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**KOSOVO, FEDERAL REPUBLIC OF YUGOSLAVIA**  
**TRANSITIONAL SUPPORT STRATEGY**

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South East Europe Country Unit  
ECC04  
Europe and Central Asia Region

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## ABBREVIATIONS AND ACRONYMS

BPK	Banking and Payment Authority
CFA	Central Fiscal Authority
EC	European Commission
FAO	Food and Agriculture Organization
FRY	Federal Republic of Yugoslavia
FYROM	Former Yugoslav Republic of Macedonia
GDP	Gross Domestic Product
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
IFI	International Financial Institution
IMF	International Monetary Fund
KCB	Kosovo Consolidated Budget
KEK	Korporata Energjetike e Kosoves (The Power Company of Kosovo)
KFOR	Kosovo Force
MEB	Micro Enterprise Bank
PSD	Private Sector Development
SEED	Southeast Europe Enterprise Development
SRSB	Special Representative of the Secretary General
TA	Technical Assistance
TFK	Trust Fund for Kosovo
TSS	Transitional Support Strategy
VAT	Value Added Tax
UN	United Nations
UNDP	United Nations Development Program
UNMIK	United Nations Interim Administration Mission in Kosovo

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**Memorandum to the Executive Directors of IDA  
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# Transitional Support Strategy for Kosovo<sup>1</sup>

## I. Introduction

1. Following the Kosovo conflict, a Transitional Support Strategy (TSS) was presented to the Board on October 7, 1999 (R99-178). The TSS proposed an assistance strategy to support post-conflict reconstruction and economic recovery as part of a broader international effort, as well as the establishment of the Trust Fund for Kosovo, with two allocations totaling US\$60 million from IBRD's net income. The TSS Progress Report of June 27, 2000 (R2000-130) took stock of the initial implementation of this strategy and set out an assistance program for the October 2000-September 2001 period, making the case for the second tranche of the net income allocation.<sup>2</sup>

2. The TSS Progress Report noted that political developments in the Federal Republic of Yugoslavia (FRY) as well as the nature and timing of an eventual settlement of the status of Kosovo would have important implications for the Bank's longer-term involvement in Kosovo. Management, therefore, indicated that it would return to the Board to assess any political changes and the Bank's future role, including whether a further replenishment of the Trust Fund was justified.

3. Following the dramatic change in government in the fall of 2000, FRY, through succession, became member of the Bank in May 2001. However, to date there has been no progress in reaching agreement on Kosovo's final status, and the nature and timing of a political settlement continue to be unclear. Hence, a separate assistance program for Kosovo remains necessary.

4. The purpose of this document is: (i) to summarize progress under the previous TSS; (ii) to propose the continuation of Bank assistance through the use of IDA grants (US\$15 million); and (iii) to describe the proposed program of assistance for the remaining period of the Reconstruction and Recovery Program (i.e. until end-2003).

## II. Background

### Political developments

5. *Kosovo has been gradually progressing toward self-government.* This political process has been taking place within the framework of UN Security Council Resolution 1244, adopted in June 1999. In order to help prepare for the first phase of self-government, the Kosovo Transitional Council was established early on to include representatives from ethnic Albanian, Serb and other groups. It served as the highest political consultative body, providing the main political parties of Kosovo with a forum for input into the decisions of UNMIK (United Nations Interim Administration Mission in Kosovo). Local participation was broadened in early 2000 with the establishment of

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<sup>1</sup> Kosovo, Federal Republic of Yugoslavia, hereinafter Kosovo.

<sup>2</sup> The two tranches were: US\$25 million and US\$35 million, respectively. The Trust Fund for Kosovo has generated some US\$2.8 million in investment income, which has also been committed for projects.

the Joint Interim Administrative Structure in which 20 departments (akin to ministries) were co-managed by international and local experts. New local governments have also been set up, following municipal elections in October 2000.

**6. *Adoption of the Constitutional Framework in May 2001 signaled a key step towards self-government.*** The Constitutional Framework set out the Provisional Institutions of Self-government that includes the President of Kosovo; the Assembly; and the Government.<sup>3</sup> Kosovo-wide elections followed in November 2001, and the establishment of the Provisional Institutions of Self-government was completed in March this year with the election of Mr. Ibrahim Rugova as President of Kosovo and Mr. Bajram Rexhepi as Prime Minister of the new Government. Government formation took several months as the three main Albanian political parties found it difficult to agree on a grand coalition. Eventually, a compromise was reached with the intermediation of the Special Representative of the UN Secretary General (SRSG), who also played a pivotal role in securing Kosovar Serb participation in the Government.

**7. *While the Provisional Institutions of Self-government have significant responsibility in governing Kosovo, the SRSG remains the final legal authority.*** The SRSG, through reserved powers, continues to have direct responsibility for law and order, the judiciary, the protection of minorities, the conclusion of agreements with states and international organizations in all matters within the scope of Resolution 1244, the administering of state and socially-owned property, and decision making in key economic areas.

**8. *The security situation has improved but the return of displaced Kosovar Serbs remains limited.*** While there has been a gradual decrease in security incidents against minorities, day-to-day intimidation and harassment continue to occur. Freedom of movement, while improved, remains the fundamental issue affecting the ability of minorities to access many of the essential services and employment. This situation also discourages the return of refugees and internally displaced persons who belong to minority communities. UNMIK is committed to the principles of multi-ethnicity and integration, including the building of an inclusive public service and the creation of the preconditions for a substantial return process. However, as experience elsewhere shows, it takes time to achieve a breakthrough in minority return.

### **Economic and social situation**

**9. *Kosovo's reconstruction has proceeded well, due to the initiatives of the population and the speedy commitment of donor support.*** In the first year and a half after the conflict, donors pledged about 90 percent of the US\$2.3-2.4 billion medium-term Reconstruction and Recovery Program, and by end-2001 disbursements reached an estimated US\$1.4-1.5 billion. Close to 50,000 houses have been reconstructed or rehabilitated, providing homes to some 300,000 people. Several units of the two power stations have been overhauled, leading to an improvement in the supply of electricity.

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<sup>3</sup> UNMIK Regulation No. 2001/9 of May 15, 2001. The 120-member Assembly includes 22 Kosovar Serb members and 10 members representing other minorities; the 11-member Government has two non-Albanian ministers.

Over 500 km of main roads and several bridges have been rehabilitated benefiting all Kosovars and providing for increased economic activity. In the social sectors, there has been a promising start, as most urgent infrastructure needs have been met and there is now a shift in emphasis towards increased training and quality. The main donor-funded school reconstruction projects have been successfully implemented and teacher training has begun. All main hospitals and clinics have benefited greatly from donor assistance, not only through modernization of outdated equipment but also through continued training of doctors and nurses, ensuring better health care. The sanitation situation has also improved considerably thanks to the extensive work on water distribution networks, and waste disposal sites and collection. Seed and fertilizer import programs have led to increased yields of the main arable crops, helping recovery in agriculture, a key sector of the economy. Finally, the reconstruction program has provided jobs to many Kosovars, and has given a major boost to small and medium-size local enterprises engaged in trade, services and construction.

