

PROJECT INFORMATION DOCUMENT (PID) CONCEPT STAGE

Report No.: PIDC28579

Project Name	Kosovo: Competitiveness and Jobs (P152881)
Region	EUROPE AND CENTRAL ASIA
Country	Kosovo
Sector(s)	General public administration sector (10%), SME Finance (20%), Other social services (20%), General industry and trade sector (50%)
Theme(s)	Micro, Small and Medium Enterprise support (20%), Technology diffusion (20%), Export development and competitiveness (30%), Improving labor markets (20%), Trade facilitation and market access (10%)
Lending Instrument	Investment Project Financing
Project ID	P152881
Borrower(s)	Republic of Kosovo
Implementing Agency	Ministry of Trade and Industry, Ministry of Labor and Social Welfare, Ministry of Education Science and Technology
Environmental Category	B-Partial Assessment
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Concept Review Decision	Track II - The review did authorize the preparation to continue

I. Introduction and Context

Country Context

1. Since independence in 2008, Kosovo's economy has performed relatively well. Benefiting from the support of the international community and a sizeable diaspora, and anchored in the overarching political objective of integration into the European Union (EU), Kosovo—a potential candidate for EU membership—has made considerable progress in overcoming the severe legacies of socialism and the 1998–99 war. For the post-independence period 2008–14, spanning both the global financial and Euro Zone crises, Kosovo's economy has demonstrated a considerable degree of resilience, with principal macro fiscal and financial indicators—average growth, inflation, budget deficits, public debt, loan-to-deposit ratios, and nonperforming loans—showing a better outcome for Kosovo during this period than for any of its neighbors in the Western Balkans.

2. However, the current growth model is not sustainable in helping Kosovo address its development challenges and ambitions. The main driver of economic growth thus far has been consumption—which has been fueled by remittances from the diaspora—rather than income earned domestically. Similarly, exceptional levels of public investment have been supported by official development assistance (ODA). With a very narrow production base and low levels of domestic productivity, trade and current account deficits have remained unsustainably high. Factor accumulation is estimated to have contributed two-thirds of the overall economic growth between 2008 and 2012, with productivity counting for the remaining one-third. Extremely low rates of labor force participation, driven by high inactivity among women, and high rates of unemployment persist. While remittances were welfare-enhancing on aggregate, there have been downsides to migration-led development. The surge in remittances has put pressure on the exchange rate, weakening the competitiveness of cost-sensitive tradable. Remittances have transformed the source of growth from export-orientation to consumption, and imports have risen strongly in line with consumption. The “emigration crisis” of early 2015 brought international attention to Kosovo’s social and economic challenges as well as a commitment to support the government’s effort to overcome those challenges by the international community.

3. The new government is committed to reforms to improve economic competitiveness and create jobs. The present coalition government was established six months after the parliamentary elections of June 8, 2014 and its National Development Strategy for 2015–20, is expected to be completed by August 2015. A strong pro-reform focus has enabled Kosovo to achieve consistent improvement in the overall ease of doing business, as reflected in a steady rise in its worldwide ranking in the World Bank’s Doing Business (DB) report. In the latest DB report (2015), Kosovo achieved a rank of 75, up from a rank of 81 last year. The government is also planning to reestablish the National Economic Council, to improve public and private sector dialogue. The government is actively seeking to enhance Kosovo’s integration into the world economy and is negotiating the Stabilization and Association Agreement (SAA) with the European Union, accession to the World Trade Organization (WTO), as well as other regional trade agreements such as the Central European Free Trade Agreement (CEFTA). The IMF Mission reached a staff-level agreement with the GoK on an economic program that could be supported by a 22 month Stand-By Arrangement of about EUR 185 million, to be considered by the IMF Executive Board by July 2015. The investment clause of the existing fiscal rule (which sets deficit at 2 percent of GDP) will be modified to support capital spending with high economic returns. This modification will expand the investment clause to enable capital spending financed through development agencies, including the World Bank investment lending.

Sectoral and Institutional Context

4. The principal challenges to boosting Kosovo's growth and shared prosperity include: (a) increasing productivity and value chain integration for key tradable (agriculture, mining, services); (b) addressing business environment bottlenecks (e.g. informality, investment policies, access to finance, etc.); (c) increasing labor market efficiency and equipping workers with market-relevant skills. The finding of the forthcoming Kosovo Systematic Country Diagnostic (SCD) underpin the design of the proposed project. There is a shared recognition among stakeholders that job creation and increasing the role of the private sector are urgent priorities for the new government. This would help Kosovo expand access to economic opportunities for its population and achieve sustainable and inclusive growth.

Trade and regional integration

5. Kosovo is one of the least integrated countries in the region, with exports of goods and services comprising less than 18 percent of GDP. Exports grew more than threefold between 2002 and 2013, albeit from a very low level. However, Kosovo continues to display a highly negative external balance on good and services (Figure 1) and exports remain considerably lower than for all other countries in South East Europe (SEE) (Figure 2) and cannot yet support the economy. Trade and export to GDP ratios are significantly lower (70.6 percent, and 18.4 percent) compared with other small states and survival of exporters is low. Kosovo's exports are concentrated on low value-added items, such as raw materials (including metals such as ferro-nickel which accounts for more than half of total exports, and minerals). This is due in large part to Kosovo's low domestic production base.

6. With its small domestic market (1.8 Million population), increased exports will be essential for economic growth and employment. With a very narrow production base, reflecting the low level of domestic productivity, Kosovo will need to rebalance its growth model to one that places greater reliance on increased productivity at home and improved competitiveness abroad to achieve higher and sustainable growth through more exports, diversification of exported goods and destinations, and increase in value addition in exports. The main challenges of increasing exports were identified as: i) lacks of domestic quality infrastructure that prevents exporters to meet quality/standards of export markets and ii) difficulty in trading across borders stemming largely from its unresolved status and landlocked location.

