fragile context. In line with the WBG's FCV strategy, the operation leverages strong collaboration and implementation support from international partners, including the European Union (EU), International Monetary Fund (IMF), German International Co-operation Agency (GIZ), United States Agency for International Development (USAID), and European Bank for Reconstruction and Development (EBRD), 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, particularly in digitalization, reduction in the administrative burden for businesses, improved waste management, and energy market reforms. This operation also complements the efforts of other development partners and is aligned with the EU's new Guidelines for the Implementation of the Green Agenda for the Western Balkans.<sup>13</sup> In addition, the OPEC Fund for International Development (OFID) has indicated its willingness to provide parallel financing of US\$40 million in support of the same program, amplifying the impact of the proposed operation.

## 2. MACROECONOMIC POLICY FRAMEWORK

### 2.1. RECENT ECONOMIC DEVELOPMENTS

9. **In 2020 Kosovo's economy experienced its first recession since independence, but a rapid recovery is now underway.** Real economic activity contracted by 5.3 percent in 2020, driven by plunging diaspora-related tourism exports and investment. Government support measures, rising remittances, and increasing goods exports helped avoid a deeper contraction in 2020. As a result of the decline in economic activity, poverty is estimated to have increased by 2.5–5.2 percentage points, mainly because of steep output losses in services (diaspora travel) and industry, despite the fiscal stimulus and a net increase in remittances. Growth returned to positive territory during the last quarter of 2020 and continued to accelerate in 2021. Growth is estimated to have reached 9 percent by the end of 2021, driven by the return of the diaspora, higher remittances and exports, the government's support measures, and recovering consumer and investor sentiment.<sup>9</sup> As real per capita income surpassed its 2019 levels in 2021, poverty is projected to fall back to its 2019 level.

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<sup>9</sup> Growth returned to positive territory during the last quarter of 2020, with GDP rising by 4.2 percent. Year-on-year growth was 4.1 percent in the first quarter of 2021, 16.8 percent in the second, and 14.5 percent in the third quarter, according to official statistics.



10. **The acceleration in vaccinations against COVID-19 is supporting the recovery.** In May 2021, less than 3 percent of Kosovo's population had received at least one dose of the vaccine, the lowest rate in the region. By February 2022, 48 percent of the population had received at least one dose, above the average for the Western Balkans. The number of cases declined in the last few months of 2021, before accelerating again in early 2022 as the omicron wave of infections reached Kosovo. The acceleration in cases and the further appearance of new variants may weigh on the pace of the recovery.

**Table 1: Key Macroeconomic Indicators**

Indicator	2019	2020	2021e	2022f	2023f	2024f	2025f
Real GDP growth (percent)	4.8	-5.3	9.0	4.0	4.3	4.1	4.0
Composition (percentage points):							
Consumption	6.2	2.2	7.0	2.0	2.4	2.3	2.2
Investment	-1.1	-2.4	3.0	3.2	2.3	2.2	2.2
Net exports	-0.3	-5.1	-1.0	-1.3	-0.5	-0.4	-0.3
Exports	2.2	-8.4	17.1	1.7	2.0	2.2	2.2
Imports (-)	2.5	-3.3	18.1	3.0	2.4	2.6	2.6
Consumer price inflation (percent, period average)	2.7	0.2	3.5	3.9	1.4	1.8	2.0
Public revenues (percent of GDP)	26.8	25.4	28.7	28.6	28.6	28.6	28.9
Public expenditures (percent of GDP)	29.7	33.0	30.0	31.6	31.4	31.4	31.4
Of which:							
Wage bill (percent of GDP)	8.7	9.8	8.8	8.6	8.4	8.4	8.4
Social benefits (percent of GDP)	6.3	7.7	7.4	7.3	7.1	7.0	6.8
Capital expenditures (percent of GDP)	7.5	5.6	5.4	6.6	7.1	7.5	7.6
Fiscal balance (percent of GDP)	-2.9	-7.6	-1.3	-3.0	-2.9	-2.8	-2.5
Primary fiscal balance (percent of GDP)	-2.6	-7.2	-0.9	-2.5	-2.3	-2.2	-1.9
Public debt (percent of GDP)	17.0	22.0	22.0	24.2	25.6	27.1	28.5
Public and publicly guaranteed debt (percent of GDP)	17.6	22.4	22.4	24.5	25.8	27.2	28.6
Of which: External (percent of GDP)	5.8	7.8	7.4	9.2	9.9	10.6	11.2
Goods exports (percent of GDP)	5.6	6.9	10.0	9.9	10.0	10.0	10.0
Goods imports (percent of GDP)	45.8	44.2	57.0	56.1	56.5	57.0	57.0
Net services exports (percent of GDP)	13.1	5.7	14.3	13.6	14.5	16.2	17.3
Trade balance (percent of GDP)	-27.1	-31.6	-32.7	-32.5	-31.9	-30.8	-29.7
Net remittance inflows (percent of GDP)	11.6	13.8	15.1	13.2	13.1	13.2	13.2
Current account balance (percent of GDP)	-5.6	-7.0	-8.6	-9.7	-9.4	-8.2	-7.1
Net foreign direct investment inflows (percent of GDP)	2.7	4.1	3.7	3.9	4.2	4.0	4.0
External debt (percent of GDP)	31.2	37.2	37.1	37.4	36.7	39.0	38.6
Real private credit growth (percent, period average)	7.9	7.6	13.4	11.0	8.5	7.5	7.0
Unemployment rate (percent, period average)	25.7	25.9	n.a.	n.a.	n.a.	n.a.	n.a.
Labor force participation rate (percent, period average)	40.5	38.3	n.a.	n.a.	n.a.	n.a.	n.a.
GDP per capita (US\$)	4,432	4,295	4,698	5,028	5,330	5,684	6,050
Poverty rate (percent of population)	20.9	23.4	19.9	18.0	16.4	15.3	n.a.

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 = estimated; f = forecast; n.a. = not available.

11. **Kosovo's good track record on headline fiscal policy before the pandemic allowed the government to use countercyclical fiscal policy to mitigate the economic and social consequences of the pandemic in 2020 and 2021.** The pandemic placed significant pressure on the fiscal position in 2020, as public revenues fell by almost 9 percent year-on-year against an increase in current expenditures by a



record 18.6 percent. As a result, the budget deficit reached 7.6 percent of GDP in 2020, up from 2.9 percent in 2019, despite a 20 percent drop in public investment. In 2020, Kosovo financed its deficit by issuing new domestic debt (2.5 percent of GDP), mobilizing external concessional debt (3.3 percent of GDP), and drawing down on privatization receipts (1.1 percent of GDP) and government deposits. In 2021, the fiscal balance improved significantly, thanks to buoyant revenues and sluggish public investment. By the end of 2021, tax revenues had increased by 29 percent year-on-year, driven by a rebound in economic activity and imports, higher inflation, and formalization. The government implemented sizable economic stimulus packages in both 2020 (4.4 percent of GDP) and 2021 (3.2 percent of GDP). These included measures for employment support, including measures targeting women; increased access to finance and liquidity for businesses and households; direct support to firms and farms; additional cash benefits for old-age pensioners and social assistance recipients; new universal child allowances; and maternity benefits for both employed and unemployed women. Capital spending remained subdued in both 2020 and 2021, averaging 5.5 percent of GDP. PPG debt is estimated to have reached 22.4 percent of GDP at the end of 2021, remaining broadly the same compared to the previous year. A lower-than-expected budget deficit enabled the government to decelerate planned domestic borrowing and build up cash buffers in 2021. Government deposits at the central bank reached 3.9 percent of GDP at the end of 2021, up from 3.3 percent in 2020.

12. **Against a halt in diaspora visits, the current account deficit (CAD) increased marginally in 2020 and further widened in 2021 as higher imports outran a considerable recovery in exports.** The CAD deteriorated only marginally in 2020, reaching 7 percent of GDP in 2020; plunging services exports due to limited diaspora visits were almost compensated by a rise in secondary income and an increase in goods exports. By the end of September 2021, due to the recovery in diaspora-related tourism exports, services exports increased by 12.6 percent on a cumulative basis, compared with the same period in 2019. In 2021, the positive trend observed in 2020 continued, with goods exports increasing by 60.5 percent at end-October year-on-year. Goods imports increased by almost 44 percent at the end of September, driven by higher import prices, higher economic activity, and pent-up demand. Hence, by the end of 2021, the CAD is expected to increase to 8.6 percent of GDP, as imports grow from a higher base, despite the sizable growth in exports. Remittances continued to finance the structural trade deficit in 2020 and 2021. In 2020, the CAD was financed mostly by a combination of net foreign direct investment inflows (4.2 percent of GDP) and external public borrowing, which included Macro-Financial Assistance by the EU, Rapid Financing Instrument (RFI) by the IMF, World Bank investment project financing, and support from the Council of European Development Bank, among others (3.2 percent of GDP). In 2021, as a result of the strong recovery in tax revenues, external borrowing by the public sector slowed to 1.5 percent of GDP. Net FDI inflows were set to reach 3.7 percent of GDP at the end of 2021.

13. **Inflationary pressures heightened in 2021, in line with global trends.** Consumer price inflation reached almost 7 percent by end-November on a year-on-year basis and is expected to average 3.5 percent for the year. The increase in food and fuel prices is the main driver behind inflationary pressures, raising concerns about their impact on poverty. Producer prices rose by an average of 6.9 percent in the third quarter of 2021, driven by an increase in energy and base metal prices. The increase in import prices contributed to both the increase in producer prices and consumer price inflation of 14.7 percent in the third quarter of 2021. The largest increases were in intermediate inputs to production, which may affect Kosovo's export competitiveness, given the country's high import dependence.



14. **The financial sector withstood the pandemic well and strong credit growth supported the recovery.** Before the pandemic, Kosovo's financial sector was well capitalized, liquid, and stable. At the end of February 2020, non-performing loans accounted for only 2.5 percent of total loans, and the capital adequacy ratio was 16.8 percent, well above the regulatory requirement of 12 percent.<sup>10</sup> The Central Bank of Kosovo (CBK) reacted to the pandemic-induced recession by issuing a decision to postpone loan payments in March 2020 which resulted in a three-month loan payment moratorium that reached more than 50 percent of total bank loans. As this window closed, the CBK in June 2021 allowed applications for up to one-year loan extensions and restructuring on a case-by-case basis. Most of the restructured loans matured in October 2021; the remaining restructured loans are expected to mature by February 2022. By the end of October 2021, non-performing loans stood at 2.4 percent of total loans. During the same period, deposit growth and credit growth remained strong, at 13.6 and 13.4 percent, respectively, supporting economic growth.

**Table 2: Key Fiscal Indicators (percent of GDP)**

Indicator	2020	2021e	2022f	2023f	2024f	2025f
<b>Total Revenue</b>	<b>25.4</b>	<b>28.7</b>	<b>28.6</b>	<b>28.6</b>	<b>28.6</b>	<b>28.9</b>
1. Tax Revenue	22.3	25.6	25.8	25.7	25.8	26.2
a. Direct Taxes	3.9	4.4	4.5	4.5	4.6	4.9
Corporate Income Taxes	1.3	1.5	1.6	1.7	1.8	1.8
Personal Income Taxes	2.3	2.4	2.4	2.3	2.3	2.3
Property Taxes	0.3	0.5	0.5	0.6	0.6	0.8
Other Direct Taxes	0.0	0.1	0.1	0.1	0.1	0.1
Direct Tax Refunds	0.0	0.0	-0.1	-0.1	-0.1	-0.1
b. Indirect Taxes	18.4	21.2	21.3	21.2	21.1	21.3
VAT	11.4	13.7	13.9	13.9	14.0	14.1
Customs Revenues	1.5	1.7	1.7	1.7	1.7	1.7
Excise Revenues	5.9	6.5	6.4	6.3	6.1	6.0
Other Indirect Taxes	0.0	0.0	0.0	0.0	0.0	0.0
Indirect Tax Refunds	-0.4	0.0	0.0	0.0	0.0	0.0
2. Non-Tax Revenue	2.7	3.1	2.7	2.8	2.8	2.7
3. Grants	0.5	0.0	0.1	0.1	0.1	0.1
<b>Total Government Expenditure</b>	<b>33.0</b>	<b>30.0</b>	<b>31.6</b>	<b>31.4</b>	<b>31.4</b>	<b>31.4</b>
1. Current Expenditure (=a + b+ c)	26.9	24.1	24.5	23.8	23.4	23.2
a. Expenditure on Goods and Services	4.4	4.3	4.7	4.7	4.6	4.6
b. Compensation of Employees	9.8	8.8	8.6	8.4	8.4	8.4
c. Current Transfers	12.8	11.0	11.2	10.6	10.4	10.2
Social Assistance	0.7	0.8	0.7	0.7	0.7	0.7
Pensions	7.0	6.7	6.6	6.5	6.3	6.1
Other Current Transfers	5.1	3.6	3.9	3.5	3.5	3.5
2. Interest Payments	0.4	0.5	0.5	0.5	0.6	0.6
3. Capital expenditure	5.6	5.4	6.6	7.1	7.5	7.6
<b>General Government Balance</b>	<b>-7.6</b>	<b>-1.3</b>	<b>-3.0</b>	<b>-2.9</b>	<b>-2.8</b>	<b>-2.5</b>
<b>Fiscal rule definition budget balance</b>	<b>-5.9</b>	<b>-0.8</b>	<b>-1.7</b>	<b>-1.5</b>	<b>-1.1</b>	<b>-0.7</b>
Memo:						
<b>Total Public and Publicly Guaranteed Debt</b>	<b>22.4</b>	<b>22.4</b>	<b>24.5</b>	<b>25.8</b>	<b>27.2</b>	<b>28.6</b>
<b>External Debt</b>	7.8	7.4	9.2	9.9	10.6	11.2
<b>Domestic Debt</b>	14.2	14.6	15.0	15.7	16.5	17.3
<b>State Guarantees</b>	0.5	0.4	0.3	0.2	0.2	0.2
Government deposits	3.3	3.9	3.6	3.1	3.1	3.5
IMF SDR Allocation	-	-	1.1	1.1	1.0	0.9

Source: World Bank staff calculations, based on data from the Ministry of Finance, the Central Bank of Kosovo, and the Kosovo Agency of Statistics.