10. ***Economic growth has been strong.*** GDP growth, estimated at 16 percent in real terms in 2001, has been driven by reconstruction spending, private transfers from Kosovars living abroad, and the presence of some 50,000 expatriates in Kosovo.<sup>4</sup> According to IMF staff estimates, prepared late last year, 2001 GDP per capita was on the order of US\$850-950.<sup>5</sup> Due to massive official and private transfers, consumption is estimated to have reached over 120 percent and imports close to 90 percent of GDP in 2001. These transfers have helped to cover the large trade deficit, and thus generate a roughly balanced current account. In 2000-2001, prices are estimated to have increased at an average rate of 2-3 percentage points per quarter, reflecting the gradual removal of exemptions from sales tax, VAT and customs duties. Annex I summarizes the available data.

11. ***UNMIK's efforts to reduce reliance on donor funding for local recurrent expenditures have been successful.*** A completely new tax system has been put in place, including a value added tax, which was introduced in July 2001. Local financing of budget expenditures has risen impressively from one-third in the final four months of 1999 to one-half in 2000 and more than 90 percent in 2001.<sup>6</sup> The general use of the Deutsche Mark and subsequently the Euro in domestic transactions, and the maintenance of a liberal trade regime have contributed to macroeconomic stability.

12. ***Progress has also been significant in building the institutions necessary for economic recovery in Kosovo.*** This is, for instance, illustrated by the creation of an efficient and transparent Central Fiscal Authority (CFA), the Banking and Payment Authority (BPK), and functioning tax and customs administrations. Given Kosovo's

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<sup>4</sup> Excluding the Kosovo Force (KFOR). Kosovo produces only limited and rudimentary official statistics on any macroeconomic aggregates, including national accounts, inflation and trade. Donors, including the Bank, have been assisting the Statistical Office of Kosovo in capacity building.

<sup>5</sup> Recent estimates by the Central Fiscal Authority put 2001 GDP per capita at US\$847. Both per capita GDP calculations are based on a population estimate of about 1.9 million which does not include displaced persons or refugees living outside Kosovo.

<sup>6</sup> The major expenditure items in the local Kosovo Consolidated Budget (KCB) relate to administration (civil service, judiciary, law and order), education, health and social protection. The KCB so far continues to cover mainly recurrent spending, while the donor-financed reconstruction effort remains off-budget.

unique circumstances (legacy of destruction related to the conflict, withdrawal of Kosovar Serbs from the public administration after 1999, and a decade of absence of Kosovar Albanians from management of public institutions), UNMIK has had to start from scratch in many areas. From the beginning, utmost importance has been placed in the design of policies and institutions to ensure continuance and sustainability when UNMIK withdraws. The success of these efforts are now being tested as the Provisional Institutions of Self-government take over many of the key economic management functions.

13. ***Despite initial progress in reconstruction and economic recovery, there is still a long way to go.*** The electric power supply remains unreliable, the industrial sector of the economy is weak, the banking sector is in a nascent stage, and the level of per capita GDP is one of the lowest in the region. Close to half of the active labor force is unemployed and poverty remains widespread (see Box 1 below).

**Box 1: Poverty in Kosovo**

The Bank's recent Poverty Assessment found that over half of the population was living below the poverty line of US\$1.65 per adult per day at the end of 2000.<sup>7</sup> For many of the poor poverty was relatively shallow, and an annual amount of US\$190 per person would have been sufficient to bring a poor household out of poverty. Nevertheless, the report suggests that around 12 percent of the population live below the extreme (food) poverty line of US\$0.88 per adult per day. The assessment also found that donor assistance, and in particular food assistance, has been quite successful in mitigating poverty in Kosovo.

According to the assessment, the typical household in extreme poverty is of Albanian ethnicity, it has seven members and a high dependency ratio (due to a large number of children), and at least one elderly person. It lives in a rural area; the typical household head is around 50 years old, with a low level of education and works in agriculture.

In the area of *educational attainment*, the most striking result of the report is the large inequality existing across income, ethnic group and gender. Only just over half of the Kosovar Albanian girls aged 15-18 were enrolled in school in 2000, compared to nearly three-quarters of Kosovar Albanian boys. Net secondary education enrollment rates for non-Albanian non-Serb ethnic groups are less than 55 percent. The private cost of education - which is reportedly US\$95-190 per child per year - is identified as the main reason for non-enrollment. The limited available data on *health* suggest that Kosovo ranks lowest in Europe on virtually every health indicator. Infant mortality, maternal health, and the decline in immunization coverage are areas of particular concern. These poor health outcomes appear to be primarily related to the quality of health care received rather than to access barriers.

The report proposes a two-prong strategy for poverty reduction in Kosovo. For many of the poor living near the poverty line, broad-based and labor-intensive economic growth should help to boost income levels and thereby reduce the incidence of poverty. However, economic growth by itself is unlikely to lift the extreme poor out of poverty, and specific anti-poverty interventions will be required. In this context, it will be critical to further improve the targeting of the current social assistance system. In education, the poverty alleviation strategy will need to focus on (i) ensuring that poor families can afford schooling and (ii) promoting the enrollment of certain groups, including girls. In health, the quality of and access to care needs to be improved, especially in the areas of child and maternal health. Under-the-table payments need to be formalized, costs should be controlled, and resources should be channeled to priority areas.

<sup>7</sup> The Poverty Assessment is based on the 2000 Living Standard Measurement Survey (LSMS) of Kosovo, which was done in collaboration with FAO, IOM, UNDP, and the Statistical Office of Kosovo. Additional funding was provided by the governments of The Netherlands and the United Kingdom. For converting the data from DM to US\$, the average exchange rate for 2000 was used.

## **Main economic challenges and the Government's priorities**

14. ***Kosovo has to prepare itself for reduced donor flows.*** While Kosovo has passed the emergency phase, and much of the reconstruction has been completed, it faces many of the same structural issues as other poor, rural, transition economies. Kosovo will have to address these challenges in an environment of declining donor funding. In 2002, in terms of actual flows, the change may not be dramatic as donor-financed public investment spending may still reach a similar level as in 2001--about US\$500 million or 30 percent of GDP. However, donor support is expected to sharply decline, perhaps to half of this level, in 2003 while economic activities generated by the large expatriate presence will also be reduced. These developments will test the sustainability of Kosovo's economic recovery.

15. ***At the time of its formation, the Kosovar Government outlined four broad economic priorities.*** These include:

- fostering economic development and growth, and increasing employment, through creating the conditions for a market-based economy;
- improving the living standard of vulnerable groups, and enhancing the quality of and access to education and health;
- ensuring an efficient and transparent public administration; and
- providing equal opportunities for all citizens.

16. ***Kosovo has yet to establish an adequate business climate.*** In spite of significant progress in building the institutional framework (see Box 2.), Kosovo has yet to create an environment in which the rules of law are respected, property rights and claims are recognized, contracts can be enforced, and investors can have access to capital. Thus, the efforts to improve the business climate need to focus on: (i) the completion of the commercial legal and institutional framework; (ii) the development of an independent, professional, impartial, and multiethnic judiciary system; (iii) the provision of significant flows of financial intermediation for viable productive activity; and (iv) the establishment of adequate systems of business support and information. Furthermore, Kosovo needs to begin the transfer of potentially viable public enterprises to private ownership, or divest productive assets from the public sector into private hands on the basis of a coherent strategy. Implementation of such a strategy will not be easy because of the political sensitivity and legal complexity of the issues involved, given Kosovo's special governance arrangement and legal framework.

17. ***Improving the living standard of vulnerable groups is high on the Government's agenda.*** While economic growth will help reduce poverty, specific anti-poverty interventions will also be required to meet the needs of the extremely poor. Given limited public resources, targeting of social assistance programs will need to be refined. Unless improvements are made to the health and education status of the population, they are likely to be an important constraint on economic growth. In both sectors, there is a need to improve efficiency, including through rightsizing the workforce, and shift budget resources into investments that will help enhance the quality of services.