7. Value addition and exports are significantly hampered by lack of credible national quality infrastructure (NQI). In Kosovo, all elements of quality infrastructure exist but they are weak. Regulations are prepared but can't be reinforced due to many reasons. This lowers the confidence of people and business in state run operations. All elements of quality infrastructure are understaffed, lack financial resources, have problems with international recognition and some of them need know-how transfer in order to develop. In absence of benchmarks, firms do not have certain standards that they can aspire to reach to creating tepid reasons to improve their competitiveness. Also export markets do not have confidence in Kosovar goods as they lack adequate certifications and do not meet preset standards. A considerable investment program is needed in order to develop quality infrastructure of Kosovo as soon as possible in order to prepare Kosovar market for EU accession and compliance with WTO rules. Without an internationally recognized quality infrastructure produced goods can't be exported to high value markets and can't compete with goods imported within trade agreements. Quality infrastructure is not only needed in order to increase the value generated by increased exports, it is also needed in order to protect Kosovar market against influx of low quality products. This helps to encourage local companies to produce goods that may substitute imports.

8. Kosovo's unresolved political status is adding specific challenges for trade. Furthermore, as a small and landlocked economy, connectivity plays a critical role for the economy's successful integration to regional and global markets. According to the most recent Doing Business report (2015) Kosovo ranks 118th for trading across borders, one of the poorest performance in Europe and lower than all EU member states. This is due to a number of factors. Less than the required two-thirds majority of UN member states represented in the General Assembly have accepted Kosovo's statehood. Specifically, by end-2014, Kosovo has been recognized by 108 UN members, including 23 of 28 EU member states. Serbia, however, continues to object to Kosovo's

independence . While Kosovo is part of the Central European Free Trade Agreement (CEFTA) together with 7 other countries from Southeast Europe and although, the Government of Kosovo implements the Agreement, Kosovar exports are facing obstacles as some CEFTA parties still do not recognize Kosovo's institutions. Kosovo is a small and landlocked economy which faces numerous challenges to trade, and its economic prospects are directly linked to its capacity to integrate successfully in the regional and global marketplaces. Integration can reduce transaction costs, increase trade, allow access to large markets and economies of scale, and enhance competition and efficiency. However, despite its proximity to important markets, Kosovo can be marginalized due to the lack of direct access to the sea and dependency on transit through other countries. Being landlocked makes it also difficult and costly to access markets to compensate for its small domestic market — a situation that increases the cost of intermediated inputs and imports and prevents efficiency and innovation.

9 . Several efforts were made to improve trade in the region. Recent trade agreements with the EU and Turkey, due to come into force in 2015 and 2016, respectively, present Kosovo with an opportunity to use trade as a means to broader economic development. However, in order to attract high levels of investments, the country needs additional efforts to integrate with its neighbors and the rest of the world. Further streamlining before-and-at-the-border procedures and processes of customs and other border agencies is much needed to reduce business costs and make Kosovo companies more competitive. Introducing single window principle for data exchange and requirements for border agencies, coupled with risk-based sampling is imperative to enable more trade. Ensuring mutual recognition of laboratory certificates, as well as other documents, and opening transit corridors with neighboring countries (only one transit corridor exists with Albania that is just now being implemented) are very important reforms that Kosovo has to undertake to reduce impact of the geographic and political challenges it faces.

10. However in order to benefit more from these trade agreements, Kosovo has to produce more and has to produce higher valued products. Naturally, this requires the fundamental elements that are needed for production such as good market analysis, innovation, R&D, an enabling investment climate and regulatory environment, capital for investments, availability of production technology, quality infrastructure that makes sure that whatever is produced it complies with rules, regulations and standards, as well as proper sales and marketing. One of the most important elements needed for production is the quality infrastructure. In addition, inspections done within market surveillance processes as well as at customs, lack accreditation in inspection and key personnel working in NQI operations lack personnel certification. The situation is not better in other areas such as management, environment certifications and HACCP certification for food safety. In summary, there is a considerable room for improvement in every aspect of quality infrastructure of Kosovo.

Small and Medium Enterprises (SMEs) development and business environment

11. Low competitiveness and productivity have limited economic diversification, business expansion and investment opportunities leading to a very weak private sector and poor economic vitality of SMEs. An unfavorable business environment and the low level of competitiveness have constrained private sector activities and impeded reductions in the high level of unemployment, poverty, and income insecurity. To date, the productive base in Kosovo's economy has remained narrow and undiversified with large agriculture (16 percent) and service (56 percent) sectors, limited manufacturing (12 percent), and very small tradable sectors, with more than 98 percent of businesses being family-owned, micro-, small-, and medium-size enterprises (MSMEs). The

challenges are reinforced by an unfavorable business environment, weak governance, and a deficit in infrastructure, especially quality infrastructure, and poor access to finance by firms especially SMEs stifling their growth prospects.

12. Domestic companies face difficulty in competing successfully in local and international markets. According to a recent survey by the Kosovo SME Promotion Program, only about 5% of the SMEs in Kosovo are currently exporting. Policies to encourage and support growth of micro enterprises as well as double exporting firms should be a priority. These firms could be supported to improve the quality of their products and services, tap into regional value chains and improve relevant skills of their employees. Moreover, most of the growth in the SME sector happens in the micro enterprise segment (less than 9 employees). These micro enterprises are the most vulnerable, have the most difficulties with access to finance and have benefited the least from support schemes put in place by the government or donors.

