



# Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 26-Jan-2022 | Report No: PIDA33254

**BASIC INFORMATION****A. Basic Project Data**

Country	Project ID	Project Name	Parent Project ID (if any)
Kosovo	P170113	Kosovo Public Finances and Sustainable Growth Development Policy Financing (P170113)	
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
EUROPE AND CENTRAL ASIA	18-Mar-2022	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	Implementing Agency		
Republic of Kosovo	Ministry of Finance, Labor and Transfers		

**Proposed Development Objective(s)**

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

**Financing (in US\$, Millions)****SUMMARY**

<b>Total Financing</b>	48.90
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**DETAILS**

<b>Total World Bank Group Financing</b>	48.90
World Bank Lending	48.90

**Decision**

The review did authorize the team to appraise and negotiate



## **B. Introduction and Context**

### Country Context

Kosovo needs faster and more resilient growth that creates jobs and is driven by higher productivity, while ensuring fiscal sustainability. In the decade leading up to the pandemic (2010–19), Kosovo grew by an average of 4.6 percent a year which translated into an almost 50 percent increase in per capita income and a 35 percent poverty rate reduction (equivalent to a decline of 7.8 percentage points). However, several structural weaknesses continue to impede higher growth and faster poverty reduction. Before the pandemic, Kosovo's economic growth was mainly driven by private consumption, fueled by remittances and higher social protection spending. Public and private investment also supported growth, but with weak returns demonstrated by low productivity growth averaging at a mere 0.5 percent between 2012–2017. The recent years marked significant job formalization, but growth did not translate into job creation limiting its impact on poverty reduction. By 2019, 1 in 5 Kosovars continued to live with less than US\$5.5 per day and only 3 in 10 of the working age population were employed.<sup>1</sup> Furthermore, limited attention to the green transition puts the sustainability of long-term growth at risk. In this context, the new government set out a reform agenda to ignite economic growth and ensure a sustainable and inclusive recovery from the COVID-19 pandemic, which plunged the country into its first-ever recession since independence.

This operation supports legal and institutional reforms to improve fiscal transparency with a view enhance fiscal sustainability in the medium term; to enhance private sector development through reducing administrative burden and fostering digitalization; and to initiate the green transition by incentivizing the move toward a circular economy and renewable energy power generation to improve the sustainability and resilience of economic growth. The pandemic only increased the urgency of the proposed reforms, as the economy plunged into its first ever recession reducing the available fiscal space by adding 4.8 percentage points to public debt-to-GDP ratio in 2020.

Kosovo's macroeconomic framework is adequate for this operation. Kosovo had a good track record of maintaining sustainable headline fiscal policy anchored by a rules-based fiscal framework before the pandemic. The COVID-19 pandemic has led to a significant increase in the fiscal deficit in 2020 at 7.6 percent of GDP and the government had to suspend the implementation of the applicable fiscal rules. In 2021, the fiscal balance improved significantly, thanks to buoyant revenues and sluggish public investment. By the end of 2021, tax revenues had increased by 29 percent year-on-year, driven by a rebound in economic activity and imports, higher inflation, and formalization induced by economic-revival measures. Strong revenue performance enabled the government to revisit and reduce domestic borrowing plans and start to rebuild fiscal buffers. The Law on Budget, which contains a Medium-Term Expenditure Framework (MTEF) for the period 2022–2024, confirms government's commitment to reinstating fiscal rules by 2023. Though, the public debt-to-GDP ratio is expected to increase over the medium term driven by primary deficits to address development gaps through development finance, it should stay within the limits of the debt ceiling of 40 percent and below the risk thresholds. External debt also remains sustainable under a combination of shocks.

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<sup>1</sup> Kosovo Country Economic Memorandum, *Gearing up for a More Productive Future (CEM)*, World Bank 2021.



