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Report No: 22283

IMPLEMENTATION COMPLETION REPORT
(TF-24903)

ON TWO

GRANTS

IN THE AMOUNT OF US\$ 5 MILLION EACH

TO THE

UNITED NATIONS INTERIM ADMINISTRATION IN KOSOVO

FOR

THE BENEFIT OF KOSOVO

06/20/2001

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CURRENCY EQUIVALENTS

(Exchange Rate Effective 5 April 2001)

Currency Unit = DM
DM = US\$ 0.4580
US\$ = 2.1835 DM

FISCAL YEAR

January 1 December 31

ABBREVIATIONS AND ACRONYMS

BPK	Banking and Payments Authority
CFÁ	Central Fiscal Agency
DFID	Department for International Development
EAG	Economic Assistance Grant
EBRD	European Bank for Reconstruction and Development
EC	European Community
FRY	Federal Republic of Yugoslavia
FYROM	Former Yugoslav Republic of Macedonia
HLSG	High Level Steering Group
IAC	Interim Administrative Council
IMF	International Monetary Fund
JIAS	Joint Interim Administrative Structure
KTC	Kosovo Transition Council
LODP	Letter of Development Policies
NGO	Non-Governmental Organization
NTM	Non-Tariff Measure
TA	Technical Assistance
QR	Quantitative Restrictions
UNMIK	United Nations Interim Administration in Kosovo
USAID	United States Agency for International Development
VAT	Value Added Tax
WLSG	Working Level Steering Group

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KOSOVO Budget Support Trust Fund for Kosovo

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<i>Project ID:</i> P071114	<i>Project Name:</i> Economic Assistance Grant II
<i>Team Leader:</i> Saumya Mitra	<i>TL Unit:</i> ECSPE
<i>ICR Type:</i> Core ICR	<i>Report Date:</i> June 20, 2001

1. Project Data

Name: Economic Assistance Grant II *L/C/TF Number:* TF-24903
Country/Department: KOSOVO *Region:* Europe and Central Asia Region
Sector/subsector: BB - Public Sector Management Adjustment

KEY DATES

<i>PCD:</i> 11/15/2000	<i>Effective:</i> 02/26/2001	<i>Original</i>	<i>Revised/Actual</i>
<i>Appraisal:</i> 12/18/2000	<i>MTR:</i>		
<i>Approval:</i> 01/10/2001	<i>Closing:</i>		

Borrower/Implementing Agency: United Nations Interim Mission in Kosovo (UNMIK)
Other Partners:

STAFF	Current	At Appraisal
<i>Vice President:</i>	Johannes F. Linn	Johannes F. Linn
<i>Country Manager:</i>	Christiaan J. Poortman	Christiaan J. Poortman
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2. Principal Performance Ratings

(HS=Highly Satisfactory, S=Satisfactory, U=Unsatisfactory, HL=Highly Likely, L=Likely, UN=Unlikely, HUN=Highly Unlikely, HU=Highly Unsatisfactory, H=High, SU=Substantial, M=Modest, N=Negligible)

Outcome: S
Sustainability: L
Institutional Development Impact: SU
Bank Performance: S
Borrower Performance: S

Quality at Entry: QAG (if available) ICR
S
Project at Risk at Any Time: No

3. Assessment of Development Objective and Design, and of Quality at Entry

3.1 Original Objective:

This Interim Completion Report (ICR) analyses jointly the first and the second Economic Assistance Grants (EAG) [P069469 and P071114]. The joint objective of these two single-tranche grants was to support Kosovo's economic reform program through providing financial resources to the United Nations Interim Administration in Kosovo (UNMIK). This reform program has centered on: (i) the establishment of key public institutions; (ii) the provision of essential public services; and (iii) the adoption of clear governance policies as well as policies facilitating the transition to a private market based economy.

A single ICR has been presented for these two EAG operations in view of their shared objectives, close similarities in the structure of the operations, including conditionalities, and the short period between their disbursements. These two separate one tranche type operations can be seen as supporting a policy reform effort that spans the period from early 2000 to early 2001.

When UNMIK entered Kosovo, there were no representative institutions. The withdrawal of all Serb public administrators at the end of the conflict combined with a decade of ethnic Albanian absence from the management of public institutions left a complete institutional vacuum. Hence, one of the main challenges facing UNMIK was to start rebuilding from scratch governing institutions and public agencies, at both legislative and executive levels.

