DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR KOSOVO

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EXECUTIVE SUMMARY

Kosovo is committed to and applying the principles of multiparty democracy, pluralism, and market economics in accordance with the conditions specified in Article 1 of the Agreement Establishing the Bank.

In the period since the adoption of the previous Strategy, Kosovo's efforts towards European Union (EU) approximation have remained the main external anchor for comprehensive reforms. The Stabilisation and Association Agreement (SAA) with the EU formally entered into force on 1 April 2016.

Kosovo's economy was more resilient than its neighbours in the Western Balkans throughout the global and Eurozone crises, growing by 3.5 per cent annually on average over the period 2009-2013. After a slow-down in 2014, the economy bounced back in 2015 with growth of 3 per cent boosted by strong domestic demand, with investment contributing the most. Growth is expected to pick up in the coming years as reforms advance and investment increases further. In January 2016, the International Monetary Fund (IMF) Executive Board completed the First Review of the 22-month €185 million Stand-By Arrangement (SBA) – which aims to preserve low public deficits and debt, remove key structural impediments to growth, and catalyse support from other multilateral and bilateral creditors – and considered it on track helping the authorities to secure favourable fiscal indicators. However, structural deficiencies bear heavily on Kosovo's economy, which is dominated by low value added industries, and, overall, is at an earlier state of transition compared to the rest of the region, with the lowest GDP per capita among the Western Balkan countries.

On the structural side, for the private sector to develop in a sustainable manner, major improvements are needed in the areas of reinforcing the investment climate, building up governance and the rule of law, strengthening the economy's competitiveness as well as upgrading public infrastructure and addressing bottlenecks in the energy sector, and all these reforms are closely embedded in the EU integration process. Kosovo has the largest challenges in terms of sustainable energy and capacity shortages. There is no stable supply of energy in the country and Kosovo's obsolete power generation plants are the most carbon-intensive in the Western Balkans, causing frequent power outages, thus inhibiting growth and deterring investment. An important challenge is getting the credit flowing to those small and medium-sized enterprises (SMEs) that need a loan but are credit-constrained due to a general weak economic environment, high levels of informality, lack of business or credit history, insufficient collateral as well as the low development of capital markets. Kosovo's integration into regional markets is lagging behind and the country is confronted with very large external deficits and has the lowest level of exports in the region, a clear sign of the difficulties Kosovan companies face in international trade. Finally, privatisation of the remaining state-owned enterprises (SOEs) has made little progress and investor appetite remains very limited and there were no revenues from privatisation in the past year.

While structural challenges remain significant, positive internal and external developments may coalesce to provide tailwind to the Bank's engagement in the new strategy period. These include 1) the entering into force of the SAA with the EU, 2) the adoption of the National Development Strategy (NDS) 2016-2021, 3) the submission of the 2nd Economic and Reform Programme 2016 – which includes a structural reform agenda to boost competitiveness and improve conditions for growth and job creation – as well as 4) the strategic alignment between the Bank's and the EU priorities guiding the allocation of €645.5 million under the new 2014-2020 Instrument for Pre-Accession Assistance (IPA II) Funds.

The strategy aims to apply some selectivity filters in guiding the Bank's investments and policy dialogue activities in the country:

- **Alignment of the Bank's priorities with Government priorities and ownership**; the Bank will avoid substantial engagement in areas and sectors where political championship is unclear;
- **Complementarity with other players**, including the European Commission (EC), the IMF, the World Bank Group (WBG) and other international financial institutions (IFIs); the Bank will not include substantial engagement where other partners are taking the lead;
- **EBRD comparative advantages and track record in Kosovo**. These will stem mainly from the Bank's engagement with the private sector (especially in agribusiness, manufacturing, ICT, power and renewables) and targeted investment in the public sector to promote private sector participation and support reform (MEI and transports).

The Bank will apply the **Green Economy Transition (GET) approach** across all sectors and operations where this is relevant, in order to maximise the support for and delivery of GET investments; providing technical assistance to address capacity and awareness gaps; and engaging in policy dialogue to alleviate prevailing barriers and create an enabling environment for green investments, among others.

Across the all its strategic priorities, the Bank will promote **inclusive growth** (youth, female labour participation and returning migrants).

Leveraging the incentives provided by the EU and IMF, as well as the authorities' own reform momentum, the Bank will aim to support Kosovo in its efforts to accelerate economic growth on a sustainable and inclusive basis, while deepening and strengthening its engagement and support as needed and in accordance with the pace and depth of progress in reforms focusing on the following strategic priorities:

- **Support competitive development of the private sector through investments, enhancing internal capacity of companies and improving business environment**. Kosovo's economy is characterised by low productivity, high unemployment, mismatch between the skills of the young workforce and employer requirements, thin export base, limited foreign direct investment, large degree of informality, and inclusion gaps, such as the extremely low female labour force participation. For the private sector to develop in a sustainable manner, major improvements are needed in the areas of investment climate, governance and competitiveness, leveraging the EU approximation process. The Bank will provide financing to Kosovo corporates and SMEs to support investment in such endeavours as increasing value added, improving competitiveness vis-à-vis imports, and enabling value-added exports. Improving access to finance for SMEs will remain a priority. In addition to financing, the Bank will provide advisory through the Advice for Small Businesses programme under the Small Business Initiative. The Bank will use its local partner banks as a principal conduit for channelling financing to MSMEs and will provide business advisory services in combination with investments to improve the competitiveness and modernisation of the agribusiness sector, including by raising quality and health standards, as well as by developing supply chains. Given the high liquidity of the banking sector, the Bank will continue to deploy targeted frameworks, some with incentives, such as the Women in Business programme (WiB), the Western Balkans Sustainable Energy Financing Facility (WeBSEFF), the Direct Finance Framework under the Small Business Initiative and introduce the Competitiveness Support

Facility (CSF), as well as offer the Risk Sharing Facility (RSF). The Bank will aim to provide access to equity to SMEs when feasible to address lack of equity finances sources in Kosovo, even if appetite for equity is often very limited due to very limited exit opportunities and informality. The Bank will also provide advisory services with the aim to further build capacity and will consider engaging in such areas addressing informality, financial reporting, management capacity, corporate governance as well as promoting social inclusion by encouraging people to actively participate in the labour market and society The Bank will also be alert to the migration challenge in the current context as the government is seeking to boost the "*Brain Gain*" from the diaspora and the Bank will seek to participate in government-led schemes to enable engaging with the Kosovo's returning diaspora in the private sector, provided adequate grant funding.

- **Enhance energy security and sustainability by financing investments in the sector, supporting sector reform, promoting energy efficiency and renewable energy.** The Bank will apply the GET approach across all sectors and operations where this is relevant in order to maximise the support for and delivery of GET investments in the country. Kosovo's dilapidated energy sector is suffering from years of underinvestment. Unreliable electricity supply disrupts businesses' operations and impedes investment and business expansion. The country's two principal coal-fired generating plants are obsolete, with one of them slated for decommissioning. Energy efficiency and renewable energy can help mitigate current and projected power shortfalls, while enhancing environmental sustainability. This will require strengthening the existing regulatory frameworks and institutional capacity for energy-efficiency and renewable energy. The country needs to further harmonise with the EU legislation, while bringing down energy intensity and improving environmental compliance. The Bank will consider supporting investments in power generation capacity, including from thermal and renewable sources, where these are consistent with its Energy Sector Strategy. In parallel, the Bank will support the strengthening and improving efficiency of the national transmission grid, as well as investments in reducing energy intensity by supporting demand-side energy efficiency investments across all sectors as part of its direct lending or sustainable energy financing facilities via partner-banks. Subject to commitment from the authorities, and in coordination with the EU, other IFIs and donors active in the energy sector, the Bank will provide policy advice and technical assistance to address institutional and policy reforms especially in the area of the development of a bankable renewable regulatory framework as well as to improve the legal framework for energy efficiency with a particular focus on the residential sector.

- **Support connectivity and regional integration**. Infrastructure development is needed to improve Kosovo's regional integration and attract foreign direct investment (FDI), as well as to harmonise with EU standards. To that end, Kosovo needs to build the main road links to Pan-European corridors. Kosovo's obsolete railway network is currently connected to the main European network only via FYR Macedonia, a significant impediment for traffic to or from most European centres as the only other connection from Pristina to Serbia is not functional. The Bank will aim to provide long term finance and advisory to help build and rehabilitate key transport links, as well as, where applicable, help Kosovo bring its transport sector into compliance with European standards. The Bank will also support investments aiming to improve the country's regional interconnections in the energy sector. The Bank will seek to co-finance investments with the European Investment Bank (EIB), as well as support the country in mobilising EU grant funding under the Western Balkans Investment Framework (WBIF) which is increasingly emphasizing projects that promote connectivity. Finally business integration is also key as Kosovan firms have not been able to take (full) advantage of the opportunities provided by these export markets and the Bank will continue to support cross-border trade through its Trade Facilitation Programme, business advisory to small businesses on export readiness as well policy advice leading to a reduction in Non-Tariff Barriers and Technical Barriers to Trade around the EC connectivity agenda.