18. ***The public sector will have to be kept small and transparent.*** With the recent election of the Kosovar Government, there is a unique window of opportunity for the creation of a small, efficient, transparent and accountable public sector, providing quality service to the population. While donor financing will decline over the coming years, the budget will have to absorb further spending items. Maintaining fiscal sustainability will require further measures in the areas of tax policy and tax administration, public expenditure policy and management, and governance.

19. ***Ensuring equal opportunities for all citizens will be a challenge.*** It will be critical to ensure that all ethnic groups in Kosovo benefit from economic development and growth, and that all citizens in Kosovo enjoy equal access to social services. The Government's statement envisages the adoption of policies that favor the integration of all communities with respect to employment in the public sector, education, health, culture and language rights. It also refers to the importance of full freedom of movement, and the right of refugees and displaced persons to return to their homes.

### **III. Implementation of the Transitional Support Strategy**

20. As outlined in the TSS of September 1999, the Bank's strategy has aimed at helping to ensure the overall sustainability of the reconstruction and recovery effort by using the Bank's comparative advantage in aid coordination and policy advice, and through selective financial support.

#### **Aid coordination**

21. ***The Bank has played an important coordinating role in Kosovo.*** It has helped to mobilize over US\$2 billion of donor assistance in support of the medium-term Reconstruction and Recovery Program through three donor conferences, co-chaired with the European Commission (EC). Also, as co-chair of the High Level and Working Level Steering Groups for Southeast Europe, the Bank has monitored the implementation of the Reconstruction and Recovery Program, including the evolution of donor flows through the Bank/EC joint office in Brussels. Annex II describes the role of donors in supporting the Reconstruction and Recovery Program.

#### **Policy and technical advice**

22. Economic policy advice to UNMIK, in close collaboration with the IMF, has been an important component of the Bank's assistance in Kosovo. The Bank has provided support to UNMIK in setting up the basic institutions of macroeconomic management, has given extensive advice with respect to the preparation and implementation of the Kosovo Consolidated Budget, and has worked closely with UNMIK in the design and implementation of the commercial framework. The Bank has prepared a comprehensive economic report, and a social assessment that identifies the key social and institutional constraints and opportunities relevant to sustainable socio-economic development in Kosovo. These reports as well as a poverty assessment have been widely disseminated, including through workshops and seminars with the participation of a large range of stakeholders. As soon as the new Kosovar Government was formed in March 2002, the

Bank organized a roundtable discussion with its members on key economic policy priorities, on the basis of a set of policy notes prepared by Bank staff.

**Financial assistance**

23. *In spite of the difficult and volatile environment, the Bank's financial assistance program in Kosovo has been quite effective.* The entire amount of US\$60 million of the Trust Fund for Kosovo had been committed by August 2001 (i.e. in less than two years), to twelve projects, in addition to two post-conflict grants of US\$2 million.<sup>8</sup> About US\$46 million, or more than 70 percent of the total, had been disbursed by May 2002. Through these projects, the Bank has played an important role in (i) assisting institution building and economic reforms, and providing critical budget support; (ii) helping employment creation through support for private sector development (see Box 3); (iii) making a contribution to the restart of agriculture and supporting the income generation capacity of vulnerable rural families; and (iv) financing small infrastructure rehabilitation investments based on community initiative in conflict-affected areas. The Bank's resources have been complemented by cofinancing of projects in the amount of US\$62 million by the European Commission, France, Germany, Italy, The Netherlands, Sweden, Switzerland, and the United Kingdom. Annexes III and IV provide a summary of the Bank's grant program and its initial results on the ground.

**Box 2: Lessons of Experience**

- The Bank's analytical contributions (reconstruction and recovery program; economic report; social assessment; poverty assessment; policy notes for the new Government) have been particularly appreciated by our counterparts and development partners.
- Constant dialogue on economic matters with UNMIK and the CFA, in part through a series of Economic Assistance Grants, has kept the Bank up-to-date on economic developments and has allowed instant policy advice.
- The Working Level Steering Group structure, co-chaired by the Bank and the EC, has provided an effective donor coordination and oversight mechanism, especially with respect to the budget.
- Projects relying on community participation have been effective in meeting local needs in a post-conflict setting and avoiding weak project implementation capacity at the center.

<sup>8</sup> Another US\$2.8 million in investment income credited to the TFK has also been committed.

### **Box 3: Private Sector Development: Bank Group Interventions**

During the past two and a half years, the Bank Group has made a concerted effort to help address some of the constraints of private sector development through a set of interventions by the Bank, IFC and the joint Bank/IFC Southeast Europe Enterprise Development program (SEED):

- The third Economic Assistance Grant (US\$5 million) was designed to support the preparation and enactment of four key commercial regulations: (i) the Regulation on Business Organizations; (ii) the Regulation on Contract for Sale of Goods; (iii) the Regulation on Pledges; and (iv) the Regulation on Foreign Investment. In addition to providing budget support, the main benefit of this grant relates to the establishment of an adequate commercial legal framework to support the development of the private sector.
- The PSD Technical Assistance Grant (US\$3 million) was developed to (i) support the establishment and operation of a modern business registry system; (ii) strengthen the capacity of the commercial courts and the Supreme Court, and improve the quality of legal services; and (iii) assist in the development of basic accounting standards, provide training for local accountants, and assist in the establishment of an association of accountants in collaboration with USAID.
- The Micro Enterprise Bank (MEB), established in late 1999 as a joint initiative of IFC, the European Bank for Reconstruction and Development (EBRD), and Internationale Projekt Consult, was initially developed to provide micro credit. However, it has quickly become a key part of the payments infrastructure of Kosovo, which was wiped out by the conflict. MEB is meeting Kosovo's growing demand for financial services through providing account management, foreign exchange and money transfer services, loans and cashless payment transactions to micro and small enterprises and individual customers. It is based in Pristina and has seven branches throughout Kosovo. IFC's investment in MEB amounts to about US\$1.1 million.
- The Pilot SME Line of Credit, a joint project with the European Agency for Reconstruction (with a combined grant amount of about US\$10 million), was developed to provide financing on market-based terms to jump-start production and economic activity of the private sector. Loans to eligible SMEs are for much needed inputs and repairs, which have helped the revival of selected industrial production, and finance an increased proportion of high value-added services. The project has been supported by the joint Bank/IFC Southeast Europe Enterprise Development (SEED) program through the provision of advisory services to private sector companies.

## **IV. Justification for Continued Grant Assistance for Kosovo**

### **Justification for the use of IDA grants**

24. *Kosovo, which is a territory of a sovereign country but is under UN administration, is a special case when it comes to the provision of Bank assistance.* Under the current circumstances, the use of regular resources--either in the form of direct lending to Kosovo or through FRY--is not feasible. However, continued Bank support to Kosovo is important because it contributes to peace and stability, and thus economic development in the Balkans. Such support so far has come from net income. In the current circumstances, where the use of IBRD net income or surplus is limited, replenishment of the Trust Fund is not an option.

25. *Management proposes that US\$15 million of IDA resources be allocated to Kosovo on grant terms for commitments during CY2002-03.* This would allow the continuation of Bank assistance in the context of the medium-term Reconstruction and Recovery Program for Kosovo. Management's proposal is based on consultations with IDA Deputies in the context of the IDA13 replenishment negotiations regarding the use of IDA grants for post-conflict purposes.