This setting formed the background for the first Economic Assistance grant. Reestablishing a budget and budgetary management practises were essential to getting public services functioning again, especially in the areas of health facilities, schools and utilities. Moreover, the institution established, the CFA, had to meet the highest possible standards of management, transparency, sound accounting and auditing, where none existed before, because of the demands and usage of donor funding. Therefore, the two EAGs had highly similar goals. Specifically, the first Economic Assistance Grant (EAG I) supported:

- (i) the creation of a fully functioning and effective budget management system within the interim government of Kosovo (the Central Fiscal Agency), with modern standards of public expenditure management, transparent fiscal operations and accounting and audit;
- (ii) the establishment of a fully functioning and effective bank licensing and supervision capability (the Banking and Payments Authority), with a view to stimulating banking activities in a safe and sound manner. After the conflict, commercial banking operations also effectively ceased and transactions through the local payment bureau system dwindled to a negligible level.

The second Economic Assistance Grant (EAG II) built on the achievements under EAG I and supported:

- (i) the adoption of a sound budget for Kosovo for the year 2001 that represents a significant step towards sustainability through increased reliance on local tax revenues, improvements in the quality of fiscal expenditures, with greater cost recovery in public utilities, and institutional strengthening of the budget management system; and
- (ii) the establishment of a fully liberal trade and customs regime with all external tariffs to be set at zero upon the introduction of a VAT regime planned for mid-2001.

Against the background of a lost decade of growth, and the institutional challenges outlined above, UNMIK policy priorities were designed to help stabilize macroeconomic conditions in order to provide an

appropriate climate for reconstruction and recovery. Both economic assistance grants supported this as an overriding objective. Permitting the use of the DM in all transactions without disturbing the legal status of the dinar helped to lay one of the fundamental conditions for macroeconomic stability. At the same time, it placed the onus of macroeconomic policy on fiscal policy. In this context, the economic assistance grants supported reform in the fiscal areas, with reforms centering on the creation of a functional and responsible fiscal agency, implementing sustainable budget policies, and stimulating bank activities in a safe and sound manner. The Bank's budget support grants also played a critical role as an indicator to the rest of the donor community. The Bank has guided other donors through its assessment of the budget and its implementation.

Utmost importance was placed in the design of policies and institutions to ensure continuance and sustainability when UNMIK withdraws and local representative authorities take its place. From its inception as the interim government of Kosovo under resolution 1244, local Kosovar experts and political leaders have been extensively consulted in policy and institution formulation. Early on, the Kosovo Transitional Council was formed with high level local representation. The Joint Interim Administrative Structure established in early 2000 has strengthened and formalized local Kosovar participation. Twenty administrative departments were created (akin to ministries), each with UNMIK and local Kosovar co-heads. Kosovar experts have played an increasingly prominent role in the management and administrative role in the functioning of these and other public administration bodies. Following the municipal elections of October 2000, a Council of Ministers has been created, a formal grouping of the 20 local department co-heads.

The project objectives were clearly articulated and highly relevant to Kosovo's post-conflict policy reform and institutional development priorities. Building government institutions and policies from scratch constituted the first steps in a medium term program of reforms of economic institutions in Kosovo that is being developed by UNMIK and the local political and technical leadership. The operations were envisaged under and constituted important elements of the Transitional Support Strategy for Kosovo and its Progress Report, discussed in the Board on 7 October 1999 and on 25 July 2000 respectively. The focus and conditions of the grants also had substantive underpinnings in supporting economic work (see Annex 7 for details). The Kosovo Education and Health Finance project, which provided technical assistance and some material support to help rebuild and restructure the governance, finance and administration of Kosovo's education and health systems, was complementary to these budget support operations.

3.2 Revised Objective:

The grant objectives were not revised.

3.3 Original Components:

The components of the reform programme supported by these operations were described in section 3.1.

3.4 Revised Components:

Not applicable

3.5 Quality at Entry:

The operation was not selected for a quality at entry assessment by the Bank's Quality Assurance Group. The Region's assessment is that the quality at entry of the operation was satisfactory.

4. Achievement of Objective and Outputs

4.1 Outcome/achievement of objective:

The grants have supported the establishment of a fiscal system, and have helped to provide basic services in a post-conflict setting. They have also contributed to laying the foundations for establishing a climate for

banking, and they have supported the design and implementation of a functioning trade and tariff regime, providing substantial revenues. Budgetary self-sufficiency is increasing and a climate of macro-economic stability has prevailed.

4.2 Outputs by components:

The creation of a fully functional and effective budget management system, with modern standards of public expenditure management and transparent fiscal operations, accounting and audit.