<sup>10</sup> Monthly Information Report of the Financial System, February 2020 and October 2021, Central Bank of Kosovo.



## 2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

15. **The baseline macroeconomic outlook is positive, with average annual projected growth of 4.1 percent between 2022 and 2025.** Growth is expected to be driven mainly by higher consumption and investment, supported by further credit growth and financial deepening; an acceleration in public investment financed by international financial institutions; and private investment. Improvements in the business environment, further capitalization of the Kosovo Credit Guarantee Fund, and increases in guarantee coverage are expected to accelerate private investment. Despite a pick-up in diaspora-related service exports and strong goods export growth, the contribution of net exports will subtract from growth over the medium term, as import growth will remain high because of higher domestic absorption.

16. **The CAD is expected to peak in 2022, but then gradually decrease as Kosovo's export competitiveness improves and import growth slows.** The pandemic diverted resources from public investment in 2020 and 2021, due to the much-needed social response. In 2022, as private investment demand is restored, the public investment financed by concessional external borrowing accelerates, and energy prices remain elevated, import demand will also increase. Despite the projected strong growth in merchandise and service exports in the medium term, as imports grow from a higher base, the CAD will remain elevated until 2024. As energy price increases slow and the export competitiveness of Kosovar businesses increase, driven by investment climate reforms, the CAD is projected to narrow to 7.1 percent of GDP in 2025. Remittances are expected to remain strong, averaging 13.8 percent of GDP between 2022 and 2025. They will continue to finance Kosovo's structural trade deficit, assuming growth in the EU area remains solid. However, lower than expected growth in remittances would be partially offset by an adjustment in imports. The CAD is expected to be sustainably financed through external borrowing from multilateral institutions, net FDI inflows, and intercompany flows recorded under other financial investments.

17. **Inflationary pressures will remain high in 2022.** Kosovo is a unilaterally euroized economy, which helped keep inflation low prior to the pandemic. However, as import prices and demand pressures remain elevated, consumer price inflation is projected to remain high throughout 2022, averaging about 3.9 percent in 2022. As demand pressures subside globally, inflation in Kosovo is expected to moderate to an average of 1.7 percent in the medium term. The financial sector is expected to remain strong, profitable, and well-capitalized. Further capitalization of the Kosovo Credit Guarantee Fund and increases in guarantee coverage are expected to increase credit to the private sector and support growth.

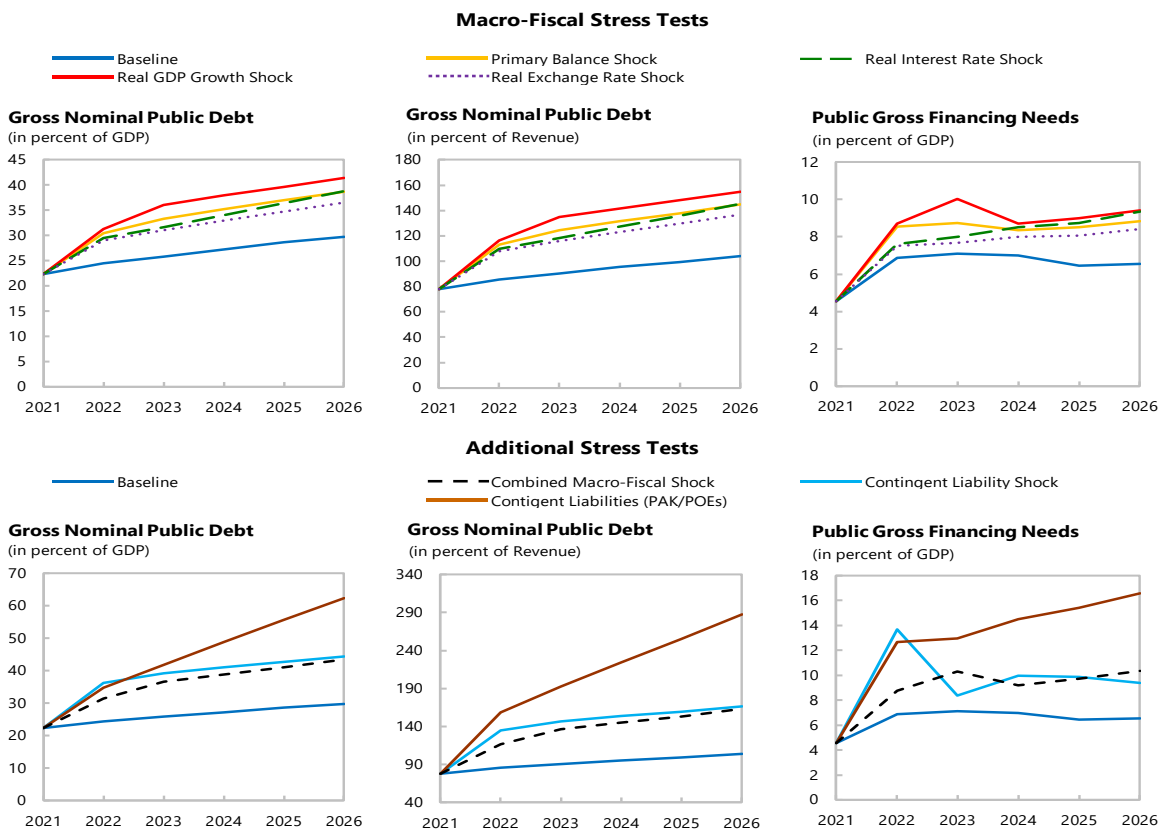
18. **The authorities are committed to reimposing the fiscal deficit ceiling in 2023.** WBG projections assume an acceleration of public investment but lower than the budgeted amount financed by international financial institutions, maintenance of the government deposits at the central bank above 3 percent of GDP for the period of 2022–25, and adherence to the fiscal rules on the deficit ceiling and nominal wage growth. Revenues are projected to remain stable during 2022-25 at 28.7 percent of GDP. The overall fiscal deficit will average 2.8 percent of GDP during 2022-25, and the fiscal deficit per the fiscal rule definition will be at 1.2 percent of GDP. The difference between the overall deficit and the overall fiscal deficit per the fiscal rule reflects capital spending financed through international financial



institutions and privatization proceedings.<sup>11</sup>

19. **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. Financing needs reached almost 12 percent in 2020, as the deficit reached 7.6 percent of GDP in 2020, moderating to 4.5 percent of GDP at the end of 2021. Assuming an increase in the absorption of new capital investments financed by international financial institutions, financing needs are expected to average 6.9 percent of GDP between 2022 and 2025. 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 1.9 percent of GDP per year, significantly reducing the pressure in the domestic market. The above macroeconomic framework does not incorporate budget financing through the IMF Special Drawing Rights (SDR) allocation announced in August 2021. That allocation will provide an additional buffer starting in 2022. The macro framework assumes that the SDR allocation is kept as a cash reserve at the central bank. It is therefore not included in public debt or the debt sustainability analysis.

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



Source: World Bank staff calculations

<sup>11</sup> The fiscal deficit according to the fiscal rule definition also excludes capital spending financed by privatization proceeds however, the MTEF does not include financing from this source.



20. **Stress tests show that public debt is sensitive to shocks.** Standardized GDP growth shocks result in the public debt ratio reaching 41 percent of GDP by 2026, and financing needs that peak at 10 percent of GDP in 2023. Under a combined macro-fiscal shock scenario (real GDP growth, primary balance, real exchange rate, and real interest rate) the public debt ratio reaches 44 percent of GDP in 2026, whereas the financing needs peak at 13.7 percent in 2022, higher than that at in 2020. A stress test scenario where the budget absorbs a combined contingent liability shock—a financial sector shock, a state-owned enterprises (SOEs) shock (modeled at 5 percent of GDP) and a shock where the government of Kosovo has to return the privatization proceeds to the Privatization Agency of Kosovo (1.5 percent of GDP)—would have a large impact on the debt profile. Nevertheless, the public debt level does not breach the high-risk threshold of 65 percent of GDP in any of the stress test scenarios. Although gross financing needs exceed 12 percent of GDP in the combined contingent liability shock scenario, they remain below the higher scrutiny threshold of 15 percent of GDP. While unlikely, if the debt-to-GDP ratio hits the debt ceiling, the fiscal rules in Kosovo would require the adoption of a fiscal consolidation path to bring the ratio below the debt ceiling.

21. **The maturity and the risk indicators have shown improvements in 2021.** The share of domestic debt to be refinanced within the year has decreased to 14.6 percent in 2021, almost 10 percentage points (pp) lower than in 2020 and 15 pp lower than in 2019. The issuance of 10-year bonds, including through a private placement with the Kosovo Pensions Savings Trust in 2020, has largely contributed to this. The average time to maturity of domestic debt has also increased, exceeding 3 years by the third quarter of 2021, up from less than two years in 2017. Through 2024, this indicator is expected to remain roughly the same as a result of planning to maintain the current domestic debt structure. Indicators of interest and exchange rate risk have undergone positive changes, with less than 10 percent of the debt portfolio tied to variable interest rates or denominated in foreign currency.

**Table 3: External Financing Requirements and Sources 2019-2025, EUR million**

	2018	2019	2020	2021e	2022f	2023f	2024f	2025f
<b>Gross External Financing Requirements</b>	<b>433</b>	<b>301</b>	<b>713</b>	<b>596</b>	<b>712</b>	<b>726</b>	<b>688</b>	<b>636</b>
Current Account Deficit	509	399	472	649	790	815	760	697
Trade Balance	1882	1914	2182	2483	2651	2761	2844	2922
Merchandise	2738	2840	2573	3572	3758	4017	4341	4626
Services	-856	-926	-392	-1088	-1107	-1256	-1497	-1704
Primary and Secondary Income Balance	-1373	-1516	-1701	-1834	-1861	-1947	-2085	-2225
o/w Remittances	761	822	948	1150	1078	1136	1219	1300
Debt Amortization (public)	22	51	89	80	63	61	70	80
Change in gross reserves (increase=+)	87	95	46	116	46	49	53	56
Adjustment for E&O	-184	-245	106	-249	-187	-199	-194	-197
<b>Gross External Financing Sources</b>	<b>433</b>	<b>301</b>	<b>713</b>	<b>596</b>	<b>712</b>	<b>726</b>	<b>688</b>	<b>636</b>
FDI (net)	226	188	287	411	367	391	417	444
Portfolio Investments (net)	200	-59	82	-175	-82	-87	-93	-99
Capital grants	-11	-9	18	57	17	17	18	19
Net other financial investment	19	180	328	304	410	405	346	271
of which: debt disbursements (public)	12	39	215	117	247	174	190	206

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

22. **External debt is sustainable in the medium term.** External debt increased by 6 percentage points of GDP in 2020, 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 and other private debt), but due to a decline in GDP. Even



though the CAD is projected remain elevated in the next three years, to a large extent it will continue to be financed by net FDI inflows and concessional financing for the public sector. The external debt-to-GDP ratio is thus expected to remain broadly unchanged in the projection period, at below 39 percent of GDP. External debt remains sustainable under a combination of standardized shock scenarios.

23. **Risks to the outlook are tilted to the downside.** The growth outlook is contingent on the global course of the pandemic and its successful management at the local level. Lower than projected growth in the European Union, potential restrictions on international travel in diaspora-hosting countries, the potential need for reimposition of containment measures, and continued rise in import prices beyond 2022, particularly on energy prices, would slow growth and worsen Kosovo's fiscal position. The rise in energy prices has already affected the economy, leading to a halt in production of at the Ferronickel plant—the main exporter of base metals in Kosovo. Lower than projected export values for base metals and minerals might increase the CAD.

24. **The macroeconomic policy framework is sustainable and adequate for development policy lending, despite the risks posed by the ongoing pandemic.** Kosovo had a good track record of maintaining sustainable headline fiscal policy anchored by a rules-based fiscal framework before the pandemic. The Law on Budget, which contains a Medium-Term Expenditure Framework (MTEF) for the period 2022-2024, confirms government's commitment to reimposing fiscal rules by 2023. The debt-to-GDP ratio is expected to increase over the medium term driven by primary deficits to address development gaps through development finance. The PPG debt-to-GDP ratio will stay within the limits of the debt ceiling of 40 percent and below the risk thresholds. The DPF program will support fiscal sustainability through improved debt management and prudent development finance through its first pillar. In addition, reforms to the business environment are expected to support growth in the medium term, while environmental reforms will help increase resilience to climate shocks. The proposed operation of US\$56.4 million and the parallel financing by the OFID of US\$40 million are expected to support the government's efforts to enhance fiscal sustainability by contributing to filling the financing gap in 2022, diversifying the sources of financing, and extending the maturity profile of the debt portfolio. The financing need in 2022 is estimated at 7.5 percent of GDP against a 3 percent of GDP fiscal deficit and amortization and on-lending needs amounting to 4.5 percent of GDP. External debt is expected to provide financing amounting to 3.1 percent of GDP, with the DPF and OFID financing representing about one third of external financing. Domestic debt issuance and privatization proceeds will finance the remainder of the financing need.

### 2.3. IMF RELATIONS

25. **The World Bank collaborates closely with the IMF on macroeconomic and fiscal policy in Kosovo.** On January 12, 2022, the IMF concluded its Article IV consultation with Kosovo, noting a strong economic recovery in 2021 on the back of renewed domestic mobility and diaspora support. On April 16, 2020 the IMF Executive Board approved US\$56.6 million in emergency support to Kosovo through its Rapid Financing Instrument. Kosovo entered Stand-by Agreement programs in 2010, 2013, and 2015 and a Staff Monitoring Program in 2011. Currently, there is no concrete discussion of an IMF program. However, the government may tap into the allocation of SDR80 million in 2022, that became effective on August 23, 2021. The Bank and the Fund regularly exchange views on issues of macroeconomics, fiscal management, and pension policies in Kosovo.