1 OVERVIEW OF THE BANK'S ACTIVITIES

1.1 The Bank's current portfolio

Private sector ratio: 30.1 per cent*, as of 31 August 2016

Sector Group	Sector Team	Portfolio no of operations	Portfolio (€m)	% Portfolio	Op Assets	% Op Assets
Energy	Natural Resources	0	0	0%	0	0%
	Power and Energy	2	31	22%	1	3%
		2	**31**	**22%**	**1**	**3%**
Financial Institutions	Depository Credit (banks)	5	9	6%	8	24%
	Non-depository Credit (non-bank)	8	16	11%	5	17%
		13	**24**	**18%**	**13**	**42%**
Industry, Commerce & Agribusiness	Agribusiness	2	2	1%	2	6%
	Equity Funds	4	6	5%	2	8%
	ICT	2	13	9%	13	42%
	Manufacturing & Services	0	0	0%	0	0%
	Property and Tourism	0	0	0%	0	0%
		8	**21**	**15%**	**17**	**56%**
Infrastructure	Municipal & Env Inf	2	14	10%	0	0%
	Transport	2	48	35%	0	0%
		4	**62**	**45%**	**0**	**0%**
Summary		**27**	**139**	**100%**	**31**	**100%**

*5-year rolling portfolio ratio
Source: EBRD

1.2 Implementation of the previous strategic directions

In 1999, private sector projects in Kosovo became eligible for support from the European Bank for Reconstruction and Development (EBRD) via dedicated externally managed regional funds and via the Bank's regional facilities for the Western Balkans. Kosovo became a member and recipient country of the Bank in 2012.

The Bank is currently operating in Kosovo on the basis of the first Country Strategy, approved in May 2013, with the following three strategic priorities:

- Supporting privatisation and private sector development with the aim to enhance its competitiveness and introduce best practices;
- Enhancing commercialisation, competition and private sector involvement in infrastructure to improve the quality of the public services; and
- Promoting and supporting sustainable development of the energy and mining sectors.

The implementation of the Country Strategy took place against the backdrop of a slowing economy, while the recurring political crises contributed to a slowdown in policy reforms and delayed the preparation and implementation of key privatisation and infrastructure projects.

Over the strategy period, the Bank signed 24 projects (64 per cent of all the investments made in Kosovo to date) for a total value of almost €113 million with Annual Business Investment (ABI) steadily increasing every year from €22 million to €56 million. Presently the Bank's portfolio in Kosovo is €139 million. Although the majority of the Bank's operations are in the

SME-dominated private sector, the private sector portfolio ratio is comparatively low (at 30.1 per cent) given the larger size of key investments in public infrastructure.

The following sections present key highlights of the EBRD performance in Kosovo and present major lessons for the new Strategy period.

Theme 1: Supporting privatisation and private sector development with the aim to enhance its competitiveness and introduce best practices

The Bank has supported private sector development by channelling long-term finance to Kosovo's Micro, Small and Medium Enterprises (MSMEs) mainly through local banks and micro-finance institutions (MFIs) but also through direct financing to local mid-caps (Asgeto and Viva Fresh).

Overall, through the Kosovo Sustainable Energy Project (KOSEP) the Bank's partners have on-lent €9.7 million to 20 SMEs and to 2,839 residential energy efficiency and renewable energy projects over the strategy period, while through the Western Balkans Women in Business Facility (WiB) the Bank's partner bank TEB has on-lent so far €2.9 million to finance 228 women-owned or -led MSMEs. In particular, the WiB enabled TEB to explore a market niche which is perceived to be riskier and develop new WiB loan products for both established and start-up businesses. The Bank's Advice for Small Businesses programme (ASB) provided advisory services to 20 women-led businesses and was instrumental in helping five of them to subsequently raise finance from TEB under the WiB.

The Bank's engagement with direct financing to locally owned companies was limited to two investment projects, one with Asgeto, the second largest distributor of pharmaceutical products (a loan under the Local Enterprise Facility) and the other one with the leading locally-owned retail chain Viva Fresh (a loan under the Enterprise Expansion Fund ENEF established in 2014). Finally through a LEF credit line[1], the micro finance institution KreditimiRural i Kosoves (KRK) financed 2.438 MSME projects.

The Bank's Advice for Small Businesses played a significant role in supporting the enterprise sector in Kosovo by implementing 226 projects that contributed on average to improving SMEs' productivity by 21 per cent, increasing turnover by 22 per cent and creating 656 jobs. Moreover, two advisory projects under the Advice for Small Businesses benefitted Asgeto and helped the company conduct market research, identify its positioning and new potential clients, as well as implement European standards for Good Distribution Practices. Under the ASB programme local SMEs received support through local consultants and international industry experts in areas such as financial management and corporate governance, environmental and quality standards, marketing and business strategy, sector and product value chains. The Bank's ASB also played an important role in developing the local consultancy market. During the strategy period, ASB trained 120 consultants in business diagnostic skills, sales and marketing, industrial energy efficiency and managing consulting business.

[1] In April 2015 the Local Enterprise Facility (LEF) became consolidated into Direct Finance Framework under the Small Business Initiative.

The Bank is an active member and has also contributed to the establishment of the European Investors Council alongside 15 European investors operating in Kosovo and the European Union's Office in Kosovo, which has been leveraged as a forum for private-public policy dialogue on business climate improvement.

Theme 2: Enhancing commercialisation, competition and private sector involvement in infrastructure

In 2015 the Bank extended a €39.9 million senior loan for on-lending to Infrakos (Kosovo's Railway Infrastructure Company) to finance the rehabilitation of the Kosovo's 148 km part of the European Route 10 Rail network, the European Union TEN-T Orient/East-Med Corridor and Kosovo's only operational rail connection with FYR Macedonia in the south and as such, vital to the country's further integration into the regional and international markets. The project is set to result in a few years' time in an enhanced commercialisation of the sector with its institutional strengthening component and by supporting Kosovo's Railway Infrastructure Company operating as an independent entity and in accordance with commercial principles. This was the Bank's first transport sector project in the country and also the first project co-financed with the EIB and with a significant EU grant investment component provided under the WBIF, which has been an effective instrument in preparing the investment project and enhancing coordination between IFIs.

In late 2015, the Bank signed its first road project in Kosovo through a €29 million sovereign loan to help the government rehabilitate 15km road section of the national road network from Kllokot to Gjilan and the upgrade of access roads for a total length of approximately 11.2 km in the cities of Ferizaj, Gjilan and Prizren. The Project addresses key sector challenges through institution-strengthening components by helping the government in the proper planning of priority investments in the road sector and procurement training to ensure application of transparent procurement process.

Separately, the Bank has been assisting the Government in the project preparation and feasibility study for key road sections which form parts of important and pan-European transport corridor sections, including:

- The Kijeve – Peje road section which is part of the South East Europe Transport Observatory Route SEETO 6b running from Pristina to Peje;
- The Pristina-Merdare road section (part of SEETO Route 7) connecting Serbia, Kosovo and Albania (Niš – Pristina – Durres) in what has been hailed as the "Peace Highway"; and
- The Pristina – Gjilan – Dheu i Bardhe motorway.

The preliminary design of these three road sections is almost completed and the aim is to improve connectivity between the Western Balkans region and the EU. The Kijeve – Peje road section project in particular is set to address key sector challenges through institution-strengthening components such as the development of a road maintenance strategy aiming to enhance commercialisation.

In March 2015, the Bank signed a Memorandum of Understanding (MoU) with the Municipality of Pristina to facilitate cooperation aimed at increasing operational efficiency and consolidating companies operating in the urban transport, supporting investments in urban road infrastructure, water and wastewater, solid waste, street lighting and energy efficiency in public buildings of the Municipality of Pristina. The first project prepared under the MoU is the Pristina Urban Transport Project under which the Bank would lend to the public transport company of Pristina to modernise its bus fleet and improve operational and environmental performance and enhance safety standards. The project was signed in June 2016 with the Municipality's continued commitment towards improved operational and environmental standards.

Theme 3: Promoting and supporting sustainable development of the energy and mining sectors

Under this priority, the Bank's engagement was limited, as Kosovo made very little progress with reforms in the energy and mining sectors over the strategy period. In 2014, the Bank extended a €30 million corporate loan to Kosovan Electricity Transmission, System and Market Operator (KOSTT) to finance the rehabilitation of substations and transformers and to strengthen the grid to 110 kV to *inter alia* meet technical requirements for joining ENTSO-E (the organisation of European electricity transmission network operators). This was the first loan to a public company in Kosovo without a sovereign guarantee, demonstrating new ways of financing public infrastructure and encouraging private sector involvement.

Energy efficiency investments in both the SME and residential sector were supported through the Kosovo Sustainable Energy Project Framework. These investments resulted in energy savings of 17,070 MWh/y and decreased CO2 emissions by 8,681 tonnes/y. As a result of the Bank's sustainable energy activities over the strategy period, the estimated total CO2 emissions reduction is 25.2 kt/y.

Within the context of the Western Balkans Sustainable Energy Direct Financing Facility (WeBSEDFF) deployed to support Western Balkan countries on renewables, the Bank has been engaged in a dialogue with the Energy Regulatory Office (ERO) of Kosovo on the necessary gradual implementation of cost reflective tariffs and has organised promotional events related to energy efficiency.

Under the EBRD Regional Energy Efficiency Programme for Western Balkans (REEP), the Bank has been providing support to the government to help transpose four draft regulations necessary for transposition and implementation of the EU Energy Performance of Buildings Directive (EPBD) into Kosovo's regulatory framework and has delivered a draft Energy Efficiency in Buildings Law to the Kosovo Energy department under the Ministry of Economic Development in June 2015. Together with the Energy Community Secretariat, the Bank has worked closely with the government to support the adoption of these deliverables. However, the approval and adoption of these regulations is still pending.

1.3 Key lessons

Notwithstanding the successes, the Bank encountered significant implementation challenges:

- **Lack of demand for the Bank's standard financing products** – High liquidity in the banking sector limits demand for the Bank's funding products. Key challenges for the Bank's indirect lending include partner bank's limited portfolio of clients due to the lack of diversification of the economy, which is based on retail trade and construction related activities with limited industrial base and suffering from high levels of informality. The private corporate sector is very small and dominated by two large mineral processing companies.