Given Kosovo's unique circumstances (legacy of destruction related to the conflict, withdrawal of all Serb public administrators, and a decade of ethnic Albanian absence from the management of public institutions), UNMIK had to start from scratch in designing a tax system, developing a budget, and creating the institutions to implement its policies. Initial fiscal spending upon the establishment of UNMIK in 1999 was

organized in an ad-hoc fashion, outside the context of a fiscal framework and budget planning process. It was directed to financing the stipends of some health employees and judges in an effort to quickly address urgent needs. In response to this situation, the establishment of a Central Fiscal Authority (CFA) with the functions of a finance ministry was identified as a first priority.

The Central Fiscal Authority (CFA) was established by regulation 1999/16 at the end of 1999. Its main divisions for budget, treasury, tax policy and tax administration became operational in 2000. In 2000 the CFA made extremely good progress in designing, implementing and managing the local Kosovar budget. The development of budget management institutions also made very significant strides. With the support of the EAG I, the CFA is now performing important functions including: (i) budget preparation and monitoring; (ii) execution of budgetary transactions through the Treasury Single Account (TSA) and their financial control; (iii) formulation of tax policy and the management of tax and customs revenues. UNMIK has developed a sound structure for processing expenditure requests within realistic budget constraints. The culmination of this is the 2001 budget.

The Central Fiscal Agency has also built a reputation as an important instrument, providing assurance for the prudent and transparent use of funds. The CFA has hired and trained many local staff who are performing key routine tasks in the budget and treasury divisions, as well as a large number of tax inspectors.

In spite of the very considerable progress, further challenges remain. In 2001, the donors will look to UNMIK to strengthen fiscal sustainability by carrying out the reduction in the bloated workforce in the education and health sectors and in the electricity company as well as raise significantly cost recovery in utility payments. The introduction of a modified VAT system, of a wage tax and a sustainable scheme for social assistance payments are also important policy commitments for 2001. Further institutional work is currently under way: the establishment of internal audit capability, moves towards a full integration of the current and capital budgets, and strengthening of sector policy analysis capability.

This output is rated as being achieved in a satisfactory manner.

The establishment of a fully functioning and effective bank licensing and supervision capability, with a view to stimulating banking activities in a safe and sound manner.

After the conflict, commercial banking operations in Kosovo effectively ceased. Transactions through the local payment bureau system dwindled to a negligible level. To facilitate the modernization and the

development of payment services and a commercial banking system, two regulations were passed in November 1999, establishing of Banking and Payments authority of Kosovo (BPK), and legislation for bank licensing, regulation and supervision. The unfettered use of the deutsche mark in all transactions without disturbing the legal status of the dinar, the large inflow of diaspora funds, the fiscal stance, and the creation of a bank licensing supervision capability at such an early stage have all contributed to the macroeconomic stability that has characterized Kosovo since the end of the conflict.

The BPK has been assigned responsibility for fostering an efficient and safe system for domestic payments, and the liquidity, solvency, and efficient functioning of a stable market-based banking system. More specifically, the BPK is responsible for providing: (i) an appropriate inventory of clean DM banknotes in the needed denominations; (ii) clearing and settlement services to banks in DM; and (iii) a full range of banking and payment services to the government; (iv) the licensing and supervision of banks and non-bank financial institutions. On a temporary and emergency basis, the BPK was also authorized to provide deposit and payment services to enterprises and to the general public until banks were able to do so.

The BPK has developed considerably since its creation. At end-February 2001, the BPK was operating with a local staff of some 350 people plus some 10 international staff. As a result of UNMIK financial regulation and BPK rules, three new commercial banks have been fully licenses. Micro Enterprise Bank was licensed in January 2000, and was partly capitalized by the EBRD and IFC. It operates in Pristina and in a number of regional centers. The New Bank of Kosovo was licensed in February 2001, and the Bank of Private Business in March 2001. Five other banks have been offered preliminary license approval, but none of them have yet met the requirements for a final license (raising capital, formulating realistic business plans, selecting fit and proper owners and managers). The BPK is also responsible for licensing, regulation and supervision of non-bank micro-finance institutions; in March 2001 nine such institutions had been registered, mainly operating outside Pristina.

Despite the very significant progress, a number of challenges remain. The payments system needs to be developed further, and an interbank payment system should be established. The IMF has been advising BPK on an appropriate sequencing for commercial banks to take over more of payment services from the BPK. The introduction of the euro in the cash-based economy of Kosovo will also constitute a new challenge, not only for the BPK but for UNMIK and the Kosovar economy as a whole. The BPK's supervision function needs to be extended to insurance companies that are operating in Kosovo, but that are currently under UNMIK's Motor Vehicle Administration. Finally, with more than 350 employees, the BPK is overstaffed.

