PUBLIC OF KOSOVO
Systematic Country Diagnostic Update

WORLD BANK GROUP
Acknowledgments

This report was prepared by a World Bank Group team led by Ana Maria Oviedo (Senior Economist, EECPV), Besart Myderrizi (Economist, EECM2), Asli Senkal (Senior Economist, EECM2), and Levent Karadayi (Economist, CELCE), comprising the following team members from across the World Bank Global Practices, IFC and MIGA: Gayané Hezo Naroyan, Lインドita Lepaja, Mjellma Rrecaj (ECCKO), Silvia Mauri (SCAAG), Blerta Qerimi, Alper Ahmet Oguз (EECF2), Oya Pınar Ardic Alper (EFNF1), Medtma Agar, Jonas Arp Fallow, Shiko Nagaki (EECG2), Harald Jedlicka (ETIIC), Angela Demas (HECED), Ha Thì Hong Nguyen, Mrkе Alu (HECHN), Stefanie Koettl-Brodmann, Sarah Coll-Black, Zoran Anusic (HECSP), Natalija Gelvanovska-Garcia (IIDD01), Rhedon Begolli (IECE1), Ian John Douglas Gillson (ETIRI), Violane Konar-Leacy, Eugenio Osmoхescu (CEUA1), Ramon Munoz-Raskin (IECT1), Nino Pkhikidze (ITRGK), Shpresa Kastrati, Klas Sander (SCAEN), Linda A. Nora, Natacha Caroline Lemasle (SCASO), Axel E. N. Baeumler, Paul Scott Pettitbore (SCAUR), Caleb Travis Johnson (SMNUR), Zhimin Mao, Tribelina Baraku (SCAWA), Nadia Fernanda Piffaretti, Sara Batmanglich, Sara Gustafsson (GTFS1), Lundrim Aliu (ECREX), Jonathan George Karver (EPVGE), Carlos Gustavo Osmino Hernandez (EECPV). Sean Lothrop provided editorial services.

The work was carried out under the overall guidance of Anna M. Bjerde (Regional Vice President, ECAVP), Xiaoqing Yu (Director, Strategy and Operations, ECAVP), Wiebke Schloemer (Regional Director, CATDR), Jesper Kjær (Chief Operations Officer, CEUPM), Linda Van Gelder (Country Director, Western Balkans), Lalita M. Moorty (EFI Regional Director), Massimiliano Paolucci (Kosovo Country Manager), Elene Imnadze (Senior Operations Officer, EECKO), Ary Naim (IFC Country Manager), Ashley D. Taylor (Economic Adviser, ECAVP), Sаimаn Zaidi (Poverty and Equity Practice Manager), Jasmin Chakeri (Macroeconomics, Trade and Investment Practice Manager), Richard James Lowden Record (Lead Country Economist and EFI Program Leader), Iamele P. Rigolini (HD Program Leader) and Simon David Ellis (SD/Infrastructure Program Leader), Visar Perani (Country Officer, CEUKO), Gianfilippo Carboni (Risk Management Officer, MIGEC).

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Kosovo experienced a decade of robust growth (2010-2019)…

…with an especially robust expansion observed between 2014 and 2019.

Kosovo has achieved the highest vaccination rate against COVID-19 in the Western Balkans.

Consumption drives growth on the demand side…

…while services drive growth on the supply side.

Agriculture contributes less to total value added than it does among peer countries…

…and the agricultural sector contributes an especially small share to total employment.

The labor market has low labor-force participation, high unemployment, and vast gender gaps.

Poverty reduction was halted by the pandemic, but it resumed in 2021.

Emigration from Kosovo accelerated between 2014 and 2019.

Remittance inflows were stable but increased during the pandemic.

An organizing framework to understand Kosovo's development constraints.

Before 2020 Kosovo's fiscal deficit was stable and low…

…but the pandemic created a short-term fiscal imbalance.

Public revenue collection in Kosovo is below the regional average.

Total factor productivity growth has been low in recent years.

Most TFPR growth comes from factor reallocation.

Informality, electricity, taxes, and political instability are top business concerns in Kosovo.

Kosovo's net FDI inflows are still below structural and aspirational peers’

Most net FDI inflows have financed real estate purchases.
Kosovo’s exports are among the lowest in the region... and they are also below their predicted level.

Health infrastructure in Kosovo is below peer countries and the EU.

Primary education students lack foundational literacy and numeracy skills.

Students in Kosovo had the lowest PISA 2018 performance in the Western Balkans.

Labor force participation and employment are structurally low in Kosovo.

Most social protection spending is related to categorical pensions.

Few, mostly urban municipalities have grown in population since 2011.

Kosovo has one of the lowest levels of agricultural labor productivity among peer countries.

Several cities surpassed the maximum annual average PM2.5 concentration of 25 μg/m³.

Residential heating and power plants account for 70 percent of annual PM2.5 emissions.

Poverty headcount ratio (%)

Poverty gap index (%)

Shared prosperity (%)

Growth incidence curve, national, 2012-2017

Gini index by area, 2012-2017

Growth incidence curve, rural area, 2012-2017

Growth incidence curve, urban area, 2012-2017

Poverty incidence by household size (%)

Poverty incidence by number of children (%)

Poverty incidence by educational attainment of the household head (%)

Contribution of income components to change in poverty

Distribution of consumption expenditure
Abbreviations and acronyms

ASA  Advisory Services and Analytics
ASYCUDA  Automated System for Customs Data
BEEPS  Business Environment and Enterprise Performance Survey
CAP  Common Agricultural Policy
CAPI  Computer-Assisted Personal Interviews
CBAM  Carbon Border Adjustment Mechanism
CEFTA  Central European Free Trade Agreement
CEO  Chief Executive Officer
CMU  Country Management Unit
EBRD  European Bank for Reconstruction and Development
EC  European Commission
ECAPOV  Eastern Europe and Central Asia Poverty
ECOICOP  European Classification of Individual Consumption according to Purpose
EFI  Equitable Growth, Finance and Institutions
ENTSO-E  European Network of Transmission System Operators for Electricity
ESA  European System of National and Regional Accounts
ETS  Emissions Trading System
EU  European Union
EUROSTAT  European Statistical Office
FAO  Food and Agriculture Organization
FCV  Fragility, Conflict and Violence
FDI  Foreign Direct Investment
GDP  Gross Domestic Product
GIZ  Deutsche Gesellschaft für Internationale Zusammenarbeit
GNI  Gross National Income
GP  Global Practice
GWh  Gigawatt hours
HBS  Household Budget Surveys
HD  Human Development
HLO  High Level Outcomes
HS  Harmonized Commodity Description and Coding System
IDA  International Development Association
IDP  Internally Displaced Person
IFI  International Finance Institution
IMF  International Monetary Fund
ISCED  International Standard Classification of Education
IT  Information Technology
ITS  Intelligent Transport Systems
KCA  Kosovo Cadastral Agency
KPST  Kosovo Pension Savings Trust
KAS  Kosovo Agency of Statistics
LFP  Labor Force Participation
LFS  Labor Force Survey
LGBTQ  Lesbian, Gay, Bisexual, Transgender, and Questioning / Queer
MFI  Microfinance Institution
MICS  Multiple Indicator Cluster Surveys
MIGA  Multilateral Investment Guarantee Agency
MP  Member of Parliament
MPO  Macro Poverty Outlook
MSME  Micro, Small and Medium Enterprise
MTI  Macroeconomics, Trade and Investment
MW  Megawatt
NCD  Non-Communicable Disease
NGO  Non-Government Organization
NQI  National Quality Infrastructure
NRW  Nonrevenue Water
OECD  Organisation for Economic Co-operation and Development
OOP  Out-Of-Pocket
OSCE  Organization for Security and Co-operation in Europe
PISA  Programme for International Student Assessment
PM2.5  Particulate Matter 2.5
PPG  Public and Publicly Guaranteed
PPP  Purchasing Power Parity
QI  Quality Infrastructure
RCC  Regional Cooperation Council
RRA  Risk and Resilience Assessment
SAA  Stabilization and Association Agreement
SAS  Social Assistance Scheme
SCD  Systematic Country Diagnostic
SD  Sustainable Development
SDC  Swiss Agency for Development and Cooperation
SDG  Sustainable Development Goal
SEETO  South East Europe Transport Observatory
SIDA  Swedish International Development Cooperation Agency
SILC  Survey on Income and Living Conditions
SPI  Statistical Performance Indicators
STEM  Science, Technology, Engineering and Mathematics
STRI  Services Trade Restrictiveness Index
TFPR  Total Factor Productivity based on revenue
UNDCO  United Nations Development Coordination Office
UNDP  United Nations Development Programme
UNHCR  United Nations High Commissioner for Refugees
UNICEF  United Nations Children’s Fund
USAID  United States Agency for International Development
VAT  Value Added Tax
WBG  World Bank Group
WCO  World Customs Organization
WDI  World Development Indicators
WFP  World Food Programme
WHO  World Health Organization
y/y  Year-on-year

Abbreviations and acronyms (Continued)

Republic of Kosovo

<table>
<thead>
<tr>
<th>Government fiscal year</th>
<th>July 1 – June 30</th>
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<td>Currency equivalents</td>
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<tr>
<td>(Exchange Rate Effective as of January 2022)</td>
<td>US$1.00 = EUR 0.8839</td>
</tr>
</tbody>
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Throughout the document, references to comparator countries are as follows. Kosovo (KOS)’s selected structural peers are North Macedonia (MKD), Albania (ALB), Kyrgyz Republic (KGZ), Armenia (ARM), Moldova (MDA). Structural peers are chosen based on income per capita, population, services as a percentage of GDP, and young population as a percentage of overall population. Latvia (LVA), Uruguay (URY), Estonia (EST), Slovenia (SVN), Lithuania (LTU), and the Czech Republic (CZE) are selected as aspirational peers. Aspirational peers are chosen based on income per capita and population. Except for Uruguay, all comparators (structural and aspirational peers) have a planned economy/transitional legacy. Regional peers are Albania, Bosnia and Herzegovina (BIH), Montenegro (MNE), North Macedonia, and Serbia (SRB).
1. Introduction

1. Kosovo enjoyed steady socio-economic progress in the decade before the pandemic. Between 2010 and 2019, Kosovo grew by an average 4.6 percent a year, which translated into an almost 50-percent increase in per capita income, and a 35-percent poverty rate reduction. Kosovo’s growth performance was robust compared to peer countries of similar or higher income per capita, and it accelerated prior to the pandemic, in part thanks to a steady expansion in consumption and investment—both relying on diaspora financing—public investment in infrastructure, and financial deepening, amid a stable fiscal stance and a low inflation environment.

2. Recent events define a pivotal moment that could shape the future path of Kosovo’s economy. In 2020, the Covid-19 pandemic brought about Kosovo’s first recession since independence, exposing the vulnerability of its growth drivers, especially diaspora visits and investment, to external factors. The depth of structural weaknesses in health, education, and social assistance became apparent as well. While government responses were decisive and partly cushioned the shock, human capital losses have been significant. Thanks to domestic policies and an improvement in external conditions, the recession was short-lived, and in 2021 the economy bounced back. Although traditional growth drivers will continue to dominate economic activity in the medium term, a new momentum for merchandise exports and recent growth in formalization signal an opportunity to consolidate structural changes. In this context, the renewed political stability generates the conditions to implement reforms and policies to put Kosovo on a path to faster and more inclusive economic progress. Still, external factors pose significant risks for the recovery, as rising inflationary pressures are further exacerbated by the war in Ukraine, jeopardizing hard-earned social gains.

3. This Systematic Country Diagnostic (SCD) examines the current constraints and policy priorities for Kosovo to achieve the Twin Goals of eradicating poverty and accelerating shared prosperity. This report follows on the first SCD, completed in 2017, which highlighted fiscal policy, competitiveness, inclusion, and environmental sustainability as priorities for sustainable poverty reduction and shared prosperity (Box 1). The SCD described Kosovo’s recent development as a combination of steady growth and poverty reduction. However, it also noted that persistently low employment and labor-force participation rates, high levels of emigration, and a heavy dependence on remittance flows had led to jobless growth, while weak institutions and slow progress in human development hindered gains in productivity and wellbeing. The analysis identified overarching priorities for establishing a more dynamic and open economy driven by manufacturing and tradable services, a more efficient public sector that invests in human development and closes socioeconomic gaps, and a sustainable approach to environmental management that preserves Kosovo’s natural resources for future generations. Today, many challenges identified in the 2017 SCD continue to hamper Kosovo’s progress and several structural weaknesses could worsen due to the pandemic, climate change, and the energy transition. In this sense, this SCD is conducted as an “update,” as it largely maintains the conceptual framework in the previous SCD, describes how the structural conditions identified in it have evolved, and proposes a revised set of development priorities for the next five years.

4. Notwithstanding progress, the structural weaknesses identified in the 2017 SCD continue to slow Kosovo’s economic convergence with the European Union. The country has seen significant progress since 2017, especially in macro-fiscal management, access to finance, and more recently, merchandise exports growth and private sector development. However, structural barriers to growth persist. Economic growth is driven primarily by credit- and remittance–financed consumption, which has fueled a heavy reliance on imports, an expansion of the non-tradable sectors and has slowed down the country’s competitiveness, productivity, and

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1 The poverty change is estimated between 2012-2019 as data are not comparable prior to 2012.
2 As a Euroized economy, Kosovo is sensitive to monetary policy in the EU.
employment growth. The contribution of investment to growth has increased in recent years, and despite new investment in wind energy, overall investment remains heavily focused on non-tradable sectors, particularly construction. Persistent governance gaps, infrastructure deficits, and low labor-force participation rates continue to limit investment and employment growth. Outmigration pressures hurt the labor market: Legacy entitlement benefits prevent an improved targeting of social protection spending (though social spending in response to the pandemic was better targeted). Fiscal space and implementation capacity remain insufficient to invest in high-return public infrastructure. Finally, Kosovo is still not a member of the United Nations, and its citizens still do not enjoy a visa-free travel regime with the EU, both considered important constraints to trade integration.

5. Social risks persist amid a context of pandemic recovery and elevated geopolitical uncertainty. For almost 22 years, Kosovo has undergone a complex process of state-building, democratization, and socioeconomic development. While free and fair elections and active participation from civil society are positive signs, Kosovo continues to face significant social, economic, and political vulnerabilities. The 2021 Risk and Resilience Assessment identified three main risks: (1) contested statehood, linked to regional geopolitical uncertainty (2) economic and political disenfranchisement, particularly among youth and (3) institutional weakness in the rule of law.\(^3\) Notwithstanding recent progress, lack of judicial independence creates an enabling environment for corruption and leads to widespread grievances.\(^4\) Weak institutions and accountability mechanisms hamper investment of public resources to build human and physical capital that stimulates job creation and the inclusion of youth into the labor market (Annex 4).\(^5\) In line with IDA19 policy commitments, the SCD update identifies solutions that address Kosovo’s drivers of institutional weakness.

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**Box 1: Summary of the 2017 Kosovo Systematic Country Diagnostic (World Bank, 2017)**

The 2017 Kosovo SCD provided a portrait of the economic and social developments in Kosovo—the youngest and one of the poorest economies in Europe—since its separation from the former Yugoslavia and later its declaration of independence. Kosovo’s growth model has relied on remittance-financed consumption, met mainly by imports and an expansion of non-tradable sectors. This model hindered competitiveness, with productivity stagnating and contributing much less to GDP growth than factor accumulation. The 2017 SCD identified weak governance, infrastructure deficits, and an abundance of low-skilled workers as the main factors that limit investment and employment growth. Historical legacy of war and weak institutions led governments to make an inefficient use of public resources, increasing public wages, benefits for veterans and former political prisoners, and investing in public infrastructure with low economic returns.

The SCD proposed a set of four blocks of policy priorities that would shift the growth model of Kosovo towards a more competitive one based on manufacturing and tradables, a more efficient public sector that invests more in people and closes socioeconomic gaps, and a sustainable economy that preserves natural resources for the future. **Pathway 1:** While preserving fiscal discipline, reprioritize public expenditures and reorient taxation to address critical development challenges. Specifically, the country should align the budget more closely with development needs and improve the allocation and efficiency of public spending, and shift to direct taxation and strengthen tax administration. **Pathway 2:** Enhance the environment for private investment and business expansion in tradable sectors and make a determined effort to reap the full benefits of European integration. This implies capitalize on comparative advantages in manufacturing and tradable services, and reducing regulatory and infrastructure gaps. **Pathway 3:** Foster greater inclusion by building human capital and ensuring equal opportunities. First, invest in better quality and more job-relevant education, and provide a comprehensive set of policies to increase incentives for labor force participation by youth and women. Second, improve the social protection system so that the state can more effectively identify and reach the most economically excluded groups with cash transfers and other services. **Pathway 4:** Enhance the stewardship of the environment and natural resources for immediate social welfare advances and the long-term sustainability of inclusive growth. Namely, increase productivity in agriculture and manage natural resources sustainably, especially around the mining sector.
6. Kosovo can sustain faster and more inclusive economic growth by leveraging its comparative advantages. Kosovo’s population is the youngest in Europe: a full 25 percent of Kosovars are under age 14, far above the EU average of 15 percent (EUROSTAT 2021b). However, Kosovo will only reap a demographic dividend if young workers are able to find job opportunities at home. In addition, due to high levels of emigration, Kosovo has a large diaspora—primarily located in the European Union—that still maintains a tight bond with the country. The diaspora represents a vast stock of human capital, as Kosovar emigrants possess skills, professional networks, and financial resources that could help the private sector attract investment, adopt new technologies, and increase its competitiveness. In addition, the Stabilization and Association Agreement (SAA) between Kosovo and the EU that entered into force in 2016, combined to Kosovo’s proximity to the EU market represent an exceptional opportunity. In recent years, Kosovo has greatly expanded its digital infrastructure, establishing the basis for the development of e-commerce and other high-tech sectors. The country’s natural assets are also underutilized, including its extensive mineral resources (beyond coal) and a rich and diverse array of natural and cultural attractions that could boost tourism. Finally, Kosovo’s legal framework for private-sector development is robust by international standards, though its implementation is uneven and often ineffective.

7. The SCD update revisits the constraints identified in the 2017 SCD against the backdrop of internal economic and policy developments and new challenges created by external factors. Section 2 describes recent economic and social developments in the country, especially since the onset of the pandemic, while Section 3 details the structural barriers that constrain progress on the twin goals of eliminating extreme poverty and promoting shared prosperity. The analysis reveals that growth has been historically supported by consumption, while low-productivity investment by firms limits the number of jobs for new labor-market entrants. Credit deepening can increase consumption growth in the short-term, but with a decreasing effect. Meanwhile, informality weakens the mobilization of public revenues to finance high-quality services and infrastructure. In turn, the relatively low administrative capacity and effectiveness limit the potential for public expenditure to support productivity growth, safeguard environmental quality, or narrow socioeconomic gaps. These conditions result in low labor force participation, high unemployment and emigration, and persistent household vulnerability. Rural areas, which are home to over half of population, have lower access to public services and economic opportunities, and rural communities are increasingly at risk from the mismanagement of natural resources and the escalating effects of climate change.

8. While most of the constraints identified in the 2017 SCD remain valid, energy policy, the low-carbon transition, and investment on human capital have taken on renewed importance. While economic output recovered rapidly in 2021, the pandemic’s impact on Kosovo’s already low levels of human capital will not be apparent for several years and could lower the country’s long-term potential growth rate. In the near term, strengthening the delivery of basic services in health, education, and social protection system are especially urgent as the country grapples with the human and social costs of the pandemic. The recent global spike in energy prices, against and outdated, unreliable, and polluting domestic energy production capacity and rapidly rising energy consumption also underscore the urgency of near-term energy efficiency measures and a longer-term energy strategy centered on the green transition. Although Kosovo’s institutional gaps, low levels of human capital, and deficient infrastructure base are products of long-standing historical factors, recent progress in areas such as digital development shows that change is possible when the right policies are in place. Section 4 of the SCD update identifies policies designed to leverage new opportunities for sustainable growth and inclusion in Kosovo, while taking into consideration their political feasibility and implementation timeframe.
2. Key recent economic and social developments

9. Growth accelerated in the years prior to the pandemic, but regional convergence remained a distant objective. Overall, Kosovo’s growth performance in the decade before the pandemic was robust compared to its structural and aspirational peer countries, except for Armenia, Moldova, and Lithuania (Figure 1). From 2010 to 2014, the GDP growth rate was, on average, one percentage point below its estimated potential, but it accelerated between 2015 and 2019 to an average 4.2 percent, exceeding its estimated potential (Figure 2). Still, by 2019, it would have taken Kosovo 35 years to catch up with new EU member countries such as Bulgaria, even with a sustained GDP per capita growth rate of 4 percent, assuming the latter grew at a rate of just 2 percent.

10. The COVID-19 pandemic upended this progress in 2020. Between March 2020 and February 2022, total COVID-19 cases were confirmed for 225,664 people and 3,105 lives were lost to the virus (Box 2). The country’s health system, like many others around the world, was unprepared to handle the virus and was overwhelmed at the onset of the pandemic. GDP contracted by 5.3 percent in 2020 in real terms as service exports plunged and investment activity slowed. However, fiscal support measures, coupled with increases in both remittances and goods exports, mitigated the pandemic-induced contraction.

11. A buoyant recovery is underway, but downside risks underscore the urgency of structural reforms. A slow vaccination rollout picked up in the second half of 2021 and by February 2022 more than half of the population was fully vaccinated. As travel restrictions relaxed and activity rapidly resumed, GDP growth turned positive again during the last quarter of 2020. Real GDP growth in 2021 is estimated to have exceeded 9 percent in 2021, driven by a strong rebound in diaspora visits, fiscal support measures, export growth, and restored consumption, all of which pushed economic activity above pre-pandemic levels. Moreover, current forecasts indicate that the growth rate could remain above 4 percent through 2024. However, heightened inflationary pressures following the war in Ukraine and pandemic-related risks threaten this outlook and could lower growth in the medium term. Persistent increases in import prices, especially for energy and food, could exacerbate inflation, slow down growth, and weaken Kosovo’s global competitiveness.