26. *Bank assistance to Kosovo in the form of IDA grants to UNMIK would be in conformity with the IDA Articles of Agreement.* The recipient of the IDA grants would be UNMIK, a subsidiary organ of a principal organ (the Security Council) of the United Nations, which is a public international organization. Providing such grants would be permissible under Article V(2)(c) of IDA's Articles of Agreement, which allows for the provision of financing to a public international organization. Such assistance would continue the practice followed so far under the Bank's Trust Fund financed program, and would be consistent with UNMIK's legal status and responsibilities in Kosovo under UN Security Council Resolution 1244. The IDA grants to UNMIK would fall within the purposes of IDA since such funding would be provided "to promote economic development, increase productivity and thus raise standards of living" in Kosovo, and Kosovo is a "less-developed area of the world included within the Association's membership".<sup>9</sup>

#### **Future involvement**

27. *Agreement on Kosovo's final status would trigger a new strategy.* With the understanding between Serbia and Montenegro on the future of FRY, and with the election of the new Kosovar authorities, the international attention may begin to focus on reaching a final settlement for Kosovo. Such agreement on Kosovo's status would trigger Management's return to the Board.

28. *However, it is difficult to predict when this will happen and what the eventual outcome will be.* In the meantime, the Bank will continue its engagement in Kosovo through IDA grants at least for the next 18 months to coincide with the remaining time of the original four-year Reconstruction and Recovery Program. This will enable the Bank to see through the implementation of the Program and fulfill its donor coordination role. At the end of that period, the scope of the Bank's future involvement in Kosovo will be reassessed.

#### **V. Proposed Program for CY2002-03**

29. *In the first phase of its program, the Bank had relatively broad-based objectives.* The Bank's assistance has been part of a concerted donor effort to support reconstruction, economic restart and the process of transition. Despite its modest size, the Bank's program has made an important contribution to reconstruction and economic recovery in Kosovo. Going forward, our strategy combines the selective use of grant resources, focusing primarily on poverty alleviation and limited budget support, with an extensive program of analytical work. The latter is designed to respond to the priorities of the new

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<sup>9</sup> Article I and Article V, Section 1 (a) of IDA's Articles of Agreement.

Kosovar authorities related to economic growth, poverty reduction, fiscal sustainability and good governance. In addition, the Bank also plans to maintain its donor coordination role, as described below.

30. ***With the new Kosovar institutions now in place, it is especially important for the Bank to be able to continue its assistance.*** This would allow the Bank to work increasingly with local counterparts and help capacity building. The proposed program of assistance, summarized below and in Annex V, has been discussed with representatives of UNMIK and the new Kosovar authorities, and takes into account the activities of other donors. The impact of the Bank's assistance program will be evaluated using the benchmarks set out in Annex VI.

### **Economic growth**

31. ***An extensive program of economic work is planned to help the authorities remove constraints to sustainable pro-poor economic growth.*** In an environment of declining donor support, Kosovo's main challenge will be to implement a fiscally sustainable reform program that fosters private sector-led growth. As experience elsewhere evidences, the entry and growth of small- and medium-sized enterprises play a crucial role in generating economic growth and creating employment, both central aspects to improving the living standard of vulnerable people. In this context, the proposed ***Economic Assistance Grant IV (US\$5 million)***, following the steps of previous policy-based budget support operations, will attempt to integrate key policies related to fiscal sustainability (as described in para 36); and improvement of the business environment and privatization/liquidation of socially-owned enterprises. Broad areas of conditionality for the private sector development component of the proposed operation might include: (i) the completion of a market-based commercial framework; (ii) the improvement of the judicial infrastructure; and (iii) fostering economic efficiency by putting the assets of socially-owned enterprises to more efficient and productive use. To further our dialogue on private sector development, the Bank also expects to prepare quick-response policy notes on selected issues, as requested by the authorities. Two other pieces of economic work would complement this effort, a report on sources of growth and a labor market analysis.

32. ***The energy sector is critical to economic growth.*** UNMIK has asked the Bank to help put the sector on a more sustainable path on the basis of experience in the region and world-wide. A relatively small amount of the Bank's grant assistance is planned to be allocated to a ***Second Energy Sector Technical Assistance Project (US\$1.5 million)*** to follow up on the comprehensive sector study financed from the Trust Fund for Kosovo. The proposed project would primarily cover a feasibility study for the priority investments identified for the power transmission and distribution networks (including an appropriate metering system), assistance to establish optimum electricity peak and non-peak exchanges with neighboring systems on a sustained basis, and assistance to strengthen different facets of KEK management.

## **Poverty alleviation and human development**

33. *The main focus of the Bank's financial assistance would be on poverty alleviation.* Almost 60 percent of the grant funds would be allocated to two operations with direct poverty focus. The Bank plans the continuation of the *Community Development Fund Project (US\$4 million)* that has effectively targeted areas with conflicted-related damage as well as vulnerable groups. This social fund supports small-scale infrastructure and social services projects at the village and neighborhood level, and operates in a demand-driven manner with a strong emphasis on community participation. Already more than a 100,000 people have benefited directly and another 100,000 indirectly from the completed infrastructure projects, which have generated a total of 17,000 man months of jobs. A detailed account of achievements under this project is provided in Annex IV.

34. *The proposed Education Project (US\$4.5 million) would be designed to increase enrollment rates in primary and secondary education and enhance access of girls and vulnerable groups to education.* The first phase of the Bank's assistance to the education sector, through the Education and Health Project, has focused on the creation of a system of education finance and management, following the conflict. It was a strategic decision to support institution-building, taking into account the Bank's comparative advantage and the fact that most donors were financing immediate school rehabilitation needs. In this second phase, the Bank intends to work with the authorities to implement the recommendations of the Poverty Assessment in the education sector. In the health sector, most urgent physical investment needs are being addressed by donors. The Bank, in the context of its supervision of the ongoing Education and Health Project and through the planned economic and sector work and perhaps a small donor-funded trust fund, intends to stay engaged in health policy issues. Finally, the Bank also plans to provide continued technical assistance to build up the capacity of the Kosovar authorities in poverty monitoring and analysis. This will help the Government design policies that more effectively reduce poverty and further improve the targeting of social assistance.

## **Fiscal sustainability and good governance**

35. *The Bank plans to maintain its role in assisting the authorities in the preparation of budgets that are increasingly sustainable.* Furthermore, the Bank would continue to monitor the implementation of the budget on a regular basis - also on behalf of the donor community. Kosovo has made tremendous progress in raising local revenues. Revenue performance has outperformed expectations, reducing the share of donor financing of recurrent budget expenditures rapidly since 1999. At the same time, expenditures have generally been kept under control, which, combined with lack of capacity of spending agencies to meet expenditure targets, have led to underspending. However, the overall good budget performance over the last two and a half years hides the fact that some major recurrent expenditure items (such as pensions and debt service payments) have not been covered while others (such as recurrent expenditures related to donor-funded rehabilitation, and operations and maintenance expenditures in general) have been insufficiently provided for. In addition, until lately, all capital expenditures were donor-financed. Despite the rapid increase in revenues, expenditure planning still lacks an appropriate medium-term framework. To remedy this situation, the Bank has been asked

to provide assistance to the authorities through analytical work in defining the sustainable level of fiscal expenditures over the medium term and their intersectoral allocation. This work, which has started and is expected to feed into the 2003 budget process, will also determine the need, if any, for future budget support by donors. The Bank will also monitor the implementation of the current's year budget, which includes a requirement of about US\$23 million for donor budget support.