This output is rated as satisfactory.

The adoption of a sound budget for Kosovo for the year 2001.

As noted above, particularly noteworthy progress has also been made in the areas of tax policy, tax administration, and budget preparation and execution. A basic tax system, mostly relying on tax collection and administration at the border, has been introduced from scratch. A large number of tax administrators and a customs administration support the implementation of tax and customs policy. UNMIK has also developed a sound structure for processing expenditure requests within realistic budget constraints. The 2001 budget is a culmination of this process. The budget revenue target is attainable. Planned expenditure levels are not excessive, either in view of the considerable social and economic needs, nor in comparison with levels in low-income countries. As a result, UNMIK has kept its commitment to reduce Kosovo's dependence on donor support for the budget. Grants will finance only one third of spending in 2001 compared with over a one-half in 2000.

Nevertheless, UNMIK must still do several important things to reduce risks to the budget. As mentioned above, on the tax side, it is essential to broaden the tax base by implementing the VAT and introducing a wage tax. Continuing efforts to strengthen tax administration and train local tax supervisors are also a priority. On the expenditure side, while the overall wage bill is not large by the standards of transition economies, the over employment in the health and education sectors should be scaled back. Also, stronger efforts should be made to reduce staffing in public utilities and improve bill collection in order to eliminate the high subsidy cost to the budget. More generally, UNMIK needs to resist pressures to raise budget wages—wage levels are not low when related to Kosovo's development level—and continue to resist pressures to extend industrial subsidies, a mistake made in other transition economies.

This output is rated as satisfactory.

The establishment of a fully liberal trade and customs regime.

In mid-1999 soon after taking office, UNMIK introduced a simple, neutral trade regime in Kosovo to replace the highly distorted and discretionary tax regime that was in place in FRY before. This was considered to be important in stimulating private sector led economic growth and reconstruction, and in creating the conditions for healthy exports. Moreover, in the absence of adequate administrative machinery to collect taxes on consumption and incomes, UNMIK saw the introduction of the customs/external trade regime as the major source of revenue for the local recurrent budget of Kosovo.

The key characteristics of the trade regime are: *First*, a uniform tariff structure of 10 percent was introduced. This tariff structure is commendable in its simplicity and the low rate involved. *Second*, the foreign trade regime is devoid of non-tariff measures (NTMs) and quantitative restrictions (QRs). *Third*, a further advantage of the system is that its registration procedures of traders (exporters, importers and forwarding agents) and licensing are non-discriminatory and transparent. There is no state trading and foreign trade activity is open to all firms. There are no non-automatic licenses and the existing regime offers limited, if any at all, opportunity for bureaucratic micro-management of foreign trade.

Although the Kosovo foreign trade regime has the right institutional design, and low and almost uniform tariff rates, a number of policy concerns arise. For instance, an important weakness of the trade regime stems from the recognition of the preferential trade agreement between FRY and FYR Macedonia. The preferential status to FYR Macedonia has distorted trade flows and led to revenue losses for two reasons: FYR Macedonia has been traditionally an important trading partner of Kosovo; and a considerable portion of total imports into Kosovo transit through FYR Macedonia. The latter has provided opportunity to falsify certificates of origin. There have been delays in closing this fiscal loophole.

UNMIK initially planned to repeal the tariff on all imports upon the adoption of the VAT. It is now

reassessing this commitment, primarily because of revenue concerns. UNMIK is analyzing the revenue loss associated with the repeal of the customs tariff and whether it could be offset by fixing the rate of VAT to achieve a revenue-neutral result. This policy change would permit all goods regardless of origin to be taxed at the rate set for the VAT. Hence, the distortions and revenue losses associated with the special trade arrangement with FYR Macedonia and with goods entering from Montenegro and the rest of Serbia would be removed.

But, the UNMIK authorities have agreed on a VAT rate of 15 per cent, based partially on political considerations, which would likely be insufficient to achieve revenue neutrality, so it is reconsidering repealing the tariffs upon the introduction of the VAT. This is a precautionary measure to ensure that significant revenues are raised to ensure sound budget management during the initial period of the implementation of the VAT. UNMIK is aware of the negative incentive effects of retaining the tariff at the time of the introduction of the VAT, and the positive effect that eliminating the tariff would have in closing 'gaps' in the tariff regime. Currently, UNMIK is of the view that revenue predictability considerations are predominant at this time, but it remains committed to repealing the tariff as early as feasible.