12. A stable pre-pandemic fiscal stance was temporarily affected by the response to the pandemic. As a result of Kosovo’s long-term fiscal discipline and

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6 According to the latest revision of National Accounts by the Kosovo Statistics Agency.

7 According to latest Kosovo Statistics Agency provisional statistics, growth in 2021 resulted at an even higher rate of 10.5 percent.
recent measures to strengthen it, the overall budget deficit averaged 2.1 of GDP in the five pre-pandemic years. Following a fiscal stimulus package mostly consisting of current expenditures amounting to 4.4 percent of GDP, the budget deficit more than doubled to 7.6 percent of GDP in 2020. In 2021, tax revenues increased by 29 percent y/y thanks to the rebound in economic activity, formalization, but also rising inflation. Even with a continued fiscal package equivalent to 3.2 percent of GDP, the deficit is estimated at just 1.4 percent of GDP in 2021, down sharply from 2020 and below the level planned in the 2021 budget. In the medium term, tax revenue collection is expected to decelerate but remain strong. However, expenditure should outpace revenues due to a rebound in capital expenditure and higher current expenditures from energy subsidies and social transfers. The overall deficit is projected to remain below 3 percent of GDP, in line with the fiscal rule. The total debt stock is projected to rise from 22.5 percent of GDP in 2021 to 27 percent by end-2024 (see Annex 1).

The pace of vaccination accelerated significantly in the second half of 2021, and over half of the population is now vaccinated. In May 2021, less than 3 percent of the population had received at least one dose of the vaccine, the lowest rate in the region. By February 2022, in contrast, over 50 percent of the population had received at least one dose and 46 percent were fully vaccinated. While Kosovo’s vaccination rate now exceeds those of all neighboring countries, it remains below the EU average (Figure 3, right). Expanding vaccine coverage through the full rollout of the third dosage is important given the heavy reliance on diaspora visits.

Box 2: Evolution of the COVID-19 pandemic and vaccination in Kosovo

The COVID-19 pandemic took a significant social, economic, and human toll in Kosovo. With over 225,000 positive cases since the onset of the pandemic and over 3,000 deaths, COVID-19 has upended normal life and economic activity in the country, as it has in the rest of the world. Kosovo was hit by four waves of infections between early 2020 and early 2022, with intermittent movement restrictions imposed to contain the increase in cases. While the total number of cases and deaths per capita remains relatively low by the standards of some neighboring countries (Figure 3, left), the pandemic put tremendous pressure on Kosovo’s already fragile and inequitable health system. Likewise, the education system was unequipped to provide continuous remote teaching and prevent learning losses. This situation is expected to further lower human capital accumulation in Kosovo, which already showed a large deficit before the pandemic.

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Figure 3: Kosovo has achieved the highest vaccination rate against COVID-19 in the Western Balkans

Notes: People vaccinated with at least one dose. Date varies between end January–mid February 2022.
Source: Ritchie H. et al. (Our World in Data) (2020) and European Centre for Disease Prevention and Control.
13. In the last decade, consumption has been the main driver of growth, followed by investment. On the demand side, private consumption financed by remittances, consumer lending, and increasing pension and social transfers contributed the most to growth. Investment has increased its contribution to growth in the last years (Figure 4). Meanwhile, the average contribution of net exports has been negative, reflecting weak export competitiveness and a high level of import dependence. On the supply side, increased value added in services and industrial activity (to a lesser degree) have been the main growth drivers, while agriculture’s contribution has been negative, on average (Figure 5).

14. Agriculture has lost ground in the economy, both in value added and employment. Agriculture’s importance has diminished over time, both in terms of value added (Figure 6) and employment (Figure 7). In other countries, this pattern has indicated a standard process of structural transformation, in which ascendant industrial and services sectors supplant agriculture as drivers of growth. In Kosovo, however, declining agricultural productivity is responsible for the sector’s shrinking contribution to total output.

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*The composition of growth remained unchanged in 2020 and 2021. Remittances, higher public wages, and accelerated consumer lending thanks to lower interest rates fueled consumption.*
15. **Growth did not translate into significant job creation, though labor formalization has increased recently.** Historically, economic growth in Kosovo has had a weak effect on job creation, and in the years prior to the pandemic the employment rate only marginally increased, reaching just 43 percent for men and 14 percent for women by 2020. The labor-force participation rate is among the lowest in the region at 39 percent, with a gender gap of over 35 percentage points (Figure 8). Unemployment rates are chronically high at around 25 percent for all workers and 50 percent for workers between 15 and 25. The employment rate in Pristina is lower than in other regions, but the capital accounts for over half of all employed workers, of which almost one-third are in the public sector (Siddiqui et al. 2018). Despite persistently high unemployment and low rates of labor-force participation, tax data from 2015 to 2018 indicate that an average of 10,000 formal jobs was added each year, twice the rate observed between 2011 and 2014, and this trend continued despite the pandemic, as formal jobs grew by around 10 percent in 2021.

17. **Limited job creation has hindered poverty reduction and slowed income convergence with regional and EU peers.** The poverty headcount rate fell by 7.8 percentage points between 2012 and 2017, but most of that reduction took place before 2016, when GDP growth accelerated, illustrating the weak links between growth, employment, and poverty reduction in Kosovo. By 2019, one in five Kosovars still lived on less than US$5.5 per day. Slow income growth and poverty reduction hindered convergence with EU living standards, and in 2019 Kosovo’s per capita income was just one-fourth of the EU average. In 2020, the COVID-19 crisis caused the poverty rate to rise by an estimated 2.1 percentage points. The crisis impacted Kosovo’s economy primarily through the loss of diaspora-driven tourism and slowing industrial activity, which occurred despite both a substantial fiscal stimulus and a net increase in remittances. With per capita GDP growth bouncing back to an estimated 8.8 percent in 2021, the poverty rate is estimated to have fallen below 20 percent; however, these estimates remain provisional, as no data are yet available regarding the overall recovery of employment (Figure 9). Moreover, the outlook for 2022 is increasingly uncertain as prices rise sharply for food, energy, and other key consumption goods.

18. **High levels of emigration and a heavy reliance on remittances continue.** Slow employment growth and limited public services have contributed to a steady outflow of workers to the European Union and elsewhere, as illustrated by the rising number of first residence permits granted by EU28 countries to emigrants from Kosovo between 2014 and 2018 (Figure 10), and a reportedly high number of new

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**Figure 8: The labor market has low labor-force participation, high unemployment, and vast gender gaps**

<table>
<thead>
<tr>
<th>Year</th>
<th>LFP Men</th>
<th>Employment Men</th>
<th>LFP Women</th>
<th>Employment Women</th>
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<td>12%</td>
<td>18%</td>
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<td>2018</td>
<td>12%</td>
<td>18%</td>
<td>63%</td>
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<td>2019</td>
<td>14%</td>
<td>21%</td>
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<td>56%</td>
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<td>2020</td>
<td>14%</td>
<td>21%</td>
<td>56%</td>
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Source: Authors, based on Labor Force Survey data from Kosovo Agency of Statistics.
EU work permit applications. The Kosovo Agency of Statistics reports that Kosovars have emigrated mainly to Germany (35.3 percent), Switzerland (23 percent), Italy (7.3 percent) and Austria (5.6 percent). Social norms and proximity with host countries have kept remittance inflows steady at about 12 percent of GDP from 2010 to 2019 but increased during the pandemic (Figure 11). Meanwhile, diaspora-driven tourism exports partially compensate for a large trade deficit in goods. Considerable remittance inflows and foreign direct investment (FDI) in real estate by the Kosovar diaspora are the main sources of financing for the current-account deficit. Overall, Kosovo’s economy continues to depend on the activities of the diaspora, which accounted for a combined 27 percent of GDP in 2020, and over 30 percent of GDP in 2021.14

19. After a period of political instability and fragmentation, a new government was elected in 2021 with a strong majority. A wide-coalition government formed following elections in 2017 lasted until July 2019, when the prime minister resigned. In the following elections held in October, no single party won a majority above 50 percent, and a coalition between the two main parties was only established in February 2020, but it collapsed within months. A new government, formed in June 2020, was ruled invalid in December by the Constitutional Court, and fresh elections were called in February 2021. Positively, the government formed in March 2021 followed the first post-independence election to produce a winner with an over 50 percent parliamentary vote. Until 2020, political instability had undermined trust in the government, and levels of trust in public institutions were the second lowest in the Western Balkans after Bosnia and Herzegovina.15

14 The calculation incorporates remittance inflows, exports of travel services and inflows of real estate FDI.
15 Balkan Barometer (2020). This was confirmed by the May 2021 Public Pulse poll conducted by UNDP and USAID (UNDP 2021).
20. The structural drivers of growth and the constraints to Kosovo’s development identified in the 2017 SCD remain valid, but the pandemic and external risks underscore the importance of fostering socioeconomic resilience and preventing inequality and social exclusion from worsening. Access to digital infrastructure and services has proven crucial to overcome the physical constraints imposed by the pandemic and are key recovery accelerators. Meanwhile, the increasing urgency of transitioning to a growth model that supports climate-change mitigation and adaptation—in line with EU commitments—present a unique opportunity for policymakers to take bold action to transform Kosovo’s energy matrix and promote the expansion of environmentally sustainable economic sectors, while also providing workers with the skills necessary to compete in those sectors.

21. Poverty reduction and shared prosperity in Kosovo depend on improved access to employment opportunities. The central weakness of Kosovo’s economic model is its low capacity to generate employment, which primarily reflects limited investments in infrastructure and human capital. In rural areas, agricultural productivity has been declining, and semi-subsistence farming is common. With few jobs available domestically, many workers emigrate in search of better opportunities, further eroding the productivity of the national labor force. Unemployment is strongly correlated with household poverty, and earnings growth is the main driver of poverty reduction. In this context, building human capital (labor supply) while accelerating the creation of high-quality jobs (labor demand) in an increasingly competitive private sector could enable rapid progress on poverty reduction and shared prosperity.

22. Long-term prosperity also requires a strategy to promote environmental sustainability, support climate-change adaptation, and accelerate Kosovo’s transition to low-carbon growth. Like most middle-income economies, Kosovo’s natural resources are under increasing pressure from unplanned urbanization, low-productivity agriculture, and climate change, as well as the negative impacts of mining and coal-based energy production. The government has committed to implement policies that promote environmental sustainability, but achieving its objectives—and retaining access to environmental funds from the European Union and other sources—will require faster progress in areas such as energy generation, transportation, waste management, and climate adaptation. In addition to strengthening environmental sustainability, a well-implemented green-growth strategy can promote employment creation and economic inclusion by creating new opportunities for the private sector.

23. Four Policy Pathways capture the priorities for Kosovo to advance towards the Twin Goals. Following internal and external consultations, the SCD update identifies the following key strategic objectives for the achievement of the twin goals: (i) a more productive workforce with access to high-quality, high-income employment opportunities; (ii) a more competitive private sector that creates high-quality jobs and strengthens Kosovo’s integration into regional and global markets; and (iii) a more sustainable and resilient use of natural resources, including a less carbon-intensive energy matrix and improved urban planning and rural land use. In turn, the SCD update organizes the identification of constraints and policy priorities along four key Policy Pathways.

24. The policy recommendations presented in this SCD update are organized according to the four corresponding Pathways, with specific priorities defined and ranked according to their relative impact. These Pathways (Figure 12) include: (i) Increasing returns and equity of fiscal policy by regaining fiscal sustainability, prioritizing public expenditures and mobilizing revenues; (ii) Improving business environment and trade integration by improving the rule of law, investing in productive-enhancing infrastructure and facilitating trade; (iii) Investing in human capital and increasing inclusion by improving health affordability and quality, increasing the quality of teaching and reforming social assistance to benefit the poor more, and
(iv) Improving environmental management and planning by increasing agricultural productivity, improving rural infrastructure, and reducing air pollution in cities through better service delivery (transport, heating) and urban planning. Together, the four Pathways and the policies included in them will contribute to accelerate Kosovo’s progress towards a more productive human capital, a more competitive private sector, and a more resilient and sustainable environment.

25. Within each Pathway, the analysis highlights Kosovo’s institutional constraints to quality and efficiency of service delivery. Public institutions at the national and local levels face constraints related to planning, coordination, monitoring, and reporting that undermine service delivery. For instance, despite recent efforts to set up inter-institutional structures for the implementation of EU-related reforms, efficient organization of donor assistance and inter-sectoral policies remains limited. In terms of prioritization of policies, the government has finalized its National Development Strategy (2021-2030), which should help to define key objectives, but these need to be linked to policy planning, performance indicators, and budgeting. Evidence-based policymaking is limited. For example, the trade-offs, sustainability, and fiscal impact of new policies are frequently unknown, either for lack of sufficient data or of mandates to produce such analysis.\(^\text{18}\) Key basic services under the responsibility of local governments face considerable capacity and governance constraints. Indeed, administrations do not receive funding in line with their competences; but they also have low accountability because municipal assemblies have weak oversight capacity. In summary, development outcomes described within each Pathway need to be linked to specific governance constraints that can then be addressed through the relevant policy actions.

Figure 12: An organizing framework to understand Kosovo’s development constraints
Pathway 1: Increasing returns and equity of fiscal policy

For a unilaterally Euroized economy, fiscal sustainability is a precondition for macroeconomic stability and socio-economic development. Kosovo maintained a stable fiscal stance, further enhancing rules-based fiscal policymaking and strengthening debt management. This allowed the government to conduct counter-cyclical fiscal policy to mitigate the pandemic shock, though it had to temporarily relax its fiscal rules. Revenue mobilization improved gradually before the pandemic but accelerated in 2021, thanks in part to measures to increase formalization, which helped fiscal consolidation. Public debt decelerated in 2021 and it has the lowest level in the region. While important policies and investments are still pending, the scope for expanding public expenditure and enhancing its effectiveness is limited by the lack of access to international debt markets, exhausted privatization proceeds, prolonged multi-year investment projects, revenues fed by relatively low tax rates and a narrow tax base, combined with growing entitlement benefits, and a limited administrative capacity.

26. Kosovo strengthened fiscal discipline and maintained sustainable headline fiscal policy. By adhering to rules that limit fiscal deficit and debt expansion, Kosovo maintained a stable headline fiscal stance (Figure 13), until 2020. From 2015 to 2019, the authorities: (i) introduced the public wage rule and included deficit reporting in the annual financial statement to improve monitoring of the minimum budget reserves rule, (ii) strengthened capacity for public debt planning and management, (iii) advanced the digitalization of tax administration and centralized tax debt collection, and (iv) standardized the use of e-procurement processes. As a result of these measures, from 2015 to 2019, the overall budget deficit averaged 2.1 percent of GDP. After a spike in 2020, the fiscal balance in 2021 improved significantly, resulting below the fiscal rule ceilings. The authorities are committed to enforce the deficit ceiling from 2023. Debt sustainability analysis (DSA) shows that Kosovo needs to run primary budget deficits of below 2 percent of GDP to safeguard fiscal sustainability by ensuring that public debt remains below 40 percent of GDP.

27. The pandemic exerted unprecedented pressure on public finances. In 2020, public revenue fell by almost 9 percent y/y, while current public spending increased by a record 18.6 percent, driven by fiscal stimulus packages totaling an estimated 4.4 percent of GDP. Meanwhile, public investment dropped by more than 20 percent. Public and publicly guaranteed (PPG) debt jumped by 4.8 percentage points, from 17.6 in 2019 to 22.4 percent of GDP in 2020.

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28. The fiscal deficit declined considerably in 2021 and is expected to remain within the fiscal rule over the medium-term. In 2021, tax revenues increased by almost 30 percent y/y, driven by a rebound in economic activity, growing inflation, but also strengthened tax compliance measures and formalization incentives. Meanwhile, the government implemented an economic stimulus package of around 3.2 percent of GDP, driving a 7 percent nominal increase in current spending. Public capital expenditures increased remained stable relative to output, at an estimated 5.5 percent of GDP, and at just above three-fourths of the capital budget. As a result, the fiscal deficit declined to an estimated 1.4 percent of GDP. Positively, the authorities used the surge in tax revenue to decelerate domestic debt accumulation, and public debt relative to GDP remained broadly the same compared to 2020. To return to the legally binding deficit ceiling of 2 percent of GDP from 2023, the government will need to mitigate risks on the revenue and expenditure side.

29. Kosovo has no access to international financial markets and a domestic market with limited depth, and privatization receipts have been depleted. Although public debt is the lowest in the Western Balkans, it started growing pre-pandemic and continued in 2020. Driven by higher primary deficits, PPG debt increased from 14.5 percent in 2016 to 22.4 percent of GDP at the end of 2020. Almost all debt is held at the central level. Domestic-bond issuance, launched in 2012, increased almost 10-fold between 2012 and 2020 (from 1.5 to 14.4 percent of GDP), with a significant share held by the Kosovo Pension Savings Trust. Unfortunately, the secondary market for domestic debt, and the overall depth of the domestic market is limited. Starting in 2023, the authorities will have to repay a portion of pension withdrawals at a cost of 1 percent of GDP. Thus, reducing domestic debt in 2021 and launching retail (diapora) bonds are important steps. External debt is mostly IFI-sourced and concessional, reaching an estimated 76 percent of GDP at end-2021, and there is scope to increase concessional financing, but execution capacity needs to strengthen. Positively, authorities opted to utilize the IMF SDR allocations announced in 2021 to bolster macro-fiscal management buffers. Privatization proceeds were an important source of financing until 2020, but they are largely depleted and associated with potential privatization related contingent liabilities.

30. Public revenues have increased but remain vulnerable to external shocks. Tax revenues relative to GDP are lower in Kosovo than in most structurally comparable and aspirational peers, reflecting lower tax rates and social security contributions, as well as a significant tax gap (Figure 15). The 2015 increase in the headline VAT rate, select excise rate increases, growth in formalization—due to enhanced digitalization in tax administration, improved tax debt collection, and the recent fiscal support measures—have boosted domestic tax revenues. However, the use of discretionary tax exemptions such as for sponsorships and domestic manufacturing undermine revenue mobilization. Meanwhile, the implementation of the SAA and the free-trade agreement with Turkey will further constrain revenue collection in the near term. Almost 70 percent of tax revenue is collected at the border, which increases the sensitivity of public revenue to external shocks. Given the limited financing options, the government will need to increase non-trade tax revenues to maintain fiscal sustainability and address the country’s development needs.

31. Despite recent progress, informality remains a major constraint for domestic revenue mobilization. Reducing the tax gap remains the key challenge on the revenue side. A 2017 study of informality estimated the VAT and corporate income tax gap at 33 percent and the personal income tax gap at 35 percent. According to the 2019 Business Environment and Enterprise Performance Survey (BEEPS), firms in Kosovo regard competition from the informal sector as a much greater concern than the tax burden. Kosovo’s persistently high rates of informality reflect administrative capacity constraints and gaps in the regulatory and governance environment, as well as structural factors such as the widespread receipt of informal remittances, the prevalence of small-scale agriculture, the legacy of transition from a largely state-controlled economy, and the legacy of conflict.

32. A stronger fiscal risk management strategy is vital to enhance fiscal governance and sustainability. In 2021, the government took important steps to prevent accumulation of liabilities from expropriation, including by enhancing safeguards to reduce expropriation costs. At the same time, it has gradually settled payment arrears, including for agriculture subsidies. Adopting a performance management framework for regional water companies was also a positive step. However, future fiscal space will continue to be compromised by the potential materialization of these and other risks.

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21 The World Bank's 2014 Public Finance Review estimated the tax gap at 34 percent of annual collections, due largely to low VAT collection from domestic suppliers, as well as a significant gap in direct taxation. The World Bank is currently working with the authorities to update the tax-gap assessment to inform further efforts to improve compliance.
33. Important reforms and new policies with high fiscal relevance face a limited fiscal space. Six important reforms with high fiscal relevance are in motion and will define the expenditure portfolio going forward, including reforms to: 1) public compensation, 2) pensions, 3) healthcare financing, 4) social protection, 5) early childhood education and 6) energy. In addition, the government program plans to implement new capital investment projects, as the budget is crowded with previous multi-year projects with prolonged implementation.

34. Public expenditure effectiveness and equity remain key challenges. Kosovo’s pre-pandemic growth enabled public expenditure to increase by more than 40 percent between 2014 and 2019, and even more since. The share of current spending in total expenditure grew in the last five years to over 75 percent of total expenditure, driven primarily by increases in transfers and employee compensation. Other examples of inefficient current expenditure are the proliferation of untargeted social transfers and pensions, the ineffective agricultural subsidy scheme and health expenditures without a proper financing mechanism. Moreover, public investment is undermined by weak management, procurement bottlenecks, and budget entrenchment on multi-year road infrastructure projects with high expropriation costs. Overall, expenditure decisions fail to tackle stated strategic priorities, and the budget process remains untied to performance. Fiscal risks generated by the weak performance of publicly owned enterprises (POE) intensified during the past year’s recession.

35. The scope of digitalization to improve public expenditure efficiency and service delivery has expanded significantly. Kosovo has the highest internet penetration rate in the region. Digitalization of the civil registry, court case management, procurement, tax filing, the municipal performance monitoring system, among others, represent significant advances. The recent use of digital means to implement the vaccination process and deliver the Economic Revival Package through online applications and back-office data validation are proof that digitalization has great potential to improve service delivery. The government recently adopted the Law on Electronic Identification and Trust Services in Electronic Transactions, but it still needs to be implemented. Efforts to digitalize public service delivery remain scattered and interoperability is improving but remains limited. For instance, there is no functional health management information system (MIS), while the education MIS has significant limitations. The digitalization of cadaster records is still ongoing, the e-inspections platform has yet to be established, and most public services still require in-person interaction. Lack of interoperability among systems, for example between the Kosovo Financial MIS and e-Procurement platform, limits the scope for improving public expenditure efficiency and service delivery. Furthermore, institutionalization of performance-oriented processes in public service delivery is lagging.