  - ➢ The Bank will focus on developing products providing capital relief for banks, risk-mitigating facilities for small businesses, including on portfolio basis and with first loss cover, and dedicated credit lines addressing underserved segments (e.g. SMEs, Women in Business, agribusiness, energy efficiency for both SMEs and residential sector such as KOSEP credit lines). Under the Advice to Small Businesses the Bank is piloting the Blue Ribbon initiative targeting SMEs with high growth potential to support them with advice and funding.

- **Limited implementation capacity of the public sector** – Due to constraints in the administrative capacity and the challenging political environment in Kosovo, the preparation and implementation of complex infrastructure projects has taken a particularly long time and requires significant hands-on technical assistance. Examples include: the loan to KOSTT (€30 million) which was signed in 2014 but took a long time to prepare and to complete the tender (the disbursement is expected for 2016) and the tenders for the first two rail and road transport sector projects signed in late 2015 (in aggregate €48 million) which are still under preparation as there are still some technical and policy CPs to be satisfied before disbursement can start in 2016.

  - ➢ In retrospect, given its current stage of development, it was premature to introduce competition and private sector involvement in the infrastructure sector' as strategic objectives for the Bank in Kosovo.

- **Business constraints to direct financing to local corporates** – Issues related to financial transparency, weak corporate practices, high indebtedness and asset ownership titles, particularly amongst SMEs, restricted the Bank's ability to provide direct financing to a larger number of companies.

  - ➢ Support under the Advice for Small Businesses to SMEs will continue improving corporate governance and financial management, business planning, accounting, and focusing on inclusive growth, enhanced competitiveness and trade promotion.

- **Challenging business environment** – Serious lack of administrative capacity, power supply shortages and widespread corruption are deterring FDI and limiting the universe of bankable projects.

  - ➢ The Bank is seeking to address these issues as a member of the European Investors' Council, the body tasked with developing proposals to improve the business environment.

- **Constraints to direct financing to municipalities** – The Bank has faced several challenges in directly lending to municipalities. The latter may not incur any debt 1) unless they have received unqualified audit opinions from the Office of the Auditor General as part of the mandatory annual audits for at least the previous two years and 2) they can only borrow for capital investments in the education and healthcare sector. Overall, municipalities in Kosovo receive 57 percent of their revenues from conditional or earmarked grants from the national government (World Bank), depending on state transfers for both capital and operating budgets.

2 OPERATIONAL ENVIRONMENT

2.1 Political context

The current governing "*grand coalition*" was established at the end of 2014. It includes the two largest political parties – the Democratic Party (PDK) and the Democratic League (LDK), as well as parties representing ethnic minorities. This broad coalition benefits from a solid majority in parliament. The government, led by Prime Minister Isa Mustafa of LDK, went through a minor reshuffling when the leader of PDK, First Deputy Prime Minister and Minister of Foreign Affairs Hashim Thaci was elected as the new President of Kosovo (inaugurated on 7 April 2016).

Despite the government's overall pro-reform orientation and sufficient parliamentary majority, the political environment remains difficult. Kosovo's weaknesses, which are common to many Western Balkans countries, include uneven culture of political dialogue and consensus building. The latter has contributed to recurring political crises. In 2014, following inconclusive general elections, the country was left with a caretaker government for almost six months.

Another political crisis has started in autumn 2015, when the coalition of nationalist-oriented opposition parties launched a blockade of the parliament and a series of violent anti-government protests. The opposition, in particular, has resisted recently reached agreements with Serbia in the framework of the continuing EU-facilitated dialogue for the normalisation of relations, as well as the border demarcation agreement with Montenegro. Opposition parties want the government to withdraw its signature under the compromise agreements with Serbia that paves the way to the establishment of the association/community of ethnic Serb majority populated municipalities in Kosovo, and demands early elections. Although elections are unlikely in 2016, the interruptions in the work of the parliament caused by the protests have already led to a significant backlog of bills requiring parliamentary approval.

Continuing EU approximation remains a key external anchor for reforms. In recent years, the country has accelerated its integration process into the EU. Kosovo signed the Stabilisation and Association Agreement with the EU in October 2015. It was approved by the European Parliament on 21 January 2016 and entered into force on 1 April 2016. The entry into force of the SAA is an important milestone. Besides creating contractual obligations to implement European standards in various areas covered by the SAA and thus establishing additional channel for leveraging reforms, this is a positive signal for foreign investors. Finally, this is an important political signal for the country and wider Western Balkans, which reaffirms European prospects for the entire region.

See Annex 1 for a detailed political assessment in the context of Article 1.

2.2 Macroeconomic context

Kosovo is the poorest country in the Western Balkans. Adjusted for purchasing power parity, GDP per capita in Kosovo is the lowest among the Western Balkan countries, and roughly half than of Eastern European countries. This gap reflects a low starting point for transition, as the country was already the poorest part of the former Yugoslavia, combined with the legacy of conflict, serious institutional weaknesses, shortcomings in education and lack of basic infrastructure. At the same time, Kosovo's convergence (catch-up) potential is large. Unemployment, inequality, and the challenges of developing a productive economy to meet global development goals are among the hard-nosed realities facing Kosovo, as highlighted in the Government's programme adopted in March 2015 as well as the National Development Strategy adopted in January 2016, focusing on the creation of formal jobs, a topic that has gained great urgency after the mass exodus of an estimated 5 per cent of the country's population to EU countries during the "*winter of discontent*" in 2014-2015. The migration pressure reflected pessimism about the rule of law and job prospects.

On the positive side, Kosovo's economy has been managed well as it was more resilient than its neighbours in the Western Balkans throughout the global and Eurozone crises, growing by 3.5 per cent annually on average over the period 2009-2013, and being one of only four countries in Europe having recorded positive growth rates in every year of the post-crisis period. However, an explosion in the country's largest (thermal) power producer in June 2014 temporarily halted electricity output as well as the output of the sector's main supplier, the mining industry, with economic growth slowing down to 1.2 per cent in 2014. Also, the six-month political stalemate after the June 2014 general elections negatively affected economic sentiment and led to the deferring of private investment.

The economy bounced back in 2015 with growth of 3 per cent. Growth was boosted by strong domestic demand, with investment contributing the most. Private investment was supported by a strong FDI (at ca. 5 per cent of GDP, it was the highest level in the last 4 years), while public investment was mostly directed at the 65-kilometre section of highway running from Pristina to the Macedonian border. Private consumption was fuelled by increasing remittances (from the country's large diaspora, many of whom are based in Germany and Switzerland) and stronger bank credit.

The growth outlook over the medium-term remains moderately buoyant. Growth is expected to pick up in the coming years, rising to 3.5 per cent in 2017 and staying at or exceeding that level in the following 2-3 years as reforms advance and investment increases further. This growth is expected to be supported by 1) remittance inflows which should continue supporting private consumption (reliance on remittances is high, with 16 percent of GDP accounted for by personal remittances received); 2) flagship private investments and 3) critical public investment in transport and energy infrastructure. A key long-term challenge for Kosovo will be to raise the productive and export capacities of its economy. This will require addressing the high level of structural unemployment, ensuring energy security, and improving the business environment. The recovery of the mining complex Trepca could significantly affect Kosovo's potential growth through increased exports, the creation of a potential chain of manufacturers and opening new jobs.

In July 2015, the authorities and the IMF signed a 22-month €185 million stand-by arrangement (SBA). The programme has three broad objectives: (i) preserving low public deficits and debt by containing current spending, while creating fiscal space for growth-enhancing capital spending; (ii) removing key structural impediments to growth, including the creation of a more conducive environment for private sector activity and investment, and the upgrade of Kosovo's infrastructure and the strengthening of bank intermediation; and (iii) catalysing support from other multilateral and bilateral creditors. In January 2016, the IMF Executive Board completed the First Review of the programme and considered it on track helping the authorities to secure favourable fiscal indicators. Public debt levels are low by regional standards (a public debt law sets the maximum public debt-to-GDP ratio at 40 per cent) and, under an investment clause in the SBA, Kosovo has €450 million for capital spending. However, significant extra fiscal space would likely be needed if the new Kosovo thermal power project (Kosovo C) goes ahead. Also, external borrowing by the government, including from IFIs, would require parliamentary ratification with a qualified majority.

The banking sector had proven resilient to the deterioration in the external environment. With a heavily banking-focused financial system, the authorities are taking key steps to make Kosovo's banks safer, including through adoption of an emergency liquidity assistance framework, progress toward risk-based supervision for all banks, and a new macro-prudential policy framework. Relative to most other countries in the Western Balkans, the banking system of Kosovo is characterized by some positive conditions:

- It has a deposit-based funding structure (loan to deposit ratio is at 74.8 per cent as of end 2015);
- It is well capitalised (the capital adequacy ratio is at 19 per cent as of end 2015) and exhibits ample liquidity buffers. without relying on foreign funding even though it is dominated by foreign-owned banks (which account for ca. 90 per cent of the total banking assets with the two largest among those being German ProCredit and Austrian Raiffeisen, with 26 per cent market share each) and;
- The percentage of Non-Performing Loans (NPLs) in the financial system is low by regional standards. Loan-loss provisions against adversely classified loans remain high.

Internal risks to the growth outlook stem from weak institutional capacity, high level of informality, unclear property rights, corruption as well as political instability, such as the ongoing blockage of the normal functioning of the parliament by the opposition. Also, the marginal benefits of previous growth drivers including foreign aid and remittances are set to decline and, without a structural transformation and improved productivity, Kosovo will struggle to cope with competitive market forces associated with EU membership as well as socioeconomic pressures linked to its young demographic profile.

External risks include on-going difficulties in the Western Balkan region and the Euro Area, Kosovo's main export markets. Political instability in particular could have an impact on the timely implementation of the IMF programme, as normal parliamentary activity is needed for passing or amending legislation agreed under the SBA. At the same time, political instability can be damaging for investor confidence.