This output is rated as satisfactory.

4.3 Net Present Value/Economic rate of return:
Not Applicable.

4.4 Financial rate of return:
Not Applicable.

4.5 Institutional development impact:
Institutional development was an important objective of these operations and the two economic assistance grants have provided substantial support to the authorities in their effort to strengthen institutional capacity for managing finances. Setting up new institutions and policies for economic management were urgent post-conflict tasks, and the Bank provided very important assistance in this area. Two critical institutions, the CFA and the BPK, were rapidly established, supported by significant technical assistance from the Bank and the IMF. As outlined above, both institutions are now functioning effectively following implementation of policies and systems to support fiscal management and the banking systems.

5. Major Factors Affecting Implementation and Outcome

5.1 Factors outside the control of government or implementing agency:
Aside from the inherent political and social risks prevailing in Kosovo today, there are substantial risks associated with the implementation of the economic reform effort itself. The long period of exclusion from civic life of the majority of the population and the legacy of the conflict have led to erosion of skills, sense of civic responsibility, tolerance and adherence to the rules of the game. This deterioration has occurred on top of already existing weak, even corrupt, standards of governance and banking that characterized the Yugoslav system. The long period of exclusion from civic life of the majority ethnic population and the legacy of the conflict has led to erosion of skills, sense of civic responsibility, tolerance, and adherence to rules of the game. Conditions of political unrest and violence and deep distrust between the ethnic communities of Kosovo resulting in political and civic non-cooperation are clearly factors hampering reconciliation and the emergence of a firm foundations for structural reforms.

5.2 Factors generally subject to government control:
There are various risks of policy implementation. Despite impressive advances in institutional development, budgetary systems and mechanisms, including tax administration and collection, are still at a

formative stage. In addition, significant gaps in tax coverage exist and the willingness of the populace to pay taxes, given recent history, is still uncertain although developments so far are encouraging. Strong pressures also are being felt to raise wages, maintain over-manning in public services and utilities and increase overall spending to amounts that would not be sustainable in the medium term.

5.3 Factors generally subject to implementing agency control:

Whereas the CFA is an integral part of the Kosovo interim government, the BPK is an autonomous public body. The reforms pertaining to the BPK were and are under its control. The BPK has received external technical assistance in implementing reforms. It has improved its technical and professional capacity greatly. It suffers, however, from over-staffing. Moreover, given the highly distinct nature of its two responsibilities -- operation of the payments system and banking supervision -- with little synergies between these two tasks, it is a challenge to maintain focus. It appears that two separate bodies for these functions (as advised by the Bank) might have been a better institutional outcome.

5.4 Costs and financing:

Not Applicable.

6. Sustainability

6.1 Rationale for sustainability rating:

The overall sustainability of the reforms supported by the grants appears likely. The policy and institutional measures implemented provide a basic framework for establishing credible fiscal management and strengthening the capacity of key institutions to carry forward more complicated reform programs. The CFA is well-established, and good progress has been made in a number of areas, including budget formulation and implementation procedures, the integration of the capital and the recurrent budget, the intensified dialogue between CFA and the spending departments, continuing reform in the tax structure, and the integration of locals in technical and policy tasks. In the case of the BPK, good progress has also been made, including with the accumulation of experience in bank supervision, the licensing of three banks, and the development of the payments system and the introduction of the euro. The simple, transparent, and open trade policy has facilitated the reintegration of Kosovo into the region.

Going forward, it remains to be seen to what extent the high standards of transparency and integrity will be preserved once the Kosovarization deepens. In this context, risks are mitigated by the increasing involvement of Kosovars in policy making and execution, and the on-the-job training and assistance that the present structure provides. The new Constitutional Framework for Provisional Self-Government and the Kosovo-wide elections to be held in November 2001, will be important steps in taking further the process of Kosovarization. A particular risk relates to fiscal decentralization, and the extent to which the high standards of the CFA on budget planning, monitoring and implementation can be transferred down to the regional level. Nevertheless, UNMIK and the local Kosovars alike recognize the importance of strong and accountable institutions and good governance. They remain committed to continue working with the Bank and other donors to deepen reform efforts. Additional funding to be provided by donors would help support sustainability.

6.2 Transition arrangement to regular operations:

Not applicable.