13. Scaling-up of existing firms, as well as establishing new ones in addition to providing avenues for non-subsistence based self-employment, is a key issue in the demand side of the labor problem. In the past 18 months (June 2012 to December 2014), 24,178 firms have been created. While there is no data of firms' survival rates or employment numbers of existing firms, the fact that new firms comprise more than one-fifth of the total employment of the private sector might imply that survivor rates of existing firms are low, and the size of existing firms very small. Therefore, efforts that focus on firm survival/growth should be prioritized for job creation.

14. Due to the lack of coordination and the legal overlaps, businesses in Kosovo are overburdened with multiple state inspections and market surveillance. Current system in Kosovo is not transparent, lacks risk-based approach, is prone to corruption, and poses significant burden to business. The system itself is not efficient to perform its main duty to protect public health and safety (excluding financial/tax/customs inspections that have goals to collect government revenues), and needs to be reformed. Similar problems exist in the area of market surveillance during which technical inspections are used for production and services provided. These technical inspections do not help to produce better and protect consumers, but actually cause damage to production by increasing the cost and slowing down the production. In addition to uncoordinated multiple and overlapping technical inspections, inspections without appropriate testing and analysis infrastructure are meaningless and is a source of corruption.

15. Direct investments have not materialized at the desired rate. Domestic and foreign investors continue to face a myriad of obstacles during the process of business establishment and doing business in general. Main reasons cited include: (i) the lack of institutional and legislative transparency; (ii) improper, discriminating or missing law enforcement; (iii) unfair competition; and (iv) various trade barriers.

16. Unfavorable business environment is one of the key constraints to firm growth and survival. Priority reforms to: (i) reduce the regulatory burden to firms; (ii) minimize the discretion of public officials; (iii) make transparent the fees and procedures required to get permits and licenses; (iv) transform the inspection system into a system fostering accountability are crucial to provide impetus to the private sector. Attracting FDI to develop a tradable sector and tapping into the steady influx of remittances for productive uses will also be critical in increasing share of private sector in the economy and improving competitiveness through adoption of imported technology and knowledge spillovers. Strengthening the capacity of Kosovo Investment and Enterprise Support

Agency (KIESA) which is responsible for providing various services ranging from SME support and export promotion to attracting FDI (which has fallen 40 percent since 2008) would be imperative to make an improvement in ease of doing business and increasing role of private sector. With negative gross domestic savings (average period -3.7), the relevance of external financial factors (remittances, aid, and private capital) to finance Kosovo's development is obvious.

Labor market and Skills

17. Limited opportunities for jobs exacerbate poverty and income insecurity, and have contributed to inequality and the recent surge in emigration. Kosovo has one of the weakest employment records in Europe, with a labor force participation rate of 40.5 percent (substantially below the 70 percent average for the countries in the region). The employment rate stood at an estimated 28.4 percent and the unemployment rate at 30.0 percent, and both rates were considerably worse for women and especially for youth. In particular, the number of individuals working in the private sector is extremely small at only about 100,400 (9 percent of the working population), which is similar to the number of government employees.

18. For the supply side of labor issues, functioning labor market intermediation, low female employment, and inefficient vocational education and training centers are key constraints. Improving the functioning and inclusiveness of the labor market is necessary to be able to access sustained income-generating opportunities. Kosovo needs to equip younger generations with relevant skills, through quality education and vocational training, and address market failures in labor market matching to facilitate employment in higher-productivity jobs and entrepreneurship. Reforms aimed at increasing domestic productivity and competitiveness are the preconditions for creating more dynamic rates of sustainable and inclusive growth.

19. High rates of unemployment and, in particular, very low rates of labor force participation and (formal) employment, particularly pronounced for women and youth, remain the country's Achilles' heel. Unemployment stands at 30 percent – and as high as 38.8 for women - , which, combined with the low participation rate, implies that only 28.4 percent of the working-age population is employed. The employment rate has remained in the 24 to 29 percent range from 2004 to 2013, but is particularly low for women at 12.9 percent in 2013. Youth unemployment is especially high, at over 55 percent. As a result, only about 10 percent of the active youth population is working, and this falls to less than 5 percent for females. Unsuccessful job searches appear to be moving discouraged workers out of the labor market at a high rate. The lack of job opportunities, rather than participation constraints, may be one of the most important factors behind the striking inactivity rates in Kosovo. Given Kosovo's demographics, with an uncharacteristically large share of youth within the population, the growth generated in recent years has proven insufficient to: (i) lower unemployment tangibly; (ii) provide wider segments of the population with access to formal employment; or (iii) reverse the trend of outward migration as the employment perspectives for the young, skilled, and educated. Private sector employment growth—the most sustainable path to improving living standards in Kosovo—has been particularly anemic.

20. Public Employment Offices (PEOs) play a crucial role in assisting the matching of unemployed workers with job vacancies when information in the labor market is costly and imperfect. More than a third of out-of-work individuals contact PEOs to find jobs. However, about 90 percent of the jobs found through PEOs are in government or state-owned enterprises (SOEs). In addition, young job seekers seem to rely less on the services of the PEO than do other demographic groups, despite

having among the worst labor market outcomes in the country. Many of the 37 PEOs in Kosovo are confronted by low staff capacity and insufficient use of technology. The number of job opportunities they have access to is very small. In addition, PEOs do not undertake labor market programs that can cover a significant share of the unemployed population and do not conduct rigorous evaluations of their programs.