36. The current fiscal framework falls short of laying the foundations for a green transition. Kosovo is moving to address climate by reforming renewable energy support schemes, investing in energy efficiency and developing a new Energy Strategy that is expected to define an ambitious path to decarbonization. However, the current fiscal framework does not explicitly account for these policies. Once
the new Energy Strategy is adopted, the fiscal costs of required investments or policies will need to be explicitly identified and accommodated in the fiscal framework to reflect the country’s commitment to a green transition. Commitment to move away from fossil fuel subsidies, including through subsidized loans to POEs, will also need to be put in action. Likewise, tax policies need to create incentives and address the costs of the transition, including by adjusting fuel and vehicle import excises to build the necessary foundations for moving towards carbon taxation.

37. In summary, the COVID-19 pandemic corroborated the importance of a sustainable, effective, and equitable fiscal policy to mitigate the impact of shocks in a unilaterally Euroized economy.

Pathway 2: Improving business environment and trade integration

Kosovo advanced towards creating a more conducive environment for private sector development. Access to credit, improvements in transport and fixed broadband infrastructure, enhanced trade facilitation, contract enforcement, and a reduction in regulatory barriers, among others, helped increase formal private sector employment and export dynamism. However, firm-level productivity and greenfield foreign direct investment grew modestly, which constrained job creation. At the same time, employers struggle to hire and retain skilled workers. Despite progress, small firms, among others, have difficulties to access financing. Finally, securing a reliable energy supply and expanding productivity-enhancing infrastructure and digitalization continue to be key objectives.

38. The private sector in Kosovo is dominated by micro and small firms that operate in an ecosystem with little creative destruction. Micro, Small and Medium Enterprises (MSMEs) account for more than 97 percent of formal firms in Kosovo. In terms of sales, medium and large enterprises are significantly smaller than their EU counterparts. While the market appears to be dynamic with a positive rate of net firm creation—firm entry minus exit—it turns out this is only true if measured by the number of firms formally registering and deregistering, but not when only firms with an “active” taxpayer status are counted. In addition, firm density—the number of firms per million inhabitants—is below both the EU average and the level expected for Kosovo’s income per capita. Because of low productivity, firm survival and the share of exporters are lower than in comparator countries. Over a five-year period, fewer than 30 percent of micro enterprises grew out of their size class. Firm management is also heavily gender-biased: only 9 percent of the firms have a female decision maker, and among those that do, access to credit is lower (38.1 percent) compared to firms with a male decision maker (45.6 percent). These outcomes chiefly result from Kosovo’s development legacy. Against the backdrop of a small domestic market which is highly sensitive to diaspora flows, private sector competitiveness and export-orientation become key to firm growth and job creation.

39. Firm-level productivity growth is slow. A recent firm-level analysis finds that a Kosovar firm needs three times as many workers to produce the same output as a firm in the EU. Between 2013 and 2017, revenue-based total factor productivity (TFPR) grew by an average of 0.5 percent (Figure 16) (World Bank 2021b). TFPR growth was mainly driven by the relocation of labor and other inputs from less efficient to more efficient incumbent firms (Figure 17), whereas within-firm productivity growth, which results when

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23 Micro enterprises are defined as having fewer than 10 employees; small enterprises have 10 to 49 employees.
24 A taxpayer is considered active if they have made at least one tax declaration in the last 12 months. For 2019–2021, net firm entry is estimated based on the historic correlation between taxpayer status and formal registration.
25 Fewer than 6 percent of registered firms in Kosovo export and only half continue to export after a year. Only 6 percent of the firms have some foreign shareholding.
firms become more efficient through better management or innovation, was very limited. Similarly, the low contribution of firms entering or exiting the market to aggregate productivity growth confirms lacking dynamism. Historically family-owned businesses and firms operate with limited professional management capacity, and relatively low investment in innovation and technology. Positively, a quarter of firms in Kosovo reported to have accelerated digitalization during the pandemic (World Bank 2020d).

40. Despite improvements in the business environment, barriers persist. In the World Bank’s 2019 Enterprise Survey, the share of managers who reported informality and electricity supply\(^{26}\) as top concerns was much higher in Kosovo than in Albania and Croatia (Figure 18) (World Bank 2020b). Interviews with business associations confirmed this view and revealed that firms see regulatory uncertainty, inspections compliance, skilled worker shortages, and delayed implementation of the legal framework for electronic identification as additional barriers to business growth.\(^ {27}\) Despite the recent modernization of the insolvency legal framework, it is rarely used due to low awareness and procedural hurdles to legally close a business and liquidate its assets.\(^ {28}\) In addition, business leaders point to skills mismatch and difficulties to hire and retain skilled labor, in part because of a migration pull (labor supply constraints are discussed in Pathway 3).

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\(^{26}\) Cost of access to the grid, access to high-voltage supply for manufacturing, and overall long-term security of supply.

\(^{27}\) During consultations, private sector representatives noted that political constraints to doing business have relaxed more recently.

\(^{28}\) One sign of this problem is that from the 3,400 companies that stopped operating between 2010 and 2018, fewer than 200 firms formally deregistered.

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41. There is significant room to attract foreign direct investment (FDI). High FDI inflows have the potential to accelerate know-how accumulation and export readiness, and to facilitate access to foreign markets. However, Kosovo attracts less FDI than its structural and regional peers (Figure 19). FDI inflows are concentrated in non-tradable sectors with limited spillover effects, such as residential real-estate investments by the Kosovar diaspora (Figure 20). The number of greenfield FDI projects is significantly lower than peers.

42. Kosovo’s export performance has gained momentum, but export readiness could significantly improve. Per capita merchandise and service exports are the lowest in the region (Figure 21), and merchandise exports in particular stand below what is predicted for Kosovo’s level of income (Figure 22). Kosovo’s merchandise exports are concentrated in a limited number of products, with a significant share of metals and minerals, but with encouraging signs of diversification in 2020 and 2021. The number of exported goods increased from 1,500 in 2013 to 1,700 in 2019, and a non-metal export (mattresses) became a top export commodity for the first time in 2021. The number of export destinations also rose. Kosovar companies export goods to nearly 80 destinations, 40 percent more than in 2013. Services trade remains highly concentrated in traditional services, mainly travel services provided to diaspora visiting Kosovo, and transport, accounting for more than 90 percent of all services exports.
43. Kosovo has implemented several reforms in trade liberalization and facilitation. Kosovo enjoys tariff-free access to the regional market and Moldova through CEFTA and to the EU market through the Stabilization and Association Agreement (SAA). Kosovo recently signed Free Trade Agreements with Turkey and the United Kingdom, and it became a member of the World Customs Organization in 2017. Several trade facilitation improvements took place in recent years, for instance, a reduction in the number of documents required by customs during border procedures, and the adoption of the ASYCUDA World Customs Processing system, which enables the online submission, processing, and payment of import, export, and transit documentation and duties. The country also invested in paperless cargo clearance processes and road connectivity. In services trade, Kosovo imposes fewer restrictions than its peers for most services subsectors, except for professional services. 31

44. Absence of a trade single-window constrains export readiness. Kosovo has adopted adequate legislation and established the institutions for a National Quality Infrastructure (NQI), but implementation remains insufficient. Customer certifications issued by Kosovo NQI authorities are not generally accepted in EU markets. This process results in costs with few benefits for MSMEs wanting to improve their product base and export to foreign markets. 32 Trade from and into Kosovo would be facilitated by an online, national import-export single window, joint controls at the border, and a risk unit in the Kosovo Food and Veterinary Agency.

45. Despite increased renewable energy investment, Kosovo’s energy sector continues to rely on outdated, inefficient, and highly polluting energy generation. Almost 95 percent of domestic electricity generation relies on two lignite power plants which are over 35 years old, highly polluting, and create significant uncertainty for current and future supply. 33 Despite continued investments after privatization in 2013, energy distribution technical and commercial losses remain significant. As shown in Figure 18, electricity supply is still reported as a top business concern, and SCD consultations revealed that the cost of access to the grid and to high-voltage supply for manufacturing is a concern. Kosovo’s transmission system operator recently became a member of the European Network of Transmission System Operators for Electricity (ENTSO–E). There has been some progress with regional integration in the electricity sector, including through the establishment of a joint transmission network with Albania. Investments in renewable energy and energy efficiency that contribute to improving sustainability of the sector have recently picked up but remain limited.

46. Kosovo has achieved a well-developed digital connectivity (broadband) infrastructure, but digitalization uptake is lagging. In a joint effort with the private sector, fixed broadband penetration reached 129 percent of Kosovar households at end-2020, driven by high coverage rates in rural areas, which places Kosovo in the lead in Europe (World Bank 2021b). In this sense, the country has laid a foundation to connect citizens, businesses, and public institutions to each other, to take advantage of new economic opportunities nationally and abroad, and to build resilience to future shocks. Sizable benefits from digital transformation of Kosovo could be achieved from the broad digitalization of real economic sectors, including of underlying infrastructures and business processes. 34

47. Trade and transport connectivity have improved, but maintenance, resilience, and rural connectivity need more attention. Regional trade and transport facilitation are priorities considering Kosovo’s geographic location and access to the Durres port. Kosovo’s road network provides transit links to broader international corridors. 35 As a member of the South-East Europe Transport Observatory (SEETO) Comprehensive Network, Kosovo has been actively rehabilitating a total of 310 km of roads and 148 km of SEETO core rail network. Large-scale investments to develop the major trade corridors linking Pristina to Skopje and beyond have increased the connectivity between the country and the EU markets. However, maintenance funding is crowded out by more politically visible priorities. Indeed, in recent years, maintenance expenditures have been falling. 36 Moreover, connecting rural to urban areas remains an unfinished but crucial agenda to increase access to markets, jobs, and opportunities for rural populations. Finally, the severity and frequency of natural hazards in the area is expected to increase and thereby affect critical infrastructure in the coming decade.

48. Domestic credit to the private sector accelerated since 2015, yet fewer than one in three firms have access to finance. The establishment and capitalization of the Kosovo Credit Guarantee Fund (KCGF), and the introduction of private bailiffs were important steps to increase access to finance. Concurrently, credit deepening increased over the last decade, but it remains among the lowest in the...
region. The financial sector is profitable, sound, and highly liquid; however, fewer than one-third of firms (one in four micro-firms) have received loans, and 70 percent of loans granted have a maturity of less than three years. Larger firms in more concentrated sectors are more likely to get credit; however, access to credit is poorly correlated with firm productivity, suggesting a misallocation of capital and a suboptimal contribution of the local financial system to long-term investment in Kosovo. Alternative firm financing, especially for startups, is limited. A few recent initiatives are supporting the innovation ecosystem for business incubation and acceleration, but these remain incipient. On the firms’ side, constraints to financial inclusion include low awareness, high informality, underdeveloped corporate governance, and inadequate financial reporting.

49. The land market is still undergoing an incipient development phase, but there has been progress, and legalization of unpermitted construction should accelerate. So far, one-third of all properties in priority economic areas (cadastral zones) have completed registration. The government has also made major strides in the development of National Spatial Data Infrastructure, provision of digital services, and digitalization of the land registration process in general. However, persistent challenges remain, including public participation in the cadastral reconstruction process, lack of registration of women’s land rights because of traditional attitudes towards property ownership and inheritance, and lack of access for marginalized groups. At the same time, the legalization of unpermitted construction has started but needs to be significantly accelerated.

50. In summary, to create more jobs, the private sector needs faster firm-level productivity growth, along with greater formalization and more modern infrastructure to gain access to foreign markets and capital. Despite the recent positive developments in regulatory environment and some dynamism in the firm landscape and exports, slow growth of domestic firms and limited foreign exposure, remain significant constraints to attract larger FDI flows, increase value added, reduce Kosovo’s significant trade deficit, and create jobs. At the same time, Kosovo’s private sector needs to be better equipped to attract investment and create jobs in sectors with value added.

Pathway 3: Investing in skills and increasing inclusion

Health indicators such as life expectancy have improved slightly in the last five years, but systemic limitations in healthcare came to the fore during the pandemic, and out-of-pocket (OOP) health costs continue to put vulnerable families at risk of poverty. In education, despite minor progress in learning outcomes, children in Kosovo have weak literacy and numeracy foundations, and secondary students have the lowest PISA performance in the Western Balkans. Finally, the social protection system has become more heavily skewed towards categorical pensions, whose eligible population continues to rise, while the targeted social assistance scheme’s coverage declined by almost half between 2005 and 2020, to only about 7 percent of the population, far below the poverty rate. As a result, the contribution of the social protection system to poverty reduction is limited, despite the relative high rates of expenditure.

51. A weak health system prevents faster improvement of health outcomes and imposes a heavy financial burden of healthcare for the Kosovo population. Despite progress, Kosovars live on average four years less than their neighbors and 10 years less than the average European; and infant mortality is around 11 per thousand deliveries, among the highest in Europe. A large share of the population does not have routine medical attention (e.g., blood pressure monitoring, consistent antenatal care, etc.), and non-communicable diseases (NCDs) affect a significant number of adults: about 21.6 percent of adults (18+ years) reported having a chronic disease in 2017. Women’s health outcomes related to fertility are concerning and access to reproductive and sexual health is limited. Only 9% of women aged 15–49 currently married or in union use a modern method of contraception (Kosovo Agency of Statistics and UNICEF 2020b). Across the population, only 6% have private health
insurance, and among those insured, only 1/3 are women (and only 1 in 5 in rural areas) (Farnsworth N. et al 2018). Health costs are disproportionately borne by users. The government spent 3 percent of GDP in 2018 on health, substantially below most other Western Balkan countries (Table 1) and EU members. Meanwhile, for each dollar spent by the public sector, OOP costs totaled 44 cents (equivalent to 30 percent of total health expenditures).

52. The COVID-19 pandemic has highlighted the structural weaknesses in the health sector and underscored the importance of investing in health to improve the country’s resilience to future shocks. For 32 municipalities for which data are available, only three meet the government’s target to have one physician per 1,000 inhabitants and only 16 municipalities meet the target of two nurses per 1,000 inhabitants. In hospitals, inpatient beds per 100,000 inhabitants (226 in 2019) are significantly below neighboring countries and the EU average of 532 (Figure 23). Likewise, over the last five years, the number of physicians fell by more than one-third, and the number of physicians and nurses per patient is among the lowest in Europe. Lack of qualified staff to perform lab tests and treat patients, absence of a unified information system to track and trace suspected infectious cases, monitor vaccination progress and vaccine side effects, and inadequate facilities for waste management, are some of the constraints that prevent the health system from protecting people and supporting the economic recovery.

Table 1: Public health expenditure in Kosovo and peer countries (% GDP)

<table>
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<tr>
<td>Albania</td>
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<td>Bosnia and Herzegovina</td>
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<tr>
<td>Croatia</td>
<td>5.66</td>
</tr>
<tr>
<td>Kosovo</td>
<td>3.05</td>
</tr>
<tr>
<td>Latvia</td>
<td>3.72</td>
</tr>
<tr>
<td>Lithuania</td>
<td>4.40</td>
</tr>
<tr>
<td>Romania</td>
<td>4.43</td>
</tr>
</tbody>
</table>

*Source: EUROSTAT and authors’ calculations for Kosovo.*

In 2019 it increased to 3.2 percent.

The recommended WHO threshold is about 20 percent of total health expenditures.
53. Kosovo’s education system does not help children acquire sufficient basic skills, especially those from vulnerable groups. Kosovo already had a significant deficit in educational quality before the pandemic. To start, children’s school readiness is low, as few children attend preschool (15 percent of girls and boys under 5) and fewer among Roma, Ashkali and Egyptian children (8 percent) and children in rural areas (8 percent). As a result, the learning achievement of children during primary education is limited: fewer than half of children ages 7–14 demonstrate foundational reading and numeracy skills, and only one-third of children of the poorest wealth quintile do so. Among minority children, fewer than 1 in 5 demonstrate foundational reading and fewer than 1 in 7 demonstrate foundational numeracy skills (Figure 24). With respect to secondary education, results from the 2018 PISA assessment showed that most students performed below the threshold for functional literacy, and Kosovo had the lowest average scores of the Western Balkans (Figure 25).

Like other middle-income and aspirational peers, Kosovo spends 4.6 percent of GDP on education, however, there are significant structural gaps that prevent students from gaining even basic competencies, including an allocation of spending heavily biased towards teacher wages and little margin to invest in learning materials, equipment, and infrastructure.

Figure 24: Primary education students lack foundational literacy and numeracy skills

<table>
<thead>
<tr>
<th>Percentage of children aged 7-14 years who</th>
<th>Demonstrating foundational reading skills</th>
<th>Demonstrating foundational numeracy skills</th>
</tr>
</thead>
<tbody>
<tr>
<td>Demonstrating foundational reading skills</td>
<td>18%</td>
<td>13%</td>
</tr>
<tr>
<td>Among poorest quintile</td>
<td>8%</td>
<td>5%</td>
</tr>
<tr>
<td>Demonstrating foundational numeracy skills</td>
<td>42%</td>
<td>32%</td>
</tr>
<tr>
<td>Among poorest quintile</td>
<td>32%</td>
<td>32%</td>
</tr>
</tbody>
</table>

Source: Authors, based on data from the Multiple Indicator Cluster Survey (Kosovo Agency of Statistics and UNICEF 2020a).

Figure 25: Students in Kosovo had the lowest PISA 2018 performance in the Western Balkans

Source: OECD (2020).
54. Within post-secondary education, women are underrepresented in STEM fields and among the academic community. Kosovo has reached gender parity in enrolment rates in pre-university education, however, there is a strong gender segregation in the fields of study at the university level. Women represent 85% of the students in the field of education, 75% in health, and 69% in humanities and arts, but they are a minority in natural and technical sciences; they are also less likely to attend vocational training centers (39%) and adult education courses (36%) (Agency for Gender Equality 2020). Female teachers are overrepresented in early education (pre-school), but their share falls in higher grades, and they are underrepresented among university professors, both in public (34%) and private universities (26%) (Farnsworth N. et al 2018).

55. The pandemic highlighted the challenges for the education system to provide continuous services. With schools closed from mid-March through June 2020 and intermittently since September 2020, the system had to be quickly adapted to provide remote teaching, which excluded many teachers and students due to lack of connectivity or access to digital devices. As a result, it is estimated that because of the pandemic the percentage of students performing below functional literacy could have increased slightly (from 79 to 80 percent) (World Bank 2021d). Moreover, remote teaching is likely to hurt students from lower socio-economic households disproportionately. Estimations based on PISA 2018 data suggest that the reading achievement gap between the poorest and the richest students could widen by 18 percent after only a short-term school closure.

56. The dismal situation of the labor market raises questions about whether employment can sustain growth and poverty reduction in a country that is in demographic transition. Although Kosovo was labeled the “youngest country” in Europe for having close to 40 percent of its population aged 20 or younger in 2015, the country’s demographic dividend is narrowing. The share of under-20s was down to one-third in 2020, and in 2050 it is projected to be just 20 percent. Meanwhile, the share of people 55 and older is expected to grow from 18 to 34 percent between 2020 and 2050. More importantly, the apparently low dependency ratio (49 percent overall and only 14 percent for old-age) ignores the low labor market activity rates of working-age Kosovars. Indeed, considering only active working-age adults, the dependency ratio increases to 128 percent. Going forward, the potential for growth, revenue mobilization, and poverty reduction through greater labor earnings will decline in the absence of a substantial increase in job creation, especially for low-skilled workers. Moreover, the spatial, gender, and ethnicity aspects of access to employment continue to be critical for the sustainability of Kosovo as a cohesive and inclusive country.41

57. The pandemic creates a renewed urgency to understand the constraints to increasing employment in Kosovo. Given the impacts of the pandemic on critical sectors for employment such as hospitality and tourism, it is unclear whether job creation...
58. Especially concerning, participation in the labor force among women and young people remains low, which further reduces growth potential and hinders the transition of young people into jobs. Disproportionate share of family care responsibilities and lack of pre-school facilities are major barriers to women employment. Roma, Ashkali and Egyptian women are further constrained by higher school dropouts, child marriages and adolescent pregnancies (Annex 3). Youth seeking jobs lack soft or job-related skills, problem-solving skills and ability to work under pressure in part because the education sector does not design curricula considering the needs of the labor market. Around 49 percent of youth have claimed intention to emigrate in the next two years (Riinvest Institute 2021). In this context, there is a need to link better the constraints for the private sector to accelerate job creation, and those of the workforce to participate in the market and access those jobs, including lack of sufficient skills, insufficient support systems (e.g., for women), aspirations incompatible with available options, and distortions generated by government policies or other income sources.

59. The government adopted specific measures through the Economic Revival Package aiming to increase the economic inclusion of women and young people. Measures include subsidies to employers who hire women, maternity allowances, and child supplements to women—with additional economic support to those unemployed—and the financing of job opportunities for young people. As of January 2022, over 14,000 women have benefitted from these measures. In addition, over 1,300 girls and women received a scholarship for the 2021-2022 academic year to pursue their studies in the fields of STEM, where they are currently underrepresented. Moreover, to further boost youth employment, the government is preparing the introduction of a Youth Guarantee Scheme.

60. Social protection in Kosovo consists mostly of government-financed, categorical cash transfer programs which are not poverty-focused and may distort incentives to work. Basic old-age and ex-contributory pensions and the relatively new war veteran’s pension represent the bulk of the growing government’s expenditure on social protection, which increased from 3.6 percent of GDP in 2009 to 7.7 percent of GDP in 2020 (Figure 27). Although overall social protection expenditure as a share of GDP is higher in Kosovo than in other Western Balkan countries, only a small fraction (about 7 percent of total social transfers) is targeted to the poor through the Social Assistance Scheme (SAS), while most spending goes to non-contributory pensions and disability benefits.