7. Bank and Borrower Performance

Bank

7.1 Lending:

The Bank's performance in project preparation was satisfactory. Project preparation was thorough, and the

measures and activities identified were realistic. The design of the operation was highly relevant to the circumstances of Kosovo and the objectives of the Bank's Transitional Support Strategy for Kosovo. The grants provided much-needed fiscal support to UNMIK within an agreed budget framework and appropriate burden sharing with other donors. In this context, there was close coordination with the IMF through joint missions and complementarity in TA, with bilateral donors, and with the Working Level Steering Group (WLSG) for Southeast Europe. The conditionalities of the grants were also grounded in supporting economic work (see Annex 7 for details), and it was formulated in a highly collaborative process with the interim administration in Kosovo.

There was high staff continuity during project preparation, and staff had extensive experience in Albania, Bosnia and Herzegovina and post-conflict environment. There was continuity and consistency between the previous economic work done and project preparation. This high level of continuity has helped to ensure a good working relationship with the counterparts and in the substance of advice.

7.2 Supervision:

Bank missions have visited Kosovo regularly to assess economic developments and review progress in key reform areas. A constant dialogue has taken place between the administration and the Bank. Supervision was used to deepen dialogue on fiscal policy (e.g. anti-corruption, tax structure, fiscal decentralization), and findings during supervision missions have informed and triggered further TA work, for instance on the budget. The Bank is also undertaking work on social assistance as well as a poverty assessment, which will help with targeting budgetary social assistance.

7.3 Overall Bank performance:

Overall, the Bank's performance was satisfactory for all stages of project development and supervision.

Borrower

7.4 Preparation:

The authorities' performance during preparation was satisfactory. UNMIK made significant progress towards completion of key legislative and institutional measures and took important policy actions prior to the release of the grants.

7.5 Government implementation performance:

The ability of the officials of the interim administration to effect wide-ranging institutional and policy reforms within a short period of time, despite limited institutional capacity, was commendable.

7.6 Implementing Agency:

The BPK has made progress, particularly in the banking supervision area, in a short period of time.

7.7 Overall Borrower performance:

Overall performance of UNMIK is judged satisfactory. Nevertheless, there have been some issues regarding implementation of policy commitments under EAG II. In particular, there is still uncertainty about the implementation of agreements on abolishing the tariff and on staffing reductions in the health sector. This has represented some reconsideration of priorities in response to evolving circumstances, some lack of coordination across pillars in the UNMIK administration and some equivocation on policy goals and objectives. These issues regarding EAG II implementation have required the Bank to maintain a close and constant dialogue with UNMIK and to monitor quite closely performance.

8. Lessons Learned

The Bank can play an important role in providing budget support in post-conflict situations, when domestic

revenues are clearly insufficient. In many post-conflict situations donor funding for the budget falls short of what is needed, making the emergency/transition phase even more difficult. The Bank's role (advisory to UNMIK, financing, and guiding other donors who provide budget support through the assessment of the budget and its implementation) has been critical. It also implies that such operations require intensive supervision to ensure that adequate progress is being made towards policy objectives and that the donor community is informed of developments. This has been facilitated by the HLSG/WLSG framework for South Eastern Europe, which is co-chaired by the World Bank and the EC.

Ownership by the authorities and selectivity in conditionality have been important in the success of the operations. The Bank and UNMIK concentrated on a few key policy areas essential for immediate recovery while laying the foundations for longer-term sustainability, in particular the probity of public finance and mechanisms and measures to kickstart the banking system and trade flows.

EAG II has highlighted that the technical details of the operation need to be negotiated carefully when the authority is segmented. It has also highlighted both the flexibility provided by single-tranche operations as well as their shortcomings, in particular monitoring implementation of the commitments in the Letters of Development Policies (LODPs).

Frequent, close, and intensive consultation with donors, and the dovetailing of the Bank's work and that of principal donors (USAID, DFID, EC) was critical. The Bank had to play an important role in judging the areas of the greatest needs, and in providing signals to donors accordingly. The Working Level Steering Group as well as informal bilateral contacts were important implementation tools. Close cooperation and good relations with the IMF had a high payoff.

Especially in the early months of UNMIK's existence, the Bank played an important role in helping to set priorities in economic policy. Through economic and donor reports, and key advisory pieces for UNMIK, the Bank can play an important role in providing a strategic vision in a post-conflict setting.

In the context of Kosovo, a number of more specific lessons can also be learnt. For instance, and with the benefit of hindsight, it is now clear that it would have been better to keep the functions of banking supervision and payments operation in separate institutions - as indeed the Bank had advised; it would have been better to start with fewer or no tariff exemptions; and an earlier focussing on municipal financing issues would have been recommendable.