21. Vocational Education and Training (VET) in Kosovo underperform in terms of its relevance, management, quality, and internal efficiency. The system fails to incorporate mechanisms for a quick response to labor market demands. VET centers are underutilized as referrals from Public Employment Offices due to the limited visibility and credibility of the trainings offered by the centers. These issues are well understood by the government and have been built into the formulation of Kosovo Education Strategic Plan (KESP) 2011–2016 and Skills Vision 2020. There is widespread recognition of the importance of ensuring a better match between the education and training systems and the Ministry of Education, Science and Technology (MEST) has recently established a working group to review existing strategies and develop a roadmap of the VET system in Kosovo.

22. The proposed project will contribute to addressing these challenges by supporting activities fit into three pillars for the purposes of this operation: 1) trade quality facilitation and integration, 2) SME development and investment climate reforms and, 3) labor market functioning and intermediation, and skills development. The components, and specific sub-components have been selected using several criteria: i) the selected activities are priority of the authorities, such as the MTI, MLSW, MES, ii) donor activity has been factored in to target intervention in areas where there is significant lack of financing and support, iii) the components mutually reinforce and complement each other. For instance, matching grants will help develop pipeline for NQI, and NQI and skills development will complement measures for SME development.

23. The project is seen by the government as one of the primary instruments to help implement the goals identified in the concept paper. In short, the project is addressing the government's key competitiveness and jobs priorities. The trade and regional integration pillar is seen by the Government as critical to upgrade quality of domestic products, facilitate trade and integration with larger markets to exploit external demand. The SME development and business environment pillar maintaining the focus on improving the business environment is a policy priority to support efforts at increasing the integration of Kosovo's private sector into global value chains and support to the agency (KIESA) in charge of promoting exports, investments and developing SMEs. And labor and skills components are essential to addressing the severe employment challenges of today. The Bank team is working with other international partners to develop a coordinated approach, and explore possibilities for pooling resources for greater impact in key areas.

Relationship to CAS

24. The proposed Competitiveness and Jobs project is aligned with the World Bank Group's Country Partnership Strategy (CPS) for FY2012 to FY2015. The first pillar of CPS seeks to accelerate broad-based economic growth and employment generation through actions in six priority areas, some of these to: improve business climate, support the private sector, continue to invest in education and skills, promote sustainable employment, and include and strengthen public financial management and anticorruption efforts. The proposed projects addresses the abovementioned issues. Currently the Country Strategic Diagnostic (CSD) is in the drafting stage for the next Country Partnership Framework (CPF) 2016-2020, and is expected to be completed by the end of

2015. The proposed project is aligned with the upcoming CPF, one of the key pillars out of three identified is the private sector led growth for Kosovo.

25. The project builds on previous and ongoing projects financed by the World Bank Group. This includes the Sustainable Employment Development Policy Operation (SEDPO), a series of two budget support operations concluded in 2012, which addressed some key constraints to sustainable employment; the Business Environment Technical Assistance Project (BETA), concluded in 2013, which aimed to improve the business environment by reducing uncertainty of key regulatory processes, improving delivery of related services, strengthening property rights, and increasing transparency and accountability of implementing institutions. The proposed project also leverages IFC activities supporting investment climate in areas such as business registration, regulatory impact assessment, licenses and permits, and support to the Kosovo Investment and Enterprise Support Agency (KIESA). The World Bank has been involved in labor market work in Kosovo for many years, including through the Sustainable Employment Development Policy Program (SEDPP). SEDPP consisted of two development policy operations that supported multi-sectoral reforms to promote the creation of good jobs in Kosovo. SEDPP was accompanied by technical assistance, which continued after SEDPP closed in 2012. Few of the lessons learned include, but are not limited to : i) when there are strong uncertainties, political volatilities and institutional weaknesses, project should be as focused as possible, ii) to sustain expected gains, the post-project agenda needs to be thought when the project is designed, iii) intensified efforts, carried out in the field by the Bank Team are extremely crucial when the country and institutions are still weak and iv) the importance of ensuring that institutional capacity is in place before promoting more complex reforms.

II. Proposed Development Objective(s)

Proposed Development Objective(s) (From PCN)

Enhance Kosovo's competitiveness and impact on employment by facilitating trade, fostering SME growth, and improving labor market intermediation and relevance of vocational training.

Key Results (From PCN)

This project will support the following key results:

Trade quality/facilitation (component 1)

- Internationally recognized metrology and certification system (in food and export sectors).
- Reduction in time/cost for private sector savings related to trade logistics

SME development (component 2)

- Increase in export value by matching grant targeted SMEs.
- Reduction in compliance cost for business for inspection and business registry.

Labor/skills (component 3)

- Increase in number of job placements through LMIS/ ALMPs.
- Increase in completion rates from accredited training programs.

III. Preliminary Description

Concept Description

27. The operation will have the following three main components: 1) trade quality facilitation and

integration, 2) SME development and investment climate reforms and, 3) labor market intermediation and skills development. Improvements in these areas will contribute to creating conditions for increased trade and upgrades to productivity which will lead to improved competitiveness and more exports, and will help in providing more efficient support to job seekers. In addition, the project will support the newly created the National Economic Council, a “horizontal” component on public-private dialogue (PPD) and policy coordination. The proposed components and reform areas were chosen based on a combination of analytical work, consultations with the private sector, and government’s priority as well as support for the reforms. A schematic structure of the operation is shown in Figure 3 below. Rather than act as stand-alone components, they are designed to be complementary, as explained above. The synergies between the components will continue to be elaborated as the project develops.

28. The overall amount of the project remains to be determined, but possibly around US\$20-30 million. Discussions, led by MTI, are ongoing among the MTI, MLSW, MEST and MoF about including the operation in the 2017 borrowing program. More detailed discussions with the MoF will then be needed to determine the final loan amount and EEPs to be supported. Nevertheless, tentative amounts will be included during the project preparation to give a rough idea of the relative share of financing for each component. Most of the lending (US\$ 22 million of proposed amount of US\$ 25 million) will be financing investment of the above mentioned activities. In addition, the TA will be provided to the PIU, which will be established under the MTI, for project coordination and M&E. The cost break down for the each of the activities is provided in appendix Annex 4.