61. The Social Assistance Scheme (SAS) covers only a fraction of the poor, and it lacks the flexibility to

Figure 27: Most social protection spending is related to categorical pensions

Source: Ministry of Social Welfare and KAS Harmonized Indices of consumer prices. Data are in 2020 prices.

42 Ex-contributory pensions refer to government-funded benefits awarded to individuals ages 65+ who contributed at least 15 years to the old Yugoslav system.
43 Figures include the Social Assistance Scheme, energy subsidies, and assistance to families with disabled children, assistance for foster families, and all government-funded pension schemes (basic and ex-contributory pensions, special pensions, war veterans and war-related pensions and disability pensions).
44 The government almost doubled spending on disability pensions in the last 10 years (from 0.28 percent of GDP in 2009 to 0.5 percent in 2019) as it increased the pension amounts for certain categories and increased coverage from about 18,500 in 2009 to almost 24,000 in 2020. However, disability pensions are only accessible for those declared 100 percent disabled and (for partial benefits) those who qualify for war-related or special pensions, and the assessment of disability status is not based on functionality and varies across programs.
effectively respond to shocks. SAS coverage has declined in recent years from over 40,000 households in 2005 to about 25,600 in 2020, which corresponds to about 7 percent of the population (1 in 4 people in the poorest quintile). By contrast, poverty affects close to a quarter of the population. Recent diagnostics of the design and implementation of the SAS revealed rigid categorical eligibility criteria that exclude the working poor, discourage people from participating in the labor market, and also exclude many families with children over the age of five.\textsuperscript{45} The stringent categorical criteria meant it was not possible to expand SAS coverage quickly to respond to the pandemic. Instead, the SAS allowance was increased temporarily, and the period of eligibility was automatically extended by eliminating the need to reapply and preventing beneficiaries from suddenly losing their benefits during the height of the pandemic. In addition, the government put in place a temporary program to support poor and suddenly losing their benefits during the height of need to reapply and preventing beneficiaries from automatically extended by eliminating the need to reapply and preventing beneficiaries from suddenly losing their benefits during the height of the pandemic. In addition, the government put in place a temporary program to support poor and unemployed households who were left out of other government programs, managing to reach over 28,700 families.\textsuperscript{46} It also allowed workers contributing to mandatory pensions (KPST) to withdraw 10 percent or up to 1,000 Euro, and promised to replenish those with balances of up to 10,000 Euro starting in 2023.\textsuperscript{47} Social care services, which provide much needed support to particularly vulnerable groups, are also limited in scope and thus tend to be reactive rather than preventive.\textsuperscript{48}

62. In addition, there is no flexible support mechanism to compensate poor and vulnerable people for eventual energy tariff increases. Although Kosovo has one of the lowest prices of electricity for residential consumers, about 15.8 percent of households and one-third of poor households spend 10 percent or more of their total budget on electricity and are thus electricity poor. As significant planned investments in the power sector are completed and tariffs are adjusted, the number of households facing affordability problems could increase significantly.\textsuperscript{49} The current electricity flat subsidy paid to some SAS recipients and war veterans is simple and easy to implement, but it has limited potential to compensate all electricity poor households affected by tariff increases.

63. The pension system is costly, fragmented, and inefficient. The non-contributory pension program has universal coverage for a basic pension for all people over 65. Moreover, war veteran benefits and war-related pensions cover people who fought during the war and their surviving spouses and children up to age 26, raising concerns about fiscal sustainability, as the number of people eligible to receive benefits continues to rise. These benefits are also more generous than the social assistance benefits and may create disincentives to work. Meanwhile, only about a third of the population of working age contributes to the second pillar, and contributory pensions only provide temporary support until the account is depleted.

64. In summary, Kosovo faces important gaps in human capital which could widen because of the pandemic, and which the state is ill-equipped to address. In the health sector, insufficient human resources and infrastructure, and high OOP costs have prevented faster progress in health outcomes for the population and have left it unprotected from the pandemic. Despite significant spending on human resources in the education sector, learning achievement is low overall and particularly for children from poor socioeconomic backgrounds. The ability of the sector to deliver education services digitally was minimal to ensure proper learning during school closures due to the COVID-19 pandemic. Likewise, the structure of the social protection sector, which provides most cash transfers based on demographic conditions or war-related status, does little to promote inclusion of the poor and prevented the government from deploying cash assistance quickly to those affected by the pandemic, even though the emergency measures were somewhat more successful than in other Western Balkan countries in reaching those in the informal sector.

65. Finally, Human Development sectors in Kosovo are not prepared to sustain a healthy, productive, and resilient population that meets the challenges posed by climate change. The health sector is failing to address the impacts of increasing urbanization and climate change on health outcomes, the education sector has not managed to build the skills for the current and future workforce to access green and technologically advanced jobs, and the social protection system has not created mechanisms to help workers transition out of sectors such as coal while protecting their incomes, to protect them from the financial burden that energy reforms could create for poor and vulnerable households, or to respond quickly to help people affected by climate shocks and other disasters.

\textsuperscript{45} Despite these limitations, 75 percent of SAS benefits go to people in the poorest quintile, among the best targeting in Europe and Central Asia.
\textsuperscript{47} The program used the existing SAS system and was targeted to households with no formal income. However, because informal work is high in Kosovo, it is likely that some households who qualified for the program were not necessarily poor.
\textsuperscript{48} While this provided much needed support to poor people during the pandemic, the system proved to have no use of digital tools, as payments were made in cash at the post office, and people applied to the program in person at the Centers for Social Work.
\textsuperscript{49} The government has initiated a reform of social services, but it does not yet include either investments in social workers (including their training) nor the introduction of a case management system to support the delivery of integrated benefits.
\textsuperscript{51} A 2019 World Bank study estimated that in case of a 50 percent tariff increase, electricity poverty could increase from 16 to 23 percent, based on the baseline elasticity estimate (\( \varepsilon = -0.5 \)). Among vulnerable households, the most affected are those in the poorest quintile not benefiting from SAS and single-elderly households.
Kosovo remains a predominantly rural country, however, agriculture’s economic contribution has diminished because of low productivity, despite growing government support. Moreover, mismanagement of natural resources, especially water and land, is hampering sustainability in the rural sector, as pressure on resources increases from agriculture, industry and population demand growth and climate change. Lack of institutional coordination, capacity, and low investment in infrastructure explain the slow progress in this area. Finally, urban areas face unplanned growth, congestion and high air pollution levels, which are gradually worsening the quality of life and reducing their potential as Kosovo’s engines of economic growth.

66. A widely rural country that is slowly urbanizing, Kosovo faces the double hurdle of increasingly deteriorating natural resources, and congested, polluted urban areas. At the time of the 2011 Census, about 6 in 10 people in Kosovo lived in rural areas, and very few municipalities had an urban share of more than 80 percent. By 2019, estimates from the Kosovo Statistical Office show population growth of over 5 percent in only a handful of municipalities, including Pristina and Prizren (large and urban) and a couple small rural ones. Most other municipalities have either shrunk or remained roughly the same, according to these estimates (Figure 28). Historically, poverty in rural areas has been significantly higher than in urban areas, although the gap has been falling since 2012. Still, economic opportunities are very limited in rural areas, because of a highly unproductive agricultural sector, and because increasingly natural resources including water and land are threatened by unmanaged pollution and collapsing infrastructure. At the same time, the urbanization process that is taking place raises questions about how well-prepared urban municipalities like Pristina are to manage the growing population and demand for services, while maximizing the opportunity to become economic poles. As the country recovers from the pandemic, it will have to find ways to restore the sustainability of its resources, to boost productivity and resilience in the agriculture sector, and to implement better urban development policies to achieve urban growth with quality of life.

67. Despite being a mostly rural country, agriculture’s role in the economy is declining, but its social role remains important. In the last three decades, the agriculture sector transformed completely, from state-run and capital intensive to family-owned, low-scale and low-productivity. Since then, the sector has shrunk in terms of its contribution to growth. During 2009–2019, the share of agriculture in GDP nearly halved. In 2019, the share of agricul-

Figure 28: Few, mostly urban municipalities have grown in population since 2011

Source: Authors with data from population estimations from KAS.
ture in GDP (6.9 percent) was much lower than in countries with a similar level of development, and closer to the one among aspirational peers. This decline resulted from a falling sectoral productivity rather than structural transformation, as agricultural value added decreased by a cumulative 6.8 percent in real terms over the decade. Indeed, most farms operate at a subsistence or semi-subsistence levels, while commercial farmers face expansion obstacles. Two notable exceptions are agri-business, especially food processing, which has grown steadily in number of firms, annual turnover, and employment; and agricultural exports which have increased in absolute and relative terms as a share of total exports.

68. Farm size and structural efficiency barriers are holding back agricultural productivity. Most agricultural production is carried out by very small farms with inefficient methods, old technology, low cash-flows and weak integration with markets. Around 93 per cent of farms operate on less than 5 hectares and 73 per cent on less than 2 hectares, while only 17 per cent of farms use 10 hectares or more. Among comparable economies, only Albania shows similar farm fragmentation. Additionally, since 2017 the number of farms over 30 hectares fell by 28 percent. Not surprisingly, Kosovo ranks low on agricultural labor productivity compared to similar economies (Figure 29). But size is not the only major cause of low farm productivity. Even medium farms face efficiency constraints associated with management practices and structural obstacles in access to credit, technology, markets, etc. that hinder transformation to more efficient units. However, larger farms do perform better, which suggests that farms can be efficient in Kosovo if they reach a minimum size. Farmers' human capital is a concern, as most of them have low levels of education and training despite being relatively young, in contrast to the farmer population in other countries.

69. Public support to the agriculture sector has recently increased, but it does not address structural productivity constraints or support livelihoods. Kosovo’s agricultural support system has veered closer to EU Common Agricultural Policy (CAP) principles. It more than doubled (from around 24 to over 64 million Euro) between 2013 and 2018, when budget transfers to agriculture reached 78 percent of agricultural output, above other Western Balkan countries except North Macedonia. However, the current level and direction of support is not directly addressing the constraints mentioned above. Direct farm payments dominate (79 percent of expenditure), whereas capital expenditure (9 percent) is much lower than that of the national budget (25.7 percent), despite significant infrastructure gaps. Subsidies go mostly to large farms (77.3 percent of total subsidies), close to the EU average (82 percent) while support to micro farms declined from 2.2 percent in 2015 to 1.2 percent in 2017. This implies that subsidies do not support the livelihood of the poorest farmers. At the same time, there is limited evidence that subsidies increase productivity; they appear to have no impact on technical efficiency and modest positive impact on scale efficiency for most farms except the largest. Overall, current farm subsidies are not yet compatible with the CAP, and do not require compliance with environmental standards (World Bank 2021b and World Bank 2021e).

Figure 29: Kosovo has one of the lowest levels of agricultural labor productivity among peer countries

Agriculture, forestry, and fishing, value added per worker (constant 2010 US$, 2018)

<table>
<thead>
<tr>
<th>Country</th>
<th>Value added per worker (2010 US$, 2018)</th>
</tr>
</thead>
<tbody>
<tr>
<td>KOS</td>
<td>3147</td>
</tr>
<tr>
<td>MKD</td>
<td>6631</td>
</tr>
<tr>
<td>ALB</td>
<td>5827</td>
</tr>
<tr>
<td>KGZ</td>
<td>1813</td>
</tr>
<tr>
<td>MDA</td>
<td>3798</td>
</tr>
<tr>
<td>LVA</td>
<td>17008</td>
</tr>
<tr>
<td>URY</td>
<td>22598</td>
</tr>
<tr>
<td>EST</td>
<td>24987</td>
</tr>
<tr>
<td>SVN</td>
<td>18628</td>
</tr>
<tr>
<td>LTU</td>
<td>12819</td>
</tr>
<tr>
<td>CZE</td>
<td>25296</td>
</tr>
</tbody>
</table>


*The share of agricultural employment in total employment is controversial in Kosovo. According to the Labor Force Survey it amounts to 5.2 percent; 2018; however, other surveys such as the Millennium Challenge Corporation’s Kosovo Labor Force and Time Use Study (2018) find a much higher agricultural employment share of 21.7 percent of total employment. According to experts, the official statistics from LFS vastly undercount agricultural employment. Uncontrolled expansion of legal and illegal construction might have contributed to this phenomenon. Among similar economies, Kosovo outperforms only Armenia and the Kyrgyz Republic. Low access to credit, technology, outdated production management practices, lack of market opportunities, aggregators of products, storage facilities, limited value chains, an underdeveloped agricultural information system, and a dysfunctional land market are some of the constraints to agricultural competitiveness.*
70. Natural resource mismanagement, especially for land and water, is jeopardizing sustainability in rural areas. Inadequate investments in infrastructure; decision-making based on limited or unreliable data; and lack of coordinated planning and enforcement of regulations add pressure on an already constrained resource base. Water resources face threats from climate change, are often heavily polluted, services are poorly managed and have low financial sustainability. For example, while drinking water access has increased, nonrevenue water (NRW) reached 58 percent in 2017, preventing utilities from improving the quality and sustainability of the service. NRW is due to a combination of factors including outdated infrastructure and metering devices, data-handling errors, and water misuse. Likewise, sewage and wastewater treatment are still minimal. Agricultural use of water resources is high (irrigation accounts for 41 percent of total water use), and lack of modern irrigation infrastructure reduces efficiency and exacerbates water stress. A major challenge is weak and fragmented institutional arrangements and capacity, as resource management, utilities, and pollution control are shared responsibilities between national and local levels. Furthermore, a severe lack of funding for these activities limits the implementation capacity of any policy or strategy. Finally, the current schemes for public and private sector complementarity for irrigation service delivery seem inadequate.

71. Contaminated land sites are largely unmanaged, which increases water pollution including transboundary risks via surface water. Kosovo has not adopted legislation on pollution prevention, control, and polluter accountability. This undermines any efforts to prevent future industrial pollution. Meanwhile, hazardous mine waste, industrial discharge into rivers, and industrial dumpsites continue undisturbed and threaten natural resources and people’s health. Around 200 sites (out of 4,000) are estimated to require remediation from mining, industrial, tailings, and ash dumping. Partially controlled or uncontrolled landfills are often located near agricultural areas, and although the number of illegal landfills decreased between 2019 and 2021 (from 2,529 to 1,189), it is still very high. In 2018 the government put in place the first policy to deal with contaminated land, but it has yet to be implemented. The strategy and action plan on integrated waste management 2021-2030 was adopted, however, low coordination and capacity, and a lack of results and monitoring framework, suggests that implementation will be challenging (European Commission 2021).

72. Meanwhile, in urban areas, especially Pristina, unplanned and unregulated growth is already generating congestion and deteriorating quality of life. As the main urban center and economic engine in Kosovo, Pristina is not following a sustainable urbanization path or helping lagging regions benefit from its economic dynamism. Located in a closed valley, Pristina is growing with a combination of sprawling, poorly connected, informal settlements and sub-urban clusters. The metropolitan area is increasingly carbon intensive as it generates longer commuting and congestion dynamics. Moreover, an inadequate public transport service (including informal taxis) competes with a growing, but old motor vehicle fleet. About 140 thousand vehicles enter the city daily, much more than the city infrastructure can manage, which generates increasing inefficiency and has a detrimental impact on health and quality of life. Congestion, along with the outdated bus fleet and the increasing trend of importing secondhand diesel cars from Western European countries (on average, 6-7 years old), is heavily contributing to the city’s air pollution. At the same time, uncontrolled construction development has taken place in flood risk zones and other sensitive land, increasing risks for floods and accelerating land degradation.

73. In addition to the transport and power sectors, residential heating generates an unhealthy amount of PM2.5 emissions, especially during the winter. Indeed, air quality in Pristina has been among the worst in the world in the last decade, rivaling big cities like Beijing, Mumbai, and New Delhi (World Bank 2019). Its concentration of PM2.5 is the 7th highest in Europe (IQAir 2021), and it is also extremely concerning in Mitrovica, the Drenas area, and the Obiliq area (Figure 30). In 2016, poor air quality was estimated to cause 760 premature deaths and cost between 2.5 and 4.7 percent of GDP annually in Kosovo. The residential sector is the largest source of PM2.5 associated with the burning of solid fuels, in particular firewood and coal, for heating. Additional sources include energy (power generation), industry, agriculture, and others (Figure 31). Kosovo continues to rely heavily on coal, which goes against the country’s own National Emission Reduction Plan.

74. In summary, Kosovo has failed to develop a productive and environmentally sustainable agricultural sector, while its natural resource base is being depleted and climate-related vulnerability grows. Kosovo’s long-term deterioration of rural areas has contributed to a progressive reduction....
of agricultural production, depletion and misuse of natural resources, and chronic poverty and outmigration. The rural population has few economic opportunities given the lack of investment in infrastructure, skills, and sustainability of natural resources to sustain livelihoods and build resilience to climate change and other risks. The government has not yet taken any concrete measures to implement climate-related policies and raise public awareness. Since the 2019-2028 Climate Change Strategy was adopted, there has been little implementation progress, for example, the Law on climate change is in drafting stage, as is the action plan 2021-23 (European Commission 2021).

75. At the same time, the haphazard urbanization process is generating serious economic costs and threats to quality of life that need to be tackled. Unplanned city expansion, congestion, and poor quality of services are already affecting people’s health and the productivity of cities in Kosovo, thus undermining an urbanization process that should create economies of scale and bring economic prosperity to the country.

![Figure 30: Several cities surpassed the maximum annual average PM2.5 concentration of 25 μg/m3](image)

*Figure 30: Several cities surpassed the maximum annual average PM2.5 concentration of 25 μg/m3*

![Figure 31: Residential heating and power plants account for 70 percent of annual PM2.5 emissions](image)

*Figure 31: Residential heating and power plants account for 70 percent of annual PM2.5 emissions*

4. Priorities for the policy agenda

Taking the evidence gathered and following a consultative process, the SCD update conducted a prioritization exercise to organize the policies according to three criteria. In addition to the evidence gathered in the preparation of this SCD update, an extensive internal and external consultation process helped the team to identify the most pressing constraints to achieve the twin goals and the policies associated to them. Under the guidance of the Country Management Unit, the team selected three criteria to rank policies in order of importance and suggest a sequencing to policymakers. The first criterion is policies’ impact on progress towards the twin goals, which in the view of most stakeholders, is the primary ranking criterion. The second is the feasibility of the policies under the current economic, governance, and capacity conditions. The third criterion is the time these policies would take to materialize into results, which puts into perspective their ability to deliver results in a shorter time frame and generate political support for longer-term reforms.

76. Following the prioritization process, policies that would stimulate private sector growth and human capital accumulation are considered as having the highest impact on the twin goals (Table 2). Specifically, placing the employment gap at the center of all development challenges for the country, stakeholders consistently prioritized policies to improve the demand and the supply of workers. These policies include those that would promote exports and FDI and improve the overall business environment through better governance and more consistent regulations. On the supply side, stakeholders agree that building human capital and improving school-to-work transition are crucial to ensure that businesses have the skills they need to increase their competitiveness, and that people have opportunities to improve their incomes through better jobs. However, these policies will depend on the government mobilizing more public revenues and increasing the returns to public spending by reallocating investment. In conclusion, the SCD update outlines a set of priorities that generate the widest consensus among all stakeholders, and this consensus suggests that policies that increase job creation and access to jobs will deliver the most benefits and generate the strongest public support. Importantly, these priorities are closely aligned to the priorities outlined in the first SCD.

<table>
<thead>
<tr>
<th>Priority</th>
<th>IMPACT</th>
<th>FEASIBILITY</th>
<th>TIMELINESS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increasing equity of taxation and transfers</td>
<td>High</td>
<td>Medium</td>
<td>Medium</td>
</tr>
<tr>
<td>Increasing returns to public spending</td>
<td>Very high</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td>Maintaining fiscal sustainability</td>
<td>Very high</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Integrating Kosovo in the global economy</td>
<td>Top</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Building a more transparent and predictable business environment</td>
<td>Top</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td>Ensuring infrastructure supports sustainable productivity growth</td>
<td>Very high</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Building inclusive skills for the future and improve the school-to-work transition</td>
<td>Top</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Providing quality and affordable health services</td>
<td>Very high</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Increasing equity and sustainability of social protection system</td>
<td>Very high</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td>Prepare for climate change and a just transition</td>
<td>Very high</td>
<td>Medium</td>
<td>Medium</td>
</tr>
<tr>
<td>Clean and maintain natural resources</td>
<td>High</td>
<td>Medium</td>
<td>Medium</td>
</tr>
<tr>
<td>Foster productivity growth in agriculture</td>
<td>High</td>
<td>Medium</td>
<td>Medium</td>
</tr>
</tbody>
</table>
77. Addressing governance constraints remains a key cross-cutting priority. The current government is in a strong position to make significant progress on governance and inclusion in Kosovo. The government has a strong majority; it has successfully managed the pandemic and the economic recovery, and it shows credible intention to fight corruption and enact social reforms. Tackling Kosovo’s structural constraints remains a long-term effort and will require building on past progress, while incorporating new evidence and managing the trade-offs of reforms that will be costly for some. In this regard, transparency and engagement with the population are crucial for sustainable progress.

78. Timely, accurate, and consistent statistics are crucial for evidence-based decision making and accountability. The availability of accurate and timely data for policymaking remains a key constraint across sectors (Annex 5). For instance, the quality and timeliness of national accounts statistics, which are key for the effective implementation of Kosovo’s rules-based fiscal framework, is often subpar, and Kosovo has been slow to implement the new Census and to publish the EU-SILC, both key instruments to measure living conditions and implement effective and well-targeted social policies.

Pathway 1: Increasing returns and equity of fiscal policy

Increasing equity of taxation and transfers

Consultation participants rate this priority with a high score on impact on the twin goals; they rate its feasibility as medium, given the impact of structural and political economy bottlenecks in expanding the tax base and reforming categorical social transfers, and time to deliver impacts as medium term on account of the longer period required to implement the required reforms.