### 3. GOVERNMENT PROGRAM

26. **Kosovo's current policy focus is on managing the health, economic and social consequences of the pandemic-induced recession and economic and social transformation of the country, with the goal of ensuring social inclusion of all citizens.** The government is preparing a new National Development Strategy for 2022-30. In the interim period, the Program of the Government 2021-25, the ERP 2022-2024, and the Economic Revival Program 2021 are the key documents guiding the policy agenda in Kosovo. The ERP, which is prepared annually as part of the EU accession process, provides a strategic anchor for policies and their alignment with that of the EU *acquis*.

27. **The government program is organized around 18 key strategic areas.** The MTEF will be the main tool for prioritization going forward to ensure a successful recovery from the pandemic while maintaining fiscal sustainability driven by a rules-based fiscal framework. 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 the sustainability of public finances; (iv) redesigning fiscal policies and formalizing the economy; (v) supporting industry, entrepreneurship, and trade by improving the business environment; (vi) developing information and communications technology (ICT) infrastructure and capacities; and (vii) strengthening environmental policies and spatial planning. In line with the government's program, the ERP 2022–2024 recognizes the need to improve the sustainability of Kosovo's growth model, which depends on diaspora-driven flows and investments that brought limited productivity growth.<sup>12</sup> It identifies key reform measures to address the longstanding structural bottlenecks in Kosovo that have the potential to unlock higher and sustainable growth and employment generation.

### 4. PROPOSED OPERATION

#### 4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

28. **The proposed operation supports the government's efforts to tackle longstanding structural bottlenecks that impede higher and more inclusive growth in Kosovo, as well as helps to chart a sustainable and inclusive recovery path from the pandemic.** The operation is organized around three interrelated pillars with a total of seven prior actions (PAs). Through its first pillar, the operation aims to improve fiscal transparency, with a view to strengthening fiscal sustainability in the medium term. It supports reforms that (i) strengthen debt management by improving the transparency of debt management operations and oversight of the Executive, and (ii) improve the evidence base for fiscal policy initiatives through improved costing of social protection initiatives. Through its second pillar, the operation supports reforms to enable private sector development by (i) improving the legal framework for business inspections, (ii) simplifying licensing and permit requirements in the agriculture and agribusiness sectors and (iii) setting up a regulatory framework for e-IDs to facilitate digitalization. Through its third pillar, the operation supports reforms that will strengthen environmental sustainability by (i) improving waste management with a view to moving toward a circular economy and (ii) establishing a legal framework for the transition to market-based support mechanisms in the renewable power

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<sup>12</sup> Diaspora related flows, diaspora-related tourism exports, remittance inflows, and diaspora driven residential FDI accounted for 30 percent of GDP in 2019.



generation sector to improve the energy mix. Importantly, reforms in the third pillar will contribute to climate mitigation efforts by reducing greenhouse gas emissions over the medium term.

29. **The reform program benefits from strong government ownership, the WBG’s extensive engagement and strong collaboration with development partners.** Each of the prior actions selected for inclusion in the program reflects a key policy priority of the government in advancing Kosovo’s structural reform agenda. Similarly, there is a strong consensus among Kosovo’s development partners around the criticality of the three pillars of the operation and each prior action is closely supported by a complementary mixture of technical assistance, advisory services and investment operations.

## 4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

### Pillar A- Improving Fiscal Transparency

30. **The first pillar of the operation supports the government in improving fiscal transparency with a view to enhancing the sustainability of public finances and increasing the impact of development finance in the medium term.** The first pillar includes two PAs related to debt management and the costing of social protection policies. Transparency, increased oversight and improved evidence base for fiscal policies would support fiscal sustainability through better management of fiscal risks and enhanced contestability in the medium term.

***Prior action #1:** To enhance the transparency and oversight of Government debt management operations, the Recipient has adopted and submitted to the Parliament the Law on State Debt and State Guarantees that: (i) codifies annual and quarterly debt reporting requirements, and (ii) requires annual reporting of the Government to the Parliament on the implementation of the State Debt Program, as evidenced by Government Decision No. 04/46 dated November 30, 2021.*

31. **Rationale:** As Kosovo’s debt portfolio expands, the government needs to improve the legislative basis to enhance transparency of fiscal and debt policy implementation practices and establish sound debt management (DeM) standards. The PPG debt-to-GDP ratio reached 22.4 percent of GDP at end 2021, up from 8.5 percent in 2012. Though Kosovo’s public debt ratio is the lowest in the region, it was increasing steadily before the pandemic driven by primary deficits.<sup>13</sup> The COVID-19 crisis alone added 4.8 percentage points of GDP to public debt in 2020, as a result of the economic contraction, plunging revenues and a much-needed fiscal stimulus. The fact that Kosovo does not have access to international capital markets limits financing sources to domestic borrowing and concessional financing through international financial institutions. The absence of monetary policy, limited financing sources, and low public revenues in comparison with other countries in the region render improved debt management even more central to fiscal policy making and sustainability. However, the primary legislation is not well harmonized.<sup>14</sup> The Law on Public Financial Management (LPFMA) and the Law on Public Debt provide authority to the Minister of Finance to borrow, but certain legal formulations are inconsistent or contradictory. The former law states that borrowing may be conducted within the provisions of the budget whereas the Law on Public Debt states that borrowing may be conducted for certain defined purposes. In addition, the Law on Public Debt does not require reporting to the Executive on the implementation of the debt management strategy and

<sup>13</sup> Kosovo has very limited bilateral debt. The medium-term debt strategy prioritizes concessional finance from international financial institutions over bilateral debt.

<sup>14</sup> Kosovo Debt Management Reform Plan, December 2018 forthcoming. The debt reform plan report also notes that there is a need for further harmonization with the secondary legislation.



annual or quarterly reporting on debt operations and statistics.

32. **Substance of the prior action:** To improve debt transparency and oversight, the DPF supports measures under the new Law on State Debt and State Guarantees to specify the purposes of borrowing, require annual and quarterly statistical debt reporting and add a binding annual reporting requirement to the Parliament on the implementation of the debt management strategy. The Law also includes a requirement to conduct a risk assessment before issuing loan guarantees or conducting on-lending. A risk premium based on the risk assessment would be levied upon the beneficiary of the loan guarantee or the on-lending. The draft Law further clarifies the ratification requirement of government guarantees and is expected to increase the impact of development finance by reducing delays. The new Law better aligns Kosovo's legal framework with international practices for government debt management and strengthens the coordination of the legislative and executive roles in the formulation and implementation of debt management operations.

33. **Expected results:** Based on the new legislation and the debt management strategy prepared annually, the Ministry of Finance, Labor and Transfer (MFLT) will regularly report on the implementation of the State Debt Program to the Parliament, as measured by the results indicator. The report, which will be published by MFLT, will include detail of all new borrowing and guarantee operations conducted by the government during the previous fiscal period. The reporting will increase the oversight of the Executive, improve fiscal policy implementation and enhance fiscal transparency by providing a quantitative assessment of targets as opposed to outcomes as outlined in the medium-term debt strategy. Strengthening debt management practices through the revised framework will ultimately contribute to fiscal sustainability and safeguard prudent use of development finance over the medium term. The WBG will continue to provide technical assistance to support the implementation of the Law through the Debt Management Facility (DMF) program.

**Prior action #2:** *To improve the evidence base for fiscal policy making and transparency, the Recipient has adopted requirements for conducting and publishing long-term costing of new pension policy proposals and other social protection policy proposals, as well as regular updating (at least every five years) for existing pension policies, as evidenced through the Administrative Instruction 09/2021 dated December 13, 2021.*

34. **Rationale:** Sustainability is a concern for the Kosovo pensions system. The fiscal cost of budget-financed pensions, including the war-related benefits, more than doubled between 2008 and 2019, from about 2.7 to 5.7 percent of GDP,<sup>15</sup> as a result of the increased generosity of existing pensions and the introduction of new pension benefits that are fully funded by the government. The cost of ex-contributory pensions has increased steadily, following a 2016 provision to increase benefits based on education level. In 2020, the financial burden of pensions was compounded with the pandemic-induced drop in GDP. The repeated introduction of new categorical benefits threatens the predictability and security of the pension system. In recent years, new social protection initiatives have been introduced without proper long-term fiscal impact, eligibility and actual welfare needs assessment. The current legislative framework requires a budget impact analysis for only three years, which falls short of costing the long-term liabilities that pensions benefits generate. Historically, even short-term costs have been miscalculated. In some cases, the problem stems from the poor design of the initiative itself, such as the case of veteran benefits, where

<sup>15</sup> The fiscal cost of pensions programs reached 6.1 percent in 2021 as benefits were supplemented for pensions below 100 euros as part of the Economic Revival Program.



the beneficiary rolls were not clearly determined, and the number of beneficiaries far exceeded the number estimated in the law. Recently, there have been initiatives to introduce special rules for early retirement and for benefit levels of the police force. Similarly, there have been initiatives to expand the ex-contributory pension benefits to individuals with less than 15 years of service. These plans are not consistent with sound principles of pension system design and are not compatible with other segments of the pension system.

35. **Substance of the prior action:** To produce reliable and long-term cost projections of social protection programs, the proposed prior action (i) extends the required financial analysis of proposed social schemes or benefits from three to at least ten years, and of proposed pension schemes or benefits from three to at least fifty years following a methodology in accordance with international best practices; (ii) requires regular updating (at least every five years) of the long-term financial analysis of pension programs; and (iii) requires these cost projections to be made publicly available. This action is also part of the FY22 Performance and Policy Actions supported under the IDA Sustainable Development Finance Policy. Through this amendment<sup>16</sup>, Kosovo has taken an important step in ensuring intergenerational fiscal responsibility and is ahead of the region in incorporating such considerations into its legal framework.

36. **Expected results:** The result indicator is that the long-term financial analyses for 15 existing pension schemes and benefits are completed and published by MFLT.<sup>17</sup> In the medium term, the PA is expected to contribute to better social protection policies, with rationalization and reallocation of spending from categorical to poverty-targeted benefits by providing proper costing in accordance with best practices and for a much longer time horizon. Publishing the long-term analyses will also improve fiscal transparency and ultimately accountability to citizens. The WBG will continue to provide technical assistance to build capacity, including in modeling, for long term costing of pension policies.

### Pillar B- Enhancing Private Sector Development

37. **PAs under the second pillar support private sector development by reducing the administrative burden through reform of business inspections, simplification of licenses and permits in the agriculture and agribusiness sector and enabling the digitalization of businesses.** The first two actions in this pillar will foster an improved enabling environment for businesses by reducing regulatory uncertainty, overlaps and compliance costs. These actions will also reduce the room for rent seeking and discretionary practices and contribute to business formalization. Introducing a legal framework that will govern electronic identification will also contribute to an improved investment climate by facilitating remote transactions, e-payments, and, in particular e-commerce. Importantly, this action will help narrow the gender gap as it will help reduce some of the barriers that female entrepreneurs face in accessing services and economic opportunities from home, given the disproportionate burden of unpaid family responsibilities that women in Kosovo face.

**Prior action #3:** *To improve the efficiency and coordination of business inspections, the Recipient has enacted the Law on Inspections to (i) reduce the number of inspectorates and legal overlaps, (ii) establish*

<sup>16</sup> The legal system in Kosovo is based on a hierarchy of laws, with the constitution being the strongest, followed by ordinary laws, administrative instructions, ministerial decisions, and other, less stringent acts. An administrative instruction is a substantive act approved by the government. As such, it undergoes a thorough process of preparation and validation and cannot be changed easily.

<sup>17</sup> There are 15 major pensions schemes, and 21 schemes in total.



*a general inspector's office, and (iii) introduce risk-based inspections, as evidenced through Law No. 08/L-067 dated December 23, 2021 and published in the Recipient's Official Gazette No.2 dated January 18, 2022.*

38. **Rationale:** An inefficient business inspections regime imposes a significant regulatory burden and creates uncertainty for businesses. Lack of coordination and legal overlaps overburden businesses with multiple state inspections and have led to a high number of business inspections in Kosovo. Businesses report that the burdensome regulatory framework and large number of inspections contribute to high levels of informality and anticompetitive behavior as well as promoting rent-seeking activities and corruption. They also note that more productive companies are subject to greater scrutiny.<sup>18</sup>

39. **Substance of the prior action:** To improve coordination, transparency, and efficiency of business inspections, the adoption of the Law on Inspections contributes to an improved business enabling environment by (i) introducing risk-based inspections; (ii) establishing an Office of the General Inspector that will coordinate the reform, provide oversight for inspections, and serve as an internal audit mechanism for inspections to help improve coordination between inspections bodies, provide continuous education and training to inspectors and certification of inspectors; and (iii) streamlining inspectorate responsibilities by reducing the inspections bodies at the central level to reduce overlaps.

40. **Expected results:** To improve the efficiency and coordination of inspections bodies, the number of inspectorates will be reduced from 36 to 20 by mid-2023 based on the new legal framework. The law requires reorganization of inspectorates within ministries as executive agencies, incorporating all inspections functions within their responsibilities. Within twelve months from the date of entry into force of the Law, the government will propose the necessary amendments to specific laws to comply with the requirements of this Law, including the reduction in the number of inspectorates and the establishment of the Office of the General Inspector. The Office of the General Inspector will provide training for inspectors, streamline inspection procedures and establish an e-inspectorate system that will enhance transparency and coordination. The Office will also provide information on the reduced number of inspectorates. Ultimately, the new legal framework will improve the transparency and predictability of the inspection regime and foster formalization, facilitate the market entry of new firms, and reduce the operating costs of existing businesses. The Competitiveness and Export Readiness Project (P152881) will support the investments required and the IFC Investment Climate TA (P601638) will provide technical assistance for the successful implementation of the Law.