20. Around 12 percent of the loan (US\$ 3 million) proceeds will be disbursed following a results-based lending (RBL) modality to ensure the anticipated results will be met. The RBL elements of the loan will disburse against Eligible Expenditure Programs (EEPs) linked to project objectives and conditioned on compliance with Disbursement Linked Indicators (DLIs). Disbursements could go directly to the Treasury. The RBL element provides a strong incentive for the Government to achieve results since if the DLIs are not met, the money is not disbursed. Annex 5 contains tables showing the preliminary list of results, DLIs and EEPs.

30. The team is also mobilizing additional donor funding, possibly from SECO, to supplement the operation through the WBG led advisory services. During the preparation of the operation, the team will continue exploring possibilities for synergies with other donors by arranging the supplementary financing which can provide additional advisory services to facilitate the implementation on the selected areas of this operation. In addition, the team will leverage the ongoing WBG advisory services, namely Regional Project on Investment Climate and Agribusiness Competitiveness, and Regional Tax simplification Project. In addition, additional advisory services can be provided to facilitate the implementation on the selected areas of this operation.

Component 1: Trade quality, facilitation and integration (US\$ 8 million)

5. This component aims to support the government to receive international accreditation for metrology/accreditation/certification system, thus to protect domestic market against low quality products and to be compliant with EU and WTO rules regarding free movement of goods. Also, this component will support the government to reduce administration burden for exporters/importers in cross borders, thus lower the costs of products and increasing the competitiveness of Kosovar products. All of these activities are ultimately expected to result in more exports and integration with the EU and neighboring countries. There are two subcomponents: 1.1 Improving national

quality infrastructure and systems, and 1.2. Trade facilitation. The team also conducted a technical assessment of the current NQI situation in Kosovo and prioritized the gap areas where the project can support.

1.1: Modernizing the National Quality Infrastructure (US\$ 6 million)

31. International accreditation of metrology/accreditation system: Aligning quality infrastructure with EU standards is a precondition for exports to EU markets. Due to the fragmented value chain and quality control issues, Kosovo has no access to EU markets for dairy products. The situation in the fruits and vegetables sector is somewhat improved, but costs are high as there are no accredited laboratories for much-needed tests. Currently, industrial metrology and market surveillance does not exist in Kosovo, as there is no single central coordinating contact point, and market surveillance inspection lacks capacity. It is imperative to upgrade Kosovo metrology and accreditation institution to reach international recognition, to enable more competitive exports.

32. International accreditation of industrial and food laboratories: No laboratory in Kosovo is internationally accredited, which adds extra costs for businesses to be compliant with international standards as they have to invest in certification by accredited certifiers in EU countries. In the fruits and vegetables sector, the cost of inputs and poor control of the quality of imported inputs, as well as quality infrastructure for calibration make this value chain less competitive. A similar situation exists with nonfood products, as the market surveillance system is not set up, since Kosovo does not even have a central coordinating point. Project needs to equip and ensure that at least one industrial metrology lab and one food laboratory are internationally accredited.

34. Market surveillance. Currently, there is no central coordinating contact point for market surveillance. In addition, market surveillance inspection lacks capacity, while technical regulations that are based on EU directives are put in action without having a necessary infrastructure for proper implementation. Finally certification, especially product certification, is extremely weak. Certification is essential in order to give an “international license” for Kosovar produced goods for export markets especially markets of industrialized countries.

35. National Quality Infrastructure (NQI) Institutions. None of Kosovo’s NQI institutions is operating according to EU and WTO rules, regulations or best practices. Kosovo lacks an NQI strategy and needs a significant upgrade of its NQI system. The legal and regulatory framework needs to be changed to allow for the creation of adequate institutional structures. The current NQI system gives rise to an implementation gap, as institutions that should provide for quality control of the NQI system cannot perform their roles, and with considerable discrepancies and implementation problems serious gaps occur. This is detrimental to the international recognition of the Kosovo NQI. In fact, the entire NQI system lacks properly trained staff and knowledge of at least one foreign language (preferably English, since almost all necessary information regarding NQI is in English). Significant investment in upgrading staff capacities of the NQI system is needed. Finally, upgrading the NQI system will require a significant upgrade of laboratory equipment.

36. This sub component with proposed allocation of US\$ 5.5 million comprises of investment lending in:

- (i) strengthening capacities of NQI staff (metrology, accreditation, standardization); technical advice to quality institutions (metrology and accreditation in particular, as well as sanitary and phytosanitary [SPS] agencies) to become internationally recognized;

- (ii) equip industrial metrology and FVA food laboratories with needed measurement equipment, equipment for MRLs and related tests, train their staff and help them become internationally accredited;
- (iii) in addition, the project will support the Ministry of Trade and Industry (MTI) to create management processes between MTI and NQI institutions for quality oversight.

And US\$ 0.5 million results based lending in:

- (iv) creation of feedback mechanisms and feedback loops between the private sector, ministries, and NQI agencies that should influence policy change going forward;
- (v) assistance in adoption of NQI strategy, and in adapting the legal and regulatory framework to enable operational independency of accreditation and metrology agencies;
- (vi) support the government to establish a central coordinating point for market surveillance, while technical advice will be provided to improve market surveillance inspection, as well as other inspections.