79. First, Kosovo needs to ramp up efforts to diversify financing and enhance tax revenue mobilization by incentivizing formalization to buttress fiscal sustainability. Informality hampers both the effectiveness and equity of tax policy. Risk-based, performance-oriented tax and customs administration capacity should continue to improve alongside efforts to increase integrity safeguards. Tax debt collection efficiency and timeliness should also improve in part thanks to targeted communication efforts to promote compliance. The credibility of the tax registry and information needs to be further strengthened by increasing the interoperability with other administrative databases, while efforts to further digitalize the delivery of tax services should continue. The role of the Kosovo Financial Reporting Council, including its regulatory functions vis-à-vis public accounting, should be modernized and their professional capacities enhanced. Given that Kosovo depends heavily on remittances and services exports to the diaspora, the government should work closely with the financial sector to incentivize digital transactions. At the same time, the government should reduce the cost of regulatory compliance by lowering the costs and red tape of licenses and permits, and by implementing effective, risk-based, and consistent inspections. Efforts to improve the immovable property tax administration, including the new tax on land, need to be accelerated; likewise, it is crucial to better incorporate profits from rental activity or sale of commercial real estate into the tax base.

80. Second, tax policy design should be advanced to promote effectiveness and equity. The Ministry of Finance, Labor, and Transfers should have the capacity to analyze ex-ante the distributional impact of taxation and review the existing framework from an effectiveness and equity perspective. At the same time, it should evaluate the impact of past policy decisions, such as the reduction of the corporate income tax and dividend income tax, to inform future tax policy design. The progressivity of the personal income brackets and the statutory rate of immovable property tax could be modified to enhance equity. Existing tax exemptions should be reevaluated to reduce the potential inequities they create, either by design or through complex and discretionary administration. The current statutory rate and fragmentation in the structure of the value added tax (VAT) should be reviewed to improve both collection and equity. Given Kosovo’s structural features, consumption taxation remains an effective tool to collect revenues without excessive distortions, but tax refund processes should be further
automated and streamlined. Tax policy also needs to consider the inherent barrier to revenue mobilization imposed by the prevalent informality, which also reduces the scope to mobilize compulsory contributions for health or other social benefits.

81. Third, the tax policy framework should be adjusted to incentivize the green transition in line with the global trends. Kosovo will need to prepare for the EU’s upcoming carbon border adjustment mechanism (CBAM). The EU CBAM will directly impact Kosovo’s exporting performance. The July 2021 EU CBAM legislative proposal applies to the import of selected goods from the most emission intensive and trade exposed sectors covered by the EU’s Emissions Trading System (EU ETS), such as electricity, base metals and minerals. 62 The EU CBAM was designed to have a targeted and limited impact, but what comes next could be a game changer (World Bank 2021f). Though the overall impact may not be immediately large, some of the manufactured goods exported to the EU could be significantly affected. However, the EU is likely to expand the CBAM to cover more sectors and more products. Diversifying into renewable energy sources will become particularly important both due to the CBAM and to ensure adequate energy supply. As an immediate first step, the government can review the existing fuel excises to close the gap between diesel and petrol excise rates and redesign excises on vehicle imports to incentivize lower emissions.

82. Finally, on the expenditure side, institutionalizing poverty targeting across social protection programs is a key milestone to enhance fiscal policy effectiveness and equity. Spending on subsidies and transfers represents more than a third of total government expenditure, yet less than 2.5 percent of total government expenditure is poverty targeted. Kosovo’s young population and significant remittances, providing an informal social safety net, have cushioned against pressures for higher spending on pensions and social assistance. However, this limited window of opportunity and the associated fiscal space is crowded by benefits which are not poverty targeted. Spending on subsidies and transfers increased from an average of 21 percent of total expenditure in 2010 to 30 percent in 2019; jumping above 35 percent of total expenditure owing to the pandemic response in 2020 and 2021. Yet, the impact on poverty reduction could be significantly higher. Given Kosovo’s limited public resources, increasing the poverty targeting of existing entitlement benefits, managing their cost and further proliferation, restructuring the social assistance scheme to increase coverage and generosity, improving healthcare financing, and commencing a comprehensive pension reform, are paramount for enhancing the effectiveness and equity of fiscal policy in the medium term and strengthening the sustainability of public finances in the longer term (see Pathway 3 below for a further discussion on the necessary reform path for the institutionalization of poverty targeting in social protection policies).

Increasing the effectiveness and returns to public spending

Consultation participants rate this priority with a very high score on impact on the twin goals; they rate its feasibility as medium, subject to higher revenue mobilization and political stability, and they rate the time to deliver impacts as medium, given the depth of the reform.

83. The government of Kosovo needs to improve public investment management (PIM) by, among others, allocating adequate resources for the maintenance of public assets. Public investment has decreased from an average of 10.5 percent of GDP during 2010–2014 to an average of 7.2 percent of GDP during 2015–2020, yet it remains high compared to most regional peers. Transport investment, mainly in road infrastructure, accounted for the largest share of capital investment and the road network expanded by almost a quarter between 2010 and 2020. However, PIM efficiency and effectiveness remain limited. According to the IMF (2016), efficiency of public investment in Kosovo trails regional peers by 30 percent, and infrastructure for education and public health is below that of regional peers. The IMF also highlights a tendency to “over-invest in new capital stock and under-invest in maintenance” This is partly because the budget preparation process does not include standard procedures to secure adequate maintenance allocations, and which is particularly problematic for pre-university education and healthcare, but also other key sectors such as roads.

84. Given PIM bottlenecks, execution is chronically low and undermines the utilization of concessional IFI financing. Aside from the implementation of two major highway projects, the level of capital budget execution remains persistently low. At end-2015,
the Kosovo Parliament approved an exception to the legally binding deficit ceiling to create additional room for capital projects with concessional IFI financing. However, to date, implementation of capital projects with IFI financing remains extremely low despite Kosovo's sizable infrastructure gap.

85. There is a pressing need to finalize existing projects, reorient spending to invest more on human capital, and rationalize capital investment. For example, historically driven by political economy considerations, many transport projects in the fiscal framework were introduced without due detailed technical preparation or financial planning, and there are continuous extensions of project implementation timelines, instead of plans to restructure stalled projects. On the other hand, funding allocation for maintenance for education and health infrastructure remains limited. This is compounded by limited municipal fiscal space, and political resistance to school or healthcare network optimization. The urgency of the situation is illustrated by the fact that over half of pre-university students attend schools with no or poor-quality physical infrastructure, including proper sanitation. Additionally, over 90 percent of spending in health and education accounts for wages. In recent years, reforms to the Kosovo Privatization Agency legislation enabled privatization receipts to finance capital spending. However, this source is practically exhausted. Given the long-term budget constraints, the government needs to prioritize carefully new capital projects and significantly enhance capacities for the implementation of projects financed through concessional IFI financing.

86. To increase public investment efficiency and effectiveness, the government needs to enhance evidence-based policymaking. Ensuring evidence-based policy requires improvements in data quality, timeliness, and availability and analyzing the impact of government policies based on available administrative and survey data. It also requires enhanced utilization and strengthening of the Kosovo PIM system.

87. In terms of transparency and accountability, important progress has been achieved but citizen engagement needs to increase. For instance, citizen-friendly budgets are regularly published, and information on budget implementation is available on the fiscal transparency portal of the government. Likewise, in 2020, more than 98 percent of primary policy documents and draft laws were published online for consultation. At the same time the Open Data Portal continues to increase the number of data sets available, but these are not always user-friendly. Public consultations required by law are not systematically carried out with minimum standards, and the Law on Access to Public Documents is not always fully enforced. To make the 'eKosova' portal an effective single window for citizens and businesses, the data platform needs to be strengthened and outstanding legal, operational, and technical challenges addressed.

Maintaining fiscal sustainability

Consultation participants rate this priority with a very high score on impact on the twin goals; they rate its feasibility as high, subject to political commitment, and they rate the time to deliver impacts as medium, given the depth of the reform.

88. Full reinstitution of fiscal rules is needed to ensure fiscal sustainability. The need for sizable fiscal support interventions amidst the pandemic impelled the relaxation of fiscal rules. However, Kosovo is a Euroized economy, without access to international financial markets, and with fiscal policy as its sole lever for macroeconomic management. Maintaining adequate fiscal reserves is needed to build resilience and preserve the ability to act against future shocks. In the medium to long-run, Kosovo’s debt trajectory is stable only under an average deficit level of 2 percent of GDP. Hence, returning to the full implementation of a legally binding deficit ceiling is paramount to ensuring public debt and macroeconomic stability.

89. Debt management should continue to be strengthened to reinforce long term debt sustainability. In the absence of a credit rating, the banking sector in Kosovo, dominated by foreign owned banks, can only have limited exposure to Kosovo’s domestic debt. On the other hand, Kosovo is estimated to have reached a public and publicly guaranteed debt level of 22.5 percent of GDP in 2021, but it has an estimated additional 8 percent of ratified undisbursed debt through international financial agreements. Against this background, Kosovo needs to continue improving debt management and transparency, including through better evaluation of fiscal risks and by diversifying financing sources to effectively address infrastructure and developmental needs.
90. The government should address fiscal risks by improving corporate governance of POEs, including improved performance and fiscal risk monitoring. Contingent liabilities related to POEs, which may not be directly debt related, pose additional fiscal risks (primarily through pressures higher transfers, cross-subsidies, or on lending). Although the extent of the overall fiscal risks posed by the POEs is currently unknown due to lack of a structured fiscal risk assessment, the latest IMF Article IV reports results from testing a scenario of POE-related contingent liabilities of 5 percent of GDP. In addition, the Medium-Term Expenditure Framework published on May 6, 2021, notes that based on available data for 2017-2019, more than half of the POEs run losses, but the largest driver of sector losses is Kosovo Telecom (Ministry of Finance, Labour and Transfers 2021). Improving POE financial monitoring and conditioning any future transfers on performance improvements is vital to public investment effectiveness and equity in Kosovo.

91. First, boosting Kosovar exports requires closing trade facilitation gaps. Establishing a single window would enable traders to meet all regulatory obligations (licenses, permits, certificates, etc.) through a single-entry point online, which would slash costs, delays, and informal payments. Institutional coordination with other customs administrations to simplify cross-border procedures, applying joint border controls and interconnecting IT systems, would lighten trade time and costs and benefit traders and consumers. Establishing a professional and transparent risk unit at the Kosovo Food and Veterinary Agency (KFVA) would ensure uniform, risk-based inspections across sanitary and phytosanitary departments. Finally, updating the 2017-time-release study supported by the World Bank to measure the efficiency of border and clearance procedures, would help implement evidence-based reforms to facilitate trade (World Bank Group and Kosovo Customs 2017).

92. Second, expanding regional market access for Kosovar exporters would build up access to international markets. From a regulatory and trade policy perspective, Kosovo’s trade regime is relatively open, as shown by the free trade agreements it has signed, including CEFTA, which eliminated all regional tariffs and opened its market to many Kosovar exporters. However, in consultations exporters acknowledge an important, de facto, non-tariff barrier linked to the limited recognition of Kosovo. Thus, minimizing all technical, non-tariff barriers to trade within the Western Balkans and improving trade facilitation would broaden market access to the EU for Kosovar exports, since most exporters use the Western Balkans as an entry point to a larger, global market.

93. Third, FDI attraction and retention remain policy priorities. A clear FDI promotion strategy would establish roles and coordination mechanisms across government agencies involved in investment, define sector priorities, and set targets and responsibilities for the implementation of reforms to strengthen the investment climate and build investor confidence. As a start, the investment promotion agency KIESA could more effectively deliver core investor services if its mandate and reporting lines were reviewed in line with international best practices and its corporate governance was enhanced by appointing a board of directors. Finally, reinstituting an effective investor grievance mechanism would help investors deal with current issues and build future confidence.
Building a more transparent and predictable business environment

Consultation participants rate this priority with a very high score on impact on the twin goals; they rate its feasibility as high, subject to political commitment, and they rate the time to deliver impacts as medium, given the depth of the reforms.

94. Kosovo should press ahead with improvements to the investment climate. Reducing the administrative burden, increasing regulatory certainty and supporting financial deepening are necessary to foster formalization and private sector productivity growth and remain at the center of the policy reform agenda.

95. First, reinforcing the rule of law, increasing regulatory certainty and streamlining regulations would encourage investment and raise firm efficiency. Above all, a sound business environment rests on a well-functioning justice sector. Efforts to strengthen the rule of law, such as allocating higher human and physical (including digital) resources, reducing court case backlogs, training judges on business cases, and building justice system capacity to deal with cybercrimes are the foundations to a conducive business climate in Kosovo. Beyond the justice sector, the implementation of the recently approved Law on Inspections will be an important step to improve the governance of business inspections. The creation of an e-inspectorate system and adoption of risk-based inspections will reduce compliance costs, uncertainty, and corruption. In addition, a continued systematic assessment and simplification of local and national business licenses and permits will contribute to facilitate businesses activity and job creation.

96. Second, private sector employers need a broader supply of skilled workers to increase productivity and grow. Improvements in firm productivity, export access, and quality are closely linked with the skills of firms and workers. Hence, investing in employee and managerial training, improving human capital skills by matching technical and vocational education and training (TVET) curricula to firm demands, strengthening the general education system to improve basic numeracy and literacy skills will lead to higher productivity for firms. Furthermore, equipping students with digital skills is crucial to effecting the digital transformation of Kosovo.

97. Third, promoting financial inclusion and enabling e-payments would improve access to finance and support entrepreneurship. Though increasing, still fewer than a third firms have access to formal finance in Kosovo. Enhanced competition in the financial sector, a stronger legal framework for the microfinance sector, enabling the usage of movable collateral, and further enabling non-banks to participate in the funding and payments markets will help close the financing gap. Furthermore, the implementation of the recovery and resolution framework in the draft Banking Law and implementation of the insolvency framework would strengthen the financial sector. Finalizing the cadastral reconstruction and formalizing inherited and unregistered property, as well as accelerating the legalization of unpermitted construction, would strengthen property rights and improve access to finance. Finally, timely implementation of the E-IDAS Law will enable e-payments and reduce cash transactions, contributing to formalization.

98. Finally, reducing regulatory barriers to competition can boost productivity growth and facilitate firm entry. Preferential treatment for POEs should be limited and follow strictly the legislation on state aid, including in relation to procurement, sub-lending and guarantees. Market entry and exit should be facilitated by simplified business registration and deregistration regulations, particularly through the introduction of the silence is consent principle. Finally, the government can further foster competition by reducing regulatory barriers in the services and network sectors.
Ensuring infrastructure supports sustainable productivity growth

Consultation participants rate this priority with a very high score on impact on the twin goals; they rate its feasibility as high, subject to political commitment, and they rate the time to deliver impacts as high, given the depth of the reform.

99. First, ensuring an adequate and sustainable energy supply is central to support productivity growth. The upcoming energy strategy with revised renewable energy targets will provide an opportunity to redefine the priorities in the sector and accelerate the energy transition towards cleaner energy and decarbonization. In parallel, the government is also working towards improving the legal framework for enabling competition in the renewable energy sector and scaling-up renewable energy investments. On the demand side, continued investment in energy efficiency, especially for heating, will contribute to efficiency gains and a just transition.

100. Second, closing logistics gaps and encouraging greener transport options are key to modernize the transport sector. Investing in regional roads and upgrading Kosovo’s international rail link would boost exports and firm productivity. Following the large investment in transport infrastructure in the last decade, improving maintenance in the sector is a priority. Deployment of Intelligent Transport Systems (ITS) in the main trade corridors would protect the road network and increase the efficiency of operations and maintenance. The government, together with municipalities, can advance the green transition by investing in urban mobility infrastructure and implementing policies for greener motorization, such as establishing low-carbon public transport corridors, creating alternative transport options, setting up smart mobility systems, and increasing vehicle standards. Greater coordination with and direct support to municipalities is needed to achieve improvements in green urban mobility.

101. Finally, enabling digitalization of the economy by improving and leveraging the broadband infrastructure and preparing for the 5G transition will support productivity and trade growth. Kosovo should continue to invest in improving digital infrastructure by developing broadband access in rural areas. With the rise in demand for mobile data, it is urgent to implement the second phase of the Frequency Release Plan to assign new spectrum and accelerate the development of the broadband market. Next, the country needs to prepare the national 5G strategy and ensure the effective implementation of the laws on Cost Reduction in Telecommunications Technology Deployment and Electronic Identification. Moreover, leveraging the digital infrastructure is even more important. This requires increasing digital skills and business digitalization. The government could consider adopting an E-commerce policy or legislation to close regulatory gaps for digital trade, which would facilitate business activity and boost productivity.

Pathway 3: Investing in human capital and increasing inclusion

Building inclusive skills for the future and improve the school-to-work transition

Consultation participants rate this priority with the highest score on impact on the twin goals; they rate its feasibility as high, subject to reallocation of public expenditure and/or higher revenue mobilization, and better government coordination, and they rate the time to deliver impacts as medium term, given the depth of the reforms.

102. Students’ standardized tests scores and worker and employer surveys present a concerning picture of the skillset of the current and future workforce in Kosovo. According to the Human Capital Index, in 2020 children in Kosovo could only expect to reach 57 percent of their potential productivity by age 18, in part because they lose an estimated 5.3 years of schooling (out of 13.2) due to low learning outcomes.
Children (especially from poor and ethnic minority families) are not acquiring the basic literacy and numeracy foundations needed to learn more advanced concepts later in school and training, and employers complain that technical and socio-emotional skills are lacking in most graduates looking for work. During consultations, employers also highlighted the difficulty in finding skilled manual labor, and the risks of training workers who soon after start searching for better opportunities abroad. To fill this gap, employers are considering bringing workers from Asia, which would further exacerbate the jobs’ shortage that domestic workers face. Hence, a top priority for the government is to set up long-term policies to increase learning outcomes in pre-university education.

103. First, the government needs to ensure children have the foundations for learning before they begin primary school. This implies working with municipalities to increase preschool enrollment by expanding the preschool supply, for example through incentives for private providers and hybrid public-private models. This expansion of supply must ensure minimum quality, through licensing (for private providers), monitoring, and training for all teachers. It is also important to raise awareness among parents of the importance of early childhood education to provide children with the basic learning foundations and promoting access of children from poor households. Broader access to childcare also reduces the barriers for women to participate in economic activity. The draft Law on Early Childhood Education should be actively disseminated and discussed to create awareness among the population, and it should be adopted and implemented to build a quality and inclusive system of early childhood education.

104. Second, in pre-university education authorities need to improve the quality of learning outcomes. Schools need to have sufficient human and physical resources to deliver good education. This requires increasing the efficiency of resource allocation in the school system. Some steps include updating the school mapping report and the education management information system; undertaking a school network optimization exercise (including the distribution of human resources); finalizing the adoption of the revised per-capita school-financing formula and including it in the next budget cycle; updating and communicating instructions, and guiding municipal administrations on the allocation of school grants based on the revised formula. An extension of the school-day duration may be considered under this re-optimization plan. The quality of learning also needs to be tracked closer, by improving the system of learning assessments that guides teacher instruction and motivates improvement over time, especially in lagging municipalities; and by implementing an education digitalization plan equitably. Finally, the ministry could move forward with creating a student registry to track students’ academic performance that includes an early warning system to identify students falling behind or at risk of dropout and provide them with extra support. In this effort, the ministry can identify and work with school support programs, such as accelerated learning, tutoring, or after school extra curriculars, and supplements such as learning center programs delivered by NGOs (especially for low-income families, minority children, and rural students).

105. Third, schools and employers need to support a smooth school-to-work transition of youth by addressing youth’s incentives and aspirations. School to work transition starts long before students graduate. Between the end of primary and the start of upper-secondary education, information campaigns can educate children, especially girls, about labor market opportunities and earnings by occupation in Kosovo’s private sector, skills required in different occupations, and training opportunities in post-secondary education. This information is the basis for selecting career and training paths in post-secondary. Schools should also partner with the private sector to increase work-based-learning through internships and apprenticeships, and the government needs to increase the labor market relevance of technical and vocational education and training programs and university courses to build the skills required by manufacturing and service sector jobs. Alternative education and after-school programs can also support disadvantaged and minority youth to build soft skills. As with learning outcomes, information systems should also monitor school-to-work transition including employer interviews and tracer surveys that provide feedback to improve labor market information, career counseling and intermediation services.
106. A universal health coverage policy will increase access to quality and affordable health services for the population. Previous administrations had placed social health insurance at the top of their agenda. However, the adoption of the Health Insurance Law has experienced multiple delays. Lack of a universal health insurance system leaves people unprotected from high OOP expenses to cover healthcare costs. This also reduces people’s use of preventive care, which ultimately increases private and public health expenditure. A policy priority is then to increase affordability and financial sustainability of healthcare by rolling out a social health insurance program with robust poverty targeting; a well-defined benefit package and a provider contracting and payment mechanism to optimize value for money in insurance strategic purchasing. By making small regular contributions to future health care needs through taxation or insurance premiums, a household can avoid facing the risk of unpredictable and potentially catastrophic OOP payments. This reform is crucial in the long term to generate additional resources for the health sector and reduce the financial burden to households from OOP health costs.

107. The health service delivery system also needs to be urgently strengthened to better deal with the growing burden of noncommunicable disease and future health emergencies. Specifically, authorities need to lay out a roadmap for improving quality of health care services, including developing a master plan for health facility network that defines the role and needs in human resources and infrastructure of primary health care and hospitals; implement an integrated health information system; and strengthen the procurement system for pharmaceutical products to achieve better value-for-money. These reforms need to be accompanied by a contingency plan for public health system to improve preparedness and resilience face to future health emergencies like COVID-19.

Consultation participants rate this priority with a very high score on impact on the twin goals; they rate its feasibility as high, subject to reallocation of public expenditure and/or higher revenue mobilization, and they rate the time to deliver impacts as medium term.