**Prior action #4:** *To reduce the regulatory burden on agriculture and agribusiness activities and trade, the Recipient has adopted regulations to: (i) reduce the number of agriculture and agribusiness sector licenses and simplify the licenses approval process, and (ii) reduce the fees and documentation requirements for producers, exporters, and importers in the agriculture and agribusiness sector, as evidenced through MAFRD's Administrative Instructions No. 3, 4, 5, 6 and 9.*

41. **Rationale:** Kosovo's agricultural sector has been stagnant in terms of productivity growth. In contrast, the agribusiness sector has shown significant progress in recent years, contributing to Kosovo's export growth performance. Extensive licensing and permit requirements hamper the competitiveness of the sector. For instance, farmers involved in cultivation, production and printing of labels for cereal seeds had to apply for five different licenses for importing, trading, producing processing and packaging.

<sup>18</sup> Kosovo CEM (2021) and SME diagnostics (2019).



Similarly, for importers, exporters, and traders of planting material twelve licenses were required for fruit seedling material trading, importing, exporting; for vine seedling trading, importing and exporting; for decorative plants seedling trading, importing, exporting; for vegetable seedling trading, importing, exporting. The validity of the licenses was only one year. For wine producers five different licenses were required for cultivation, production and processing, for distillatory, exporting, importing and serving the domestic market. These licenses were given a two-year validity period. By simplifying, merging, and repealing licenses and permits, the authorities aim to establish a more transparent and conducive operating environment for businesses. The high administrative burden not only hampers the performance of farms and firms in the sector, it also incentivizes informality—in a sector that is particularly prone to informality—and opens up room for rent-seeking behavior and corruption.

42. **Substance of the prior action:** The reduce the administrative burden on businesses in the agriculture and agribusiness sector, the proposed PA simplifies twenty-two licenses and permits under the supervision of the Ministry of Agriculture, Forestry and Rural Development (MAFRD). This has been achieved through the amendment of five administrative instructions (AIs): 1) AI No. 05/2021<sup>19</sup> has amended and supplemented the AI 08/2009<sup>20</sup> for cereals seeds. Through these amendments five licenses are simplified and merged into one; 2) AI No. 06/2021<sup>21</sup> on planting material, twelve licenses for fruit seedling material were simplified into four and the validity of these licenses were increased to three years from one year by amending the AI No. 14/2004<sup>22</sup> and No. 04/2007; 3) AI No. 04/2021 on registration of grape growers, and wine products abolished the AI No. 06/2013 on registration of these products; 4) AI No. 03/2021<sup>23</sup> on determination of criteria for internal trade, import, export of wine and other grape and wine products abolished the AI No. 11/2009 on assessment of criteria for internal trade, import, export of wine and other grape and wine products; 5) AI No. 09/2021 on services performed by the department of vineyards and wine simplified five licenses for wine by merging them into two and the validity of these licenses were increased to five years from three. The fees were adjusted to reflect cost recovery in line with the Law on Business Licenses and application documents were simplified by requesting a copy of the Business Certificate instead of the certified copies for all licenses.

43. **Expected results:** Compliance costs for the twenty-two licenses that were simplified and merged into seven through amendments/repealing of five administrative instructions are expected to decline by 25 percent, as measured by the results indicator. The methodology for measuring reduced compliance savings will be based on estimates of time and cost savings for businesses. Ultimately, the reforms are expected not only to result in compliance cost savings for enterprises over the medium term, but also to

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<sup>19</sup> Administrative Instruction (MAFRD) No.05/2021 on amending and supplementing of the Administrative Instruction No. 08/2009 on determination of tax for registration of entities, testing of varieties for the cultivation production value and printing of labels for cereals seeds - <https://gzk.rks-gov.net/ActDetail.aspx?ActID=41142>

<sup>20</sup> Administrative Instruction No. 08/2009<sup>20</sup> on determination of tax for registration of entities, testing of varieties for the cultivation production value and printing of labels for cereals seeds <https://gzk.rks-gov.net/ActDetail.aspx?ActID=7704> (Abolished by A.I No 05/2021)

<sup>21</sup> Administrative Instruction (MAFRD) No. 06/2021 on amending and supplementing the Administrative Instruction No. MA 14/2004 on registration, licensing and determination of tax for importers, exporters and traders of planting material, amended and supplemented by the Administrative Instruction No.04 / 2007 dated: 14.03.2007 and the Administrative Instruction No.04 / 2011 dated: 24.04.2011 – <https://gzk.rks-gov.net/ActDetail.aspx?ActID=41143>

<sup>22</sup> Administrative Instruction No. MA 14/2004 on registration, licensing and determination of tax for importers, exporters and traders of planting material - <https://gzk.rks-gov.net/ActDocumentDetail.aspx?ActID=7243>

<sup>23</sup> Administrative Instruction (MAFRD) - No. 04/2021 on registration of grape growers, wine producers, fruit wines and other grape and wine products - <https://gzk.rks-gov.net/ActDetail.aspx?ActID=41139>



reduce discretionary practices and rent seeking. The IFC Investment Climate TA (P601638) will continue to provide technical assistance for the successful implementation of this PA, including support to MAFRD on measuring compliance cost savings.

**Prior action #5:** *To foster digitalization and digital service delivery by businesses, the Recipient, has adopted the Law on Electronic Identification and Trust Services in Electronic Transactions that enables electronic identification and trust services for electronic domestic transactions, as evidenced through Law No.08/L-022 dated December 6, 2021 and published in the Recipient's Official Gazette No.11 on December 23, 2021.*

44. **Rationale:** Digital identity enables interactions and transactions in the digital space. The ability to uniquely, securely, and promptly establish the identities of people and businesses in cyberspace builds trust and is therefore essential to economic and social development. In the absence of trust, individuals, businesses, and public institutions alike hesitate to carry out transactions electronically or use services online. The COVID-19 pandemic accelerated digitalization and usage of e-commerce, globally and in Kosovo.<sup>24</sup> However, lack of a legal framework for e-IDs has been an important barrier to digitalization of businesses in Kosovo. During the COVID-19 pandemic customers and businesses had to continue making in-person visits for transactions as remote transactions were not possible. Furthermore, due to the lack of a framework governing electronic identification, most e-commerce transactions rely on cash-on-delivery, impeding formalization. A functioning e-ID system would enable digitalization of firms, in particular e-commerce, generating new business opportunities and raising productivity. In addition, an established e-ID system would enable e-government services and e-payments to develop at a faster pace with increased efficiency. The government has established core elements of the legal framework for cybersecurity and data protection which is well aligned with the EU *acquis* and is making strong progress in expanding the digital infrastructure and strengthening digital skills. Digital technologies offer a lot of room for inclusion, especially through enabling women entrepreneurs. In Kosovo, there is a large gender gap in entrepreneurship and access to finance for women. In only 9 percent of the firms, the decision maker is a female, and they are less likely to have access to credit (38.1 percent) compared to firms with a male decision maker (45.6 percent).<sup>25</sup> Women also face a higher burden of unpaid responsibilities in the home. However, the pandemic provided an opportunity for faster digital adaption for women in Kosovo. Business Pulse Surveys conducted in April 2020 and June 2021 revealed that women entrepreneurs were digitally more ready compared to men (0.96 vs 0.63)<sup>26</sup> and invested in digital adoption more than men. Thus, women are more likely to disproportionately benefit from the introduction of e-IDs, helping to close the gender gap in entrepreneurship.

45. **Substance of the prior action:** The Law on Electronic Identification and Trust Services (E-IDAS) introduces EU-compliant rules on electronic transactions. It is a foundational reform to support the digitalization of key public and financial services, as well as the development of e-commerce and digital financial services. More specifically, the adoption of the Law creates a common framework for operationalizing a national e-ID system that would facilitate trusted and secure electronic transactions between citizens, businesses, and public authorities, thereby increasing the effectiveness of public and

<sup>24</sup> Kosovo Business Pulse surveys (2021) and forthcoming SCD update (2022)

<sup>25</sup> Kosovo CEM, 2021.

<sup>26</sup> The digital readiness index is constructed by using the following variables, (i) use of platforms for sales and/or digital payments solutions (mobile money, card and online payments), (ii) use online chat, social media, or big data analytics for marketing and product development, and (iii) use enterprise resource planning software for operations planning or business administration.



private online services, electronic businesses, and e-commerce.

46. **Expected results:** The e-ID system is expected to be set up and operationalized in early 2023 and will enable businesses to use remote transactions through e-IDs. It is expected that at least 15 percent of all registered businesses—and 20 percent of registered businesses owned by women<sup>27</sup>—will be using them by end-2023, up from a baseline of 0 in 2021. For measurement purposes, the use of e-IDs will be proxied by the number of e-IDs issued to active businesses by the Ministry of Economy. This will result in a partial closure of the gender gap in digital access. Over the medium term, implementation of the prior action will enable businesses, citizens, and public authorities to carry out secure and seamless electronic interactions and promote digitalization of services. It is also a milestone towards creating a predictable regulatory environment, including for digital financial services. The EU will continue to provide technical and financial support to the implementation of the e-ID system.

### Pillar C- Strengthening Environmental Sustainability

47. **The third pillar supports the government’s efforts to strengthen environmental sustainability and establish a greener economy.** Kosovo endorsed the Green Agenda for the Western Balkans at the Sofia Summit in November 2020 and has made some progress in the energy sector, notably with the increased investments in renewables but only limited progress in the areas of environment and climate change. The third pillar includes two PAs related to improving waste management and enabling competition in the renewable power generation sector. Energy production that is highly dependent on fossil fuels and inadequate waste management contributes to air pollution and environmental degradation and puts the health of the population at risk. The first PA under this pillar supports the government’s efforts to improve waste management by incentivizing the transition to a circular economy. The second PA under this pillar incentivizes the transition to renewable energy generation through market-based and competitive support schemes.

**Prior action #6:** *To foster sustainable development through better management of solid waste and transition towards a circular economy aligned with European Union norms and standards, the Recipient has (i) adopted and submitted to the Parliament the Law on Amending and Supplementing the Law No. 04/L-060 on Waste to create the legal basis for an extended producer responsibility mechanism and procedures for the establishment of the deposit refund system, as evidenced by Government Decision No. 06/44 dated November 10; and (ii) adopted the Integrated Waste Management Strategy (2021-2030) and Action Plan (2021-23) which sets objectives, instruments, and targets to pave the way for a circular economy and improve public service delivery, as evidenced through Government Decision No.068/44 14 dated May 28, 2021.*

48. **Rationale:** Kosovo’s solid waste management system is unsustainable. According to the ERP 2022-2024, 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. Separate collection is scarce and related mostly to pilot projects by some municipalities, while licensed private operators partially cover the recycling of paper, plastics and glass. A large number of non-compliant landfills and dumpsites of very different sizes and risk factors pose a serious threat to the health of the population, environmental safety and biodiversity conservation, and are a source of potent greenhouse gas (methane) emissions. The waste sector in general contributes to about 4 percent of total greenhouse

<sup>27</sup> Businesses owned or co-owned by a woman, based on administrative data.



gas emissions in Kosovo. In addition, the current system of waste management based on uncontrolled and partly illegal landfilling is highly vulnerable to the impacts of climate change, including changed precipitation patterns and extreme heat, which can cause flooding and fires of waste on landfills.

49. **Substance of the prior action:** To ensure coherence with the objectives of the Green Agenda for the Western Balkans, Kosovo's Waste Management Strategy 2021-2030 along and the Action Plan 2021-2023 provide the basis for (i) the adoption of a Circular Economy Program; (ii) the establishment of a network of recycling centers across Kosovo (multi-functional facilities, including green waste composting, areas for separation and storage of bulky waste, and facilities for the separating and preparing and packaging waste for reuse and recycling); and (iii) the closure of illegal landfills, in order to prevent of environmental degradation. Amendments to the Law on Waste provide (i) a legal basis for the Extended Producer Responsibility mechanism for various e-waste streams (Waste Electronics and Electronic Equipment, Batteries, Packaging and Packaging Waste, and End of Life Vehicles), (ii) procedures for the establishment of the Deposit Refund System (DRS), which will be further regulated through secondary legislation in line with the polluter pays principle, including a legal basis for imposing sanctions and fees for non-compliance. This PA will contribute to climate change mitigation and resilience by increasing waste separation and recycling.

50. **Expected results:** The results indicator is the establishment of a new Producer Responsibility Organization (PRO) that facilitates self-organization by industrial producers towards greater recycling. This will in turn facilitate the introduction of an extended producer responsibility scheme that ensures producers of products bear financial and organizational responsibility for the management of waste over the course of a product's life cycle. This is an important result that would in turn contribute towards objectives set out in the Law and the Strategy to increase the percentage of municipal solid waste that is managed in controlled facilities to 50 percent by 2023 and to expand the coverage of municipal collection services to 85 percent by 2023. Oversight will be conducted by the Ministry of the Environment, Spatial Planning and Infrastructure (MESPI). GIZ has been providing support to the MESPI on the development of a new legal framework on waste and is expected to continue implementation support including the establishment of the PRO and the framework for extended producer responsibility.