2.3 Structural reform context

For the private sector to develop in a sustainable manner, major improvements are needed in the areas of reinforcing the investment climate, building up governance and the rule of law, strengthening the economy's competitiveness as well as upgrading public infrastructure and addressing bottlenecks in the energy sector. These reforms are closely embedded in the EU integration process as key policy instruments to attract direct investments of the scale and scope needed to increase productivity of the economy, generate "catch-up growth" and ultimately reduce the high rates of unemployment and poverty of the country. Other key priorities include addressing skills mismatches to increase employment and labour productivity and ensuring the sustainable management of natural resources.

Kosovo has the **largest challenges in terms of sustainable energy, energy security and capacity shortages**. The latest Business Environment and Enterprise Performance Survey (BEEPS) found that electricity supply was among the top three obstacles constraining domestic companies and deterring potential investors from locating their businesses in Kosovo, along with corruption and the informal sector. There is no stable supply of energy in the country. Kosovo's obsolete power generation plants are the most carbon-intensive in the Western Balkans, causing frequent power outages, thus inhibiting growth and deterring investment. A recent USAID report showed that unreliable energy supply costs Kosovo's businesses nearly €300 million each year in lost productivity. Other major challenges in the energy sector include the modernisation of the transmission grid and the reduction of non-technical losses in the distribution grid. Combined with the energy supply-side issues, demand-side energy efficiency across all sectors (private SMEs, residential buildings, public entities, etc.) presents an important challenge as the overall energy intensity of the country remains to be significantly above the EU average (and among the highest in the Western Balkans).

An important challenge is **getting the credit flowing to those SMEs** that need a loan but are credit-constrained due to general weak economic environment, high levels of informality, lack of business or credit history, insufficient collateral as well as the low development of capital markets. High lending interest rates and the sizable spread over deposit rates reflect commercial banks' high credit risk perception due to wide-ranging informality in the corporate sector and the legal environment.

Despite an open trade regime, Kosovo's **integration into regional markets is lagging behind**. Major investments in the region's energy and transport infrastructure, along with associated reforms, can help boost connectivity and therefore trade and investment with neighbouring countries. The country is confronted with very large external deficits and has the lowest level of exports in the region, a clear sign of the difficulties Kosovo's companies face in international trade reflecting binding public infrastructure and business climate constraints. These include Non-Tariff Barriers to trade such as government procurement policies and anti-dumping measures, technical barriers to trade and sanitary and phyto-sanitary Standards/Measures.

Privatisation of the remaining SOEs managed by the Kosovo Privatisation Agency **has made little progress** and there were no revenues from privatisation in the past year as the Agency was not functioning.

In April 2015, the government decided to further postpone the privatisation of the telecommunications company PTK. Under the new National Development Strategy a Working Group was established to draft the methodology on how future privatisations could be carried out. 18 SOEs, including PTK and Trepca mine, are likely to remain under central government management during the future strategy period. The mining complex is currently held in trust and readied for sale by an agency created by the United Nations Interim Administration Mission in Kosovo (UNMIK). However, it suffers from ownership issues which make the privatisation difficult.

However, certain reforms are already underway:

- **The SAA with the EU,** which has recently entered into force, suggests that Kosovo is committed to adherence to certain standards in terms of regulations and the general business environment. As the first contractual relationship between Kosovo and the EU, the agreement is a milestone in Kosovo's EU approximation; it serves as a framework for co-operation and political dialogue between the two sides, formalising the country's preferential access to the EU market in exchange for specific commitments on required reforms in areas such as competition and state aid.
- Under the Investment Clause in the new IMF Stand-by Arrangement Kosovo has €450 million for donor-financed capital spending.
- The government has adopted the **National Development Strategy for 2016 – 2021** aiming to form a basis for sustainable and inclusive growth, as well as to accelerate Kosovo's integration into the EU through pre-requisite reforms. It has also established the **National Investment Committee (NIC),** chaired by the Ministry of EU Integration and Ministry of Finance, and the **Single Project Pipeline** to help the country prioritise future major infrastructure projects, including their fiscal impact.
- The country has also submitted its second **Economic and Reform Programme** to the European Union's authorities covering the period 2016-2018, an important step in deepening the economic dialogue with the EU.
- Key reforms aimed at enhancing the legal environment, strengthening public administration, developing institutions, and reinforcing physical infrastructure, resulting in the improvement of certain preconditions for inclusive and sustainable growth This notwithstanding, the overarching business environment has not improved sufficiently to translate into a noticeable improvement in formal employment, social conditions, and the socio-economic welfare of the most disadvantaged segments of society.
- Finally, the construction of the 400kV interconnection line between Albania and Kosovo will enable Kosovo to exchange electricity with Albania to maximise the use of Albania's hydropower plants in winter and Kosovo's coal-fired plants in drier weather. In addition, Kosovo and Albania have announced the start of work on the establishment of a common energy market for the two countries.

2.4 Access to finance

Private sources of capital
Kosovo's banking system is relatively small and it is currently well capitalised, liquid and profitable. 10 banks operate in the market – 6 commercial banks (4 subsidiaries of foreign banks and 2 locally owned) and 4 branches of foreign banks with total assets of €3.4 billion or 60 per cent of GDP. The banking system is majority foreign-owned, and dominated by the subsidiaries of German (ProCredit), Austrian (Raiffeisen), Slovenian (NLB) and Turkish (TEB) parent banks. System-wide CAR is above 18 per cent, liquidity ratio is well above the regulatory minimum and return on equity above 25 per cent. Asset quality is acceptable. NPLs are the lowest in the region and on a downward trend (6.2 per cent at year-

end 2015), as a result of stricter lending standards, better enforcement for problem loans and overall expansion of lending by commercial banks. Also, because of the relatively low level of cross border integration with the European Financial System and the small export base, the financial sector remained relatively stable throughout the turbulence of the crisis. Whilst remittances from the Kosovan diaspora initially slumped in 2009, they have recovered strongly and add some stability to the deposit base.

However, cost of finance is considered to be a major obstacle to growth, given the low loans to GDP ratio, high interest rate spread, uncompetitive behaviour in the banking sector and a high level of contract enforcement risk (ERP, 2016). Access to finance is a key obstacle for most businesses in Kosovo. According to the latest Business Environment and Enterprise Performance Survey (BEEPS V) carried out in 2013, the share of firms identifying access to finance as a major obstacle to doing business is around 40 per cent. This is mainly due to the general weak economic environment, high levels of informality and the lack of capacity at the SMEs level to present bankable projects (the level of financial literacy and the share of firms preparing audited accounts are among the lowest in the Western Balkans).

Of significant concern is the low level of credit activity in Kosovo. Based on World Development Indicators (WDI), Kosovo's level of domestic credit provided by the financial sector, as a percentage of GDP, stands at a mere average of 18 per cent for the period 2009-2012, compared to 46 per cent in FYR Macedonia, 56 per cent in Serbia, 66 per cent in Bosnia and Montenegro, 90 per cent in Croatia and 94 per cent in Slovenia. According to the EBRD Gender gaps analysis, gender gaps in access to finance are also large.

Kosovo uses the Euro as its currency of exchange although some banking business is also conducted in Serbian dinar in the north. Loan to deposit ratios are conservative and there is a basic deposit insurance scheme that is backstopped by an EBRD loan facility. Both deposit and loan exposures are relatively highly concentrated reflecting the very narrow investor and borrowing base in the market.

Non-bank financial institutions – particularly MFIs – are active but still account for a relatively small share of total loans (4 per cent) in the Kosovan financial system, primarily to the agricultural sector. Access to finance shows a clear gender imbalance with far fewer women having bank accounts and access to loan financing at the SME level. The insurance market is small with the insurance premia/GDP ratio well below its peers in the SEE region – one life and 10 non-life insurers operate with the bulk of the premia collected from motor vehicle insurance. The insurance law attempted to strengthen the legal and regulatory environment, there are still major issues with the implementation and supervision of the industry.

Capital markets remain underdeveloped. There is a nascent government securities market with t-bill issuance and a 2-year, 3-year and 5-year government bonds with 8 commercial banks acting as primary dealers. Banks and pension funds are major buyers and there is little secondary market activity as the financial system has excess liquidity and there is a lack of other local investment options. There is virtually no equity market in Kosovo – corporations tend to be small and the few medium sized targets tend to be reluctant to increase disclosure and reporting to a standard required of listed entities. This is also an issue with public corporate bond issues. Whilst a standalone exchange may not be an option there might be a case for some sort of listing arrangement with one of the markets involved with the SEE Link project which aims to increase the level of cross border equity transactions in the region. The small population also presents a significant barrier to the development of a local capital market.

Multilateral and bilateral development bank finance and the EU[2]

A number of multilateral development banks (MDBs) and bilateral financial institutions are active in Kosovo, with varying investment levels and priorities.

The **European Union** is the single largest donor providing assistance to Kosovo, with more than EUR 3 billion contributed so far. The EU has provided financial assistance to Kosovo under the Instrument for Pre-accession Assistance for 2007-13, with a total allocation of €673.9 million. Additional €38.5 million were provided through IPA in 2013 to support the Pristina-Belgrade dialogue, normalisation and integration processes in Kosovo, including the visa dialogue. Under IPA II, Kosovo will continue to benefit from pre-accession assistance for 2014-20, with a total indicative allocation of €645.5 million, designed to support the following sectors: (i) Rule of Law; (ii) Agriculture; (iii) Energy; (iv) Public Administration Reform and (v) Competitiveness and Innovation.