1.2: Facilitating trade and integration (US\$ 2 million)

37. Border clearances. Significant costs are incurred when inputs or products cross borders. Multiple clearances by technical agencies at the border and lack of harmonization of transport documentation with neighboring countries hamper the movement of goods. Poor implementation of risk-based border inspections add further delays. Documentation requirements and control procedures between countries are not harmonized, thus creating extra costs for businesses (for example, one extra day of transit for fruits and vegetables lowers their sale price by 1 percent).

38. Efforts must be made to increase the integration of Kosovo's private sector into global value chains by taking a holistic approach to trade and investment policy and anchoring supportive policies in a strategic framework. Kosovo needs to focus on improving before-and-at-the-border clearances involving customs, and phytosanitary and veterinary inspections. At present, there is no electronic data exchange between these agencies, and businesses are faced with multiple and complex procedures to clear import/export goods. A single-window will reduce business costs and ensure better quality control. Furthermore, Kosovo needs to work with neighboring countries on mutual recognition of laboratory/inspection certificates and tests, as well as transit corridors. These reforms would help Kosovo reduce business costs related to trade.

39. This sub component with proposed allocation of US\$ 1.5 million comprises of investment lending in:

- (i) Kosovo's border agencies to operationally implement the transit facilitation corridors with neighboring country(ies). Following the political agreement between countries, what is needed is primarily linked to equipment purchase to ensure electronic tracking of shipments; upgrading software to enable electronic data exchange with customs agencies of neighboring country; capacity building and trainings of customs officers;
- (ii) Helping to establish a single-window online Government to Business (G2B) platform for border agencies (customs, food and veterinary agency laboratories, and a central coordinating point for market surveillance).

And US\$0.5 million results based lending in:

- (iii) Customs and other border agencies, including quarantine and food safety agencies operating at the border, to align their processes and procedures with WTO's Trade Facilitation Agreement and

reduce documentation requirements;

(iv) Kosovo customs with further development of trusted traders' regimes and post clearance audit competencies;

Component 2: Business Environment and Small and Medium Enterprise (SME) Development (US \$7.5 million)

40. The aim of this component is to:

(i) Promote SME development by providing targeted support to increase standards, foster exports, and improve their competitiveness.

(ii) Improve the business environment and reduce the administrative burden for businesses in order to create a transparent and efficient operating environment for both local and foreign companies.

The work will partially build on ongoing advisory support provided under the IFC Kosovo Investment Climate Project (2013 – 2016) which focuses on business regulation and investment policy. A follow-up T&C Investment Climate II advisory project will be designed to provide continued technical assistance with potential SECO financing. A major challenge during implementation of the project mentioned above was the low capacity of civil servants specifically at the local level. This has presented difficulties and delays in collecting information on the administrative processes of municipalities. More support will be provided to local officials. Additionally, local elections slowed down project activities at the local level. It is important to liaise with both elected and technical officials in order to ensure sustainability of relationships even after changes in leadership.

2.1: Enhancing Business Environment (US\$3.5 million)

41. This subcomponent aims to increase transparency and efficiency in interactions between the state and firms, both foreign and local, through upgrading business registration, improving inspection systems, and targeting investment policy. Investment lending will be provided mainly for: (i) business registration and (ii) inspections reform, while results based financing will be provided to support: and (iii) strengthen investment policy framework. To supplement the technical assistance necessary to achieve these results the advisory project Investment Climate II will be used.

42. Business registration. The project will support the Kosovo Business Registration Agency (KBRA) to upgrade the business registration software, upgrade seven municipal business centers (MBCs), and establish three to four new MBCs in the north of Kosovo. With support from the WB BETA Project, KBRA set up an integrated business registration system in 29 MBCs. While previously a business entity had to obtain registrations for business, income tax, VAT, exports and/or imports from KBRA and tax administration separately, after integration of the registration system, a business entity can obtain all these registration numbers in one certificate within three days from KBRA in Pristina or from the MBCs. While an integrated registration system is an important step toward a streamlined and simplified business registration system, it is still far from the international good practice of a virtual one-stop shop (OSS) that delivers not only on business registration formalities in minutes but also a number of licenses, permits, and government to business services. The IFC Investment Climate Advisory Project has provided a comprehensive assessment of KBRA and a reform map for further improving the process of registration and increasing interoperability with other institutions. The current project can support the

implementation of this reform plan. Through investment lending the project proposes to support KBRA to: (i) extend business registration services in the north of Kosovo through establishing three to four new MBCs; (ii) enhance activities of seven regional MBCs and equip them to provide a wider range of services for businesses and (iii) upgrade the current software KBRA uses to achieve online business registration and implement a unique business identifier for registered companies.

43. Business inspections. In Kosovo many aspects of business life are subject to government requirements and governmental monitoring and control, and thus, inspections. Kosovo has the highest number of individual inspections among all its neighboring countries . Kosovo's inspectorates are regulated by some 80 to 90 different laws and several hundred bylaws and acts (World Bank 2012). Furthermore, inspection bodies lack the resources (human, financial, and equipment) to enforce the laws and bylaws that fall under their jurisdiction. Current organization of inspections in Kosovo leads to widespread lack of coordination between inspectorates. The legal framework lacks a clear definition of competencies of inspection bodies' mandates, which increases overlaps and redundancies of businesses undergoing several inspections for the same requirement.

44. Investment policy. Foreign direct investment (FDI) in Kosovo has been decreasing and is among the lowest in the region. About 85 percent of FDI flowing into Kosovo in 2012 was in the resource-seeking and market-seeking categories. The dominance of real estate, infrastructure investment, and construction sustains FDI investment flows. However, efficiency-seeking, mobile greenfield investment is disproportionately low. Considering Kosovo's advantageous characteristics (small market but proximity to EU and Central Asian markets, relatively skilled labor force, developed infrastructure, and rapidly improving business environment), and global and regional FDI dynamics that lean toward efficiency-seeking investment (global compartmentalization of the regional value chains in manufacturing, for example, FDI flows in textiles, services, and food processing and certain services), this type of investment should be prioritized.