**Prior action #7:** *To launch the introduction of a competitive mechanism to support renewable energy investments in the power sector, the Recipient has adopted a Concept Document on Renewable Energy Sources, that initiates the required regulatory and legal changes to the current legal and policy framework, as evidenced by Government Decision No. 19/52 dated December 29, 2021.*

51. **Rationale:** Kosovo achieved its renewable energy target commitment of 25 percent as a share of total primary energy consumed in 2020, as a signatory of the Energy Community Treaty.<sup>28</sup> The overall target was met under the current feed-in-tariff support schemes by attracting private investment in renewable energy generation. However, some of the targets for small hydro and biomass were not met. Feed-in-tariffs established in the last decade reflect fixed contract prices that are sometimes more expensive than the current costs of renewables that can be procured under competitive terms today,

<sup>28</sup> In line with these targets, the Ministry of Economy set renewable targets for each technology. These targets translated into allocated quotas for each technology that would be supported through a fixed Feed-in Tariff and a period of guaranteed offtake (10-12 years depending on the technology). To date, 193 small HPPs with a total capacity of 61MW 80MW have been put into operation, while 25 wind power plants licensed projects with for a combined capacity of 13733.75MW are now operational. Additional 6 solar PV plants of combined installed capacity of 10MW have been connected to the distribution grid supported by the feed-in-tariff scheme.



placing a burden on the ratepayers. Hence, with declining prices of solar and wind power generation technologies and lack of sustainable hydropower potential in the country, Kosovo is looking into reallocating small hydro quotas into wind and solar in a sustainable manner through introducing market-based mechanisms. With the successful achievement of the renewable energy targets in 2020, Kosovo will need to introduce a new regulatory framework that sets new energy targets for 2030 in line with the Energy Community Treaty and as part of its National Energy and Climate Plan (NECP). However, the current legal framework for the energy sector does not provide a harmonized and clear framework to implement renewable energy policies. Finally, like other countries in the region, Kosovo needs to adapt to the EU’s new policy framework for climate and energy, which mandates that national support schemes for renewable energy should be rationalized to become more compatible with the internal electricity market, state-aid regulations, be more cost-effective and provide greater legal certainty for investors.

52. **Substance of the prior action:** Kosovo has made progress tapping into renewable energy sources through feed-in-tariff mechanisms, but power generation remains highly dependent on coal-fired thermal power generation. This is the country’s leading source of greenhouse gas emissions and a major contributor to poor air quality. Kosovo needs to attract new and cost-effective investments in renewable energy generation. To initiate the legal reform process for the transition to market-based mechanisms in renewable energy generation, Kosovo has adopted a Concept Document<sup>29</sup> on Renewable Energy Sources. This is a critical step towards attracting lower cost private investment in renewable energy. In Kosovo, concept documents are a critical and mandatory step in the policy and institutional reform process and they involve significant analysis and public consultation before they can be adopted. The Concept Document on Renewable Energy Sources sets out the required regulatory and legal changes for fair, sustainable, and competitive renewable energy investments in Kosovo by requiring harmonization and updating of the primary legislation through a new law that clarifies the procedures, responsibilities and recommends an update of the renewable energy targets.

53. **Expected outcome:** Adoption of the Concept Document has triggered the preparation of the new law on renewable energy. At least one auction is expected to be launched under the new legislation that will follow the Concept Document. In the medium term, the reform is expected to contribute to new greenfield investment attraction, diversification, and increased sustainability of energy resources. Several partners are expected to continue providing technical assistance to support the Ministry of Economy to successfully implement this reform including the WBG, EBRD, and USAID.

**Table 4: DPF Prior Actions and Analytical Underpinnings**

Prior Actions	Analytical Underpinnings
<b>Pillar A: Improving Fiscal Transparency</b>	
<b>Prior action #1:</b> Enhancing transparency and oversight of government debt management operations	<i>Documents:</i> MTDS (P162995), Kosovo Debt management and Debt Sustainability Note (P162140), Kosovo DEMP (P165071), Kosovo Debt Management Reform Plan (169569), Kosovo Credit Risk Framework TA (166518). <i>Description:</i> Neither the primary legislation nor the secondary legislation is well harmonized, leaving

<sup>29</sup> Concept documents are an important first step government is required to take in the process of proposing and developing a law. They undergo public consultations and only after approval of the prime minister, along with a financial opinion of the Ministry of Finance, can the sponsoring ministry proceed with preparing the draft law, which has to be based on the reform option of the concept note approved by Government.



	<p>room for interpretation for DEM, practices. There is a need to harmonize laws, in order to clarify the role of the debt issuance authority, DEM objectives, and requirements for guarantee issuance. The oversight by the executive should be strengthened through reporting requirements on the implementation of the debt management strategy to Parliament. The legal framework does not legislate the reporting requirements.</p>
<p><b>Prior action #2:</b> Improving the evidence base for fiscal policy making and transparency</p>	<p><i>Documents:</i> Social Protection Situational Analysis (P176230), Social Assistance System Reform Project (P171098), Social protection and health expenditures note (P161140), Debt sustainability and debt management note (P162140), Fiscal risks note (P170113), Western Balkans Pension Technical Assistance, several fiscal years (P168178, P175000, P177035).</p> <p><i>Description:</i> Analysis shows that social protection expenditure on basic pensions will grow from 2 percent of GDP today to an estimated 2.8 percent by 2050, with relatively low replacement rates of around 30 percent. Further increases in categorical pension expenses will significantly increase the debt-to-GDP ratio without significant impacts on poverty reduction.</p>
<p><b>Pillar B: Enhancing Private Sector Development</b></p>	
<p><b>Prior action #3:</b> Improving the efficiency and coordination of business inspections and fostering formalization</p>	<p><i>Documents:</i> Business Environment Technical Assistance (P088045) Inventory of inspection bodies in 2012 and survey on the number of inspection visits. Competitiveness and Export Readiness (P152881), Consultative Note on inspection system reform in Kosovo (2017), Kosovo Investment Climate II (P601638) Concept Document on Inspection System Reform (2017), updated inventory of inspection bodies (2019), Policy note on SME growth (P169112), and Kosovo CEM (P171951).</p> <p><i>Description:</i> The analysis show that the business inspection regime is one of most pressing constraints to investment and Kosovo has one of the highest numbers of inspections in comparison to the neighboring countries. Kosovo lacks an overarching Inspections Law that would coordinate and reduce legal overlap which overburden businesses with multiple inspections. As such, a more coordinated and risk-based inspections regime can reduce the regulatory burden faced by businesses.</p>
<p><b>Prior action #4:</b> Reducing the regulatory burden on agriculture, agribusiness activities and trade</p>	<p><i>Documents:</i> Competitiveness and Export Readiness (P152881), Kosovo Investment Climate I (P597287), Kosovo Investment Climate II (P601638), Policy note on SME growth (P169112), and Kosovo CEM (P171951).</p> <p><i>Description:</i> Kosovo’s agricultural sector growth has been hampered by low productivity growth, while the agri-business sector has been developing a comparative advantage and has improved its export potential. However, the sector is subject to extensive licensing and permit requirements. Kosovo should implement the Law on Licenses and permits which categorizes issuance of licenses and permits based on public health, public safety and environmental risks. Simplified licensing regime for businesses and specifically for farmers reduces time and cost to comply with business regulations.</p>
<p><b>Prior action #5:</b> Fostering digitalization and digital service delivery by businesses</p>	<p><i>Document:</i> Kosovo CEM (P171951).</p> <p><i>Description:</i> Kosovo lacks an overall framework governing digital identification. Adoption of the law on digital identification would enable remote transactions and e-payment and promote e-commerce, the importance of which has grown as a result of the COVID-19 pandemic. Facilitating secure e-payments transactions rather than cash on delivery has the potential to promote formalization.</p>
<p><b>Pillar C: Strengthening Environmental Sustainability</b></p>	
<p><b>Prior action #6:</b> Fostering sustainable development through better management of solid waste and transitioning to a circular economy</p>	<p><i>Documents:</i> European Progress Report (2021), Managing pollution hotspots in Kosovo – Healing Land for the Future (P170041), Managing Contaminated Sites – Promoting Cleanup of Contaminated Sites and Promotion of Circular Economy for Pollution Prevention.</p> <p><i>Description:</i> Kosovo lacks the infrastructure, resources, and strategic approach needed for integrated waste management. Landfilling remains the predominant source of waste disposal, posing significant health and environmental hazards. Defining concrete measures for improving policies and legislation</p>



	and undertaking implementable actions to protect public health and reduce environmental impact from waste remain crucial for the green transition. Efforts include implementation of the extended producer responsibility and the polluter pays principle.
<b>Prior action #7:</b> Introducing competitive mechanisms for renewable energy investments in the power sector	<i>Documents:</i> Least Cost Renewable Energy Mix Study (KEEREP [P143055]); Kosovo CEM (P171951) <i>Description:</i> Moving to competitive mechanisms requires changes in Kosovo’s primary legislation. The Least Cost Renewable Energy Mix Study assesses the technical potential and least-cost renewable options for Kosovo. The Kosovo CEM shows that limited deregulation in the sector reduces the incentives to compete in the market, limiting adequate energy supply, which becomes a binding constraint for the private sector and limits productivity growth.

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

54. **The proposed DPF is an important part of the WBG engagement in Kosovo.** The proposed DPF was envisaged in the CPF FY17-21<sup>30</sup> and is fully aligned with the CPF’s three focus areas: (i) Enhancing Conditions for Accelerated Private Sector Growth and Employment, (ii) Strengthening Public Service Delivery and Macro-Fiscal Management, and (iii) Promoting Reliable Energy and Stewardship of the Environment. Furthermore, the DPF’s relevance to achieving the twin goals, through sustainable, resilient, inclusive, and greener policies (GRID) has been reaffirmed by the CPF Performance and Learning Review and the Systematic Country Diagnostic (SCD) Update, which focuses on strengthening fiscal sustainability, fostering an enabling environment for private sector development, and initiating a focus on environmental sustainability and climate action.

55. **The proposed program is closely aligned with the WBG active portfolio in Kosovo and has served as a platform for coordinated policy dialogue by the WBG and other development partners.** Actions on fiscal sustainability, and particularly improving the methodology for costing of social protection initiatives will form the basis for the reform of the social assistance reform to be supported by the Social Assistance Reform Project (P171098), which aims to improve the equity and adaptability of Kosovo’s social safety net through improved poverty targeting. The implementation of the Law on Inspections is expected to unlock investments from the Competitiveness and Export Readiness Project (P152881). Establishment of an e-ID system will enable the productive use of the broadband infrastructure deployed through the Kosovo Digital Economy Project (P164188) for access to broad range of online services for all businesses without regard to geographical location, particularly for women. The operation also complements the Energy Efficiency and Renewable Energy Project (P143055) and the Greening Land Project (P172992) under preparation that will support promotion of circular economy in industries to reduce waste and prevent new land and soil contamination.

56. **Analytical and advisory activities complement the DPF program.** The WBG has been providing analytical and advisory support to strengthen fiscal policy making to improve debt management practice through the DMF and to improve costing of pensions policies through the Regional Pensions TA. The operation is also closely coordinated with IFC advisory services on the inspections reform, on the simplification of licenses and permits in the agriculture and agribusiness sectors, and in support to private investments in renewable energy. The WBG is also supporting the government’s efforts to promote

<sup>30</sup> Report No.112337-XK, discussed by the Board of Executive Directors on May 23,2017. The CPF Performance and Learning Review (Report No. 167914-XK) has been circulated to the Board on an absence-of-objection basis with closing date of February 25, 2022 and proposes to extend the CPF duration by one year, to June 30, 2022.



female digital entrepreneurship via the Women in Online Work pilot that supports women to pursue online employment, with resources from the Kosovo Digital Economy Project.

#### 4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

57. **Kosovo has a consolidated legislative framework for public consultations for public policies and regulatory reforms.** Since 2011, all legislation (primary and secondary), strategies, and concept documents are subject to mandatory public consultations based on the Administrative Instruction on the Rules and Procedures of the Government No.09/2011.<sup>31</sup> In 2016, the Government also approved Regulation No. 05/2016 on minimum standards for public consultation. 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 legislations were finalized with public consultations in 2020 and out of 184 documents that were drafted, 181 (98 percent) were published on the official platform for public consultations.<sup>32</sup>

58. **The program of reforms supported by this DPF has been subject to significant public consultations, often undertaken with the support of the WBG and development partners.** Key stakeholders driving the reform agenda include the MFLT, the Office of the Prime Minister, Ministry of Industry, Trade, and Entrepreneurship, the Ministry of Economy, and the Ministry of Environment and Spatial Planning. Despite several changes in the government, consultations and partnerships built across the political spectrum have progressively fostered an alliance of support to the proposed reforms. Consultative events undertaken with business associations, with the private sector and with parliamentarians within the context of the DPF, but also for the preparation of the Kosovo CEM and the forthcoming SCD Update, have also helped to build consensus around the DPF program. 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 EU and GIZ, in the areas of inspections reform, simplification of licenses and permits, waste management, and the implementation of the e-IDs. Similarly, there is close alignment between the DPF and support provided by USAID and EBRD in the area of energy sector reform.

### 5. OTHER DESIGN AND APPRAISAL ISSUES

#### 5.1. POVERTY AND SOCIAL IMPACT

59. **The DPF program is expected to have broadly positive impacts on poor and vulnerable people in Kosovo, however proposed energy sector reforms will need to be matched by mitigating social assistance measures.** Policy and institutional actions supported within the DPF will contribute towards Kosovo's broader development goals, as outlined in the 2022 SCD Update, of increasing the returns to and equity of fiscal policy, improving the business environment for increased job creation, and strengthening

<sup>31</sup> The Rules and Procedures of the Government No.09/2011 requires a mandatory use of prior consultations and public consultations (article 7 and article 32) for draft laws, secondary legislation, strategies and concept documents.

<sup>32</sup> Out of 181 documents, there were 16 concept documents, 44 draft laws, 2 strategies, 4 programs, 6 action plans, 42 draft regulations, 70 administrative instructions Platform for public consultations, annual report for 2020: *Doc-606c64aa41753.pdf* (*rks-gov.net*)



management of the environment.

**60. Most PAs supported by the DPF are expected to have positive or neutral impacts on the poor.**

To the extent that sustainably managed debt contributes to fiscal sustainability, the impact of the first PA on long-term growth, investment, and ultimately welfare is expected to be positive. The second PA is similarly expected to have a positive impact on poor people by ensuring that social benefit programs are placed on sound fiscal framework and better aligned with poverty reduction goals. The third and fourth PAs are also expected to have neutral or positive impacts on the poor by reducing the costs of business operations and thereby supporting private sector investment and job creation, especially in the rural economy. The fifth PA is also expected to have a positive impact on the poor by accelerating the digitalization of businesses and public services and helping to close the gender gap. Improved waste management as a result of the sixth PA is also expected to have a positive impact on the poor by reducing harmful risks associated with waste mismanagement which tend to disproportionately impact the vulnerable.