To date, the **World Bank** committed to roughly US$400 million for more than 30 operations in Kosovo in a wide array of sectors with the aim to accelerating broad-based economic growth and employment generation and improving environmental management. Since 2012 the World Bank has committed US$107 million mainly for infrastructure projects in the areas of water, transport, solid waste disposal and energy, the latter representing the central element of the World Bank assistance to Kosovo. With regards to projects in the energy efficiency and renewable energy sectors, the World Bank current portfolio includes a total of US$52.6 million addressing the environmental legacy issues related to the open dumping of ashes from Kosovo’s oldest TPP and aimed at reducing energy consumption and fossil fuel use in public buildings and support Kosovo in enhancing the policy and regulatory environment for renewable energy and energy efficiency (US$32.5 million). The World Bank has also been active in designing projects to improve the business climate and competitiveness and its portfolio in this area includes, among others, a US$7.8 million project to strengthen the financial market infrastructure (including the provision of seed funding to the Deposit Insurance Fund of Kosovo) and a US$8 million comprehensive public sector modernisation project. Moreover, with the objective to help developing Kosovo’s land and property markets, the World Bank is financing a US$13.8 million Real Estate Cadastre and Registration Project and supporting the Government in agriculture and rural development with US$44 million of financing to promote competitiveness and growth in the livestock and horticulture subsectors over the next decade. The World Bank is also cooperating with the Government in developing the Kosovo Digital Economy Programme whose main components are based on projects that will develop the relevant broadband infrastructure as well as human capital and digital businesses to include Kosovo in the future of digital economy. The World Bank has now begun preparations for a new Country Strategy Framework for Kosovo for the period 2016–20.

The International Finance Corporation’s **(IFC)** advisory services in Kosovo aim to improve the investment climate and the performance of private sector and to attract private sector participation in the development of infrastructure projects. Kosovo became a member and shareholder of IFC in 2009 and since then, IFC commitments reached US$389.8 million. IFC investments include the Balkan Renewable Energy Project (BREP), a US$7 million regional advisory program to enable the creation of a renewable energy (RE) market and support the development and financing of RE initiatives in the Western Balkan countries and the Investment Climate Project, a US$2.5 million project to link in a programmatic manner

[2] This section focuses on large scale financing, whereas other donor and TC activities are captured in Annex 6.

the business regulatory, investment policy, and industry-specific work in agribusiness to maximize impact. IFC also invested in the financial markets, general manufacturing and mining sectors. Kosovo Government recently appointed IFC as their Transaction Advisor for the new Kosovo C project.

The **IMF** has been focusing on a number of structural reforms aimed at boosting Kosovo’s growth potential and moving away from the remittance-based growth model. The IMF’s engagement to date has been mostly focused on:

- Supporting the Investment Clause that exempts privatisation-funded investment from the fiscal rule's deficit ceiling and create fiscal space for new donor-funded infrastructure investment projects (incl. R10 funded by EBRD/EIB/EU);
- Strengthening public procurement processes through introduction of e-procurement and centralized procurement practices;
- Supporting amendments to the Law on Enforcement Procedures to ease the case burden for the courts; and
- Removing structural bottlenecks to credit provision including removing legal and judiciary obstacles that prevent banks from better supporting economic growth.

The **EIB** in 2015 has signed a Framework Agreement with Kosovo allowing it to finance priority projects, particularly in the areas of the environment, transport, telecommunications and energy infrastructure. The EIB is supporting railway modernisation with a €42 million loan for the modernisation of the Kosovo part of European Rail Route 10, the first EIB loan to the public sector in Kosovo ever. Among others, the project is also funded by a €40 million loan from the EBRD.

Finally, Kreditanstalt für Wiederaufbau (**KfW**) has been assisting Kosovo since 1999 to establish efficient and sustainable power supply, upgrade municipal infrastructure and promote SMEs. Kosovo’s banking sector has been supported by KfW for almost 15 years, including by supporting the establishment of ProCredit Bank – of which the EBRD was one of the founding shareholders – and the Deposit Insurance Fund of Kosovo (DIFK). In the energy sector, KfW supported the rehabilitation of the two coal-fired power stations and in 2009 KfW financed a transmission line to Albania, which ever since contributes to ensuring electricity supply to Kosovo. With regards to municipal infrastructure, KfW was involved in the rehabilitation and improvement of existing drinking water supply and sanitation systems in Gazivode and the municipality of Leposaviq. Currently, KfW is financing together with EU funds an investment in the water supply and waste water disposal systems in Pristina to safeguard a continuous and hygienic supply of drinking water.

2.5 Business environment and legal context

Business Environment

Some progress has been made in business climate reforms, in particular in strengthening the basic legal framework and institutional structures, partially supported by the World Bank, but much more remains to be done. The government's commitment to improve the business environment has been recognised by the World Bank's most recent Doing Business report where in areas such as starting a business the country has improved significantly and the country has improved by 40 positions in two years. However, Kosovo still lags behind regional peers on most indicators in the report. Stronger political will and improved institutional capacity are needed in order to tackle some of the most binding constraints to investment in Kosovo: unfair competition from informal firms, corruption, poor contract enforcement and unclear property rights.

The recently approved National Development Strategy and the Economic Reform Programme underscore the progress that the government has made in clearly articulating its reform priorities and committing to undertake a number of significant actions to improve the investment climate. Some of the measures mentioned in the documents, notably reforming licensing and inspections regimes, could represent important "low-hanging fruits" that would allow to improve the ease of doing business in the short run and gain traction for further reforms.

In recent years, the authorities have taken a range of measures to make the business environment more conducive to private sector development. These include making paying taxes easier for companies by abolishing the annual business license fee. The government also made dealing with construction permits easier by establishing a new phased inspection scheme, substantially reducing the building permit fee, eliminating the requirement for validation of the main construction project and eliminating fees for technical approvals from the municipality. The government has also made enforcing contracts easier by introducing a private bailiff system. Finally, it has simplified the procedures to start a business by creating a one-stop shop for incorporation.

On the other hand, transferring property has become more difficult since the authorities have increased the fee for the registration of property transactions.

Several donors have been engaged in the area of investment climate with the Kosovo government, in particular through their support to SECO-IFC – Investment Climate project aiming to improve though Technical Assistance the country's investment climate for both domestic and foreign investors and linking in a programmatic manner business regulatory, investment policy and industry specific work in agribusiness to maximize impact. In addition, the World Bank is planning a-IDA loan to be launched by 2017, consisting of hardware support especially in the area of quality infrastructure.

Legal Context

The legal system in Kosovo has been the subject of constant reforms in recent years with a view of strengthening its legal framework for business. While there has been a significant progress, reforms are still required in a number of sectors as highlighted by the EBRD assessment on the corporate governance legislation and practices of companies.

Land ownership presents serious legal issues. Until recently, clarity of ownership titles was very difficult in Kosovo as several properties were left damaged, destroyed, or abandoned by the conflict in 1999 and property transactions in the country were often unregistered because of problems with government offices. The World Bank Kosovo's Real Estate Cadastre and Registration Project aims to strengthen the property rights system and create legal certainty among investors and allow citizens to use property as collateral for access to funding and develop land and property markets in the country. This is particularly important as the government wants to establish industrial zones with significant impediments to be overcome in offering locations to businesses which may freely and securely rely on the land it purchased to develop the economic activity.

With regards to the financial sector, despite recent reforms, the legal framework on secured transactions faces serious challenges which come from the uncertainties in the registration system of immovable property and the narrow scope of information covered by the credit bureau (trade credit and utilities) which harms the quality of credit referencing. Due to delays in adopting relevant regulations, the Bankruptcy Law has only recently started to be applied in practice with the first case registered in 2015. There seems to be a lack of practical experience in insolvency and training in insolvency should be undertaken within the judiciary and wider legal community.

Although the Constitution explicitly states that judicial power is independent, issues regarding judicial independence in Kosovo persist. Other issues faced by the Kosovo judicial system include poor accessibility, delays and a backlog of unresolved cases. Judicial reform efforts in Kosovo should focus on strengthening independence of the judiciary and enhancing capacity of the dispute resolution system. All court judgments should be made publicly available within an easily accessible and searchable system. This will foster greater investor confidence in the dispute resolution system and contribute to improving the national business environment.

Some positive steps have been undertaken in the fight against corruption, notably publishing asset declarations of public officials. The 2015 Report on Kosovo by the European Commission provides an important set of key recommendations for the authorities and the four main bodies involved in the fight against corruption in Kosovo, including prioritising handling of high-level corruption cases particularly in public procurement, and revising the conflict of interest law and all related laws in line with European standards.

Although Kosovo has made significant progress in developing its framework on energy efficiency, a substantial amount of work remains to be done to ensure compliance with EU energy efficiency and environmental legislation (see Legal Annex). Kosovo has only recently adopted a new legislation on energy, the energy regulator, electricity and gas aimed at transposing the Third Package. A full assessment of their impact for relevant sectors is still pending but it is expected that next steps would involve developing secondary legislation and providing adequate capacity building of the regulator to support market liberalisation.

Similarly, the public procurement and telecommunication legal framework needs to be aligned with EU law.

See Annex 4 for a more detailed assessment of the legal environment in specific areas relevant to the Bank's investment strategy.

2.6 Social context

Kosovo's labour market suffers from high rates of unemployment and few job opportunities, especially for young entrants. Youth unemployment stands at 61 per cent and at an even higher 71.7 per cent for young women. The adult unemployment rate for women is 41.6 per cent compared to 33.1 per cent for male adults. According to the International Labour Organisation, only 24.1 per cent of the working age population is formally employed, which is substantially below that of other countries in the region, including Albania (44.3 per cent) and 35 per cent of youths are not in education, employment or training. Unemployment is also high among women, with 71 per cent of women unemployed. Furthermore, the percentage of people employed in vulnerable jobs increased from 23.6 per cent in 2013 to 24.9 per cent in 2014 and informal employment is common. The service sector remains the main formal employer in the country (67.1 per cent) compared to industry (28.4 per cent) and agriculture (13.9 per cent).