45. This sub component with proposed allocation of US\$ 3 million comprises of investment lending in:

- (i) Support to KBRA to extend business registration services in the north of Kosovo through establishing three to four new MBCs;
- (ii) enhance activities of seven regional MBCs and equip them to provide a wider range of services for businesses and
- (iii) upgrade the current software KBRA uses to achieve online business registration and implement a unique business identifier for registered companies;
- (iv) introduce standard procedures for business inspections in Kosovo at all levels; reduce the number of individual inspection bodies (through mergers, and organizational and operational changes); introduce better internal controls, better governance standards, and a risk-based approach and business enabling inspections, while at the same time protecting public health and safety; and finally reduce ambiguity and close the regulatory implementation gap .

And US\$0.5 million results based lending in:

- (i) Technical assistance for continuous capacity building can be provided through the supplementary advisory project.

2.2: Developing SMEs (US\$4 million)

46. This subcomponent supports SMEs to increase standards, improve access to markets, and foster

innovation by improving the effectiveness of KIESA through results based finance and providing matching grants through investment lending.

47. Capacity of KIESA. The Kosovo Investment and Enterprise Support Agency (KIESA) leads export/investment promotion, but its weak capacity is of concern. KIESA is an agency under the Ministry of Trade and Industry (MTI), created in the beginning of 2014 as a merger of IPAK, the Investment Promotion Agency of Kosovo and the Kosovo SME Agency. KIESA's mandate also extends to export promotion for Kosovo, which previously had been the responsibility of the MTI. While KIESA does offer various services for SMEs and investors, these are mainly reactive. This means that no dedicated programs or activities exist that clearly target sectors or investors in a proactive manner. Some of the main issues faced by KIESA are its limited resources and capacity in providing SMEs and investors with continued personalized follow-up and lack of data showing Kosovo's value proposition and comparative advantages.

48. Matching grants scheme. This subcomponent will provide investment lending through matching grants for enterprise upgrades and export readiness. Re-exports make up half to a third of Kosovo's exports. Most of these are base metals that provide little employment, however, sectors with higher export potential include, but not limited to, agro processing, textile, vegetable products, hides and skins, and ICT sector. However, please note that there is no dominant export sector in Kosovo, except for the raw material which the proposed matching grants will not support. Currently lack of access to finance and poor quality of goods/services produced impede firm growth and exports. The matching grants scheme will address these issues. Additionally, the scheme will help increase demand for the NQI, help build a culture of use of management consultants, and improve competitiveness of firms (especially export-oriented firms) in key sectors. This activity is expected to generate market demand for business development services of a general nature (accounting, diagnostics of problems such as SWOT analysis, management consulting, legal support, training of SME personnel, and business software). While the grant is expected to be sector neutral given Kosovo's small size and need for robust pipeline, emphasis would be on export oriented sectors.

49. Horizontal reforms: Policy coordination and project management. In order to increase coordination with the private sector and get high level endorsement of reforms, the project will potentially support through Technical Assistance and experts the National Economic Development Council (NEDC) through technical assistance. NEDC was re-established in June 2015 after a long period of inactivity. It serves as a national public-private dialogue platform, it is chaired by the Prime Minister and MTI serves as its secretariat. NEDC initiates and coordinates inter-institutional activities related to economic development and the improvement of the business environment and supports strengthening the role of the business community. As such, NEDC is very well positioned to support and drive the reforms being proposed.

50. This sub component with proposed allocation of US\$ 3.5 million comprises of investment lending in:

Establishment of the matching grants facility for enterprise upgrades and export readiness. Currently lack of access to finance and poor quality of goods/services produced impede firm growth and exports. The matching grants scheme will address these issues. Additionally, the scheme will help increase demand for the NQI, help build a culture of use of management consultants, and improve competitiveness of firms (especially export-oriented firms) in key sectors.

And US\$0.5 million results based lending in support to KIESA that is based on the following achievements: (i) improving the capacity of the organization through staffing and imparting required skills sets to personnel; (ii) improving the monitoring and evaluation process of KIESA by incorporating annual reviews and action plans and independent evaluations; and (iii) providing the necessary state budget for the staff and activities outlined in its action plans. Technical assistance to increase KIESA's capacity will be provided through the Investment Climate 2 advisory project

In order to increase coordination with the private sector and get high level endorsement of reforms, the project will potentially support through Technical Assistance and experts the National Economic Development Council (NEDC) through technical assistance.

Component 3: Labor market intermediation and skills development (US\$8 million)

51. Kosovo has one of the weakest employment records in Europe with a labor force participation rate of 40.5 per cent, employment rate at 28.4 percent and unemployment rate at 30 percent in 2013 (and considerably worse for women and, especially, youth). Youth unemployment is especially high, at over 55 percent. As a result, only about 10 percent of the active youth population is working, and this falls to less than 5 percent for females. Education seems to be a key factor for improving the chances of finding a job in Kosovo: while 62.5 percent of individuals with tertiary education are employed, only 9.7 percent of those with just a primary education level have a job. Unsuccessful job searches appear to be moving discouraged workers out of the labor market at a high rate. The lack of job opportunities, rather than participation constraints, may be one of the most important factors behind the striking inactivity rates in Kosovo.