**61. The seventh PA on the transition towards renewable energy sources may have negative impacts on the poor that will need to be mitigated by increases in targeted social assistance.**

This PA lays out a roadmap for increasing investments into renewable energy through market-based pricing mechanisms. This is expected to lower the country's dependence on coal for power generation, reducing emissions. The action will also contribute to higher growth through new energy investments, as frequent outages, and inadequate supply of energy are a constraining factor for Kosovo's private sector. While Kosovo's transition to renewable energy sources is likely to provide economywide positive impacts in terms of reduced air pollution and increased reliability of electricity supply, it will inevitably also require tariff increases. Higher tariffs passed onto consumers may result in a welfare loss for the poor and vulnerable people in Kosovo. As part of the broader social protection reform supported through the Social Assistance Reform Project (P171098), the government will introduce a social registry and unified poverty targeting system to identify poor and energy vulnerable households and to better capture energy poor consumers through an improved social safety net. The social registry is also expected to support the expansion of the social safety net in response to climate-induced shocks by enabling the government to quickly identify and support households negatively affected by climate-induced shocks.

## 5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

**62. The program support by the DPF is envisaged to have positive environmental impacts and no significant adverse impacts on the environment, forests and natural resources are expected.**

Substantial positive environmental effects are expected under the proposed PAs in the environmental sustainability pillar of the operation. The PAs will contribute to reductions in Greenhouse Gas (GHG) emissions and climate change adaptation and mitigation through reforms that support improved waste management 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 (including energy efficient) ICT solutions. Business inspection and licensing 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.



63. **Kosovo's existing policy framework is adequate for addressing environmental protection and ensuring sustainable implementation of projects.** The Environmental Impact Assessment (EIA) and Strategic Environmental Assessment ensure that environmental implications are taken into consideration before public policy decisions are made.<sup>33</sup> 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. Mandatory public consultations are a key feature of the EIA, which is designed to identify and help prevent significant adverse environmental changes that could be associated with economic development activities during construction and operation phases. The main objectives of the EIA in Kosovo can be summarized are to: (i) assess potential environmental impacts and assist in decision making related to the approval process, before the project is undertaken, (ii) help optimize the project design by identifying potential environmental impacts, (iii) identify and compare alternative means of achieving the project's goals to help select the preferable alternative and provide source of information for all participants. The competent authority for applying the EIA is the MESPI. Capacity gaps are a key constraint in the implementation of the EIA in Kosovo, but several development partners are providing technical assistance in support.

### 5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

64. **Kosovo has participated in several detailed reviews of its Public Financial Management (PFM) that have documented the significant progress the country has made.**<sup>34</sup> The key strengths include the sound legal framework, the integrated central Treasury system, and an increasingly effective external audit office. The strengths are offset by limited professional capacities and gaps in implementation. Lagging areas include (i) poor alignment of strategic plans with medium term budgets and concerns with respect to budget reliability; (ii) weak fiscal risk management; (iii) weak public investment and asset management, (iv) financial management control and audits that are not fully effective, and (v) inadequate follow up on external audit findings. The government's efforts to address these gaps are anchored in the current PFM Strategy. A monitoring and reporting framework for the implementation of PFM reforms is fully operational, however, the implementation of an ambitious reform agenda is a challenge due to capacity constraints across the public sector. The proposed DPF is fully aligned with government PFM reform and supports the strengthening of its PFM systems.

65. **In Kosovo, the government formulates, approves and publishes its budget online, and monitors its fiscal framework through the general budget which includes central government (line ministries and central government institutions), social insurance and health funds, and local governments.** The MTEF, setting out the main budget categories and fiscal aggregates for three years, has improved in both

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<sup>33</sup> 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. The Kosovo 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.

<sup>34</sup> These include five PEFA assessments (2007, 2009, 2013, 2016 and 2021); several municipal PEFA assessments between 2011-2013; a country fiduciary review (2012); annual EU-SIGMA reviews; and other analyses by the World Bank, IMF, EC, and other organizations.



substance and process. In particular, the coordination of inputs by line ministries into the MTEF preparation and annual budget formulation has steadily improved. Better procedures for budget preparation have been established and compliance with authorized procedures has improved. The latest MTEF approved in April 2021 includes an evaluation of the previous MTEFs. There has been positive progress toward strengthening and integrating its PFM ICT systems, by integrating seven systems<sup>35</sup> that have been previously poorly linked.<sup>36</sup> The core systems operated by the MFLT include: Kosovo Financial Management Information System based on Freebalance software and operated by the Kosovo Treasury and two separate custom-built systems for budget preparation and public investment management operated by the Budget Department.

66. **Generally, there is a sound legal base for public sector financial management and control.** The government is taking practical steps towards the development of the management accountability and delegation of tasks, but full implementation of the legal requirements will take time to be fully and effectively implemented in public bodies. While internal audit departments have been established in most Budget Organizations, the internal control and audit functions remain poorly understood and the capacity of line ministries' internal audit units remains weak.

67. **The MFLT discloses the Budget Law and publishes online the annual consolidated government financial statement, that is prepared in accordance with International Public Sector Accounting Standards (IPSAS) on a cash basis.** The latter includes information on revenues, expenditures as well as financial assets/liabilities for general government, excluding state owned enterprises. In-year budget reports are prepared on a monthly and quarterly basis and are consistent with budget coverage and classification to allow some monitoring of budget performance. The government's future plans involve implementation of accrual based financial reporting according to IPSAS.

68. **There has been notable progress in the area of 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. The audits are conducted in compliance with international standards. The Assembly uses the NAO's annual audit report to scrutinize the Executive in line with the legal procedures and, generally, supports the audit recommendations. Nevertheless, the implementation rate of the recommendations is low.

69. **The public procurement system rests on a sound legal framework, which is comprehensive and based on transparency, open competition, fairness, equal treatment and non-discrimination.** The Public Procurement Law mandates that procurement of all public funds is conducted through the e-procurement platform. Transparency of public procurement has further increased with introduction of two new e-procurement modules which will enable evaluation of contractor's performance and improve contract monitoring. However, public procurement remains prone to irregularities and vulnerable to corruption during the procurement process and contract implementation. As per the Public Procurement Regulatory Commission (PPRC) 2020 annual report, 86.2 percent of contracts are awarded through open procedures (as compared to 88.4 percent during 2019), while the difference was conducted using other procedures. Due to the pandemic, the volume of procurement activities fell in 2020 and a significant share of public

<sup>35</sup> Integrated systems are: Treasury system; PIP system; BDMS system; TAK system (SIGTAS); Customs system (ASYCUDA); Property tax system (Protax 2) and Payroll system. Source: PFM strategy monitoring report.

<sup>36</sup> Government of Kosovo. Annual progress report 2018 on the implementation of the PFM strategy 2016-2018.



procurement activities (10.4 percent) was carried out via negotiated procedure. Additional efforts are needed to ensure interoperability between the e-procurement system and the treasury system, which would allow tracking of payments for ongoing contracts.

70. **Based on the updated safeguards assessment, conducted by the IMF in connection with the Rapid Financing Instrument approved in April 2020, the CBK continues to maintain broad operational controls.** All recommendations from the previous safeguards assessment have been implemented. However, recent Board vacancies have resulted in the lack of a quorum and the absence of a functioning Board poses substantial governance and oversight risks for the central bank. 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 framework is advancing. Of note, during the last three years, the CBK has received unqualified audit opinions from the appointed auditor<sup>37</sup>.

71. **According to IMF reports, Kosovo does not maintain exchange restrictions or multiple currency practices, except for restrictions maintained solely for reasons of national security.**<sup>38</sup> In Kosovo, de jure and de facto exchange rate arrangement is one of no separate legal tender. Since the unilateral adoption of the Euro, this currency is a legal tender in Kosovo and circulates freely. Kosovo is not part of the Euro area and the CBK is not part of the European System of Central Banks.

72. **The fiduciary risk for this operation is assessed as Moderate.** Although the fiduciary risk related to the use of the credit proceeds is primarily driven by the current PFM environment in Kosovo, the shortcomings in this area do not indicate major fiduciary risk given the nature and content of the program. The clean audit opinions of the CBK and the medium-term PFM reform program support this assessment.

73. **The proceeds of the DPF will be disbursed in one single tranche to the existing treasury account in the CBK.** Disbursement will be made upon declaration of credit effectiveness and submission of a withdrawal application to the WBG. It will not be linked to a specific purchase; thus, no procurement requirements are necessary. The Government shall ensure that upon receipt of the deposited amount, an equivalent amount is accounted and reflected in the public sector financial reports. The financing and disbursement currency would be the same as the country currency, that is the 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 confirmation to the WBG in the form of an official letter from the MFLT on the amounts deposited within 30 days of receiving the funds. The closing date for the proposed DPF is September 30, 2023.

#### 5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

74. **The MFLT is responsible for coordinating the proposed operation.** It is the main counterpart for this operation and coordinates the preparation and implementation of 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.

<sup>37</sup> Central Bank of Kosovo, Annual Reports 2018 (Deloitte Kosova) 2019, 2020 (Grant Thornton).

<sup>38</sup> Notified to the IMF pursuant to Decision No. 144.



75. **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.

76. **The Macroeconomic Policy and International Financial Cooperation Department is responsible for monitoring of the reform program supported by the DPF.** The Department will furnish information to the WBG, as required, to monitor outcomes in the results framework. The WBG may provide implementation support and periodic monitoring and dialogue with the relevant ministries and other stakeholders to ensure timely implementation and adequate monitoring of indicators and outcomes of the program.

77. **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 WBG Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WBG's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WBG's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WBG non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the WBG's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the WBG's corporate GRS, please visit <http://www.worldbank.org/GRS>. For information on how to submit complaints to the World Bank Inspection Panel, please visit [www.inspectionpanel.org](http://www.inspectionpanel.org).

## 6. SUMMARY OF RISKS AND MITIGATION

78. **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 pillar. This risk is mitigated by close coordination with the government, with parliamentary commissions, and the strong consensus among Kosovo's development partners. Technical assistance has been provided—and is expected to continue to be provided—across all three pillars to support implementation of the proposed reforms by the WBG and other development partners, including the EU, GIZ, EBRD, and USAID. All other risk categories are assessed as Moderate or Low.



**Table 5: Summary Risk Ratings**

Risk Categories	Rating
1. Political and Governance	● Moderate
2. Macroeconomic	● Moderate
3. Sector Strategies and Policies	● Low
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	
<b>Overall</b>	● Moderate



**ANNEX 1: POLICY AND RESULTS MATRIX**

Prior actions	Results		
Prior Actions under DPF	Indicator Name	Baseline	Target (end 2023)
<b>Pillar A: Improving Fiscal Transparency</b>			
<p><b>Prior Action #1:</b> To enhance the transparency and oversight of Government debt management operations, the Recipient, has adopted and submitted to the Parliament the <b>Law on State Debt and State Guarantees</b> that (i) codifies annual and quarterly debt reporting requirements and (ii) requires annual reporting of the Government to the Parliament on the implementation of the State Debt Program, as evidenced by Government Decision No. 04/46 dated November 6, 2021.</p>	<p>1. Regular reports on the implementation of the State Debt Program, including all new borrowing and guarantee operations conducted by the Government during the previous fiscal period, are prepared and submitted to the Parliament</p>	<p>No (2021)</p>	<p>Yes (2023)</p>
<p><b>Prior Action #2:</b> To improve the evidence base for fiscal policy making and transparency, the Recipient has adopted requirements for conducting and publishing long-term costing of new pension policy proposals and other social protection policy proposals, as well as regular updating (at least every five years) for existing pension policies, as evidenced through the <b>Administrative Instruction</b> 09/2021 dated December 13, 2021.</p>	<p>2. Number of long-term financial analyses for existing pension schemes and benefits completed and published online</p>	<p>0 (2021)</p>	<p>15 (2023)</p>
<b>Pillar B: Enhancing Private Sector Development</b>			
<p><b>Prior Action #3:</b> To improve the efficiency and coordination of business inspections, the Recipient has enacted the <b>Law on Inspections</b> to (i) reduce the number of inspectorates and legal overlaps, (ii) establish a general inspector’s office, and (iii) introduce risk-based inspections, as evidenced through Law No. 08/L-067 dated December 23, 2021 and published in the Recipient’s Official Gazette No.2 dated January 18, 2022.</p>	<p>3. Number of inspectorates affecting private sector operations</p>	<p>36 (2021)</p>	<p>20 (2023)</p>
<p><b>Prior Action #4:</b> To reduce the regulatory burden on agriculture and agribusiness activities and trade, the Recipient has adopted regulations to: (i) reduce the number of agriculture and agribusiness sector licenses and simplify the licenses approval process, and (ii) reduce the fees and documentation requirements for producers, exporters, and importers in the</p>	<p>4. Percentage reduction in total compliance costs for simplified licenses and permits in the agriculture and agribusiness</p>	<p>0 percent (2021)</p>	<p>25 percent (2023)</p>



Prior actions	Results		
agriculture and agribusiness sector, as evidenced through MAFRD's <b>Administrative Instructions</b> Nos. 3, 4, 5, 6 and 9 <sup>39</sup> .	sector		
<b>Prior Action #5:</b> To foster digitalization and digital service delivery by businesses, the Recipient, has adopted the <b>Law on Electronic Identification and Trust Services in Electronic Transactions</b> that facilitates electronic identification and trust services for electronic domestic transactions as evidenced through Law No. 08/L-022 dated December 6, 2021 and published in the Recipient's Official Gazette No.11 dated December 23, 2021.	5a. Percentage of businesses using digital ID as a share of total number of businesses	0 percent (2021)	15 percent (2023)
	5b. Percentage of women owned businesses using digital ID as a share of total number of women-owned businesses	0 percent (2021)	20 percent (2023)
<b>Pillar C: Strengthening Environmental Sustainability</b>			
<b>Prior Action #6:</b> To foster sustainable development through better management of solid waste and transition towards a circular economy aligned with the European Union norms and standards, the Recipient has (i) adopted and submitted to the Parliament the <b>Law Amending and Supplementing the Law No. 04/L-060 on Waste</b> to create the legal basis for an extended producer responsibility mechanism and procedures for the	6. Establishment of a Producer Responsibility Organization that facilitates self-organization by industrial producers towards greater recycling	No (2021)	Yes (2023)

<sup>39</sup> The following are the list of adopted and amended/abolished AIs.