**36. *Depending on the need this year and the next, the Bank will, in consultation with the authorities, decide on the timing of the Economic Assistance Grant IV.*** Given the fragility and incompleteness of the Kosovo budget, the fact that only a few donors can provide budget support, and that this operation could be a key vehicle for dialogue on a series of critical policy issues with the Kosovar authorities, the Bank would proceed with this grant as long as the need is demonstrated and economic policy performance warrants it. In addition to policy reforms in support of private sector development described above, specific areas of conditionality related to fiscal sustainability might include: (i) the introduction of an affordable pension system; (ii) strengthening the capacity for fiscal policy formulation; and (iii) ensuring transparency and accountability in fiscal management. Related to this last point, the Bank also plans to provide assistance to the authorities in designing an anti-corruption program. In case better-than-expected budget performance does not justify the planned budget support, the Bank would substitute this operation with a technical assistance project that would support the same basic objectives through a different delivery mechanism.

**37. *The Bank will rely on the existing and functioning fiduciary arrangements.*** This is foreseen in the case of the Economic Assistance Grant IV, the Community Development Fund Project, and the Second Energy Sector Technical Assistance Project. As for the school grant scheme to be financed under the Education Project, the procurement and financial management procedures would be similar to those already defined under the Community Development Fund.

### **Donor coordination**

**38. *Finally, the Bank plans to continue its donor coordination role.*** As in the past, it would monitor donor flows to Kosovo and co-chair donor meetings with the European Commission. The next major meeting of donors is expected to take place in the second part of the year, and will allow a thorough stocktaking of the implementation status of the Reconstruction and Recovery Program, as well as a discussion between the authorities and donors on the Government's medium-term priorities.

## **VI. Risks**

**39. *Since the inception of the Transitional Support Strategy in late 1999, Southeast Europe has gone through tremendous changes.*** These changes have improved the overall political and security environment in the region. Although tensions in Southern Serbia and the armed insurgency in FYR Macedonia during the spring of 2001 marred the overall positive picture, the democratic changes in FRY and the increased intra-regional cooperation in the framework of the Stability Pact represent clear signs of improvement in the regional context. Nevertheless, there remain major risks affecting Kosovo and the effectiveness of the Bank's assistance program.

40. ***The first set of risks has to do with the continuing fragile political situation in the region.*** In particular, a possible deterioration of the security situation in FYR Macedonia could lead to an inflow of refugees as happened during the conflict in 2001. While about 70,000 refugees returned shortly after the conflict, there are still about 9,000 refugees from FYR Macedonia in Kosovo. With the signing of the Framework Agreement, the disarmament of ethnic Albanian militants, and the adoption of the constitutional amendments and other legislation foreseen in the peace agreement, there are improved prospects for sustained peace in FYR Macedonia.

41. ***The second set of risks relates to the effectiveness of governance in Kosovo's post-conflict situation.*** There are several potential risks here: the possible break-up of the coalition government; the lack of cooperation between Kosovar Albanians and Serbs in the administration, including in the Assembly, resulting in mutual blocking of decisions; and increased tensions between local decision-makers and UNMIK stemming from different political agendas, including matters related to cooperation with Belgrade. All this, coupled with weak administrative capacity of the nascent Kosovar Government, might severely constrain Kosovo's development prospects and lead to delays in implementation of ongoing Bank-financed projects as well as in the preparation of new ones. As capacity building has always been an important objective of the Bank's interventions, the Bank has tried to engage the local counterparts as much as possible in the preparation of the currently ongoing projects. Therefore, it is not expected that those projects would be significantly affected by the new governance arrangement. Nevertheless, during the coming months, the Bank will redouble its efforts to work with the newly elected authorities to consolidate progress in project implementation and in the preparation of new projects. The Bank will also minimize this risk by being highly selective in its interventions, and by limiting the number of future projects to avoid overstretching of local capacity.

42. ***Finally, the third set of risks concerns the possibility of limited progress in a dialogue between the new Kosovar leaders and the authorities in Belgrade on political and economic issues.*** Furthermore, there might be a prolonged impasse in agreeing on Kosovo's final status. The expected rapid decline of donor resources might in fact focus attention on the final status issue. However, it is equally possible that this would simply increase the risk of slow or unsustainable economic development, if it is coupled with a stalemate on the political side. In any event, lack of progress towards a political settlement would have negative implications on Kosovo's future development in many ways. For example, Kosovo's continued inability to borrow externally, to offset some of the decline of donor grant funds, may jeopardize future economic growth. This constraint is being recognized increasingly by UNMIK, as well as by major donors who would like to see an increased role for the IFIs. This issue has come to the forefront recently, and it is hoped that a solution, perhaps even preceding the settlement of the final status, may be found. This could also allow the use of regular Bank instruments for the benefit of Kosovo, in which case Management would return to the Board with a new strategy.

## **VII. Recommendation**

43. In light of the foregoing, I recommend that the Executive Directors endorse Management's proposal for IDA to provide up to US\$15 million of financing to UNMIK, for the benefit of Kosovo, on grant terms, for commitments during CY2002-03, subject to approval of each grant by the Executive Directors. This would allow the continuation of Bank assistance in the context of the medium-term Reconstruction and Recovery Program for Kosovo.

James D. Wolfensohn  
President

By Shengman Zhang

Washington, D.C.  
July 2, 2002

## Kosovo

## Selected Economic and Social Data

Area	11 000 square kilometers
Population	2.2 million
Life expectancy at birth <sup>7</sup>	71.5 years (males); 76.5 years (females)
Total fertility rate <sup>8</sup>	2.6 births
Poverty:	
• Population living in extreme poverty, under food poverty line (2100 calories or US\$ 0.88 per day)	12%
• Population living under full poverty rate (US\$ 1.65 per day)	50%

## National Accounts and Balance of Payments Data

	2000	2001
GDP (US\$ billion)	1.4	1.7
GDP per head (US\$) <sup>9</sup>	759	899
Real GDP growth rate	-	16%
Inflation	10%	10%
Investment (in % of GDP)	51.7	55.3
Private investment (in % of GDP)	17.4	18.1
Consumption (in % of GDP)	126.6	121.0
Private consumption (in % of GDP)	113.0	102.8
Exports of goods and services (in % of GDP)	13.2	12.3
Imports of goods and services (in % of GDP)	91.5	88.7
Trade balance (in % of GDP)	-78.4	-74.3
Net transfers from abroad (in % of GDP):	73.5	64.1
• Private	24.6	22.3
• Official	49.0	41.7
Current account balance (in % of GDP)	0.2	-4.4
Kosovo general budget tax revenue (in % of GDP)	7.7	14.3
Kosovo general budget expenditure, KCB only (in % of GDP)	13.8	14.8
Kosovo capital expenditure (reconstruction budget, in % of GDP)	35.9	27.5

Sources: IMF, CFA/MOFE, Staff estimates

<sup>7</sup> 2001 data. Source: IPH, UNDP Kosovo HDR

<sup>8</sup> Total Period Fertility Rate (1996-1998) KIS/UNFPA/IOM 2000 p.100.

<sup>9</sup> IMF estimate, prepared late last year and based on a population number of 1.9 million, excluding displaced persons or refugees living outside Kosovo. Recent CFA estimate for 2001, based on similar population data, is US\$847.