High levels of poverty and exclusion of ethnic minorities persist. According to the World Bank, 29.7 per cent of the population in Kosovo live below the poverty line of €1.72 per day. Extreme poverty is disproportionately prevalent in households with children, elderly, or disabled members, female-headed households, and in those that are part of an ethnic minority (especially in the Roma, Ashkali, and Egyptian communities). Average life expectancy at birth is 71 years, which is five years lower than that of neighbouring countries (and substantially below the EU-average of 78.8 years), indicating weak health outcomes[3]. The education infrastructure and outcomes are well below regional standards. Enrolment rates for ethnic minority groups is particularly low: only 77 per cent of non-Serb children (Roma, Ashkalia, Egyptian, Turkish, Bosniak and others) between the ages of 6 and 14 are enrolled in school, compared to over 97 per cent for the Kosovo Albanian and Kosovo Serb communities. Gender disparities persist, with only 69 per cent of girls from minorities enrolled in schools.

There is a substantial mismatch between the skills of the young job seekers and the requirements of the labour market, specifically at vocational level. The unemployment rate for those who have no school education stands at 64.6 per cent, compared with those who completed secondary school (41.2 per cent) and those who completed tertiary education (18.9 per cent). According to the ILO Key Indicators of Labour Markets (KILM), 24 per cent of young people are under-educated and unable to offer the qualifications required in the labour market. Almost a quarter of businesses report an inadequately skilled workforce to be an obstacle for their business. At the same time, qualifications are no guarantee for young people to be able to offer skills that are of relevance to employers; school-to-work transition is slow, especially for graduates with higher educational attainment, with the ILO estimating that 17.6 per cent of young people in Kosovo are over-educated for the types of jobs that they end up having to accept.

Given the high rates of youth unemployment, young people across all levels of education increasingly choose to leave the country in order to improve their economic condition, leaving Kosovo with a brain drain challenge. According to UNDP's 2014 Human Development Report, the majority of the Kosovan Diaspora community live in Germany and Switzerland, followed by Italy, Slovenia and Austria. The vast majority of Kosovan migrants are employed and primarily in the private sector.

[3] The Health Insurance Law passed in April 2014 introduced a mandatory health insurance scheme with a potential of relieving the challenge of low public health expenditure (as a share of GDP) and thereby reducing the household out-of-pocket spending. The Roma, Ashkali, and Egyptian communities have the same access to healthcare services as other citizens.

Kosovo has one of the lowest rates of female **labour force participation** in the world at 21.4 per cent, well below the EU average of 60 per cent. The labour market in Kosovo shows both, vertical and horizontal segregation along gender lines. Women are overrepresented in administrative positions, and according to the BEEPs survey (2015), only 4 percent of employed women advance to management positions. By sectors, women are underrepresented in energy, construction and transportation. The gender gap in relation to **access to finance** is also large. Women are less likely than men to have a bank account at a formal financial institution (36 per cent of women have bank accounts compared to 59 per cent for men). Additionally, women's participation in **entrepreneurship** and formal business ownership in Kosovo is also low by regional standards. In 2015, only 11 per cent of firms had women among the owners, while the proportion of firms fully owned by women stood at 7.8 per cent, one of the lowest in EBRD's countries of operation.

2.7 Resource efficiency and Green Economy Transition

Kosovo's energy intensity remains to be one of the highest in the EBRD's region of operation. Compared to the EU average, Kosovo is over four times more energy intensive than EU-28 (0.46 TPES/GDP vs 0.11, IEA - 2013). Solid fossil fuels (predominately coal) and oil represent over 85 per cent of the country's total energy mix. The electricity sector is dominated by several lignite-fired power plants, which are responsible for the majority of Kosovo's electricity production. Energy saving potential is therefore high across all sectors. The country has some potential for expanding the use of renewable energy sources for electricity generation. Currently hydropower and biomass are the only renewable energy resources currently used. There is potential for greater exploitation of these resources as well as some scope for wind and solar power generation. Diversification of Kosovo's energy mix by increasing the share of renewable resources will contribute to increased security of energy supply while reducing its carbon intensity and improving environmental sustainability. Kosovo also needs to enhance energy interconnections with its neighbours.

In addition, Kosovo has one of the highest ratios of residential sector energy consumption to total energy consumption in the Balkan region. Specifically, over 60 per cent of the country's total electricity demand is attributed to household consumption, which is particularly high due to a wide scale utilization of electricity for space heating – which is not an efficient medium for heat supply. The vast majority of the housing stock in the Western Balkans has been built in the 1960-80s period and is outdated, while the buildings constructed since 1990s were often built without any regard to energy efficiency (EE) standards and are energy inefficient. The recent EBRD market study concluded that the overall penetration rate of EE materials, appliances and equipment is very low at ca. 9 per cent in Kosovo.

Amongst other Western Balkans countries, in 2013 Kosovo had the lowest consumption of energy per capita, ca. 32 per cent of the EU-28 average; at the same time average energy costs represented over 10 per cent for all of the income groups and over 29 per cent for 70 per cent of the total population – meaning that overall the society has been falling within the definition of "fuel poverty". This was despite energy (mainly electricity) tariffs being heavily subsidised. The relatively low level of the per capita energy consumption also means that energy consumption will be increasing in Kosovo in the future in line with the economic growth and convergence of living standards with EU averages, putting further pressure on outdated energy-supply infrastructure, household budgets and public finances providing energy subsidies, increasing negative carbon footprint of the country, etc. Addressing energy supply-side as well as demand-side energy efficiency – particularly in buildings – is therefore crucial. Similar to the situation in the residential sector, public infrastructure and buildings (schools, hospitals, street lighting networks, etc.) also have a significant potential for energy efficiency. While the ESCO approach to addressing EE challenges in the public sector has not been applied to date (due to low energy tariffs and the lack of necessary supportive regulations), a sovereign lending approach could be the route to addressing this sector in the meantime. While SME and residential sectors offer significant energy saving potential in Kosovo, the inadequate legal and regulatory frameworks, lack of awareness and high transaction costs create barriers to investments in energy efficiency projects. Addressing these barriers by continuing to provide long-term commercial financing for energy efficiency investments, with policy and market development support, and capacity building is needed.

On the regulatory front, similarly to other Western Balkans countries, Kosovo is a Contracting Party to the Energy Community Treaty which means it has to implement the relevant EU directives concerning renewable energy and EE with implementation deadlines that vary from 31 December 2011 to January 2017. The key obligation under the Energy Services Directive 2006/32/EC (ESD) is for the countries to prepare and implement National Energy Efficiency Action Plans (NEAPs), which provide the framework for a strategic approach to EE improvement, specifically setting energy savings targets and proposing concrete measures and actions that would contribute to meeting these targets. Kosovo has developed the first National Energy Efficiency Action Plan (NEEAP) compliant with EU requirements, which has been accepted by the EC Secretariat. According to the NEEAP, Kosovo is bound by a 9 per cent energy savings target which has to be achieved by end-2018.

Climate change poses a number of threats to Kosovo's economy and development. Regional projections indicate increased mean and seasonal temperatures together with reduced summer precipitation, and greater precipitation variability overall. As a consequence, Kosovo is expected to experience water deficits during summer months. More variable precipitation may also result in fluctuations in river hydrology and more frequent extreme events such as floods. Water resources and agriculture are identified as the most sensitive sectors. Water stress will have implications for the Bank's operations in agribusiness and other water-intensive manufacturing. Agribusiness may also be affected by climate change through impacts on agricultural production, thus affecting the availability of primary produce and increasing the need for irrigation. Hydropower investments may also have to take into account climate-related changes in river hydrology. The need for investment in more efficient and better-managed water supply systems will increase in the face of greater water stress caused by climate change. In response, the Bank will systematically look for opportunities to boost climate resilience through its investments, paying particular attention to climate-sensitive sectors such as water supplies, power and energy (especially hydropower), agribusiness, infrastructure, and water-intensive industries such as mining and manufacturing.

3 STRATEGIC ORIENTATIONS

3.1 Strategic Directions

While economic growth increased in 2015 and is forecast to rise further in the short term, structural deficiencies bear heavily on Kosovo's economy, which is dominated by low value added industries, and, overall, is at an earlier state of transition compared to the rest of the region. The country suffers from high unemployment, particularly among the young and women, while erratic power supply (owing to the country's ailing energy sector) and outdated infrastructure deter investment and hinder development.

While structural challenges remain significant, positive internal and external developments may coalesce to provide tailwind to the Bank's engagement in the new strategy period. These include 1) the entering into force of the SAA with the EU, 2) the adoption of the National Development Strategy 2016-2021, 3) the submission of the 2nd Economic and Reform Programme 2016 - which includes a structural reform agenda to boost competitiveness and improve conditions for growth and job creation – as well as 4) the strategic alignment between the Bank's and the EU priorities guiding the allocation of €645.5 million under the new 2014-2020 IPA II Funds.

The strategy aims to apply some selectivity filters in guiding the Bank's investments and policy dialogue activities in the country:

- **Alignment of the Bank's priorities with Government priorities and ownership**; the Bank will avoid substantial engagement in areas and sectors where political championship is unclear;
- **Complementarity with other players**, including the European Commission, the IMF, the World Bank Group (WBG) and other IFIs; the Bank will not include substantial engagement where other partners are taking the lead;
- **EBRD comparative advantages and track record in Kosovo**. These will stem mainly from the Bank's engagement with the private sector (especially in agribusiness, manufacturing, ICT, power and renewables) and targeted investment in the public sector to promote private sector participation and support reform (MEI and transports).