## Relationship to CPF

The proposed DPF was envisaged in the CPF FY17-21 and is fully aligned with the CPF's three focus areas: (i) Enhancing Conditions for Accelerated Private Sector Growth and Employment, (ii) Strengthening Public Service Delivery and Macro-Fiscal Management, and (iii) Promoting Reliable Energy and Stewardship of the Environment. Furthermore, the DPF's relevance to achieving the twin goals, through sustainable, resilient, inclusive, and greener policies (GRID) have been reaffirmed by the forthcoming Program Learning Review and the Systematic Country Diagnostic (SCD), which focuses on strengthening fiscal sustainability, fostering an enabling environment for private sector development, and initiating a focus on environmental sustainability and climate action. The operation builds upon and complements the World Bank Group's extensive engagement in Kosovo. Improving the methodology for costing of social protection initiatives will form the basis for the reform of the social assistance reform to be supported by the Social Assistance Reform Project (SARP, P171098), which aims to improve the equity and adaptability of Kosovo's social safety net through improved poverty targeting. The implementation of the Law on inspections is expected to unlock investments from the World Bank Competitiveness and Export Readiness Project (CERP, P152881).<sup>2</sup> Establishment of an e-ID system will enable the productive use of the broadband infrastructure deployed through the Kosovo Digital Economy (KODE, P164188) for access to broad range of online services for all businesses without regard to geographical location. The operation also complements the Energy Efficiency & Renewable Energy Project (KEEREP, P143055) and the Greening Land Project (P172992) under preparation that will support promotion of circular economy in industries to reduce waste and prevent new land and soil contamination.

## C. Proposed Development Objective(s)

The objective of the proposed Public Finance and Growth Development Policy Financing (DPF) is to support the Republic of Kosovo's efforts to improve fiscal transparency, to enhance private sector development, and to strengthen environmental sustainability in the wake of the COVID-19 crisis.

### Key Results

Reforms supported under the Pillar 1 of this operation will enable authorities to improve the evidence base for fiscal policy making and establish sound debt management practices to ensure sustainability of public finances. Reforms supported under the Pillar 2 of this operation should provide the foundations for private sector growth by reducing administrative burden and regulatory uncertainty and fostering digitalization. Reforms supported under Pillar 3 provide the foundations for green growth, through supporting improved waste management and enabling competition in the renewable power generation sector. Pillar 3 not only supports a reduction in greenhouse gas emissions and environmental degradation, but also incentivizes industry-led solutions that would create opportunities for new jobs and investment, and ultimately contribute to resilient and sustainable economic growth.

## D. Project Description

The proposed stand-alone operation supports the government's efforts to tackle longstanding structural bottlenecks that impede higher and inclusive growth in Kosovo and charting a sustainable and inclusive recovery path from the pandemic. Through its first pillar, the operation aims to improve fiscal transparency, with a view to strengthening fiscal sustainability in the medium term. It supports reforms that (i) strengthen debt management by improving the transparency of debt management operations, enhancing oversight of the Executive, and creating a legal basis for credit risk assessments for

<sup>2</sup> [The CERP \(152881\)](#) was approved by the World Bank Board on May 18, 2017.



government guarantees and on-lending and (ii) improve the evidence base for fiscal policy initiatives through improved costing of social protection initiatives. Through its second pillar, the operation supports reforms to enable businesses by (i) improving the legal framework for business inspections, (ii) simplifying licensing and permit requirements in the agriculture and agribusiness sectors to reduce administrative burden on firms and (iii) setting up a regulatory framework for e-IDs to facilitate digitalization. Through its third pillar, the operation supports reforms that will initiate the green transition by improving waste management, with a view to improving livelihoods and moving toward a circular economy and creating a legal framework for the transition to market-based support mechanisms in the renewable power generation sector to improve the energy mix. These reforms will contribute to climate mitigation efforts by reducing greenhouse gas emissions and environmental impact. Actions under the third pillar will also contribute to private sector development in the medium term, by improving the legal framework in ways that will provide more certainty for investment and greener private sector solutions, including through FDI attraction.

The reform program benefits from strong government ownership the World Bank Group's extensive engagement and strong collaboration with development partners. Key priorities of the government include promoting comprehensive economic growth by redesigning fiscal policies and ensuring the sustainability of public finances and reducing poverty by restructuring of social assistance and pension schemes, which are supported by the Pillar 1 of the DPF. The second pillar of this operation directly supports government's priority of improving the doing business environment. As part of this priority, the government program and the Economic Revival Program (ERP) 2022-2025 note Government's efforts to implement the inspections reform and incentivizing digitalization of firms, which is supported by prior actions 3 and 5 of this operation. The government program and the ERP 2022-2025 also place a special emphasis on increasing competition in the agri-food sector as part of its priorities and highlights the high administrative burden faced by the farms and firms in the sector due to overlapping licensing and permitting requirements, which is directly supported by prior action 4 of this operation. Finally, the government program and the ERP envisage investing in sustainable development policies to mitigate and adopt to climate change as a strategic priority and initiate the green transition, including through incentivizing private sector solutions. As part of this effort, the government program and the ERP envisage the adoption of an integrated waste management strategy, the Law on waste, and the creation of a more competitive energy market in renewables as important milestones.