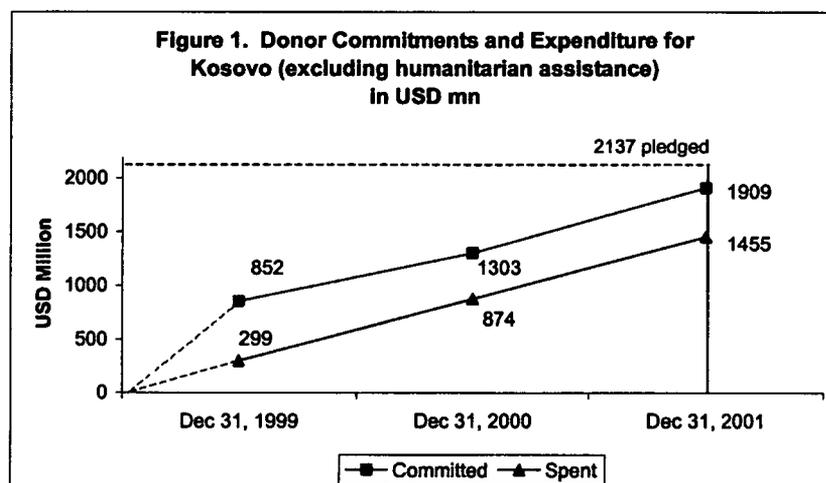
### Donor Support for Reconstruction and Recovery in Kosovo

A reconstruction and recovery program presented to donors by the European Commission (EC) and the Bank in November 1999 set out a framework with three main objectives: (i) to develop a thriving open and transparent market economy; (ii) to support the restart of public administration and to establish transparent, effective and sustainable institutions; and (iii) to mitigate the impact of the conflict and to start addressing the legacy of the 1990s.<sup>10</sup> The cost of the reconstruction and recovery program was estimated at US\$2.3-2.4 billion, on a commitment basis, for the period 1999-2003, with capital-intensive investments particularly for housing, energy, water and solid waste. The program also put a strong emphasis on private sector development and rehabilitation of agriculture.

Over the past three years, three donor meetings for Kosovo were held to mobilize and coordinate international assistance. As of the end of 2001, donors pledged assistance of over US\$2.1 billion to support the Kosovo budget, and for reconstruction and peace implementation activities<sup>11</sup>. About 90 percent of the pledges had been committed and two-third had been spent by then (see Table 1 and Figure 1).

Table 1: Summary of Donor Assistance from 1999-2001

	In US\$ millions		
	Pledged	Committed	Spent
<b>Budgetary Assistance</b>	169	216	202
<b>Reconstruction and Recovery</b>	1802	1575	1146
<b>Peace Implementation</b>	166	118	107
<b>Total:</b>	<b>2137</b>	<b>1909</b>	<b>1455</b>



<sup>10</sup> "Towards Stability and Prosperity. A program for reconstruction and recovery in Kosovo." While this program has provided the overall framework, annual public investment plans have been developed by the authorities as part of the budget preparation process.

<sup>11</sup> The US\$2.1 billion includes about US\$170 million pledged for peace implementation activities, such as support for the media and elections, whose external financing requirements were not included in the original reconstruction and recovery program. The information in this note is based on the World Bank and European Commission Joint Office database.

The Kosovo budget, reconstruction and peace implementation activities have received grant funding from 30 donor governments and international organizations. The largest source of these funds is the EC and EU Member States, which provide about two-thirds of the assistance to Kosovo. The EC support alone accounts for about 40 percent of the total (see Box 1 below). The US is the second largest single donor, contributing 15 percent of the overall funds. Non-EU bilateral donors, including Japan and Switzerland, have also contributed substantially to the reconstruction effort. Coordination in the field has been carried out by UNMIK through bi-weekly meetings of donors and with the help of a comprehensive project database.

**Box 1. The European Commission in Kosovo**

The EC has been a key source of support for the reconstruction and recovery program in Kosovo. By the end of 2001, all of its pledged funds of about US\$840 million had been committed, and over 70 percent had been spent. The Commission's aid is implemented through its Agency for Reconstruction.

The EC assistance has been allocated to assist virtually all sectors of the economy, and has been the primary source of capital intensive investments for infrastructure, notably energy and housing. While the EC will continue to invest in these areas, the emphasis for 2002 has shifted towards capacity building and further developing Kosovo as a market economy. The US\$135 million program for 2002 is divided into three areas:

- Good governance and institution building
- Economic reconstruction, regeneration and reform
- Social development and civil society

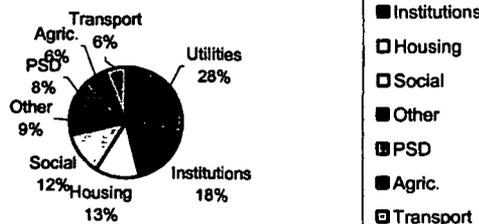
Together with the World Bank, the EC has been actively involved in donor coordination, has provided base information and needs assessments for the design of the reconstruction program, and helped to mobilize donor funding.

As shown in Chart 1 below, donors allocated about 83 percent of their commitments to support reconstruction and economic recovery, some 11 percent for critical budget support, and about 6 percent for peace implementation activities. Chart 2 shows that about half of the amount allocated for reconstruction and recovery was committed to support three objectives: rehabilitation of utilities, especially in the energy sector; reconstruction of damaged houses; and development of the private sector. Another almost one-fifth of the funds were committed for institution development, reflecting both the fact that many institutions had to be built from scratch and the importance donors attached to the creation of a functioning administration in Kosovo. Finally, about 12 percent of donor support has gone towards strengthening the education sector to accommodate Kosovo's large young population, and towards improving health care services.

**Chart 1. Donor Allocations for Kosovo 1999-2001**



**Chart 2. Donor Support by Reconstruction Sector 1999-2001**



**Actual Grant Program for Kosovo (CY99-01)<sup>1</sup>**  
**(US\$ million)**  
**As of May 31, 2002**

	<b>Grant Amount</b>	<b>Disbursed</b>
<b>CY 1999</b>		
Budget Support <sup>2</sup>	1.0	1.0
Community Development <sup>2</sup>	1.0	1.0
<b>CY 2000</b>		
Economic Assistance Grant I	5.0	5.0
Emergency Farm Reconstruction (Prep. Grant)	0.6	0.6
Emergency Farm Reconstruction	10.0	10.0
Education and Health Project	4.4	2.7
Urgent Road Project	5.0	3.8
Pilot Line of Credit for SMEs	4.4	4.8
Community Development Fund	5.0	1.4
Pilot Water Supply Project	4.6	0.7
<b>CY 2001</b>		
Economic Assistance Grant II	5.0	5.0
Economic Assistance III	5.0	5.0
Private Sector Development TA	3.0	0.4
Energy Sector TA	2.5	0.9
Social Protection	4.2	0.2
Emergency Farm Reconstruction (Suppl. Grant)	4.1	3.6
<b>TOTAL</b>	<b>64.8</b>	<b>46.1</b>

<sup>1</sup> Unless noted otherwise, the grants have been provided from the Trust Fund for Kosovo (TFK). The total amount includes US\$ 2.8 million in investment income credited to the TFK.

<sup>2</sup> Post-conflict Fund grant. Kosovo also benefits from a regional project to support early childcare development, financed from the Post-conflict Fund.