The Bank will apply the GET approach across all sectors and operations where this is relevant, in order to maximise the support for and delivery of GET investments; providing technical assistance to address capacity and awareness gaps; and engaging in policy dialogue to alleviate prevailing barriers and create an enabling environment for green investments, among others.

Across the all its strategic priorities, the Bank will promote **inclusive growth** (youth, female labour participation and returning migrants).

Leveraging the incentives provided by the EU and IMF, as well as the authorities' own reform momentum, the Bank will aim to support Kosovo in its efforts to accelerate economic growth on a sustainable and inclusive basis, while deepening and strengthening its engagement and support as needed and in accordance with the pace and depth of progress in reforms focusing on the following strategic priorities:

- **Support competitive development of the private sector through investments, enhancing internal capacity of companies and improving business environment**. Kosovo's economy is characterised by low productivity, high unemployment, mismatch between the skills of the young workforce and employer requirements, thin export base, limited foreign direct investment, large degree of informality, and inclusion gaps, such as the extremely low female labour force participation. For the private sector to develop in a sustainable manner, major improvements are needed in the areas of investment climate, governance and competitiveness, leveraging the EU approximation process. The Bank will provide financing to Kosovo corporates and SMEs to support investment in such endeavours as increasing value added, improving competitiveness vis-à-vis imports, and enabling value-added exports. Improving access to finance for SMEs will remain a priority. In addition to financing, the Bank will provide advisory through the Advice for Small Businesses programme under the Small Business Initiative. The Bank will use its local partner banks as a principal conduit for channelling financing to MSMEs and will provide business advisory services in combination with investments to improve the competitiveness and modernisation of the agribusiness sector, including by raising quality and health standards, as well as by developing supply chains. Given the high liquidity of the banking sector, the Bank will continue to deploy targeted frameworks, some with incentives, such as the Women in Business programme (WiB), the Western Balkans Sustainable Energy Financing Facility (WeBSEFF), the Direct Finance Framework under the Small Business Initiative and introduce the Competitiveness Support Facility (CSF), as well as offer the Risk Sharing Facility (RSF). The Bank will aim to provide access to equity to SMEs when feasible to address lack of equity finances sources in Kosovo, even if appetite for equity is often very limited due to very limited exit opportunities and informality. The Bank will also provide advisory services with the aim to further build capacity and will consider engaging in such areas addressing informality, financial reporting, management capacity, corporate governance as well as promoting social inclusion by encouraging people to actively participate in the labour market and society The Bank will also be alert to the migration challenge in the current context as the government is seeking to boost the "*Brain Gain*" from the diaspora and the Bank will seek to participate in government-led schemes to enable engaging with the Kosovan returning diaspora in the private sector, provided adequate grant funding.

- **Enhance energy security and sustainability by financing investments in the sector, supporting sector reform, promoting energy efficiency and renewable energy.** The Bank will apply the GET approach across all sectors and operations where this is relevant in order to maximise the support for and delivery of GET investments in the country. Kosovo's dilapidated energy sector is suffering from years of underinvestment. Unreliable electricity supply disrupts businesses' operations and impedes investment and business expansion. The country's two principal coal-fired generating plants are obsolete, with one of them slated for decommissioning. Energy efficiency and renewable energy can help mitigate current and projected power shortfalls, while enhancing environmental sustainability. This will require strengthening the existing regulatory frameworks and institutional capacity for energy-efficiency and renewable energy. The country needs to further harmonise with the EU legislation, while bringing down energy intensity and improving environmental compliance. The Bank will consider supporting investments in power generation capacity, including from thermal and renewable sources, where these are consistent with its Energy Sector Strategy. In parallel, the

Bank will support the strengthening and improving efficiency of the national transmission grid, as well as investments in reducing energy intensity by supporting demand-side energy efficiency investments across all sectors as part of its direct lending or sustainable energy financing facilities via partner-banks. Subject to commitment from the authorities, and in coordination with the EU, other IFIs and donors active in the energy sector, the Bank will provide policy advice and technical assistance to address institutional and policy reforms especially in the area of the development of a bankable renewable regulatory framework as well as to improve the legal framework for energy efficiency with a particular focus on the residential sector.

- **Support connectivity and regional integration**. Infrastructure development is needed to improve Kosovo's regional integration and attract FDI, as well as to harmonise with EU standards. To that end, Kosovo needs to build the main road links to Pan-European corridors. Kosovo's obsolete railway network is currently connected to the main European network only via FYR Macedonia, a significant impediment for traffic to or from most European centres as the only other connection from Pristina to Serbia is not functional. The Bank will aim to provide long term finance and advisory to help build and rehabilitate key transport links, as well as, where applicable, help Kosovo bring its transport sector into compliance with European standards. The Bank will also support investments aiming to improve the country's regional interconnections in the energy sector. The Bank will seek to co-finance investments with the EIB, as well as support the country in mobilising EU grant funding under the WBIF which is increasingly emphasizing projects that promote connectivity. Finally business integration is also key as Kosovan firms have not been able to take (full) advantage of the opportunities provided by these export markets and the Bank will continue to support cross-border trade through its Trade Facilitation Programme, business advisory to small businesses on export readiness as well policy advice leading to a reduction in Non-Tariff Barriers and Technical Barriers to Trade around the EC connectivity agenda.

3.2 Key challenges and Bank activities

Theme 1: Support competitive development of the private sector through investments, enhancing internal capacity of companies and improving business environment

Transition challenges

- Although the quality of the **investment climate** (which comprises the effectiveness of state institutions, rule of law, quality of legal and operating environments) has improved in recent years, businesses still face a number of severe obstacles, including dealing with construction permits and resolving insolvency. Kosovo ranked 66th out of 189 economies on the World Bank's Ease of Doing Business ranking 2016. The time and costs needed to obtain export licenses are also high by regional standards. Informality and corruption are among the main business environment obstacles identified by Kosovan companies in the latest round of the EBRD-World Bank data (BEEPS V), as corruption practices are considered to be highest in the Western Balkans region with more than 50 per cent of firms surveyed by the World Bank stating corruption to be a major obstacle to growth, compared to 3.1 per cent in Montenegro, 12.2 per cent in Slovenia, 13.4 per cent in FYR Macedonia, 17 per cent in Albania, 18.9 per cent in Serbia, and 26.4 per cent in Bosnia.
- Uncertainties around **land ownership** and **basic infrastructure** needs hinder local and foreign investors. Kosovo needs to strengthen the property rights system, in particular in relation to developing a legal framework that clearly defines rights and creates legal conditions for marketable land rights, putting land to use, strengthening judicial capacities for dealing with property rights as well as activities that would ensure better protection of property rights for marginalised groups, including ethnic minorities as well as women.
- Major improvements are needed in the **area of improvements to productivity and export competitiveness**. Kosovo is at an early stage of developing a functioning market economy as its economic model is based on trade with very little industrial base. Furthermore, the country's capacity to cope with competitive pressure with the EU is low, according to EC assessments. Small enterprises lack the know-how to expand their businesses, improve productivity and competitiveness and to innovate.
- Another important challenge is the **impaired ability of the banking sector to provide effective financial services** to those SMEs that need financing but are unbankable, mainly due to the general weak economic environment, high levels of informality and the lack of financial management capabilities necessary to approach external financiers at SMEs level. Inadequate levels of financial literacy and low collateral base further prevent many SMEs from securing finance. The interest rate spread between loans and deposits, despite the downward trend in recent years, remains high as compared to peer countries, signalling imperfect competition in the banking sector, while investments are perceived as high-risk ones by foreign businesses as well as those from the Kosovan Diaspora. According to EBRD Gender gaps analysis, Kosovo has large gender gaps in access to finance and penetration of banking services remains shallow in the segment of female entrepreneurs. There is also no active private local or foreign equity VC fund.
- As mentioned in depth in the social context section (2.6), there is a substantial **skills mismatch** between the requirements of the labour market and the output of Kosovo's education system, specifically at vocational and tertiary levels as, at a time of rampant unemployment, the paradox is that many enterprises actual run into

difficulties recruiting skilled labour. Kosovo faces major economic and social inclusion challenges: unemployment is high especially for the young cohort and there is a continued migration, mainly to Western Europe. A growing private sector will be key to offering job opportunities for excluded groups, especially in rural parts of the country, as well as women, youth and minorities to also adequate capitalize on the skills of the Kosovan Diaspora members as the lack of qualified labour discourages investment and is an obstacle to enterprises competitiveness.

- The **agriculture sector** is an especially important driver of economic expansion in the country given:
  - Its sizeable share in the overall economic activity (14 per cent of GDP in 2011;
  - It is the largest private employer accounting to 20 per cent of total employment) – and as such has a strong potential for being one of the engines of growth over the short- to medium-term;
  - 53 per cent of the territory is considered as good, arable land and endowed with favourable agro-climatic conditions.

  However, it is fraught with systemic and structural challenges that need to be addressed to harness its competitive and growth potential (ERP 2016 and NDS) as, despite a steady growth in the sector over the past years, the overall balance of trade in agricultural products is still negative. At present, agriculture is characterised by (still) poor overall productivity, primarily due to:
  - Fragmented land holdings averaging 1.5 hectares (often spread across an average of seven smaller plots, further exacerbating economies of scale) requiring improvements to agricultural land regulation;
  - Outdated farm technologies and lack of modern agricultural knowledge among farmers and agro-processors,
  - Lack of diversification of agricultural products;
  - Lack of investments in irrigation and the absence of a participatory system of irrigation management;
  - Limited processing facilities, including lack of cold storage, packaging, and transport facilities, which are especially important for high-value added fruit and vegetables production;
  - Limited implementation of food safety and hygiene standards;
  - Limited access to, and especially high costs of, credit and investment capital, partly reflecting high informality and the inability to realise the value of collateral. The latter contributes to outdated farm technologies and lack of modern agricultural knowledge/skills among farmers and agro-processors.

