I. Project Context

Country Context

Kosovo is Europe's youngest country both in terms of its population and its statehood. Kosovo's population of about 1.8 million inhabitants and an average age of 26 years represents a resource for future prosperity. Since gaining independence in 2008, Kosovo experienced rapid "catch-up" growth in its post-conflict period and remained the fastest-growing economy in the Balkans with growth averaging 3.4 percent during the period 2008 - 2016. The economic growth has been largely inclusive, averaging 3.9 percent for the bottom 40 percent of the population.

Despite recent progress, Kosovo remains one of the poorest countries in Europe and unemployment rates, especially among the youth, remain high - 61.0 percent in 2014. About 30 percent of its people live in poverty and 12 percent in extreme poverty. Nearly one-third of young Kosovars are not engaged in education, employment, or training (NEET).

The current growth model is not sustainable and will not allow Kosovo to meet its development goals. Growth from 2008 to 2015 has been driven by consumption, fueled by remittances and by foreign aid. In 2015, net exports (1.7 percent of GDP) had a negative contribution to growth. Together with high public sector wages, remittances have led to an increase of labor costs in Kosovo. Meanwhile, labor productivity, measured as GDP per worker, declined. The manufacturing sector saw average labor productivity decline by 12 percent during the period, according to data...
from the Business Environment and Enterprise Surveys (BEEPS). There is, therefore, an urgent need for redirecting the current growth model toward a productivity-driven and export-oriented one.

The Government of Kosovo has taken important initiatives to address Kosovo's declining competitiveness and limited job creation. In January 2016, the Government of Kosovo (GoK) approved the National Development Strategy (NDS) for 2015 to 2020, which identifies four priority pillars: (i) human capital and employment, (ii) good governance, (iii) competitive industries, and (iv) infrastructure. Similarly, the GoK approved the Economic Reform Program (ERP) for 2016 to 2018, which prioritizes structural reform issues, supported by Kosovo and EU joint dialogue on economic policy. Additional signs of the GoK's commitment to reforms are the IMF's Stand-By Arrangement of EUR184 million, which was approved by the IMF Board, and Kosovo becoming the Millennium Challenge Corporation’s (MCC’s) candidate country in 2015.

The GoK is also actively seeking to enhance Kosovo's integration into regional and international communities. In 2015 the GoK signed the Stabilization and Association Agreement (SAA) with the EU which entered into force in April 2016. This first step toward EU integration opens a window of opportunity for conducting a larger reform agenda supported by the EU. Kosovo is also working toward accession to the World Trade Organization (WTO) and other regional trade agreements.

**Sectoral and institutional Context**

Given its small domestic market (1.8 million population), increased export competitiveness is essential for growth and job creation in Kosovo. The lack of competitiveness of Kosovo's economy is related to a number of factors. Kosovo's landlocked geography and limited transport infrastructure makes it costly to access international markets and increases the cost of intermediate inputs and imports. Business environment and access to workers with the right qualifications are also relevant factors.

Some aspects of Kosovo's business environment have improved significantly in recent years, as stated in the Doing Business reports and in the WB World Governance Indicators, where Kosovo improved its score from 2.6 in 2015 to 4.6 in 2016, after adopting a Better Regulation Strategy 2014 - 2020, yet a number of policies that support trade and investment need to be improved.

Among the most pressing constraints to investment is the business inspection regime. Kosovo has the highest number of individual inspections among all its neighboring countries (for instance, on average, inspectorates carried out 22 visits a year per firm in Kosovo), which poses a significant regulatory and compliance burden on businesses. A lack of coordination and legal overlaps overburden businesses with multiple state inspections. Border inspections are not aligned with international standards and processes, including risk assessment. This lack of harmonization between inspectors on technical and customs regulations at the border further delays the process of obtaining relevant certification for trade and sampling. Even though there was a major improvement in the 2017 Doing Business Report, where Kosovo was ranked 51st compared to 118th in 2016 for the Trading across Borders indicator, it still remains one of the worst performers in the Western Balkans.

The government has undertaken measures to reform the business inspection system. While preparing a new business inspection law, the GoK has taken actions to set up a broader framework for the inspection reform. The GoK is currently redrafting the law and expects to submit it to
Parliament in the first half of 2017. With the WBG's support, the GoK is currently developing the Concept Note and Action Plan for inspection reforms, which will be adopted by the GoK by February 2017 and through a Government Decision will appoint the Minister of Trade as the champion of the reform.

Exports are significantly hampered by the lack of access to product certification and related services at affordable prices. For the laboratories accreditations to be recognized internationally, the accreditation organization that issued them has to be recognized internationally. A minimum requirement for national quality infrastructure (NQI) is that metrology and accreditation organizations must be internationally recognized. Supporting the National Metrology and Accreditation agencies’ efforts to become internationally recognized could reduce firms’ costs for certification of products. In addition, firms may need support to acquire quality certifications and other knowledge necessary to enter export markets. Helping SMEs to improve the quality of their products and export readiness could contribute to improved competitiveness.

In summary, to increase competitiveness and export readiness, it will be necessary to tackle (i) low export performance, which is partially the result of a quality infrastructure system that is not internationally recognized; (ii) an unfavorable business environment, including a burdensome inspection system for businesses; and (iii) weak capacity of businesses to upgrade their product and to export.

II. Proposed Development Objectives
To support product certification for export markets, strengthen the capacity of export-oriented firms and reduce the cost of business inspections.

III. Project Description

Component Name
Component 1: Enhancing business environment and export readiness

Comments (optional)
Component 1 will contribute to the Government’s efforts to enhance the business environment and export readiness of firms by modernizing the National Quality Infrastructure, supporting SMEs with export potential, and reforming the business inspections system.

Component Name
Component 2: Project Implementation and Coordination Support

Comments (optional)
This component will help to ensure efficient and effective implementation of all Project components. This component will finance goods, services, training and operating costs to support the implementation and coordination support for the project, inter alia by financing: (i) consultants to support project management, coordination, fiduciary and monitoring and evaluation functions of the project; (ii) capacity building for the personnel; and (iii) equipment and operating costs necessary for the implementation of the project.

IV. Financing (in USD Million)

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V. Implementation
The Ministry of Trade and Industry (MTI) will be responsible for the implementation of the Project. A Project Coordination Unit (PCU) will be established and be responsible for supporting the ministry in all procurement, financial management, monitoring and evaluation, and reporting on the use of Project funds and activities. Policy oversight and strategic decisions affecting the Project will be the responsibility of the Project Steering Committee (PSC), chaired by the MTI and consisting of representatives from the Prime Minister's Office and the Ministry of Finance to provide policy guidance and approval of the annual work plan and budget. Based on the new regulation of borrowing funds and based on the evolution of the capacity in the ministry to implement the project in a timely and rule-abiding manner, the PCU functions could be replaced by public sector employees, conditional on the WBG agreement based on the capacity assessment conducted by the fiduciary team. Implementation support will be provided by the WBG throughout the project and include periodic supervision missions and a midterm review.

VI. Safeguard Policies (including public consultation)

<table>
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Comments (optional)

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