**Grant Program for Kosovo (CY99-01)**  
*A Preliminary Assessment*

This Annex summarizes achievements of Bank-financed projects in Kosovo during the two and a half years since the inception of the program. The operations, many of which are still under implementation, have supported three main objectives: (i) economic reforms and institution building; (ii) economic restart; and (iii) selective rehabilitation of infrastructure.

**Table 1. Projects by objective**

Project/Main objective	Economic reforms and institution building	Economic restart, job creation and income generation	Selective rehabilitation of infrastructure
Budget Support Grant	X		
Community Development Fund			X
Economic Assistance Grant I	X		
Emergency Farm Recon. Project		X	
Education and Health Project	X		
Urgent Road Project			X
Pilot Line of Credit for SMEs		X	
Pilot Water Supply Project			X
Economic Assistance Grant II	X		
Economic Assistance Grant III	X		
Private Sector Development TA	X		
Energy Sector TA			X
Social Protection	X		

**I. ECONOMIC REFORMS AND INSTITUTION BUILDING**

**Budget Support Grant (US\$ 1.0 million. Approved in CY99. Closed)**

*Objective:* To support the restart of education and health services through financing the employment of teachers and health workers.

*Achievements:*

1. The grant was instrumental in helping the prompt restart of key social services.
2. It also supported the kick-start of the budget preparation process following the conflict.

**Economic Assistance Grant I (US\$ 5.0 million. Approved in CY00. Closed)**

*Objectives:* To support the creation of a fully functioning and effective (i) budget management system; and (ii) bank licensing and supervision capability.

*Achievements:*

1. The newly-created Central Fiscal Authority (CFA) made good progress in designing and implementing the Kosovo budget. The CFA has been in charge of: (i) budget preparation and monitoring; (ii) execution of budgetary transactions and their financial control; and (iii) formulation of tax policy, and management of tax and customs revenues.
2. The Banking and Payments Authority of Kosovo (BPK) was established at the end of 1999, and legislation for bank licensing, regulation and supervision then followed. As of March 2002, BPK had issued 7 licenses to newly established banks.

**Education and Health Project (US\$ 4.4 million. Approved in CY00.)**

*Objectives:* To support the re-building and re-structuring of the governance, finance, and administration of Kosovo's education and health systems. (This project complemented the Economic Assistance Grant I.)

*Achievements - Education component:*

1. A new formula funding system was prepared and is being implemented.
2. Education budgets for 2002 were prepared in the form of devolved block grants to each of Kosovo's 30 municipalities.
3. A Municipal Education Finance Handbook and a Municipal Education Governance Handbook were prepared, and related training is now underway.
4. EU-compatible regulations for general and higher education were drafted and await adoption.
5. Fifty-two Kosovars are currently receiving core management and education skills training.

*Achievements - Health component:*

1. A new interim allocation formula and methodology were prepared and implemented for the 2002 budget.
2. A set of guidelines and templates were developed to enable the Ministry of Health (MoH) to evaluate and prioritize capital investments within the health sector.
3. A new health care financing strategy was adopted, including a model of the flow of funds and future sources of revenue and identification of priorities for public financing. Implementation is underway.
4. A Health Care Commissioning Agency was established as an independent purchaser of health care services and performance based contracts were signed with all Kosovo hospitals and municipalities.
5. Regulations were put in place to control private financing and provision of health services in relation to the public sector.
6. The plan for financing civil works and equipment for the MoH was completed, and implementation is underway

**Economic Assistance Grant II (US\$ 5.0 million. Approved in CY01. Closed)**

*Objectives:* To support (i) the formulation of a sustainable 2001 budget increasingly financed by local taxation; and (ii) the establishment of a liberal trade and customs regime.

*Achievements:*

1. A basic tax system relying on tax collection at the border was introduced.
2. The share of donor funding in total revenues was reduced from 48% in 2000 to 21% in 2001.
3. A liberal trade and customs regime was maintained. However, the full elimination of tariffs at the time of the introduction of the VAT did not take place because of revenue considerations.

**Economic Assistance Grant III (US\$ 5.0 million. Approved in CY01. Closed)**

*Objective:* To support the development of the private sector through the introduction of the first package of commercial regulations.

*Achievements:*

Assistance was provided in the drafting and discussion of the following key regulations, which were then approved by UNMIK:

1. Regulation on Contract for Sale of Goods;
2. Regulation on Foreign Investment;
3. Regulation on Pledges;
4. Regulation on Business Organizations.

**Private Sector Development TA (US\$ 3.0 million. Approved in CY01.)**

*Objectives:* To support a more favorable environment for private sector development through assistance to implement the first package of commercial regulations, particularly: (i) the establishment and operation of a company registry system; (ii) strengthening the capacity of the legal profession and commercial judges; and (iii) developing business accounting and auditing. (This project complemented the Economic Assistance Grant III.)

*Achievements:*

1. A competitively selected company manages the business registry system (with more than 45,000 companies registered by the end of 2001), and is providing training and support to local staff.
2. Arrangements to provide formal and informal training to both legal professionals and commercial judges are being finalized.
3. An Association of Accountants (SKAAK) has been established, and the grant supports its management. In collaboration with donors, SKAAK provides training, defines criteria for accountants' certification, and supports legislation in the sector.

**Social Protection** (US\$ 4.2 million, and co-financing of US\$ 2.5 million from the UK. Approved in CY01.)

*Objectives:* To support (i) the design of a basic safety net for the immediate future; (ii) the design of a sustainable social welfare system for the medium term; (iii) the upgrading of social welfare infrastructure; and (iv) the development of an adequate administrative capacity for delivery of pensions, and veterans' and invalidity benefits.

*Achievements:*

1. The project has provided support to the design of a new pension system for Kosovo, based on citizen's pension and advance funded scheme, and it is now supporting the implementation of the plan.
2. Information technology support has been installed in the Ministry of Labor and Social Welfare to set up a monitoring system for social assistance provision and social services.

## II. ECONOMIC RESTART, JOB CREATION AND INCOME GENERATION

**Emergency Farm Reconstruction Project** (US\$ 14.7 million, and co-financing of US\$ 1.8 million from the Netherlands, US\$ 1.4 million from Italy, and US\$ 1.0 million from Sweden. The preparation grant and the first operation were approved in CY00. Supplemental Bank financing was approved in CY01.)

*Objectives:* To support the re-launching of the rural economy through (i) investing in key farm assets (distribution of cattle, and farm mechanization) in conflict affected areas, supporting vulnerable groups; (ii) providing key agricultural services; and (iii) building institutional capacity for effective policy making.

*Achievements:*

1. More than 3,800 pregnant heifers were distributed. In value terms, the resulting milk production increased the family income of beneficiaries by an estimated US\$180 per month. As 95% of the milk is consumed in the households, the increased availability of milk to the vulnerable families (one selection criteria relates to the number of children under the age of 8 in the family) assures adequate nutrition for children.
2. More than 2,400 tractors were repaired in 13 municipalities, and more than 180 new tractors with implements were distributed in 5 municipalities, serving about 5,400 beneficiaries (one distributed tractor serves 30 beneficiary families). Beneficiary selection was based on full community participation.
3. Equipment and drugs, as well as training to 82 veterinarians were provided. The number of free visits by veterinarians reached 16,000.
4. Capacity building support was provided to the Department of Agriculture (DOA) over 14 months on various aspects of rural development. The local staff was trained and contributed to the development of different policy documents.