- 1) Administrative Instruction 05/2021 on amending and supplementing of the Administrative Instruction 08/2009 on determination of tax for registration of entities, testing of varieties for the cultivation production value and printing of labels for cereals seeds, duly published in the official gazette website on May 6, 2021.
- 2) Administrative Instruction 06/2021 on amending and supplementing the Administrative Instruction 14/2004 on registration, licensing and determination of tax for importers, exporters and traders of planting material, amended and supplemented by the Administrative Instruction 04/2007 and the Administrative Instruction 04/2011; duly published in the official gazette website on May 6, 2021.
- 3) Administrative Instruction 04/2021 on registration of grape growers, wine producers, fruit wines and other grape and wine products, abolishing the AI no. 06/2013 on registration of growers of grape, producers of wines and other products of wine, duly published in the official gazette website on May 6, 2021.
- 4) Administrative Instruction 03/2021 on determination of criteria for internal trade, import, export of wine and other grape and wine products, abolishing AI no. 11/2009 on assessment of criterions for import, export, and internal market of wine and other products from grape and wine, duly published in the official gazette website on May 6, 2021.
- 5) Administrative Instruction 09/2021 on services performed by the department of vineyards and wine; duly published in the Recipient's website on November 11, 2021.



Prior actions	Results		
establishment of the deposit refund system, as evidenced by Government Decision No. 06/44 dated November 10, 2021; and (ii) adopted <b>the Integrated Waste Management Strategy (2021-2030) and Action Plan (2021-23)</b> which sets objectives, instruments, and targets to pave the way for a circular economy and improve public service delivery, as evidenced through Government Decision No.068/44 14 dated May 28, 2021.			
<b>Prior Action #7:</b> To launch the introduction of a competitive mechanism to support renewable energy investments in the power sector, the Recipient has adopted a <b>Concept Document on Renewable Energy Sources</b> , that initiates the required regulatory and legal changes to the current legal and policy framework, as evidenced by Government Decision No. 19/52 dated December 29, 2021.	7. Number of auctions launched based on the new legal framework for market-based mechanisms to support renewable energy investments	0 (2021)	1 or more (2023)



## ANNEX 2: FUND RELATIONS ANNEX

### IMF Executive Board Concludes 2021 Article IV Consultation with the Republic of Kosovo

**Washington, DC—January 12, 2022:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation <sup>[1]</sup> with Kosovo and considered and endorsed the staff appraisal without a meeting.

Kosovo's economy is rebounding from its deepest recession in a decade, driven by improved vaccination rates, renewed mobility, policy actions and extraordinary support from the diaspora. After contracting 5.3 percent in 2020, real GDP is projected to grow by 7.5 percent in 2021.

The fiscal response to the pandemic provided lifelines for households and firms and cushioned the impact of the shock on those most affected by the pandemic. On the back of a strong rebound in revenues, the fiscal policy stance tightened to an almost balanced position in 2021 from a deficit of close to 8 percent of GDP in 2020. However, its drag on the economy was more than offset by extraordinary diaspora inflows and sustained increases in net credit to the private sector. Inflation in 2021 is forecast to have increased to more than 5 percent (year-on-year) due to higher energy and food prices, which rebounded to their pre-pandemic levels. With strong capital and liquidity buffers and low NPLs, the banking sector has been resilient overall.

Economic activity is forecast to grow at 3.8 percent in 2022, driven partially by strong economic momentum in 2021. Uncertainty around the outlook remains high, and the pandemic continues to represent the main downside risk. Long-term scarring from the pandemic is now expected to be lower than that projected in the 2020 Article IV consultation, as diaspora flows have been more resilient than expected. Structural policies, such as diversifying Kosovo's growth engines, tackling informality, and creating the conditions for greener economic growth, could mitigate these longer-term effects of the pandemic.

#### Executive Board Assessment <sup>[2]</sup>

In concluding the 2021 Article IV consultation with Kosovo, Executive Directors endorsed the staff's appraisal, as follows:

**Kosovo's people and its economy experienced a return to a certain degree of normality in 2021.** Increased vaccination rates allowed a relaxation of stringency measures, supported mobility, and created the conditions for a resumption of diaspora travel. While the health system continued to cope reasonably well, still-binding supply constraints are a reminder of the need to expand the sector's capacity more decisively. Though uncertainty appears to have subsided with respect to 12 months ago, it remains high.

**The fiscal response to the pandemic has been broadly adequate.** The use of lifelines for households and firms, wage bonuses for essential workers, employment support, and child and maternity allowances for vulnerable households adequately cushioned the impact of the shock on those most affected by the



pandemic. While the fiscal policy stance tightened in 2021 on the back of a strong rebound in revenues, its drag on the economy was more than offset by extraordinary diaspora inflows and sustained increases in net credit to the private sector.

**Fiscal policy needs to return to a more supportive stance in 2022.** The projected normalization of diaspora inflows calls for a relaxation of the fiscal stance of around 2 pp of GDP; this will require additional expenditures, mainly in the form of investment projects of about 1-1.5 pp of GDP. The relaxation of the fiscal stance would help sustain the recovery by cushioning the projected softening of external inflows, while keeping the deficit within the fiscal rule limits.

**The focus, composition, and transparency of public spending needs strengthening, including to support economic resilience.** While the objective to intensify vaccinations is both appropriate and commendable, intended policy actions under the “Economic Revival Program” need to be better defined, new social transfer programs should be more targeted, and the growth of existing transfers needs to be contained. While across the board wage hikes are currently not expected, the new law on public salaries should contain the wage bill within its legal ceiling. Public investment should be geared towards increasing economic resilience and preparing the economy for a renewed spike of cases.

**Continued fiscal contingency planning is needed in the face of still-high uncertainty.** Options for risk mitigation, on top of the reserves already in the 2022 budget, include anticipated public debt placements and contingent bilateral and multilateral financing. Other fiscal risks include the ongoing revision of the law on salaries and the indexation of war veteran benefits, which continue to breach their 0.7 percent of GDP legal ceiling. The upbeat GDP growth and revenue projections in the budget for 2022 call for the preparation of an alternative fiscal scenario based in the consensus growth forecast to identify potential financing needs as well as expenditure programs that need containing.

**The commitment to stick to the fiscal rule as the guide for medium-term policy is appropriate.** This will anchor public debt below the 40 percent of GDP legal debt ceiling through the medium term. Other medium-term fiscal priorities include expanding the tax base, strengthening fiscal transparency, and expanding the investor base of government debt. Importantly, the revenue windfall provided by the diaspora should be used to close social and economic infrastructure gaps and diversify growth engines.

**The CBK’s decision to gradually unwind its pandemic-related support measures in 2021 was warranted.** While the financial system has remained resilient overall and the increase in aggregate NPLs is expected to be limited, strengthening credit risk monitoring is essential to ensure that bank-by-bank provisioning reflects the underlying change in asset quality, and that capital buffers are sufficient to absorb write-downs and keep the flow of credit. The supervisor authority’s capacity to evaluate the ECL frameworks of regulated entities in the context of IFRS-9 implementation needs to continue improving.

**The recommendations of the 2019 FSSR and those of the 2020 Safeguards Assessment need to be implemented.** The resumption of CBK Board operation will allow the implementation of FSSR and SA recommendations, including to ensure that the financial stability function reports directly to the Executive Board; that the CBK’s governance is reviewed to assess the effectiveness of decision-making bodies and the appropriateness of membership in key committees; and that the audit and risk committees are strengthened, including through expanding their scope to the oversight of financial reporting and risk management activities.



**The new SDR allocation can be used to strengthen the CBK's ability to provide liquidity support to banks.** The SDR allocation would enhance international reserves, which are projected to fall below 100 percent of the IMF RA metric in the medium term, and thus support the CBK's lending facilities. On competitiveness, Kosovo's external position was assessed to be moderately weaker than the level implied by fundamentals and desirable policy settings in 2021.

**Gaps in physical infrastructure, labor force skills, and institutional quality limit FDI flows, leaving diaspora inflows as the main growth engine.** Diversifying the sources of economic growth requires improving infrastructure, public investment management, investment composition, POEs' management and performance, and for the education system to meet the needs of the economy.

**Kosovo's high levels of informality negatively affect competition, working conditions and firm size, limiting economic growth.** Simplified tax procedures, improved secondary education, and enhanced financial inclusion will help sustain and expand recent formalization gains. In the medium-term, formalization gains will be tied to improving the efficiency of the judicial system and tackling corruption.

**Kosovo's intentions to reduce carbon emissions are commendable.** A credible climate and environment mitigation strategy should be centered around carbon pricing, while allocating its proceeds to investment in green projects and to mitigate the impact of higher energy prices on vulnerable households. In the near term, the priority is to make progress in the installation of filters in the largest lignite-based energy generation plant in collaboration with the EU.

**The next Article IV consultation with Kosovo is expected to be conducted on the standard 12-month cycle.**

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.



Kosovo: Selected Economic Indicators, 2018–26									
	2018	2019	2020	2021	2022	2023	2024	2025	2026
				Est.		Projections			
<b>Real GDP growth</b>	3.4	4.8	-5.3	7.5	3.8	3.8	3.6	3.5	3.5
Contribution to growth (percentage points of GDP)									
Consumption	4.3	5.8	2.3	4.3	2.4	2	2.3	2.5	2.5
Investment	2	-0.1	-2.3	2.4	1.6	1.6	1.1	1.1	1.2
Net Exports	-3.1	-0.3	-5.3	0.3	-0.3	0.2	0.1	-0.1	-0.2
<b>Official unemployment (percent of workforce) 1/</b>	29.5	25.7	26	25.8	...	...	...	...	...
<b>Price changes</b>									
CPI, period average	1.1	2.7	0.2	3.2	3.9	2.4	2.2	2.1	2
GDP deflator	1.5	1	1.4	2.9	3.5	2.6	2.2	1.9	1.7
<b>General government budget (percent of GDP)</b>									
Revenues and grants	26.4	27	25.6	29.2	28.5	28.3	28.2	28.2	28.1
Expenditures	29.2	29.9	33.5	29.6	30.9	30.7	30.6	30.6	30.6
Overall Balance (Fiscal rule) 2/	-1.5	-0.8	-6.6	0.2	-1.3	-1.6	-1.4	-1.4	-1.7
Overall balance	-2.8	-2.9	-7.9	-0.4	-2.4	-2.4	-2.3	-2.4	-2.5
Stock of government bank balances	4.5	5.1	3.4	5.5	5.5	5.2	4.9	4.6	4.5
Total public debt 3/	17	17.7	24.3	24.3	25.3	26.1	26.9	27.8	29
<b>Balance of Payments (percent of GDP)</b>									
Current account balance, incl. official transfers	-7.6	-5.7	-7	-7	-6.5	-5.9	-5.8	-5.7	-5.6
<i>Of which: Official transfers 4/</i>	3.4	3.4	4.1	3.6	3.3	3.1	3.1	3	3
<i>Of which: Remittance inflows</i>	12	12.1	14.5	15.6	15	14.2	13	12.6	12.3
Financial account	-5	-2.3	-8.3	-3.9	-4	-3.3	-3.4	-3.4	-3.1
<i>Of which: Direct investment, net</i>	-3.4	-2.7	-4.2	-4.7	-3.6	-3.6	-3.6	-3.7	-3.7
<i>Of which: Portfolio investment, net</i>	-3	0.8	-1.2	1.5	0.6	1.8	1.9	2	2.2
Errors and Omissions	2.8	3.5	-1.6	2.6	2.2	2.4	2.2	2	2.3
<b>Financial Sector</b>									
Non-performing loans (percent of total loans)	2.5	1.9	2.5	...	...	...	...	...	...
Bank credit to the private sector (percent change)	10.8	10	7.1	13.4	11	8.5	7.5	7	6.2
Deposits of the private sector (percent change)	9.3	15.6	10.9	9.3	9	8.2	7.2	7	6.8
Regulatory capital to risk weighted assets	17	15.9	16.5	...	...	...	...	...	...
<i>Memorandum items:</i>									
GDP (millions of euros)	6,672	7,056	6,772	7,493	8,049	8,571	9,076	9,569	10,072
Real GDP growth per capita	3.6	5.6	-5.7	7.1	3.4	3.4	3.2	3.1	3.1
<i>Sources: Kosovo authorities; and IMF staff estimates and projections.</i>									
<i>1/ 2021 as of Q2 2021. 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/ Includes guarantees and beginning in 2020, Euro 120 million of debt with KPST. It does not include contingent debt of former Yugoslavia. 4/ Total foreign assistance excluding capital transfers.</i>									



**ANNEX 3: LETTER OF DEVELOPMENT POLICY**



**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, 09 shkurt 2022

Mr. David Malpass  
President  
The World Bank  
1818 H Street NW  
Washington, DC 20433  
USA

**Subject: Letter of Development Policy for the Public Finances and Sustainable Growth DPF (P170113)**

Dear President Malpass,

On behalf of the Government of Kosovo, I am pleased to submit this Letter of Development Policy for Kosovo Public Finances and Sustainable Growth Development Policy Financing in the amount of EUR 50 million.

This letter describes the macroeconomic context of this operation and summarizes the key reforms of the program that we have committed to undertake. The design and implementation of these reforms will enhance the transparency and sustainability of our public finances over the medium term, strengthen the enabling environment for private sector development, and strengthen environmental sustainability.