108. To boost the inclusion impact of social spending, Kosovo needs to increase funding to poverty-targeted benefits, by reallocating resources out of categorical to targeted benefits. Kosovo has a relatively high cash transfer expenditure, compared to other Western Balkan countries, at 74 percent of GDP in 2021, up from 41 percent in 2009. Yet, over 90 percent goes to old-age pensions, war-related pensions, and disability pensions, whereas poverty-targeted transfers only represent about 0.7 percent of GDP. Given the still high monetary poverty linked to structural socio-economic conditions such as family size, education, and labor market status, increasing the marginal impact of cash transfers in reducing poverty and inequality requires improving their targeting and expanding coverage to more poor and vulnerable families.

Eliminating or significantly narrowing categorical benefits (for example keeping only disability benefits and, over time, introducing poverty-targeting for old-age pensions) would liberate resources to expand the Social Assistance Scheme and increase its generosity. An initial step towards consolidation would be to maintain the key structure of the current pension system and transfer other pensions (especially war-related) towards the general pension system and establish mechanisms to prevent future unsustainable benefit increases. This would also allow to increase old-age, survivor, and disability pension generosity with the aim of creating more equity within the social protection system.

Consultation participants rate this priority with a high score on impact on the twin goals; they rate its feasibility as medium, subject to targeting of social expenditure (reforms of categorical pensions) and/or higher revenue mobilization, and they rate the time to deliver impacts as medium term.

109. Second, the social protection system needs a minimum infrastructure to identify eligible individ-
Kosovo needs to implement its Climate Change Strategy. Climate change is already affecting livelihoods globally, and Kosovo is no exception. This impact could become more acute in Kosovo as it has a relatively large rural population that depends on already scarce land and water resources. Moreover, the country’s legacy of coal-based energy, outdated infrastructure and unplanned urban development has rapidly increased air pollution and undermined sustainability. Kosovo’s power sector is one of the most reliant on coal globally (~95% of domestic power generation comes from coal-fired power plants). As the EU moves towards the implementation of its Green Deal to reduce emissions, reduce dependence on natural resources and foster more inclusive economic progress, Kosovo faces a unique opportunity to break with the past and enter a path of more efficient and sustainable resource use and energy mix, which can also create new economic development opportunities. As a first step, Kosovo needs to speed up the implementation of its Climate Change Strategy, including the adoption of the Law on Climate Change and the action plan 2021-23.

Municipal governments need increased urban planning capacity to curb growing congestion, improve the quality of life and increase resilience, while the national government should support investments to improve air quality. Although urbanization is advancing relatively slowly in Kosovo, its negative effects, including increasing emissions, are growing much faster. Pristina and other cities already have among the worst air qualities in Europe and the world, and this problem will only get worse if residential heating does not become more efficient and people continue to expand urban sprawling and rely on private vehicles. Considering this, municipal government should contribute to lowering emissions and increasing climate resilience.
by implementing strategies to improve livability and competitiveness of cities, by reducing congestion, improving public transport systems, and reducing uncontrolled and sprawling development. The national government should also set targets to reduce air pollution by increasing air quality standards, generating more data to monitor progress, and to support investments to reduce generation of pollutants.

113. The country also needs to accelerate its energy transition. Although Kosovo achieved its target share of energy consumption from renewable sources in 2020 (25.7 percent), its energy mix should progressively rely more heavily on renewable sources, in line with the commitments to the Energy Community Treaty and EU Directives. This can be done through an assessment of alternative energy sources and revised targets for 2030 and beyond, to be included in the National Energy and Climate Plan, as well as funded programs to ensure a just energy transition by mitigating social impacts in coal mining regions. The government should also speed up the implementation of energy efficiency investments in residential buildings and the private sector, which needs to be accompanied by greater data collection to monitor, verify, and disseminate progress on energy savings.

Clean and maintain natural resources

Consultation participants rate this priority with a high score on impact on the twin goals; they rate its feasibility as medium, subject to reallocation of public expenditure and/or higher revenue mobilization, and better government coordination, and they rate the time to deliver impacts as medium term.

114. Kosovo needs to improve water management to reduce water stress and increase sustainability. Kosovo has low water availability and storage, and its water basins will experience mounting stress from demand due to agricultural, industrial and population growth, as well as climate change. To improve water sustainability, Kosovo needs to pursue a long-term, multi-sectoral water management strategy that prioritizes building institutional capacity and upgrading infrastructure. Although Kosovo has a 2017-2036 Water Strategy, its implementation needs to be improved. This includes making the river basin district authority operational, finalizing flood risk and hazard maps, increasing data collection, and implementing monitoring mechanisms and green engineering programs for groundwater and water protection zones. On the utilities’ side, it is crucial to reduce NRW by increasing tariff collection and reducing (especially commercial) water losses. Better collection and dissemination of data would also increase accountability in the water sector.

However, its implementation requires building government capacity at all levels, establishing targets and a timeframe, and setting up proper monitoring mechanisms. Some important decisions, such as the locations for new landfills in agreement with the local authorities are still pending. Likewise, despite progress in the planning and construction of wastewater treatment plants, these are still not properly functional, and the country needs more investment to clean up water sources and identify urban areas at risk for water contamination. Regarding land decontamination, the government should set up and implement a long-term program to clean up the most polluted sites, building on the 2018 policy to deal with contaminated land.

115. Wastewater, solid waste management and land decontamination are also priorities to increase environmental sustainability, especially in rural areas. Household and industrial waste, including mine and industrial discharge have become serious threats to soil, water, and overall health. Large quantities of household waste and industrial discharge are dumped in unmanaged landfills and rivers each year. Authorities have made progress on legislation, for instance, through the adoption of the Strategy on Integrated Waste Management 2021-2030. However, its implementation requires building government capacity at all levels, establishing targets and a timeframe, and setting up proper monitoring mechanisms. Some important decisions, such as the locations for new landfills in agreement with the local authorities are still pending. Likewise, despite progress in the planning and construction of wastewater treatment plants, these are still not properly functional, and the country needs more investment to clean up water sources and identify urban areas at risk for water contamination. Regarding land decontamination, the government should set up and implement a long-term program to clean up the most polluted sites, building on the 2018 policy to deal with contaminated land.

65 In 2020, Kosovo’s renewable energy totaled 139 MW (95 MW of hydropower, 34 MW of wind and 10 MW of solar) (European Commission 2021). The planned construction of several small hydroelectric power plants needs to comply with environmental legislation and citizen engagement processes due to their environmental risks.
66 This includes the Water Law.
67 European Commission (2021) reports progress in the reporting of waste and adoption of modern, integrated municipal waste management plans for some, but not all municipalities.
Foster productivity growth in agriculture

Consultation participants rate this priority with a high score on impact on the twin goals; they rate its feasibility as medium, subject to reallocation of public expenditure and/or higher revenue mobilization, and better government coordination, and they rate the time to deliver impacts as medium term.

116. To increase farm productivity, the first step is to facilitate greater farm size. Kosovo has the challenge of switching from small, subsistence farming to a market-oriented agriculture. Evidence shows that larger farms are more competitive; however, the lack of a dynamic land market makes it difficult to aggregate farmland. The government needs to expedite cadastral reconstruction and legalization, by giving priority to economically active agricultural land. This would consolidate the land market, increase access to finance, and protect agricultural land from construction. Enforcing the agricultural land tax and introducing market-based valuation of properties would encourage the productive use of agricultural land. To increase scale, small producer associations and cooperatives could better link farmers to finance and markets. The KCGF agriculture window could also help micro and small farmers to access financing, by providing financial products along the agricultural cycle (longer maturities) and developing agricultural risk management instruments.

117. Second, promoting technology adoption and helping farmers meet production standards would grow the agri-food export base and create positive spillovers. Current support mechanisms are not encouraging productivity enhancing investment. However, more public investment in public goods for farmers (advice, training, extension services, R&D, infrastructure, and storage) would provide farms with much needed technology to increase their competitiveness and would reinvigorate rural economies. Promoting forward and backward links for production, processing, and marketing and reducing import barriers and custom duties for capital goods and technologies would also support growth in agri-food exports with positive spillovers in the non-exporting rural economy.

118. Third, along with increasing water sustainability, expanding sustainable irrigation is needed to sustain commercial farming. With only 17 percent of agricultural area irrigated (lower than the regional average) and a worsening situation for rainfed agriculture, agricultural productivity will continue to decline. The revitalization of agriculture and the rural economy requires expanding the area under irrigation. This includes the revitalization and intensification of the current area and the expansion of equipped areas for irrigation, which will need to be implemented in partnership with the private sector within and outside current schemes. Existing irrigation companies need to improve reliability, adequacy of the service, and cost recovery, e.g., through performance contracts with users, technical oversight, improved budgeting, tariff setting, and cost recovery targets. Per the Irrigation Master Plan and Investment Framework a diversified support model for irrigation expansion is needed, where investments in irrigation build on successful cases to avoid perpetuating non-viable farm models and are planned in complement with infrastructure and capacity building to improve productivity.

119. Finally, the government can encourage farm productivity growth by decoupling farm support and expanding financial products for farmers. The current subsidy design has a negative net effect on farm efficiency because of factor misallocation. Instead, decoupling subsidies would encourage farmers to produce based on competitive advantage, increase farm investment and specialization, and shift land use to high-value production. By establishing and enforcing environmental farming standards, decoupled subsidies would promote the adoption of sustainable farming practices and increase Kosovo’s competitiveness in agri-food production.

**“Decoupling” means separating agricultural subsidies from agricultural output or area cultivated, thus allowing farmers to produce according to market demand. Decoupled payments, instead, compensate farmers for compliance with higher environmental and animal welfare standards, which reduce price competitiveness, and for their contribution to clean air and landscape maintenance. Because they do not distort production, consumption, and international trade flows, decoupled payments comply with WTO requirements (World Bank 2021b).**

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68 **The Ministry of Agriculture has started preparing the Agriculture and Rural Development program 2021-2027, based on independent sector studies (European Commission 2023).**
Annex 1:
Selected Economic Indicators – 2019–2024

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<th>KOSOVO</th>
<th>2019</th>
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<td>Real GDP growth (percent)</td>
<td>4.8</td>
<td>-5.3</td>
<td>9.1</td>
<td>3.9</td>
<td>4.3</td>
<td>4.2</td>
</tr>
<tr>
<td>Composition (percentage points):</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consumption</td>
<td>6.2</td>
<td>2.2</td>
<td>6.0</td>
<td>17</td>
<td>23</td>
<td>18</td>
</tr>
<tr>
<td>Investment</td>
<td>-11</td>
<td>-2.4</td>
<td>31</td>
<td>27</td>
<td>24</td>
<td>25</td>
</tr>
<tr>
<td>Net exports</td>
<td>-0.3</td>
<td>-5.1</td>
<td>0.0</td>
<td>-0.5</td>
<td>-0.4</td>
<td>-0.1</td>
</tr>
<tr>
<td>Exports</td>
<td>2.2</td>
<td>-8.4</td>
<td>15.0</td>
<td>17</td>
<td>19</td>
<td>21</td>
</tr>
<tr>
<td>Imports (-)</td>
<td>2.5</td>
<td>-3.3</td>
<td>15.0</td>
<td>21</td>
<td>23</td>
<td>22</td>
</tr>
<tr>
<td>Consumer price inflation (percent, period average)</td>
<td>2.7</td>
<td>0.2</td>
<td>3.4</td>
<td>5.4</td>
<td>16</td>
<td>2.2</td>
</tr>
<tr>
<td>Public revenues (percent of GDP)</td>
<td>26.8</td>
<td>25.4</td>
<td>28.7</td>
<td>28.4</td>
<td>28.2</td>
<td>28.2</td>
</tr>
<tr>
<td>Public expenditures (percent of GDP)</td>
<td>29.7</td>
<td>33.0</td>
<td>30.1</td>
<td>30.6</td>
<td>30.9</td>
<td>30.7</td>
</tr>
<tr>
<td>Of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wage bill (percent of GDP)</td>
<td>8.7</td>
<td>9.8</td>
<td>8.8</td>
<td>8.5</td>
<td>8.9</td>
<td>8.8</td>
</tr>
<tr>
<td>Social benefits (percent of GDP)</td>
<td>6.3</td>
<td>7.7</td>
<td>7.4</td>
<td>7.2</td>
<td>7.0</td>
<td>6.6</td>
</tr>
<tr>
<td>Capital expenditures (percent of GDP)</td>
<td>7.5</td>
<td>5.6</td>
<td>5.5</td>
<td>6.5</td>
<td>6.8</td>
<td>7.0</td>
</tr>
<tr>
<td>Fiscal balance (percent of GDP)</td>
<td>-2.9</td>
<td>-7.6</td>
<td>-1.4</td>
<td>-2.2</td>
<td>-2.6</td>
<td>-2.5</td>
</tr>
<tr>
<td>Primary fiscal balance (percent of GDP)</td>
<td>-2.6</td>
<td>-7.2</td>
<td>-1.0</td>
<td>-1.7</td>
<td>-2.2</td>
<td>-2.2</td>
</tr>
<tr>
<td>Public debt (percent of GDP)</td>
<td>170</td>
<td>22.0</td>
<td>22.1</td>
<td>24.0</td>
<td>25.3</td>
<td>26.9</td>
</tr>
<tr>
<td>Public and publicly guaranteed debt (percent of GDP)</td>
<td>176</td>
<td>22.4</td>
<td>22.5</td>
<td>24.3</td>
<td>25.4</td>
<td>27.0</td>
</tr>
<tr>
<td>Of which: External (percent of GDP)</td>
<td>58</td>
<td>78</td>
<td>76</td>
<td>92</td>
<td>99</td>
<td>10.6</td>
</tr>
<tr>
<td>Goods exports (percent of GDP)</td>
<td>5.6</td>
<td>6.9</td>
<td>9.9</td>
<td>9.8</td>
<td>9.8</td>
<td>9.9</td>
</tr>
<tr>
<td>Goods imports (percent of GDP)</td>
<td>45.8</td>
<td>44.2</td>
<td>56.7</td>
<td>55.2</td>
<td>55.0</td>
<td>54.7</td>
</tr>
<tr>
<td>Net services exports (percent of GDP)</td>
<td>13.1</td>
<td>5.7</td>
<td>14.2</td>
<td>12.6</td>
<td>13.5</td>
<td>14.4</td>
</tr>
<tr>
<td>Trade balance (percent of GDP)</td>
<td>-271</td>
<td>-31.6</td>
<td>-32.7</td>
<td>-32.9</td>
<td>-31.7</td>
<td>-30.4</td>
</tr>
<tr>
<td>Net remittance inflows (percent of GDP)</td>
<td>116</td>
<td>13.8</td>
<td>15.7</td>
<td>14.7</td>
<td>14.1</td>
<td>13.9</td>
</tr>
<tr>
<td>Current account balance (percent of GDP)</td>
<td>-56</td>
<td>-7.0</td>
<td>-9.1</td>
<td>-9.7</td>
<td>-9.0</td>
<td>-8.0</td>
</tr>
<tr>
<td>Net foreign direct investment inflows (percent of GDP)</td>
<td>2.7</td>
<td>4.2</td>
<td>4.2</td>
<td>4.2</td>
<td>4.0</td>
<td>4.0</td>
</tr>
<tr>
<td>External debt (percent of GDP)</td>
<td>312</td>
<td>37.2</td>
<td>37.3</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Real private credit growth (percent, period average)</td>
<td>78</td>
<td>76</td>
<td>75</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Nonperforming loans (percent of gross loans, end of period)</td>
<td>19</td>
<td>2.5</td>
<td>2.3</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Unemployment rate (percent, period average)</td>
<td>25.7</td>
<td>24.5</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Youth unemployment rate (percent, period average)</td>
<td>49.4</td>
<td>49.4</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Labor force participation rate (percent, period average)</td>
<td>40.5</td>
<td>37.8</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>GDP per capita (US$)</td>
<td>4,416</td>
<td>4,350</td>
<td>5,058</td>
<td>5,281</td>
<td>5,657</td>
<td>5,967</td>
</tr>
</tbody>
</table>

Source: Country authorities, World Bank estimates and projections.
Annex 2:
Poverty trends and profiles

This section describes the latest poverty trends and the characteristics of the poor and the bottom 40 percent of the population. The analysis was conducted based on the Household Budget Survey 2012-2017 (latest year available). Welfare is measured in terms of consumption per capita, expressed in PPP (2011) US dollars, and poverty is measured as the percentage of the population with a per capita consumption below the US$5.5 (PPP 2011) per capita, per day, poverty line used for upper-middle income countries.

Poverty fell and shared prosperity was positive over the 2012-2017 period. Poverty fell from 31.9 to 23.6 percent of the population between 2012 and 2016 (8.6 percentage points), but it increased again in 2017 to 24.4 percent (Figure 32), driven by an increase in rural poverty. Both poverty and poverty depth (measured by the poverty gap in Figure 33) remain higher in rural than in urban areas, despite the 11.5 percentage-point reduction in rural poverty in 2012-2016. In that period, the gap in the poverty headcount rate between rural and urban areas contracted from 12.6 to 4.5 percentage points. In 2017 the rural and urban poverty headcounts were 24.7 percent and 19.8 percent, respectively. As approximately 61 percent of Kosovo’s population lives in rural areas, this implies that two-thirds of poor households are rural. Overall, consumption among the bottom 40 percent grew faster than median and mean consumption during this period both in urban and rural areas (Figure 34), and it grew relatively more among the bottom percentiles, which also happen to be mostly rural. Consumption also grew significantly among the 95th percentile (Figure 35).

Figure 32: Poverty headcount ratio (%)

Figure 33: Poverty gap index (%)

Figure 34: Shared prosperity (%)

Figure 35: Growth incidence curve, national, 2012–2017

Source: Household Budget Survey.

The poverty gap index measures the extent to which individuals fall below the poverty line (the poverty gap) as a proportion of the poverty line. It measures the depth or intensity of poverty. It considers both the percentage of the population below the poverty line as well as the size of the gap between the poverty line and the average consumption of those below the poverty line. Compared to the poverty headcount, the poverty gap has the advantage of detecting changes in welfare that occur below the poverty line, such as households becoming less poor, but not enough to cross the poverty line.

The growth incidence curves present the percentage change in real consumption per capita for each centile of the population (ranked from poorest to richest) over the period, indicating how consumption is growing in the poorest part of the distribution relative to those who are better off.
There's a noticeable increase in urban inequality between 2012 and 2017. The Gini index increased in urban areas and it lays above the national average since 2014. On the contrary, in rural areas inequality improved from 2012 to 2015 and although the Gini index has increased, it was still lower in 2017 than in 2012 (Figure 36). To understand this evolution, growth incidence curves in rural and urban areas between 2012 and 2017 show that growth at lower percentiles of the consumption distribution was much higher than the mean and median in rural than in urban areas (Figure 37). Indeed, in urban areas, growth at the bottom 40 percent was barely higher than the average (Figure 38), while it was significantly higher among the richest people. In the period 2016-2017, when inequality increased more significantly, consumption did not grow for most urban households, but for those in the 90th percentile. Whereas in rural areas the bottom 15 percentiles had slightly above-average growth, while the 90th percentile experienced more significant growth, hence increasing rural inequality in a lesser extent to urban inequality.

Poverty incidence is highest in Ferizaj and in Mitrovica, but the highest share of the poor are concentrated in Pristina, followed by Mitrovica and Ferizaj (Table 3). As in many countries, rural regions in Kosovo tend to have fewer poor but higher poverty incidence; this is the case for instance in Ferizaj, which has around 19 percent of the poor population but a poverty incidence of 44 percent. On the other hand, Prizren has a lower poverty incidence (14.6 percent) but has 10.7 percent of the total poor. One notable exception is Pristina, which has both a high poverty incidence and a high share of total poor. Poverty is heavily concentrated geographically. The three regions with the highest poverty rates have a higher share of the bottom 40 percent than that of the overall population. Furthermore, combined, they account for 70 percent of the poor, 65 percent of the population in the bottom two quintiles, but just over 50 percent of the overall population.

Between 2012 and 2017, the main driver of poverty reduction at the national level was consumption growth, as opposed to changes in its distribution. Despite the faster growth of consumption at the lower parts of the distribution (Figure 35), poverty reduction can be linked to a larger extent to growth in the whole distribution (86%) rather than to changes in the consumption distribution (14%). This is especially true in urban areas, where virtually all poverty reduction is attributable to growth (Figure 38) (112%), whereas in rural areas a larger share of poverty reduction came from changes in the distribution (27%) from faster-than-average consumption growth among the poorest deciles (Figure 37).

Changes in the consumption distribution had a negative impact on poverty reduction in urban areas or –12%.

### Table 3: Poverty Rates, distribution of the bottom 40%, by region, 2017

<table>
<thead>
<tr>
<th>Regions</th>
<th>Poverty %</th>
<th>Share of the poor</th>
<th>Share of bottom 40%</th>
<th>Share of population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gjakov</td>
<td>4.7</td>
<td>1.9</td>
<td>4.3</td>
<td>9.8</td>
</tr>
<tr>
<td>Gjilan</td>
<td>14.3</td>
<td>6.0</td>
<td>6.2</td>
<td>10.2</td>
</tr>
<tr>
<td>Mitrovic</td>
<td>40.0</td>
<td>24.5</td>
<td>20.6</td>
<td>15.0</td>
</tr>
<tr>
<td>Pej</td>
<td>26.9</td>
<td>10.7</td>
<td>9.9</td>
<td>9.7</td>
</tr>
<tr>
<td>Prizren</td>
<td>14.6</td>
<td>10.7</td>
<td>13.9</td>
<td>17.8</td>
</tr>
<tr>
<td>Prishtin</td>
<td>24.7</td>
<td>27.3</td>
<td>29.8</td>
<td>27.0</td>
</tr>
<tr>
<td>Ferizaj</td>
<td>44.0</td>
<td>19.0</td>
<td>15.3</td>
<td>10.5</td>
</tr>
<tr>
<td>Total</td>
<td>24.4</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>
Large households and households with children have a higher likelihood of being poor and account for a large share of the poor. There's a clear positive relationship between household size and poverty (Figure 39). Poverty incidence among households with at most 2 members was 3.4 percent in 2017, whereas it was 36 percent among households with 7 or more members. Likewise, over half of the poor belonged to households with 7+ members. Similarly, poverty is much higher for households with children. In 2017 there was a 7-percentage-point gap in the poverty incidence of households with no children and households with one child. This gap grows as the number of children increases, reaching 29 percentage points between household with no children and those with 3 or more children (Figure 40). Child dependency rates are considerably higher in Kosovo than in the other Western Balkan countries, especially among households from the bottom 40% of the consumption distribution.\textsuperscript{73} Only Montenegro has a child dependency rate higher than Kosovo among poor households (0.59 vs 0.51).\textsuperscript{74} Figure 40 confirms the positive relationship between number of children and adult members and poverty incidence. However, the table also shows that the presence of older adults reduces the probability that the household is poor.