52. This component will support the Kosovo Employment 2020 Strategy and the Skills Vision 2020 Strategy. Kosovo's vision is to achieve the following by 2020: "A globally competitive knowledge society, with skills that adapt to the needs of the economy, fostering innovation and entrepreneurship, and attracting investment for sustainable development and social inclusion." To achieve this vision, four areas have been identified: (i) implementing competency-based learning and improving the responsiveness of the education and training system to labor market demands; (ii) fostering entrepreneurship and innovation; (iii) modernizing employment services to meet the needs of the labor market; and (iv) enhancing capacities for coordinated sector policy development and implementation. The team will specify the proposed amount for result based lending and DLIs during the project preparation.

3.1: Improving labor market intermediation and active labor market programs (US\$4 million)

53. Strengthen Labor Market Intermediation. This subcomponent aims to strengthen labor market intermediation services, by supporting the public employment services (PES) for unemployed and inactive people and the active labor market programs. Active or passive programs cover only a small portion of the population. This subcomponent will support two key activities.

54. Public employment services (PES). PES modernization entails improving some facilities and equipment, and enhancing the capacity of PES staff. There is considerable variation in the quality of facilities and equipment available at the 37 PES, which in turn affects interest in the PES, staff quality, and productivity of staff. In addition, the PES staff capacity is low, so more outreach and capacity building will be needed for a better functioning PES.

55. Labor management information system (LMIS). Three main areas will be supported: (i) increasing the number of job vacancies in the LMIS; public-private-partnerships will be facilitated to allow the LMIS to benefit from the work of private job portals; (ii) improving the efficiency of job matching and active labor market program (ALMP) matching; a profiling methodology will be implemented; and (iii) facilitating regional mobility; the LMIS will be linked with neighboring countries.

56. The World Bank has been involved in labor market work in Kosovo for many years, including through the Sustainable Employment Development Policy Program (SEDPP). SEDPP consisted of two development policy operations that supported multi-sectoral reforms to promote the creation of good jobs in Kosovo. SEDPP was accompanied by technical assistance, which continued after SEDPP closed in 2012. Other stakeholders have also been active, including UNDP, GIZ,

57. Active labor market programs (ALMP). This subcomponent aims to improve the design and implementation of active labor market programs (ALMPs), more specifically, on-the-job training for targeted groups (women, youth). This subcomponent will support the following key activities: First, reforming the design of on-the-job training by including targeting criteria to ensure that the deadweight loss associated with the program is as low as possible. Targeting will be achieved by profiling job seekers by their risk of facing long-term unemployment, but additional criteria will also be applied such as gender and age filters. Second, implementing a prototype of an on-the-job training program with impact evaluation embedded to inform scale-up. Kosovo has implemented small-scale ALMPs over the years, but no rigorous impact evaluations have been carried out. Implementing an impact evaluation of a targeted on-the-job training program can give stakeholders the information needed to scale up a prototype program in the country.

3.2: Improve Relevance of Vocational Education and Training (US\$4 million)

58. This subcomponent would support the reform agenda led by the Ministry of Education, Science, and Technology (MEST) and the Ministry of Labor and Social Welfare (MLSW) to improve quality assurance and relevance of vocational education and training (VET) provision in Kosovo. It would also aim to strengthen inter-ministerial and interagency coordination in the development and implementation of the main improvements needed in VET, as identified in the strategic documents. This subcomponent would also aim to establish systems and processes that ensure a sustainable link of the vocational training provision with the National Qualifications Framework (NQF) and the quality assurance and certification process led by the National Qualifications Agency (NQA). These activities lead to improvements in the quality and relevance of training profiles, clear definition of occupational competencies, and accreditation of training programs and providers of vocational education and training.

59. Professional profiles and learning standards. This support would aim to facilitate the consolidation of professional profiles and development of occupational standards and learning outcomes. This activity would support the MEST and the MLSW to facilitate consolidation of existing occupations and in defining the key competencies that must be acquired in every educational profile, and within every occupation, and general and specific professional competencies. A primary focus here is to ensure that consolidation of occupations is effectively linked with national priorities for economic development, and that professional competencies are identified and developed with active participation of the private sector and incorporated into the training program and curriculum. Technical assistance would be provided to carry out the mapping

of profiles, the consolidation of professional profiles, and the development of specific occupational standards and learning outcomes. This component would also support and facilitate the update and modernizations of training programs for select priority professional fields. The improved links between training provision and accreditation by NQA would be facilitated through the establishment or a regular process of review and accreditation of providers (both public and private) and monitoring and evaluations of such practices.

60. Modernization of vocational training centers (VTCs). The modernization of VTCs would include measures that are targeted to do the following: (i) improve the capacity of VTC staff and trainers; (ii) develop tools for screening job seekers' skills to determine placement at certain training levels; (iii) develop and test models for cooperation with employers and companies; and (iv) provide models for diversification of training, which may include outsourcing of training to private accredited providers.

IV. Safeguard Policies that might apply

Safeguard Policies Triggered by the Project	Yes	No	TBD
Environmental Assessment OP/BP 4.01	x		
Natural Habitats OP/BP 4.04		x	
Forests OP/BP 4.36		x	
Pest Management OP 4.09			x
Physical Cultural Resources OP/BP 4.11			x
Indigenous Peoples OP/BP 4.10		x	
Involuntary Resettlement OP/BP 4.12	x		
Safety of Dams OP/BP 4.37		x	
Projects on International Waterways OP/BP 7.50		x	
Projects in Disputed Areas OP/BP 7.60		x	

V. Financing (in USD Million)

Total Project Cost:	25.00	Total Bank Financing:	0.00
Financing Gap:	0.00		
Financing Source			Amount
Borrower			25.00
International Bank for Reconstruction and Development			0.00
Total			25.00

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