The operation leverages strong collaboration and implementation support from international partners, including European Union, IMF, GIZ, USAID, and EBRD, World Bank Group operations, and technical and advisory. The reforms are well aligned with the Economic Reform Program (ERP) 2022–25, an important reform anchor for Kosovo's EU accession process, of the new government, particularly in digitalization, reduction in administrative burden, improved waste management, and energy market reforms. This operation also complements the efforts of other development partners and is aligned with the European Union's new Guidelines for the Implementation of the Green Agenda for the Western Balkans.<sup>13</sup> In addition, the OPEC Fund for International Development has indicated its willingness to provide parallel financing with EUR 30 million for this operation, amplifying the impact of the proposed operation.

## **E. Implementation**

### **Institutional and Implementation Arrangements**

The MFLT is responsible for coordinating the proposed operation. It is the main counterpart for this operation and coordinates the preparation and implementation of supported reforms with all line ministries and institutions involved in the DPF. The line ministries and institutions report on the prior actions and result indicators to the MFLT and the World Bank as and when requested. In addition, the team consults and coordinates with the Office of the Prime Minister



regularly. The World Bank has a strong technical, advisory, and operational engagement in almost all areas supported under this DPF, with the exception of prior actions 5 and 6. The European Union will be providing support for the implementation of the establishment of the e-ID system. The World Bank will closely collaborate on the implementation and the monitoring of prior action 6 and the corresponding results indicator in close collaboration with GIZ, given their active engagement in waste management policies.

The results framework presented in Annex 1 of the program document will be used as a monitoring tool by both the government and the World Bank. Data availability and quality are appropriate to monitor progress towards the achievement of the results indicators. The Department for Economic, Public Policies and Financial Cooperation is responsible for the overall coordination and monitoring of the reform program supported by the DPF and will furnish information to the World Bank, as required, to monitor outcomes in the results framework. The World Bank may provide implementation support and periodic monitoring and dialogue with the relevant ministries and other stakeholders to ensure timely implementation and adequate monitoring of indicators and outcomes of the program.

## **F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects**

### Poverty and Social Impacts

The actions included in this DPO are expected to lead to welfare improvements in the medium to long term and can have positive distributional impacts, through improved fiscal sustainability, economic growth, and job creation. The actions supported under Pillar 1 to improve fiscal transparency through improved debt management and costing of social protection policies could have a positive impact on the poor and vulnerable by creating additional fiscal space for targeted social spending. The actions included under Pillar 2 to enhance private sector development are expected to have an overall positive medium-term effect on poverty and economic inclusion by promoting higher growth in the medium term. The prior action #6 supported under Pillar III initiating the green transition through improving waste management is expected to benefit livelihoods over the medium term, particularly the rural population that is more vulnerable to water pollution, illegal waste sites, industrial discharge into rivers, and industrial dumpsites. Prior action #7 under Pillar 3 may have negative distributional impacts, if potential increases in tariffs are passed onto the consumers, affecting the poor and the vulnerable. However, the government aims to mitigate the potential adverse impacts on the population by reforming the social protection system, supported through the Social Assistance System Reform Project (SARP, P171098). Through the SARP, the government will introduce a social registry and a unified poverty targeting system to identify poor and energy vulnerable households and to better capture energy poor consumers through an improved social safety net. The social registry is also expected to support the expansion of the social safety net in response to climate-induced shocks by enabling the government to quickly identify and support households negatively affected by climate-induced shocks. The reforms supported under Pillar 3 will have positive returns on the overall welfare through reducing environmental impact, creating new economic opportunities in these areas through the creation of recycling centers, other facilities, and higher FDI attraction.

### Environmental, Forests, and Other Natural Resource Aspects

The prior actions envisaged in this project are expected to have positive environmental impacts and no significant adverse impacts on the environment, forests and natural resources are expected. The environmental risks are low. Positive environmental effects are expected as prior actions will contribute to reductions of greenhouse gas emissions and to climate change adaptation and mitigation by improving waste management and accelerating the new greenfield investments in the renewable power generation sector and energy diversification.



## **G. Risks and Mitigation**

The risk of the proposed operation is assessed as Moderate, with implementation risks rated at substantial. Institutional capacity risks are assessed substantial given Kosovo's young institutions, limited interministerial coordination, particularly for reforms that are supported under the second and the third pillar. All other risk categories are assessed as Moderate or Low. Risks are mitigated by close coordination with the government, parliamentary commissions, and the development partners. Technical assistance is provided in several areas to support implementation of the proposed reforms by the World Bank Group and other development partners, including European Union, GIZ, EBRD, and USAID.

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#### APPROVAL

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#### Approved By

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