9. Partner Comments

(a) Borrower/implementing agency:

This section presents the comments from the borrower:

"UNMIK appreciates the strong support, both financial and technical, of the World Bank in its efforts to establish strong and sustainable budgetary and banking institutions in Kosovo.

We note the discussion on the trade regime and particularly the aspect of removal of tariffs, to which there is a commitment in the EAG II agreement and on which we continue to hold discussions. UNMIK is currently actively considering the steps that can be taken to move towards the commitment to remove all tariffs in a manner agreeable to the Bank.

There have been other lessons learnt from the last two years of institution building to which we

would like to draw attention. The first is that inevitably it is a slow process. It is clear that the institutional void in Kosovo was very deep. While under the EAGs there has been considerable progress, even now there is still a significant human capital deficit that needs to be addressed. In particular we consider that more attention must be given to technical assistance related to specific needs of the future leaders of Kosovo and the paucity of modern management skills resulting from a decade of exclusion. This should reinforce the basic rules of good governance that underpin the two Grants under discussion as well as other major capital investments made by donors in the past two years. While there has been considerable investment in international expertise on the ground in Kosovo, the role many played in actually being members of the Government rather than advisers as in more traditional transitional economy assistance may have meant that less attention has been given to the high intensity support and direct involvement of the local staff that is needed to address the skills deficit. It is clear also that in undertaking the role of Government, the Mission has taken some time to accept that precedent and practices established over 50 years are not necessarily appropriate in the particular circumstances of Kosovo.

The support of the Bank, both as a donor and an adviser has been a vital component of the achievements to date. We look forward to a continuation of both modes of support."

(b) Cofinanciers:

Not Applicable.

(c) Other partners (NGOs/private sector):

Not Applicable.

10. Additional Information

Not applicable.

Annex 1. Key Performance Indicators/Log Frame Matrix

The operation did not include output impact indicators. A table indicating objectives and achievements is instead included below.

Objective

Creating a functioning and effective budget management system.

Establishing a functioning and effective bank licensing and supervision capability, with a view to stimulating banking activities in a safe and sound manner.

Adopting a sound budget for 2001 that represents a significant step towards sustainability.

A simple uniform trade regime to be implemented: all external tariffs will be set at zero upon the introduction of a value added tax regime planned for July 2001.

Output/Achievement

The CFA has performed well. Treasury payments are managed effectively and transparently. Budget planning and allocation mechanisms continue to be improved, and steps are being undertaken to integrate the recurrent and capital budgets.

The BPK has been established. Proper supervision over banking has been established and three banks have been licensed.

The 2001 budget, adopted prior to the release of EAG II, marks a significant step towards sustainability. A sound budget for 2001 is being implemented. However, it is unclear at this stage whether the reductions in public sector employment that were initially envisaged will be implemented.

Preparations for the introduction of the VAT were underway. At present, the authorities are considering delaying the abolition of the tariffs because of revenue predictability considerations.

Annex 2. Project Costs and Financing

Project Cost by Component (in US\$ million equivalent)

Project Cost By Component	Appraisal Estimate US\$ million	Actual/Latest Estimate US\$ million	Percentage of Appraisal
Economic Assistance Grant I from the Trust Fund for Kosovo	5.00	5.00	
Economic Assistance Grant II from the Trust Fund for Kosovo	5.00	5.00	
Total Baseline Cost	10.00	10.00	
Physical Contingencies	0.00	0.00	
Price Contingencies	0.00	0.00	
Total Project Costs	10.00	10.00	
Total Financing Required	10.00	10.00	

Annex 3: Economic Costs and Benefits

Not applicable.

Annex 4. Bank Inputs

(a) Missions:

Stage of Project Cycle	No. of Persons and Specialty (e.g. 2 Economists, 1 FMS, etc.)		Performance Rating		
	Month/Year	Count	Specialty	Implementation Progress	Development Objective
Identification/Preparation	EAG I	3	1 macro economist, 1 fiscal consultant, 1 financial sector economist	S	S
	EAG II	3	1 macro economist, 1 fiscal economist, 1 trade economist	S	S
Appraisal/Negotiation	EAG I	3	1 macro economist, 1 fiscal economist, 1 financial sector economist	S	S
	EAG II	3	1 macro economist, 1 fiscal economist, 1 trade economist	S	S
Supervision	EAG I	2	1 macro economist, 1 fiscal economist	S	S
	EAG II	2	1 fiscal economist	S	S
ICR	EAG I	1	1 macro economist	S	S
	EAG II	1	1 macro economist	S	S