The Government of Kosovo appreciates the long-standing partnership and cooperation with the World Bank, including support in responding to and recovering from the COVID-19 pandemic.

**Macroeconomic Framework and Key Structural Reforms**

Our main medium-term objective is to promote robust, inclusive and sustainable economic growth, which would lead to a significant improvement in the living standards of our citizens. Therefore, we have adopted our Government's Program in May 2021 to define the Government's vision and the respective pillars of reforms to be undertaken in order to achieve the aforementioned objective. To minimize the human toll of COVID-19, our program focused primarily on the successful management of the pandemic. Given the severe implications of COVID-19 for Kosovar businesses and citizens, our second priority was to mitigate the economic and social consequences of the pandemic. Finally, the program focused on the economic and social transformation of the economy to build back better.

Under our first priority, we have so far fully vaccinated 56% of the eligible population (over 12 years of age), highest rate of vaccination in the region, and advanced our testing and monitoring procedures, while better targeting of containment measures has been achieved. In this regard, we have financially supported the additional personnel needed to meet the increased demand for health services, and reduced the burden of the pandemic on our citizens by committing additional funds to purchase essential medicines. To ensure that the country can cope with unprecedented shocks in the future, we are continuing to improve the capacity of our



health system.

We have seen a strong rebound in economic activity in 2021. The first three quarters have marked an average growth rate of 12 percent, according to official KAS quarterly data. This was driven by a strong recovery in tourism receipts from the Kosovar diaspora, a significant increase (and diversification) in exports of goods, private investment and consumption. The government's short- and medium-term policy actions, focused on managing the health emergency and providing targeted support to those most affected by the pandemic, and the citizens' confidence in our long-term vision of economic and social transformation, contributed to these results. In addition, the success of our vaccination program, accelerated vaccinations, and the careful lifting of containment measures are supporting growth.

To address the impact of the pandemic, we have implemented significant measures under our Economic Revival Program (ERP), which amounted to 3.2 percent of GDP in 2021. These measures include employment support, revival of the economy and manufacturing, support to families, support for the enhancement of public services, and investments in infrastructure and environment. Some of the key sub-measures under ERP include support to employ those who lost their jobs during the pandemic; employment of women and youth; incentives to move from informal to formal employment; support to businesses to improve access to finance; investment loan subsidies; support for families who have lost their family members from COVID-19; additional support for retirees and social assistance recipients; maternity allowances for employed and unemployed mothers, and child allowances.

With the strong rebound in growth, both domestically and globally, we have also experienced increased inflationary pressures, which are mainly due to external factors, such as supply chain disruptions. At the end of 2021, due to the energy crisis in Europe, which resulted in higher electricity import prices, we had to take measures to shield households and businesses from the impact of price increases, through subsidizing a portion of the impact. As a result, from February 2022 energy tariffs are set to increase only for consumers who exceed a certain bracket, representing around 20 percent of households. However, we remain committed to further support our energy vulnerable households. These recent developments have further underscored the importance of maintaining adequate fiscal agility and accelerating the green transition to strengthen our economy's resilience to shocks.

We note our strong commitment to maintaining and further improving macro fiscal sustainability over the medium term, including through actions supported by the DPF. Since 2014, we have continuously improved our rules-based macro fiscal framework and have demonstrated our commitment by strictly adhering to it. However, in 2020, due to the depth of the pandemic, the decline in revenues, and the fiscal space needed for economic and social response, the implementation of the deficit ceiling was temporarily suspended. Thanks to a strong revenue performance in 2021, an increase of 27 percent compared to 2020, driven by a strong recovery in economic activity, increased tax debt collection, and formalization induced by the economic revival measures, our fiscal deficit, as per the fiscal rule, is estimated at 0.8 percent of GDP at the end of 2021. The overall fiscal deficit was also well below the ceiling set by the fiscal rule. This has led to a reduction in our domestic borrowing needs and has allowed us to begin rebuilding our fiscal buffers by increasing government deposits at the Central Bank. We plan to return to the implementation of the fiscal rule on the budget deficit ceiling of 2 percent of GDP by 2023. We continue to comply with the 40 percent debt-to-GDP ceiling and the fiscal rule on wage bill growth. Over the medium term (2022-2024), we expect growth to remain strong, above the historical average.

As part of our efforts to improve fiscal sustainability, as per our commitment in the Government Program, we will review all social and pensions programs to ensure better targeting, such that social protection spending reaches those in need, encourages employment and reduces poverty. We currently allocate a fair share of our budget to social protection programs, but recognize that there are gaps in coverage and overlaps because



of fragmentation. Through the proposed DPF, and as a first step, we are improving the legal framework for costing pensions and other social protection programs. In the medium term, there is a need to reform these programs to improve spending outcomes and sustainability. To this end, we are also working with the World Bank through an Investment Project Financing in the amount of EUR 47 million to support the reform of Kosovo's only poverty-targeted social assistance program, the Social Assistance Scheme (SAS). This project will enable reforms that are central to improving the performance of our social protection system. One of the components of this project is establishing a poverty targeting system, through which households in need can be identified, as well as creating a social registry, which will provide comprehensive information on the type and extent of social benefits households receive. These two systems will enhance transparency and will contribute to an evidence-based approach for further reforms of social and pensions programs.

Alongside these investments, as part of our efforts to create a more equal society and increase the well-being of our citizens, also with the aim of reducing the burden of the pandemic, our Government has allocated over EUR 50 million for the implementation of family support measures under ERP. Out of these, EUR 10 million are allocated for child allowances and maternity benefits for unemployed and employed women. Child allowances are being phased in by cohorts of children between 0-16 years old depending on the fiscal space available. Given the important economic disruptions caused by COVID-19, these universal measures started under ERP, but they are part of the longer-term and holistic reform of the social protection sector that we have outlined in our Government program. We remain committed to the evaluation of the welfare and fiscal impacts of these programs, with the aim of ensuring and further enhancing the overall effectiveness of social protection spending in the medium-term. Learning from the COVID-19 pandemic, we will also include provisions in the new legislation of SAS that enables scheme coverage to expand in response to shocks, thereby protecting families from destitution during crisis.

Moreover, we remain committed to ensuring debt sustainability and improving debt management practices and transparency, including through the DPF and IDA's Sustainable Development Finance Policy (SDFP) Performance and Policy Actions (PPAs). 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. The World Bank debt management and transparency indicators can attest to the strong performance of Kosovo in this area. Through the FY21 PPAs, we have successfully increased the coverage of our debt reporting to include centrally owned public enterprises and we publish our annual domestic borrowing plan. We will start publishing quarterly financial data for each publicly owned enterprise in a comparable format before April 2022, as part of FY22 PPAs.

At the same time, we are working on the design and the implementation of various structural reforms, to create the foundations for higher growth through improving the regulatory environment for the private sector, digitalization, and setting up mechanisms with a view to improve environmental sustainability, including through the DPF. We will implement these reforms to improve business and export dynamism, and to increase the productivity of firms to generate faster growth. In this context, the Government is reviewing the legal framework on competition, business organizations, international trade, and above all working on ensuring the effective implementation of the rule of law. The reform agenda is also responsive to reducing environmental degradation, protecting ecosystems, enhancing waste management, controlling air pollution, improving administrative procedures for environmental protection and addressing climate change.

### **Reforms supported by the Public Finances and Sustainable Growth Development Policy Financing**

The proposed Kosovo Public Finances and Growth DPF from the World Bank supports our efforts to (i) strengthen fiscal transparency and evidence-based policy making to reduce medium term fiscal pressures, (ii) improve the regulatory environment for private sector development; and (iii) initiate the green transition.



*(i) Improving fiscal transparency*

As a necessary condition for growth, we are committed to design and implement reforms aimed at maintaining and further strengthening transparency and sustainability of our public finances. This will help us mitigate fiscal risks and prevent growth setbacks. To this end, we are strengthening our legal framework to safeguard fiscal sustainability through evidence-based fiscal policy making and improved transparency.

Under Pillar I of the DPF:

- We have adopted a new Draft Law on State Debt and Guarantees<sup>1</sup>. Through the new Law, we shall (i) strengthen the oversight of the Assembly on debt policy and management through mandating a regular reporting requirement, (ii) codify the regular publishing of debt bulletins and the state debt program, and (iii) streamline the roles and responsibilities in managing government debt and guarantees and aligned them with international best practices. In line with the results indicator agreed upon under this operation, we will be preparing the first report on the implementation of the state debt program to the Assembly by Q2 2023.
- We have amended the regulation on budget impact assessment of new government initiatives, to ensure (i) all non-pension social protection policy proposals are costed for at least a 10 year time horizon, including concept documents, government decisions, laws, and regulations, (ii) all pension initiatives and government decisions are costed for at least a 50 year time horizon using a financial analysis, including concept documents, government decisions, laws, regulations, (iii) the costing for all new policy initiatives are made public, (vi) existing pensions programs are costed every 5 years and the costing is made public. In line with the agreed upon results indicator, we will publish long-term financial analyses for at least 15 existing pension schemes and benefits by mid-2023.

These changes will contribute to strengthening the evidence-base data, improve transparency in fiscal policy making and contribute to fiscal sustainability in the medium term.

*(ii) Enhancing private sector development*

To lay the foundations for faster growth and to provide better opportunities for Kosovar citizens, we need to move our growth model to one that is driven by productivity growth rather than factor accumulation. This requires providing an enabling environment for firms and farms through a more business friendly regulatory environment and higher levels of digitalization.

To this end, under the Pillar II of the DPF:

- We have adopted the Law on Inspections, (i) to create the legal basis for risk-based inspections, (ii) to better monitor and evaluate all the inspections performed, with a view to eliminate excessive ones, (iii) to establish a coordinating mechanism between inspection bodies to ensure better coordination of procedures and a more effective oversight mechanism, including the establishment of an information system for exchanging information between inspectorates. In line with the agreed upon results indicator, we shall reduce the number of inspectorates from 36 to 20 by mid-2023.
- We have amended five Administrative Instructions on License and Permit Requirements within the functional authority of the Ministry of Agriculture, Forestry and Rural Development with the aim to reduce the regulatory burden on agriculture, agribusiness activities and trade. This allowed us to simplify 22 licenses and permits. In line with the agreed upon results indicator, this will help reduce compliance costs of firms and farms over the medium term.

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<sup>1</sup> The Draft Law on Public Debt was approved on a first reading by the Kosovo Assembly on February 08, 2022



- We have adopted the Law on Electronic Identification and Trust Services. Through this Law, we have created a legal framework that fosters the use of digital services which will lead to increased efficiency by digitalization of service delivery, thereby reducing travel and time costs to citizens and businesses in Kosovo. Following the adoption of the Law, we will be setting up a system that allows for issuance of e-IDs. In line with the agreed upon results indicator, we expect businesses to start using the e-IDs and the successful implementation of the system. The establishment of the e-ID system will contribute to reducing the gender gap in entrepreneurship, given the readiness and technology adoption women entrepreneurs have shown during the COVID-19 pandemic.

*(iii) Strengthening environmental sustainability*

To increase the sustainability and resilience of economic growth, we need to address pressing environmental and climate change challenges. Kosovo is only at the beginning of this transition, so a key priority of our government is to lay the foundations of the green transition through sustainable public investments, and by incentivizing and attracting industry-led solutions that would create opportunities for greener investments.

To this end under Pillar III of the DPF:

- We have adopted the Law on Waste and the Integrated Waste Management Strategy (KIWMS 2021 – 2030) and the action plan (2021-2023). Through the Law on Waste and the Kosovo Integrated Waste Management Strategy and Action Plan (2021 – 2023), we have (i) strengthened our legal framework to create the legal basis for extended responsibility establishment of the deposit refund system, (ii) set forth concrete actions to protect public health and reduce environmental impact from waste and, (iii) enabled the increase of business and employment opportunities and transition towards a circular economy aligned with the European norms and standards. In line with the agreed upon results indicator, an industry-led Producer Responsibility Organization, will be established based on the revised regulatory framework. In addition, the reform will lead to an increase in the access to adequate and regular municipal waste collection services through controlled facilities, improving livelihoods and public service delivery.
- We have adopted the Concept Document on Renewable Energy Sources. Through the concept document we have kick-started the changes to the legal framework to define the reform path for the transition from current feed-in tariff support schemes to a competitive mechanism for renewable energy generation, including through the organization of auctions. In line with the agreed upon results indicator, we aim to have at least one auction launched under the new legal framework through a competitive mechanism.

Let me conclude by underlining how much we value our partnership with the World Bank, and emphasize that the Government of Kosovo is fully committed to the World Bank to do its utmost to ensure the timely implementation of this program, and to put in place the necessary arrangements for the implementation of all these critical reforms.

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
<b>Pillar A: Improving Fiscal Transparency</b>		
<b>Prior action #1:</b> Enhancing transparency and oversight of government debt management operations	Neutral / Positive	Positive / Neutral
<b>Prior action #2:</b> Improving the evidence base for fiscal policy making and transparency	Positive	Positive / Neutral
<b>Pillar B: Enhancing Private Sector Development</b>		
<b>Prior action #3:</b> Improving the efficiency and coordination of business inspections and fostering formalization	Neutral	Positive / Neutral
<b>Prior action #4:</b> Reducing the regulatory burden on agriculture, agribusiness activities and trade	Neutral	Positive / Neutral
<b>Prior action #5:</b> Fostering digitalization and digital service delivery by businesses	Positive	Positive / Neutral
<b>Pillar C: Strengthening Environmental Sustainability</b>		
<b>Prior action #6:</b> Fostering sustainable development through better management of solid waste and transitioning to a circular economy	Positive	Positive / Neutral
<b>Prior action #7:</b> Introducing competitive mechanisms for renewable energy investments in the power sector	Positive	Potential negative impacts of higher tariffs on consumers are expected to be addressed through the reform of the social assistance scheme