**Pilot Line of Credit for SMEs** (US\$ 5.0 million, and co-financing of US\$ 5.0 million from the European Agency for Reconstruction – EAR. Approved in CY00.)

*Objectives:* To support (i) the jump-starting of production through a line of credit for small and medium size enterprises (SMEs); and (ii) capacity building in the financial sector.

*Achievements:*

1. The Interim Credit Unit approved 60 operations for a total value of Euro 7.6 million, and disbursed Euro 6.5 million.
2. About 1200 new jobs were created in various sectors (e.g. building materials industry, food processing, production of furniture, textiles, and PVC materials) with significant economic impact.
3. The project contributes to the training of Kosovar credit officers, and intends to support capacity building in local banks.

### III. SELECTIVE REHABILITATION OF INFRASTRUCTURE

**Community Development Fund** (US\$ 6.0 million, and co-financing of US\$ 6.0 million from the Netherlands, and US\$ 1.3 million from Switzerland. Pilot phase, financed from a Post-conflict grant and some donor resources, approved in CY99; the scaled-up operation approved in CY00.)

*Objectives:* To support (i) small-scale infrastructure and social services projects in communities with a high incidence of conflict-related damage and poverty; and (ii) community participation in project identification, preparation, financing, contracting, and supervision.

*Achievements:*

1. Over 100,000 people benefited directly, and another approximately 100,000 indirectly, from the completed infrastructure projects. The number of indirect beneficiaries of social projects is estimated at 50,000. The project generated a total of 17,000 man months of jobs.
2. The Community Development Fund, managed by a local NGO, received more than 500 proposals, and approved 145 projects, of which 86 had been completed by the end of 2001 (62 for works, and 24 for social services). It also carried out on-the-job training benefiting both local project committee members and contractors.
3. Outputs of *infrastructure repair* include: 64 kilometers of water supply pipes, some 13 kilometers of sewerage pipes, about 3,400 square meters of new school space, 370 square meters of playground/ kindergarten space, and 2 cultural centers. Outputs of *social projects* include: 50 kilometers of irrigation canals cleaned, 5,100 youth completed training, 20 villages participated in health education training, and more than 200 women had literacy and vocational training.
4. 175 community meetings were organized, with approximately 1,750 members attending. On average, communities have contributed 19% of total project costs (above the prescribed 15%). 10% of the portfolio is in mixed/minority communities.

**Urgent Road Project** (US\$ 5.0 million, and co-financing of US\$ 28.0 million from the EAR, US\$ 7.2 million from Germany, US\$ 7.0 million from the Netherlands, and US\$ 0.9 million from France. Approved in CY00.)

*Objectives:* To support: (i) the re-establishment of a road management capacity; (ii) emergency road maintenance activities on the main network; and (iii) restoration of a local contracting capacity for road/bridge rehabilitation and maintenance.

*Achievements:*

1. Core road administration was re-established with a Road Infrastructure Division (9 staff), and a Directorate of Roads (45 staff), and training was provided. Implementation of a strategy to strengthen the road administration is underway.
2. 510 km of roads were rehabilitated under the project. The remaining 70 km are expected to be completed before end 2002.
3. Several contracts financed through the Grant were awarded to local contractors and were successfully implemented, although local contractor capacity is still limited.
4. The project has functioned as an efficient coordination mechanism among donors.

**Pilot Water Supply Project** (US\$ 4.6 million. Approved in CY00.)

*Objectives:* To support the reform of the Radoniqui water system, by (i) financing urgent repairs to infrastructure; (ii) demonstrating the viability of private sector participation in the provision of water supply services; and (iii) developing a model for integrated water resources management for Kosovo.

*Achievements:*

1. The management team of the competitively selected private operator assumed day-to-day management responsibility of the Radoniqui Water Company, and prepared an investment plan.
2. A comprehensive study on institutional reforms of Kosovo's water supply system was completed.

**Energy Sector TA** (US\$ 2.5 million. Approved in CY01.)

*Objectives:* To support long-term strategic energy decisions, by preparing, disseminating and discussing a comprehensive study on future energy demand and supply. The study analyzes available energy options and assesses future physical investment needs in the energy sub-sectors. It also examines the internal organizational structure and operations of the energy companies and makes recommendations to improve efficiency.

*Achievements:*

1. First drafts of all thirteen modules have been prepared and are under review. The full report will be ready by June/July 2002.
2. During preparation of the report, the Kosovo Electric Company (KEK) has been closely associated with the work of the consultants, and its staff has received hands-on training on the use of state of the art techniques and software instruments.

**Indicative Assistance Program for Kosovo  
(CY02 - 03)  
(US\$ million)**

CY 02

CY 03

**Grant Financing**

Economic Assistance Grant IV	5.0	Community Development Fund II	4.0
Energy Sector TA II	1.5	Education	4.5
	6.5		8.5

**Analytical Work**

Policy note for the new government (completed)	Economic report on sources of growth
Report on medium-term expenditure management issues	Poverty monitoring and analysis TA
Policy notes on private sector development issues	Labor market analysis
Anti-corruption TA	Quick response policy notes
Quick response policy notes	

**Transitional Support Strategy for Kosovo**  
**Matrix of Development Objectives, Bank Program and Performance Benchmarks**

<b>Objective</b>	<b>Bank Program</b>	<b>Performance Benchmarks</b> (to be completed by 2003 unless otherwise noted)
<b>Economic growth</b>	Economic Assistance Grant IV Energy Sector TA II <u>AAA:</u> Policy notes on private sector development issues Report on sources of growth Labor market analysis	Business environment substantially improved, evidenced by: Bankruptcy Law adopted, Business Registry fully operational, legal and institutional framework for secured transactions and contract enforcement fully operational, other remaining elements of a modern commercial framework in place. Kosovo Trust Agency (KTA) fully operational; privatization/spin-off/liquidation of 100 of some 350 socially-owned enterprises (SOEs) underway; appropriate mechanism to deal with claims against SOEs established. Strategy for large-scale lay-offs designed and operational. A regular employment-service based labor market monitoring system in place. Feasibility study for priority investments in power transmission and distribution under preparation; management of the electric power company (KEK) improved.
<b>Poverty alleviation and human development</b>	Community Development Fund II Education Project <u>AAA:</u> Poverty monitoring and analysis TA	Infrastructure and social services in poor communities further improved; cooperation in mixed communities increased. Near 100 percent enrollment in compulsory education (grade 1-8) and significantly increased enrollment in secondary education to 80 percent for all groups achieved (by 2006). Poverty monitoring and assessment capacity established, and results in government policy formulation applied. Targeting of social assistance improved, and commission for monitoring living standards established.
<b>Fiscal sustainability and good governance</b>	Economic Assistance Grant IV <u>AAA:</u> Report on medium-term expenditure management issues Anti-corruption TA	A fiscally sustainable basic pension system introduced and functioning. Levels of social assistance and the basic pension aligned to be mutually consistent and fiscally sustainable. Fiscally sustainable severance pay arrangements in place for large-scale lay-offs. A comprehensive medium-term macro-fiscal framework for public expenditure planning implemented. Organic budget law passed and influencing budget management. Progress towards integrating the capital and recurrent budgets achieved. A satisfactory 2003 budget developed and implemented. Functions of the CFA and the Ministry of Finance and Economy merged. Audit capacity developed. Procurement Law approved. Anti-corruption strategy developed. Accounting norms standardized and strengthened.







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Type: CAS