Poverty is lower among more educated households. Poverty incidence is four times larger among households whose head of household did not complete primary education, relative to those with tertiary education (Figure 41). Almost forty percent of poor household heads attained only primary education, against 32 percent in the entire population. By contrast, only 4.5 percent of poor household heads have tertiary education, against 16 percent in the entire population. Results from a regression analysis shown in Table 4 confirm that having a household head with tertiary education reduces the probability of living in a poor household between 16% and 18% relative to households whose heads did not complete primary education.

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\textsuperscript{73} Child dependency rates are defined as the proportion of children 0-14 of age to the number of working age individuals in the households (15-64 years of age).

\textsuperscript{74} Estimates using SILC 2018 for Western Balkan countries, except Bosnia and Herzegovina. The rates for the rest of countries are Albania, 0.45; North Macedonia, 0.36; Serbia, 0.31.
Consumption poverty is closely related to the main income sources of a household, the employment status of its individuals and, if employed, the sector and type of employment. In 2017, households whose main source of income was salaried work were less likely to live in poverty than those whose main source of income was occasional (per-diem) work. Poverty rates are highest among households that depend on social assistance as their main source of income, followed by those who depend on benefits to families of children with permanent disabilities. Poverty rates are lowest among households that depend primarily on remittances from abroad, public sector wages, household businesses income, war-related pensions, and those with private sector wages. Among individuals 15+ years of age, those disabled, unemployed or with occasional employment show above-average rates of poverty. Reporting being an employer as the main activity does not guarantee that the person will avoid poverty, since 7% of these are poor. Due to larger household sizes and high dependency ratios, incomes from employment are spread thin among the poor. For example, in 2017, more than a quarter (27.2 percent) of households did not have a single wage earner, and 46 percent were dependent on a single wage earner. Although in the population women have a higher chance than men to be poor, female headed households have a lower probability of consuming below the poverty line as shown in Table 4. Nonetheless, only about 10 percent of households are female headed in Kosovo.

<table>
<thead>
<tr>
<th>Household characteristics</th>
<th>Probit</th>
<th>LPM</th>
</tr>
</thead>
<tbody>
<tr>
<td>Children 14 and under</td>
<td>0.055*** (0.002)</td>
<td>0.068*** (0.003)</td>
</tr>
<tr>
<td>Individuals (15-64)</td>
<td>0.032*** (0.002)</td>
<td>0.037*** (0.002)</td>
</tr>
<tr>
<td>Individuals (65+)</td>
<td>-0.019*** (0.005)</td>
<td>-0.018*** (0.006)</td>
</tr>
<tr>
<td>Highest level of education completed, Primary</td>
<td>-0.023 (0.016)</td>
<td>-0.023 (0.014)</td>
</tr>
<tr>
<td>Highest level of education completed, Secondary or vocational</td>
<td>-0.082*** (0.016)</td>
<td>-0.083*** (0.015)</td>
</tr>
<tr>
<td>Highest level of education completed, Tertiary</td>
<td>-0.178*** (0.016)</td>
<td>-0.166*** (0.015)</td>
</tr>
<tr>
<td>Sex of household head, Female</td>
<td>-0.051*** (0.009)</td>
<td>-0.047*** (0.010)</td>
</tr>
<tr>
<td>Area of residence, Urban</td>
<td>0.000 (0.006)</td>
<td>0.003 (0.007)</td>
</tr>
<tr>
<td>Wage share of total income</td>
<td>-0.107*** (0.020)</td>
<td>-0.136*** (0.025)</td>
</tr>
<tr>
<td>Pension share of total income</td>
<td>-0.004 (0.023)</td>
<td>-0.003 (0.028)</td>
</tr>
<tr>
<td>Social Assistance share of total income</td>
<td>0.260*** (0.024)</td>
<td>0.402*** (0.032)</td>
</tr>
<tr>
<td>Remittance share of total income</td>
<td>-0.119*** (0.022)</td>
<td>-0.129*** (0.026)</td>
</tr>
<tr>
<td>Property share of total income</td>
<td>-0.113*** (0.038)</td>
<td>-0.122*** (0.039)</td>
</tr>
</tbody>
</table>

Observations 13,786

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Source: Authors with Household Budget Survey data.

Note: The table shows the marginal effects of household characteristics on the probability of being poor. The first column uses a probit model while the second one uses a linear probability model. The regression includes regional and year fixed effects, not shown.

Labor earnings and pensions are the main sources of household income in Kosovo for all households, though income from social assistance also plays an important role among poor households. In 2017, labor earnings represented more than half of urban and rural poor households’ total income. These shares are lower than those for the total population. Labor earnings and pension shares are larger for poor households in urban areas relative to rural areas. Remittances represented around 12 percent of household income (8 percent for poor households) in rural areas, against 8 percent of household income in urban areas (6 percent for poor households). In contrast, social assistance represented only 4 percent of average household income, but 13 and 12 percent for poor households, in urban and rural areas, respectively. Notably, between 2012 and 2017, urban poor households’ income relied relatively more on pension income and
slightly less on labor earnings, social assistance, and remittances. Rural poor households had a similar trend but with a much lower increase in incomes from pensions. The decline in poverty between 2012 and 2017 was mainly driven by wages, which explained close to 80 percent of the total poverty reduction (5.6 out of 71 percentage points). This is particularly the case in urban areas, where it explains 152% in the reduction. Income from pensions and employment rates also contributed to poverty reduction, especially in rural areas. Besides pensions, non-labor income did not play a substantial role in poverty reduction. On the contrary, social assistance, remittances, unemployment benefits, and agricultural sales played a very limited role in poverty alleviation.

Consistent with poverty reduction, the share of expenditure on food dropped by 8 percentage points for the average household between 2012 and 2017 in Kosovo, however, the poor spend 63% of total household consumption in Food by 2017. Food is by far the largest expenditure component for households in Kosovo at about 55% of total consumption as shown in Figure 43. For the poor, however, this share is 8 percentage points higher than the national average and 3 percentage points higher than the bottom 40%. Such higher-than-average shares of food consumption can leave poor households vulnerable to price shocks of basic consumption items. The second largest expenditure component for the poor is housing and utilities. At almost 9%, it is close to the national average of 10% and the same share as the bottom 40% households. The poor spend about 5.5% of their consumption on alcohol and tobacco, a similar share as what the national average and the bottom 40% spend on these items.

Figure 42: Contribution of income components to change in poverty

Consistent with poverty reduction, the share of expenditure on food dropped by 8 percentage points for the average household between 2012 and 2017 in Kosovo, however, the poor spend 63% of total household consumption in Food by 2017. Food is by far the largest expenditure component for households in Kosovo at about 55% of total consumption as shown in Figure 43. For the poor, however, this share is 8 percentage points higher than the national average and 3 percentage points higher than the bottom 40%. Such higher-than-average shares of food consumption can leave poor households vulnerable to price shocks of basic consumption items. The second largest expenditure component for the poor is housing and utilities. At almost 9%, it is close to the national average of 10% and the same share as the bottom 40% households. The poor spend about 5.5% of their consumption on alcohol and tobacco, a similar share as what the national average and the bottom 40% spend on these items.

Figure 43: Distribution of consumption expenditure
Annex 3:  
Social inclusion challenges

As documented in the SCD (World Bank 2017), several groups in Kosovo face persistent economic and social exclusion, which increases their likelihood of being stuck in poverty across generations. The following groups have been identified as experiencing larger exclusion and vulnerability.

Women

Women are marginalized from economic opportunities. While overall employment rates are low in Kosovo, they are among the lowest in Europe and Central Asia for women. In 2020, the female employment rate was 14%, compared to 43% for men. Meanwhile, 79% of working-age women were inactive, against 44% of men. For women who are employed, dominant sectors include education, trade, and health care (53%), whereas men work predominantly in trade, construction, and manufacturing (44%) (KAS 2021b), although this seems to have increased recently (Farnsworth N. et al 2018). A disproportionate share of family care responsibility falls on women, which contributes to their withdrawal from economic activity (a 2017 Millennium Challenge Corporation study reported that 32% of women respondents indicated it as the primary reason of inactivity). The lack of affordable pre-school facilities is another major barrier. There is little research on gender-based discrimination in the labor market, however anecdotal evidence suggests that some women are discriminated during hiring processes because of maternity leave.

Within the education system women are underrepresented in STEM fields and among the academic community. Kosovo has reached gender parity in enrolment rates in pre-university education, however, there is a strong gender segregation in the fields of study at the university level. Women represent 85% of the students in the field of education, 75% in health, and 69% in humanities and arts, but they are a minority in natural and technical sciences; they are also less likely to attend vocational training centers (39%) and adult education courses (36%) (Agency for Gender Equality 2020). Women are also slightly more likely to attend public universities while men are more likely to attend private universities. Female teachers are overrepresented in early education (pre-school) but their share falls in higher grades, and they are underrepresented among university professors, both in public (34%) and private universities (26%) (Farnsworth N. et al 2018).

While men and women face similar barriers in access to health services, women’s health outcomes related to fertility are concerning. Despite the lack of up-to-date official data, maternal and infant mortality are concerning and highlight the need to strengthen perinatal and neonatal services. Child mortality is considered among the highest in Europe, with 16 children in 1,000 live births who die before reaching their 5th birthday in Kosovo, which is four times higher than the European Union average of 3.9. The rate rises to 27 in 1,000 live births among Roma, Ashkali and Egyptian communities. Access to reproductive and sexual health remains limited: only 9% of women aged 15-49 currently married or in union use a modern method of contraception (Kosovo Agency of Statistics and UNICEF 2020b). Across the population, only 6% have private health insurance, and among those insured, only 1/3 are women (and only 1 in 5 in rural areas) (Farnsworth N. et al 2018).

Women participation in public and private institutions is still limited. Women are still underrepresented in political bodies, including public administration, security and justice systems, and local governments. However, there has been notable progress in the last parliamentary election, when 40 women became MPs (the highest number since 2008), and eight of the fourteen functional committees of the Assembly are now chaired by women (European Commission 2021).

Gender-based and domestic violence are widespread in Kosovo. Social norms and stereotypes influence attitudes towards violence, and in Kosovo gender-based violence is still tolerated. The most
recent reports indicate that 68% of women have experienced some form of domestic violence in their lifetime, and over 55 women died because of domestic violence between 2015 and 2019 (Kosovo Women’s Network 2019). The number of cases of domestic violence reported to the police is increasing (over 1,000 annually) but is still low. Sexual violence is rarely reported by the victims (Agency for Gender Equality 2020). Health support, including mental health support, for victims of domestic and sexual violence is also insufficient. Identification and treatment of cases of sexual harassment are challenging, despite evidence suggesting that 64% of women have experienced it in their lifetime (Farnsworth N. et al 2018).

LGBTQ people in Kosovo are also marginalized and discriminated. Homophobia remains widespread in the country. According to a 2018 study, 67% of men and 55% of women believe that homosexuality is not normal nor natural (OSCE Mission in Kosovo and UNFPA Kosovo 2018). LGBTQ people face barriers to access health services, employment, and education, however a lack of data and in-depth studies of this issue results in a significant knowledge gap regarding the key drivers that can be corrected by policy to reduce discrimination and exclusion of this group (Farnsworth N. et al 2018).

Roma, Ashkali and Egyptian communities

Members of Roma, Ashkali and Egyptian communities are among the most marginalized people in Kosovo and are highly affected by poverty. According to the 2011 official records, Roma, Ashkali and Egyptian people constitute only 2.06% of the total population (35,784 people), however, they are believed to be undercounted by official statistics. Roma, Ashkali and Egyptian communities face high rates of unemployment (48%). Among the 13% who are employed, 70% work in informal jobs, compared to 46% among the non-minority population.76 Poverty is widespread among Roma, Ashkali and Egyptian people, who also face high deprivation and inadequate infrastructure, as they often live in informal settlements with limited access to water, sanitation and electricity. Many of them depends on public social assistance (OSCE Mission in Kosovo 2020 and Agency for Gender Equality 2020).

Roma, Ashkali and Egyptian women and girls are highly vulnerable. While both female and male Roma, Ashkali and Egyptian have lower enrolment rates in compulsory education compared to the rest of the population, there is a 12 percentage-point gap in favor of Roma, Ashkali and Egyptian boys in upper-secondary completion. Young girls and women among Roma, Ashkali and Egyptian communities are more affected by child marriage and adolescent pregnancies and have a higher fertility rate (3.6 compared to the national 2.3). One in ten women aged 20-49 have been married before 18 years old in Kosovo, while the rate is 4 in 10 among Roma, Ashkali and Egyptian women. Moreover, there are 13 live births per 1,000 adolescent girls aged 15–19 years in Kosovo, compared to 78 among Roma, Ashkali and Egyptian adolescent girls of the same age (Kosovo Agency of Statistics and UNICEF 2020b).

Children from Roma, Ashkali and Egyptian communities are more affected by poverty and child mortality and have lower access to education and health services. One in three children in Kosovo belongs to the poorest households, and almost half of them are members of Roma, Ashkali and Egyptian communities. For 1,000 live births, 16 children die before reaching 5 years in Kosovo, while among Roma, Ashkali and Egyptian communities 27 children for 1,000 live birth die. School attendance is lower among Roma, Ashkali and Egyptian communities compared to the national rates and the gap widens at each step of the education system. While 96% of children in Kosovo attend primary school, 94% attend lower secondary, and 87% upper secondary, only 84% of Roma, Ashkali and Egyptian children attend primary school, 64% lower secondary, and only 31% upper secondary. Foundational skills among Roma, Ashkali and Egyptian children aged between 7 and 14 are below the national performances. Only 18% of Roma, Ashkali and Egyptian children show foundational reading skills, compared to 41% on average, while 13% show foundational numeracy skills compared to 42% on average. With respect to health, 73% of children between 24 and 35 months are fully immunized, compared to 38% of fully immunized Roma, Ashkali and Egyptian children (Kosovo Agency of Statistics and UNICEF 2020b).

Kosovo Serb community

Members of the Serb community face similar challenges to those experienced by the rest of the society but lack trust towards the public institutions. Surveys highlight a general dissatisfaction with the political, economic and security situation of the country, and a high level of mistrust towards the government as well as towards the country political leaders, both Serb and Albanian. Unlike members of

other communities living in the country, members of the Serb community perceive public and personal security as one of the main issues affecting them (UNDP 2021). Despite the general mistrust, an increased number of Kosovo Serbs possess personal documents issued by the Republic of Kosovo. While 35% of surveyed members of the Serb community claimed to not possess them in 2016, the number has decreased to 11% in 2020. Moreover, 73% of respondents affirm to participate to elections regularly or occasionally in Kosovo, compared to only 32% of respondents who in 2016 claimed having taken part to the 2014 elections (Marinković M. M. et al 2020 and Jović N. et al 2016).

**Persons with Disabilities**

Persons with disabilities in Kosovo face barriers in access to education, health and employment opportunities and are more affected by poverty. The number of persons with disabilities in Kosovo is unknown due to lack of data and the use of multiple definitions by different institutions and stakeholders. An estimation suggests that there are 150,000 persons with disabilities in the country (Hunt P. F. and Belegu-Caka V. 2017). Findings from the 2020 Multiple Indicator Cluster Survey (MICS) show that 8% of children between 2 and 17 years old have a functional difficulty in at least one domain, while among Roma, Ashkali and Egyptian children the incidence is higher (14%). Children with disabilities in Kosovo experience barriers to access education. The main challenges are the lack of trained professional staff, inadequate transportation, inaccessible infrastructure, including school rooms, and lack of adapted learning equipment and materials. Girls with disabilities face more difficulties than boys. The rate of gross inclusion of girls with disabilities at the primary and lower secondary levels is 37%, while in upper secondary it decreases to 18% (Agency for Gender Equality 2020).

Persons with disabilities face limited access to economic opportunities and public services. A 2019 survey of 404 persons with disabilities found that only 15% of the respondents were currently employed. Among them, close to 1 in 3 reported earning low wages and 1 in 5 reported poor working conditions. A smaller share reported low access to infrastructure (16%), health insurance and other benefits (15%), and transport (13%) (UNDP 2019).

**Internal Displaced People (IDPs) and Returnees**

Internal protracted displacement triggered by the 1999 crisis is still an unresolved issue in Kosovo affecting about 16,100 people (UNHCR 2021). While the majority of IDPs are ethnic Serbs, members of Roma, Ashkali and Egyptian communities and ethnic Albanians have also been displaced. According to a sample-based profiling assessment conducted in 2016, IDPs face similar challenges to the overall population of Kosovo, although in some cases they experience worse outcomes, including low levels of education, high rates of unemployment, inadequate housing conditions, and difficult access to health care. Education levels are lower than among the rest of the population, particularly for Roma, Ashkali and Egyptian IDPs: 41% of men and 54% of women do not have a complete secondary education. Employment outcomes among IDPs are dismal: unemployment is prevalent (41% among Albanians, 84% among Roma, Ashkali and Egyptian, 43% among Serbs living in private accommodation and 62% among Serbs in collective centers), and the vast majority among those who are employed earn less than 300 EUR per month. Housing conditions are also problematic, especially for IDPs residing in collective centers, where close to 1/3 has no connection to the sewerage system. In terms of future perspectives, the majority of Albanian IDPs (62%) prefer to return to their places of origin, while the overwhelming majority of Roma, Ashkali and Egyptian IDPs (80%) and Serb IDPs (93% of IDPs living in private accommodation and 83% of IDPs living in collective centers) prefer to integrate in their places of displacement (UNHCR 2018).

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77 Domains are the following: seeing, hearing, walking, fine motor, communication, learning, playing, controlling behavior, self care, remembering, concentrating, accepting change, making friends, anxiety and depression.
Annex 4:
Summary of Kosovo’s Risk and Resilience Assessment

Kosovo is a post conflict society, whose further consolidation process is linked to sustained progress in institutional development and socio-economic inclusion. The main social risks the Risk and Resilience Assessment identifies are:

**Low interethnic cohesion:** Since declaring independence in 2008, Kosovo has struggled to overcome its legacy of conflict. Although recent developments have helped ease political grievances, the structural causes of economic exclusion remain unresolved. These continue to aggravate social tensions in a context without legal freedom of movement in the European Union. Ethnic, regional, and political dimensions of risk that individually represent a low to medium level of risk of violence interact, and so doing generate a risk of deeper social discontent and violence—particularly for young men.

**Low meritocracy and social inclusion:** Close networks of family ties and loyalties dominate business relations in Kosovo. The April 2020 UNDP Public Pulse survey found that over 80 percent of respondents considered employment in the public sector to be based largely on family connections (30.8), party allegiance (30.4), bribery (13.8), or other personal connections and unethical practices, while less than 20 percent viewed public-sector employment as primarily rooted in personal merit. The failure to build a truly meritocratic public administration exacerbates social fragmentation, undermines trust in institutions, and generates economic and social costs by excluding qualified workers from valuable opportunities.

**Youth disenfranchisement:** The youth unemployment rate reached 49.4 percent in 2019, almost double the 25.7 percent overall rate. Moreover, due to low rates of labor-force participation, only 131 percent of 15-to-24-year-olds are employed, and 32.7 percent are neither employed nor in education or training. Kosovo is at risk of a “lost generation,” and this risk may worsen in the post-pandemic era. Youth disenfranchisement generates significant economic costs and can also intensify the threat of social unrest and violence.

**Governance, voice, and accountability:** Kosovo ranked 104th among the 180 countries surveyed in Transparency International’s 2020 Corruption Perceptions Index, a slight improvement since 2012, but still worse than Western Balkan neighbors such as Montenegro (45th) and Serbia (94th). Personality-centered political parties, a lack of policy-oriented public debate, and low governmental capacity have prevented successive governments from advancing long-term development objectives. The two Strategies for Cooperation with Civil Society (2014–2017 and 2019–2023) represent a positive step, but their implementation has been slow.

Annex 5: Data availability and quality to inform policy decisions

Timely, accurate, and consistent statistics are crucial for evidence-based decision making. For instance, the quality and timeliness of national accounts statistics are key for the effective implementation of Kosovo’s rules-based fiscal framework and having an accurate way to measure living conditions is key to implement effective targeting of social policies.

As the agency responsible for coordinating Kosovo’s Statistical System, the Kosovo Agency of Statistics (KAS) is the main institution in charge of producing official statistics. Although external assessments continue to note KAS’ progress along several areas, they also point to remaining structural challenges to produce accurate and timely data to inform policymakers and to strengthen transparency and accountability. On statistical infrastructure, as the EC (2021) country report notes, the implementation of the statistical legal framework still needs to be strengthened. KAS should be seen by all public institutions as the main agency in charge of coordination of the statistical system, including guaranteeing its access to administrative data sources. Meanwhile, Kosovo received a score of 46.9/100 for 2020 on the World Bank’s Statistical Performance Indicators (SPI) overall score, which measures a country’s statistical performance around 5 pillars designed to capture (i) use of publicly accessible data; (ii) transparent methodology; (iii) easy replicability; (iv) a time series to track performance; (v) clear portrayal of outcomes and their supporting elements; and (vi) being reflective of the SDGs; (vii) enable at-a-glance comparisons on a global scale.