(b) Staff:

Stage of Project Cycle	Actual/Latest Estimate	
	No. Staff weeks	US\$ ('000)
Identification/Preparation	40 (EAG I)	
	30 (EAG II)	
Appraisal/Negotiation	12 (EAG I)	
	12 (EAG II)	
Supervision	25 (EAG I)	
	12 (EAG II)	
ICR	1 (EAG I)	
	1 (EAG II)	
Total	78 (EAG I)	
	55 (EAG II)	

Annex 5. Ratings for Achievement of Objectives/Outputs of Components

(H=High, SU=Substantial, M=Modest, N=Negligible, NA=Not Applicable)

	<i>Rating</i>
<input checked="" type="checkbox"/> <i>Macro policies</i>	<input type="radio"/> H <input checked="" type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input type="radio"/> NA
<input checked="" type="checkbox"/> <i>Sector Policies</i>	<input type="radio"/> H <input checked="" type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input type="radio"/> NA
<input type="checkbox"/> <i>Physical</i>	<input type="radio"/> H <input type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input checked="" type="radio"/> NA
<input checked="" type="checkbox"/> <i>Financial</i>	<input type="radio"/> H <input checked="" type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input type="radio"/> NA
<input checked="" type="checkbox"/> <i>Institutional Development</i>	<input type="radio"/> H <input checked="" type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input type="radio"/> NA
<input type="checkbox"/> <i>Environmental</i>	<input type="radio"/> H <input type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input checked="" type="radio"/> NA
<i>Social</i>	
<input type="checkbox"/> <i>Poverty Reduction</i>	<input type="radio"/> H <input type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input checked="" type="radio"/> NA
<input type="checkbox"/> <i>Gender</i>	<input type="radio"/> H <input type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input checked="" type="radio"/> NA
<input type="checkbox"/> <i>Other (Please specify)</i>	<input type="radio"/> H <input type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input checked="" type="radio"/> NA
<input checked="" type="checkbox"/> <i>Private sector development</i>	<input type="radio"/> H <input checked="" type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input type="radio"/> NA
<input checked="" type="checkbox"/> <i>Public sector management</i>	<input type="radio"/> H <input checked="" type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input type="radio"/> NA
<input type="checkbox"/> <i>Other (Please specify)</i>	<input type="radio"/> H <input type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input checked="" type="radio"/> NA

Annex 6. Ratings of Bank and Borrower Performance

(HS=Highly Satisfactory, S=Satisfactory, U=Unsatisfactory, HU=Highly Unsatisfactory)

6.1 Bank performance

Rating

Lending

HS S U HU

Supervision

HS S U HU

Overall

HS S U HU

6.2 Borrower performance

Rating

Preparation

HS S U HU

Government implementation performance

HS S U HU

Implementation agency performance

HS S U HU

Overall

HS S U HU

Annex 7. List of Supporting Documents

Transitional Support Strategy for Kosovo. The World Bank. October 1999.

Transitional Support Strategy for Kosovo Progress Report. The World Bank. July 2000.

Kosovo. Building Peace through Sustained Growth: The Economic and Social Policy Agenda. The World Bank. November 1999.

Toward Stability and Prosperity: A Program for Reconstruction and Recovery in Kosovo. The European Commission and the World Bank. November 1999.

Kosovo, FRY. Memorandum of the Country Director to the Regional Vice-President on a Proposed Economic Assistance Grant to the United Nations Interim Administration in Kosovo for the Benefit of Kosovo from the Trust Fund of Kosovo. World Bank Report No. P. 7369. March 2000.

Kosovo Budget 2001. UNMIK. December 2000.

Kosovo, FRY. Memorandum of the Country Director to the Regional Vice-President on a Proposed Economic Assistance Grant to the United Nations Interim Administration in Kosovo for the Benefit of Kosovo from the Trust Fund of Kosovo. World Bank Report No. 21740 KOS. January 2001.

Kosovo, FRY. Economic and Social Reforms for Peace and Reconciliation, World Bank Report No. 21784-KOS, February 2001.

Kosovo 2001-2003 from Reconstruction to Growth. A Preliminary Assessment by the Department of Reconstruction. Department of Reconstruction, UNMIK. February 2001.

Kosovo: Macroeconomic Issues and Fiscal Sustainability, IMF, 2001.