As the EUROSTAT Peer Review (2015) noted, KAS has challenges on cost-effectiveness, quality management and relations with data users. Human resources continue to be a limiting factor in the production of timely and quality products. The agency has not replaced staff since 2013, it currently has 13 positions to fill just to replace attrition of staff (and will lose 10 more in the next years) in addition to needs of additional staffing regarding specialized surveys such as SILC and the upcoming Population Census. Given the very limited staffing of the agency, staff turnover represents a significant loss of human resources. For instance, the agency struggled to implement its workplan on the statistical business register after a key staff left, a similar situation has occurred in the production of the SILC. Limited staffing and capacity also reduce the amount of documentation of work processes, which further hurts institutional memory. Technical capacity of enumerators for surveys is also problematic, especially regarding the upcoming Census. Currently, KAS has no robust system to monitor and control the work of the interviewers who conduct the data collection, for instance on issues such as impartiality, confidentiality, and relevant quality dimensions.

Managerial capacity is also limited by the fact that a CEO has not been appointed yet. Further, KAS premises and infrastructure remain inadequate, which, among others, creates risks for data security.78 Internal management faces challenges of limited internal communication between the departments which creates bottlenecks for processing information, especially for national accounts. In addition, administrative capacity (only one person taking care of procurement and human resources) is severely limited and generates a significant risk of delays or cancellation of key processes for the Census and other large operations. Increasing administrative capacity is urgent considering the upcoming Census.

On macroeconomic statistics, several weaknesses remain in the production of accurate and timely national accounts. Kosovo does not have a proper business registry to form the basis of the national accounts’ production approach, and national accounts are also not prepared through the income approach. Quality of national account statistics depends on the quality of business statistics, household surveys, price statistics, and external accounts, among others. Hence, it would be important to take a holistic assessment of the statistics in Kosovo with the aim to improve national account statistics and overall statistical quality. KAS compiles annual...
and quarterly national accounts, and has managed to shorten the production period, however methodological inconsistencies need to be addressed. Annual and quarter sector accounts, supply/use tables and the regional accounts are not regularly compiled. The number of ESA 2010 transmission tables to EUROSTAT has seen some improvements in the last year. Monthly statistics for trade in goods are submitted to EUROSTAT. Balance of payments data are compiled by the Central Bank and are broadly in line with the EU standards; annual and quarterly data are submitted to EUROSTAT. Government finance statistics are published quarterly. The Harmonized Index of Consumer Prices is published based on EU Standards (ECOICOP classification).

Structural business statistics are still limited, and they lack key levels of disaggregation. Industry statistics are produced broadly in line with the relevant regulation. KAS has, for the first time, published services sector statistics (covering the period Q1 2018-Q4 2020) in March 2021. Construction sector statistics are largely not available; only the construction cost index is produced on a quarterly basis. Industry statistics (PRODCOM survey) for the year 2019 has not been published. Foreign Affiliates Statistics are not available. Tourism statistics and transport statistics are still not aligned with the EU standards, while statistics on development and innovation are not produced on a regular basis. The ICT statistics for households started in 2018 and is now regularly being published whereas the ICT statistics for enterprises were collected for the reference year of 2019 and results have been published in December 2020 but suffer from technical problems.

The preparation for the population census 2021 was derailed by the pandemic and political instability. KAS conducted a very limited pilot test in 2020 but was not able to follow with the general census in 2021, thus postponing it to end-2022. The government has recently approved the budget line for 2022 but funding does not meet the minimum required for the operation. The Census Law has still not been approved in Parliament.

Regarding labor statistics, since 2012 KAS has collected the Labor Force Survey (LFS) year-round to eliminate the seasonal bias. Since then, KAS also adopted International Labor Organization and EUROSTAT standards in defining labor market status, and efforts were redoubled to capture small activities and informal employment. Since 2016, LFS data are also published on a quarterly basis. There is scope to improve the quality of LFS data collection, however. For instance, LFS data show that informal employment (employees without a contract) fell from 26.3% in 2016 to 13.4% in 2019, but this change cannot be explained and does not match other data sources. Another gap in the LFS is the scant information on wages, which is only collected using 10 salary ranges. Likewise, agricultural employment is underrepresented in LFS compared to other surveys. The labor cost index, structure of earnings data and job vacancy statistics are still not produced.

**Household consumption is measured by the Household Budget Survey.** In 2012, the Kosovo Agency of Statistics made major changes to the reference periods for household expenditures, however bridges to the previous collection methods were not developed and data is not comparable backwards. HBS has been conducted regularly until 2018; thereafter, it is being implemented every 5 years. In 2019, using HBS data, the Kosovo Agency for Statistics and the World Bank finalized the latest poverty report referring to period 2012-2017. HBS data on subnational regions is likely to be biased because there is one HBS interviewer per region, and the interviewers do not rotate across regions. For several topics, the HBS provides little detail or disaggregation. One notable example is social protection benefits, on which the questionnaire does not distinguish among different types of pensions or social transfers (with exception of social assistance category 1 and 2).

**The Survey of Income and Living Conditions (EU-SILC) is being implemented for the third year in Kosovo.** With support of the World Bank, EU-SIDA and experts from Bulgaria and Malta, the Kosovo Agency of Statistics (KAS) collected the first wave of EU-SILC in 2018. The EU-SILC is an instrument for collecting timely and comparable micro-data on income, poverty, social exclusion and living conditions. The EU-SILC is in line with the EUROSTAT methodology and is used by European Union member states. Field data collection was done through the CAPI / tablet method (computer assistance for data collection) through the Survey Solutions application. So far, only the 2018 report has been published, with limited information on living standards. The report provides data on affordability of expenditures, difficulties of households in making the necessary payments and quality of housing but does not present information on income levels or other financial information. Results from the 2019 SILC haven’t been published yet.
Other social statistics are scarce. For example, education statistics are partially produced but are still not classified according to international education classification standards (ISCED 2011). Public health and crime statistics are not yet in line with EU standards. Vocational training statistics are still not produced. Occasional surveys such as the Multiple Indicator Multiple Cluster Survey (MICS) and the Labor Force and Time Use Survey help to fill knowledge gaps, but these are not conducted regularly and depend on external funding.

For agricultural statistics, the Agency published data on annual agricultural crops, livestock production and orchard statistics. The agricultural holding survey is regularly produced, but the last farm structure survey was conducted in 2014 and the new one is not planned until 2023. Agricultural price indices and economic accounts for agriculture are produced on a regular basis. Supply balance sheets and the agriculture labor index are not yet produced on regular basis.

Energy and environment statistics are partially in line with EU standards. KAS has shortened the deadlines for publishing energy balance results and has increased the number of statistical products sent to EUROSTAT. However, energy consumption statistics for residential, services and transport are not published regularly. The lack of energy efficiency indicators continues to be an obstacle to reporting on energy savings. Waste and water statistics are produced regularly. Greenhouse gas emission statistics are being collected but the information is not published regularly. Other environmental statistics such as air emissions accounts, environmentally related taxes by economic activity, environmental protection expenditure and material flow balances are not yet produced.
Annex 6: Knowledge gaps

The SCD identified several knowledge gaps regarding key areas for development in Kosovo. These areas include labor markets (understanding whether queuing for public sector jobs and elevated reservation wages reduces labor supply or crowds out private sector); informality (understanding incentives to remain informal, as well as scale of corruption and illegal economic activities); migration (profile of Kosovo’s out-migrants, as well as the levels, frequency, and longevity of their remittances); minorities (barriers to inclusion of Roma, Ashkali and Egyptian, ethnic Serbs, persons with disabilities, LGBTQ, etc.); gender (deeper analysis of trends in female employment, gender constraints to labor market participation); and political economy (particularly the role and influence of various interest groups). Since then, the World Bank has contributed substantially to close this gap through the following studies (in addition to evidence generated by other stakeholders in Kosovo):

- Labor market
  - Ex-ante Evaluation of the Impact of Increases in Minimum Wages on Labor Market Outcomes in Kosovo (English)
  - Student Today, (Un)employed Tomorrow? Addressing Youth Unemployment in Kosovo
  - Kosovo Country Report: Findings from the Skills towards Employment and Productivity Survey

- Informality
  - Promoting Tax Compliance in Kosovo with Behavioral Insights
  - Behavioral Support to Tax Compliance and the Informal Economy in Kosovo

- Migration
  - Learning Needs Assessment for Remittance Receivers
  - Baseline Survey on Remittance Beneficiaries’ Financial Behaviors

- Minorities:
  - Overview of Roma, Ashkali and Egyptian Communities in Kosovo
  - Breaking the Cycle of Roma Exclusion in the Western Balkans
  - Capacity Assessment of Kosovo’s Centers for Social Work

- Gender
  - Gender Inclusion in Productive Investments in the Western Balkans
  - Closing the Gender Gaps among Marginalized Roma in the Western Balkans

- Political economy
  - Risk and Resilience Assessment 2017
  - Risk and Resilience Assessment 2021

During the preparation of the SCD Update, the team has identified additional key gaps in the knowledge base in Kosovo. Additional information to fill these gaps would enable a more precise identification of policy actions to address the priorities identified by the SCD Update. They include the following areas:

1. **Climate change / Resilience / Green growth**
   a. Climate change adaptation strategy and the action plan on climate change
   b. Public expenditure review of water sector
   c. Climate change impacts on future water resources availability and associated infrastructure needs
   d. Growth potential from technological upgrade and green investment
The current list is outlined in Table 5.

**Table 5: Recent analytical work in Kosovo by the World Bank Group and others**

<table>
<thead>
<tr>
<th>Report / institution</th>
<th>Year</th>
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<tbody>
<tr>
<td>Agriculture for Jobs and Growth in the Western Balkans</td>
<td>2017</td>
</tr>
<tr>
<td>Air Pollution Management Kosovo/WB</td>
<td>2019</td>
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<tr>
<td>Annual Report on the State of Air/ Ministry of Environment</td>
<td>2019</td>
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<tr>
<td>Annual Report on the State of Environment in Kosovo/Ministry of Environment</td>
<td>2017</td>
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<tr>
<td>Balkans Digital Highway / Pre-feasibility studies / Market Study</td>
<td>2018</td>
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<tr>
<td>Baseline Survey on Remittance Beneficiaries’ Financial Behaviors</td>
<td>2017</td>
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<tr>
<td>Behavioral Support to Tax Compliance and the Informal Economy in Kosovo</td>
<td>2021</td>
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<tr>
<td>Business Pulse Survey, WB</td>
<td>2020 and 2021</td>
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<tr>
<td>Breaking the Cycle of Roma Exclusion in the Western Balkans</td>
<td>2019</td>
</tr>
<tr>
<td>Capacity Assessment of Kosovo’s Centers for Social Work</td>
<td>2018</td>
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<tr>
<td>Country Economic Memorandum</td>
<td>2021</td>
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<tr>
<td>CERP restructuring proposal</td>
<td>2020</td>
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<tr>
<td>Climate Change Strategy (2019-2028) and Action Plan (2019-2021)/Ministry of Environment</td>
<td>2018</td>
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<tr>
<td>Cybersecurity Maturity Model Assessment</td>
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<tr>
<td>Developing a Framework for the Implementation of a Deposit Refund System in Kosovo/Ministry of Environment</td>
<td>2018</td>
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<tr>
<td>ECD Situational Analysis / WB</td>
<td>2021</td>
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<tr>
<td>Economic Reform Program 2019-2021/European Commission</td>
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<td>Enterprise Surveys: Kosovo Profile/World Bank/EBRD/EIB</td>
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<tr>
<td>Ex-ante Evaluation of the Impact of Increases in Minimum Wages on Labor Market Outcomes in Kosovo (English)</td>
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<tr>
<td>Exploring the Potential of Agriculture in the Western Balkans</td>
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<td>Feasibility Study Report on Healthcare Institutions Infrastructure / EU</td>
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<td>FSAP, WB</td>
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<td>Gender Inclusion in Productive Investments in the Western Balkans</td>
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<td>HIF financing plan</td>
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<td>IFC Investor Perception Survey for the Western Balkans</td>
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<td>Indicative Strategy Paper (ISP) for Kosovo 2014-2020/EU office in Kosovo</td>
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<td>Investment Climate Statement, US Dept. of State</td>
<td>2020</td>
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<td>Kosovo CEM – Boosting Foreign Direct Investment background note</td>
<td>2021</td>
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<tr>
<td>Kosovo Constraints Analysis/Millennium Challenge Corporation</td>
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<td>Kosovo Country Economic Memorandum - Key Drivers of Growth in Agriculture in Kosovo Using Micro-Foundations, and the Role of the State in Crowding In/Out Agricultural Productivity</td>
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<td>Kosovo Country Report: Findings from the Skills towards Employment and Productivity Survey (English)</td>
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<td>Kosovo Irrigation Master Plan</td>
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<td>Kosovo Progress Report/European Commission (Page 96)</td>
<td>2020</td>
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<tr>
<td>Kosovo Productivity Survey</td>
<td>2018</td>
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<td>Kosovo Risk and Resilience Assessment</td>
<td>2021</td>
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<td>Kosovo Social Assistance Scheme Study: Assessment and Reform Options</td>
<td>2019</td>
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<td>Kosovo: A Future of Green Transport and Clean Air</td>
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<td>Kosovo: Pension Policy Challenges in 2020</td>
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<td>Kosovo Social Protection Situation Analysis</td>
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<td>Learning Needs Assessment for Remittance Receivers</td>
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<td>Maternity, paternity and parental leaves in Europe: Comparison of family-related leave policies and key legal provisions with Implications for Kosovo</td>
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<td>MICS report / UNICEF</td>
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<td>Modernizing irrigation in Europe - Regional Activity ASA (P166828)</td>
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<tr>
<td>New Risk and Resilience Assessment (upcoming)</td>
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<td>Pension System in Kosovo. Inputs for Social Expenditure Review and Comments on Teacher Benefits Proposal</td>
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<td>PHC Quality of Care Study / SDC</td>
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<td>Policy Note Financial Sector</td>
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<td>Pristina Mobility Assessment</td>
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<td>Pristina Sustainable Urban Mobility Plan</td>
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<td>Promoting Tax Compliance in Kosovo with Behavioral Insights (World Bank)</td>
<td>2019</td>
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<tr>
<td>Reform Momentum Needed, Western Balkans Regular Economic Report: No.15 (Focus on human capital and spotlight on labor taxation)</td>
<td>2019</td>
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<tr>
<td>Report on contaminated sites in Kosovo/WB</td>
<td>2019</td>
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<td>Report on Environmental Indicators/ Ministry of Environment</td>
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<td>Report on Hazardous wastes in Kosovo/Ministry of Environment</td>
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<td>Report on Municipal Waste in Kosovo / Ministry of Environment</td>
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<td>Retail Payments Cost Study</td>
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<td>Selected Issues Paper/IMF</td>
<td>2018</td>
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<td>Social Protection and Health Expenditure Note / WB</td>
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<td>Strengthening the Integration of Disaster Risk Management and Climate Resilience in the Western Balkans</td>
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<td>Student Today, (Un)employed Tomorrow? Addressing Youth Unemployment in Kosovo</td>
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<td>Study on Outpatient Drug Prescriptions / WB</td>
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<td>Tax reform for climate mitigation and COVID-19 recovery in Kosovo ASA</td>
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<td>Water for green and resilient growth</td>
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<td>Water security outlook/World bank</td>
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<td>Western Balkans Labor Market Trends 2020</td>
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<td>Western Balkans Regional Investment Policy Review (UNCTAD)</td>
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<td>OSCE – Overview of Roma, Ashkali and Egyptian Communities in Kosovo</td>
<td>2020</td>
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<td>USAID – Redesigning Procedures to Encourage Legal Recognition of Informal Relations to Property</td>
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<td>The Effectiveness of Social Behavior Change Communications (SBCC) in Changing Social Attitudes on Equal Rights to Property for Women – the Case of Kosovo</td>
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<td>ICR for Real Estate Cadastre and Registration Project (RECAP)</td>
<td>2018</td>
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</tbody>
</table>
Annex 7: Team members

The SCD Update core team comprises Ana Maria Oviedo, Asli Senkal, Besart Myderrizi, Gayané Hezo Naroyan, Levent Karadayi. The country team focal points are listed in Table 6.

<table>
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<th>Topic</th>
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<td>Digital Development</td>
<td>Natalija Gelovanska-Garcia</td>
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<td>Education</td>
<td>Angela Demas, Mrike Aliu</td>
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<td>Energy and extractives</td>
<td>Rhedon Begolli</td>
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<td>Environment</td>
<td>Simon David Ellis, Shpresa Kastrati, Klas Sander</td>
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<td>Health</td>
<td>Lorena Kostallari, Mrike Aliu, Ha Thi Hong Nguyen</td>
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<td>Macroeconomics, Trade and Investment</td>
<td>Asli Senkal, Besart Myderrizi</td>
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<td>Ana Maria Oviedo, Jonathan George Karver</td>
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<td>Social Protection and Labor</td>
<td>Stefanie Koettl-Brodmann, Sarah Coll-Black, Zoran Anusic</td>
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<td>Social Inclusion</td>
<td>Bekim Ymeri, Natacha Caroline Lemasle</td>
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<td>Governance</td>
<td>Mediha Agar, Jonas Arp Fallo, Shiho Nagaki</td>
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<td>Private Sector Development</td>
<td>Blerta Qerimi, Harald Jedlicka</td>
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<td>Financial Sector</td>
<td>Blerta Qerimi, Alper Ahmet Oguz, Oya Pinar Ardic Alper</td>
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<td>Paul Scott Prettitore, Caleb Travis Johnson, Axel E. N. Baeumler</td>
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<td>FCV</td>
<td>Nadia Fernanda Piffaretti, Sara Batmanglich, Sara Gustafsson</td>
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<td>Gianfilippo Carboni</td>
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Annex 8:
Consultations

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<th>Date</th>
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<td>July 9 - September 15</td>
<td>Online Consultations: Kosovo Website &amp; Facebook</td>
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| July 14               | **Think-Tanks & Business Associations:**  
Mr. Muhamet Mustafa, Advisor at Rinvest Institute  
Mr. Arsim Brucaj, Director of Association of Microfinance Institutions of Kosovo  
Ms. Qëndresa Kukaj, Universum College  
Ms. Sytrime Dervisholl, German-Kosovar Business Association (OEGJK-KDWV)  
Ms. Arieta Pozhegu, Kosovo Wood Processors Association (SHPDK), CEO  
Ms. Filloreta Bajqinofci, European Investors Council, Economic Affairs Officer |
| July 15               | **Civil Society Organizations:**  
Mr. Muhamet Arifi, Balkan Sunflowers, CEO  
Ms. Judita Krasniqi, Democracy for Development Institute (D4D)  
Ms. Pranvera Selimi, Balkan Green Foundation  
Mr. Vilson Haxholli, Youth Initiative for Human Rights |
| September 9           | Mr. Florian Bieber, Professor of Southeast European History and Politics, University of Graz, Austria                                          |
| September 20          | Ms. Nicole Farnsworth, Kosovo Women's Network, Program Director and Lead Researcher  
Ms. Valmira Rashiti, Youth Initiative for Human Rights                             |
| September 21          | Mr. Sazan Ibrahimi, Association of Kosovo Municipalities, CEO                                                                             |
| September 22          | **Parliamentary Committee on Budget, Labor and Transfers:**  
1. Mr. Armend Muja (LVV), Committee Chairman  
2. Ms. Jeta Statovci (LVV), Committee Member  
3. Mr. Mergim Lushtaku (PDK), Deputy Committee Chairman  
4. Mr. Eman Rahmani (LVV), Committee Member |
| September 23          | **Office of the Prime Minister:**  
5. Mr. Lulezon Jagxhiu, Advisor to the Prime Minister  
6. Mr. Vedat Sagonjeva, Director of the Office for Strategic Planning  
7. Mr. Florim Canolli, Director of International Assistance Department  
**Ministry of Finance:**  
8. Ms. Vjosa Zeqiraj, Debt Management Officer, Treasury  
9. Ms. Durime Haklaj, Debt Management Officer, Treasury |
| September 23          | Mr. Lutfi Haziri, Deputy President of LDK party and Mayor of Gjilan                                                                        |
| September 27          | Mr. Miodrag Milicevic, NGO AKTIV (North Mitrovica)                                                                                       |
| September 28          | Mr. Mytaher Haskuka, Mayor of Prizren                                                                                                    |
October 13

**Development partners:**
- Mr. Neil Taylor, EBRD Mission Director
- Mr. Arianit Blakaj, EBRD
- Mr. Selim Thaci, IMF
- Ms. Zeinah Salahi, USAID Mission Director
- Ms. Hillen Francke, EU
- Ms. Feride Zeka, EU
- Mr. Tankut Soykan, Council of Europe
- Ms. Isme Humolli, WHO
- Ms. Chiara Amato, UN
- Ms. Maria Suokko, UNDP
- Ms. Marta Gazideda, UNDP
- Ms. Yllka Pllana, UNDP
- Ms. Dafina Mucaj, UNICEF
- Mr. Dren Rexha, UNICEF
- Mr. Bashkim Isufi, UNDCO
- Mr. Jan Axel Voss, Embassy of Germany
- Mr. Margus Sarapuu, GIZ
- Mr. Jun Hirashima, Embassy of Japan
- Mr. Kay Kurimoto, Embassy of Japan
- Mr. Peter Verheyen, Embassy of Netherlands Deputy Head of Mission
- Ms. Katrin Ochsenbein, Swiss Cooperation Agency
- Ms. Krisztina Szabo, Embassy of Hungary

October 21

**Private sector companies:**
- Mr. Astrit Panxha – CEO of Producers Club
- Mr. Visar Pacarada – Deputy CEO of Pro Credit Bank
- Ms. Sytrime Dervisholli, German-Kosovar Business Association
- Mr. Shpend Nura – CEO of KEP Micro Finance Institution
- Mr. Visar Bytyqi – CEO of HIB (wholesales and retailer of fuel derivatives)
Annex 9:
List of references:


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