  The government is supporting the transition from primary agriculture crops to higher return products and organic farming. It is also addressing policy measures including land property issues by developing a strategy with the Ministry of Justice.

- The **ICT sector** is considered to hold significant potential for growth (ERP, 2016). However, the dissemination of ICT infrastructure in Kosovo is highly uneven. Key challenges for the sector include developing modern telecommunications infrastructure (broadband internet) and further improving the implementation and enforcement of a modern regulatory framework. Businesses face needlessly high cost due to failure to incorporate IT in their operations and there have been no incentives for private sector to invest in IT processes.

- The government is planning support to municipalities in the functioning of 5 to 7 **economic and industrial zones**, i.e. consolidated land plots providing basic infrastructure for investors (access roads, electricity, water treatment) to mitigate risks for new businesses. There are however significant impediments to be overcome such as offering locations to businesses. The zones would be run on commercial principles, with equal access to local and foreign investors.
- The utilisation of mining potential is key for Kosovo's economic potential. The future of the **Trepca mining** complex remains unclear because of complications over the ownership structure and potential creditor claims from Serbia. The Supreme Court of Kosovo has set 1 November 2016 as a deadline for submission of the reorganisation plan for the complex. The recovery of the complex could directly affect Kosovo's economic growth through increased exports, the creation of a potential chain of manufacturers and opening new jobs. However, key challenges include a legacy of environmental degradation and environmentally irresponsible mining practices, the need to complete the restructuring and resolve legal ownership issues.
- A persistent weakness of Kosovo's SMEs relates to their **corporate governance,** especially their **financial reporting standards**. Kosovo has to move towards international accounting standards and best practices. Based on the latest World Bank enterprise survey, only about 20 per cent of Kosovo firms reported having their annual financial statements reviewed by an external audit. Weak internal accounting standards prevent Kosovo SMEs from exploiting their growth potential.
- **Privatisation** has not advanced in recent years as the Privatisation Agency was not functional because the Board was incomplete. There is still need to commercialise and – where feasible – gradually privatise SOEs and create an enabling environment for FDI.
- Since autumn 2014, Kosovo has been witnessing an accelerated rate of outward migration into the European Union (mainly Germany and Austria), as well as Switzerland, reflecting both political uncertainty and limited economic opportunities at home**.** However, on the bright side, Kosovan **diaspora** acquired skills and know-how the transfer of which would be beneficial to Kosovo's economy. Studies indicate that the expatriates from diaspora who possess the skills have managed to find employment in Kosovo much easier than those possessing no skills, which demonstrates their worth as human capital. However, to date, the so-called brain gain process has been sporadic and lacking in institutional support. Establishment of mechanisms that would facilitate engagement of diaspora would enable the transfer of skills and help in durable return of a number of skilled diaspora members. In terms of skills transfer schemes, there is only one programme aimed at boosting the return of scholars and no schemes to enable engaging with diaspora in the private sector.

Operational response

- The Bank will support Kosovo's corporates and SMEs, in increasing efficiency, standardisation and productivity, supporting competitiveness vis-à-vis imports, and encouraging value-added exports through a combination of investment and business advice. The Bank will continue to develop a sustainable MSME support infrastructure through the capacity building and development of local consultants.
- The Bank will use its local partner banks as a principal conduit for reaching out to MSMEs products, focusing on providing capital relief for banks, risk-sharing

facilities, credit guarantees and dedicated credit lines to foster financial intermediation and reach underserved market segments and strengthen competition and market effectiveness in the financial sector. Given the high liquidity of the banking sector, the Bank will continue to deploy blended instruments such the Women in Business programme, the Western Balkans Sustainable Energy Financing Facility and introduce the Competitiveness Support Facility, as well as offer the Risk Sharing Facility.

- The Bank will provide business advisory services with the aim to further build capacity and, subject to the government's commitment, will consider engaging in such areas addressing informality, financial reporting and management capacity, as well as corporate governance.
- Through ASB, the Bank will continue to develop a sustainable MSME support infrastructure through capacity building and development of local consultants.
- The Bank will provide business advisory services in combination with investments to improve the competitiveness and modernisation of the agribusiness sector, including by raising quality and health standards, as well as by developing supply chains. Under the Advice for Small Business Initiative the Bank will continue supporting the local banking sector with credit lines to SMEs in the agribusiness sector, enhancing the value chains, enhanced by local and international advisory services. The Bank will also explore financing opportunities to expand irrigation system coverage, building on current TC support, and it stands ready to support the Iber-Lepenc canal.
- As the ICT sector is considered a key priority for development by the government, the Bank could consider support to Kosovan IT businesses as part of a regional project, given the small market and similar potential in neighbouring countries, in order to export services abroad and to other businesses to upgrade their business operations through use of IT.
- When engaging in direct transactions with private corporates, including via equity investments and not only bank debt, the Bank will seek to build on its private sector-focused inclusion model via improving training and work based learning programmes (e.g. apprenticeships) and supporting initiatives to enhance private sector participation in the setting of national skills standards that reflect labour market needs, particularly at vocational level. This will serve to promote formal employment opportunities, and skills transfer, particularly for young labour market entrants, women and returning migrants. In addition to this, the Bank will also seek opportunities to support its corporate clients in the area of Equal Opportunities with a view to improve women's participation in their workforce and women's career opportunities.
- The Bank will support FDIs as well as the process of privatising the remaining state-owned companies subject to transparent tendering and involvement of qualified strategic investors, especially in the telecoms and posts sector.
- Subject to privatisation advancing and presence of reputable foreign strategic investors, the Bank will selectively consider quality investment projects in the mining sector, with the aim to unlock the significant growth and employment potential of this sector.
- The Bank will strive to enhance private sector participation in road maintenance under performance-based contracts under the current road projects.

- To boost the engagement on inclusion policy and building on its strategic partnership with the European Training Foundation (ETF), the EU's agency for vocational education and training policy engagement in EU neighbourhood and accession countries, the Bank will focus on the development of technical and vocational education and training skills standards, as well the geographic expansion of facilities for testing vocational skills as well as support youth employment through career guidance with private sector involvement and implementation of the youth guarantee.
- The Bank will seek to participate in government and companies-led schemes to enable engaging with the Kosovan returning diaspora in the private sector, making use of the diaspora human capital for transfer of know-how provided adequate grant funding, in particular via the establishment of matching grants schemes to stimulate investment of Diaspora in establishing companies in the country.

Policy dialogue

- The EBRD will closely coordinate with other IFIs on policy advisory activities to improve corporate governance and the investment climate, building on its expertise in specific areas, including improving administrative and judicial procedures, restructuring SOEs to make them more efficient, and developing financial markets. The activities will be based on detailed needs assessment, agreed with the authorities.
- The government has encouraged EBRD's involvement initially for policy advice and technical assistance in setting up industrial zones providing a more liberal legal and regulatory framework, efficient public services, and better infrastructure (including better roads, power, water, and wastewater treatment) and creating a more conducive business environment for investors.
- The Bank will conduct TC and advisory activities to promote the consolidation, modernisation and efficiency of the agribusinesses as well as to improve the links through the agribusiness value chain (from farming, to food processing and to food retail), reaching out to both larger corporates as key pillars as well as SMEs by adopting best practices in supply chain management. The objective is to develop a sustainable approach to the value chain integration, including through investment support to upgrade operations and to promote platforms of collection and distribution.

Results Framework for Theme 1: Support competitive development of the private sector through investments, enhancing internal capacity of companies and improving business environment

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
1.1	Value-added production is hampered by limited internal capacity, obsolete technology, difficult business environment and limited access to finance	**Strengthen competitiveness of the private sector through gains in efficiency, adoption of innovative operational practices, improved managerial practices, improved business environment and access to finance**	• Providing financing (both debt and equity) to SMEs, complimented by TC, under the Advice for Small Businesses to invest in improving quality standards, enhancing core competencies, and transferring skills with a view to strengthen competitiveness vis-à-vis imports and encourage value added exports • Deploy targeted credit frameworks (e.g. WiB, CSF, RSF) and available risk-sharing products. • Advice for Small Businesses to improve financial management and corporate governance, increase productivity via implementation of quality standards, trade promotion and enhancing competitiveness and export potential.	• Evidence of successful introduction of higher corporate governance and business standards by clients *(Baseline – N/A)* • Total number/volume of MSME sub-loans provided by client banks incl. to identified target areas (women entrepreneurs, agri). (*Baseline – established at projects approval)* • Number of ASB projects that reported increased productivity, turnover and/or number of employee *(Baseline – established at project approval)*
1.2	Agribusiness is constrained by the prevalence of small and inefficient subsistence farming and limited availability of finance	**Increase production, efficiency and quality along the agribusiness value chains via support to access to finance, output markets and technical skills.**	• Direct lending and on-lending through banks, including risk sharing, targeted at agribusinesses to upgrade their facilities and equipment, to support value chains through consolidation of farming and improvement of processing capacities (in particular of meat, dairy, fruit and vegetable industries), and to promote quality and health standards. • Investments and advisory services to enhance agribusiness value chains, promoting improvement of the links through the agribusiness value chain (from farming, to food processors, and retailers). • Advice for agribusinesses as pre-and post-investment support, to improve the standards, efficiency and competitiveness of their operations. • Explore financing opportunities to expand irrigation system coverage.	• Examples of successful implementation of training/capacity building to agri-farmers (*Baseline – N/A)* • Number of agri-companies supported through projects via backward and forward linkages (*Baseline – 0)*
	Context indicator: Δ % of firms in Kosovo identifying access to finance as a major constraint to their operations (BEEPS V) *(Baseline 2013 – 40%)*			

Theme 2: Enhance energy security and sustainability by financing investments in the sector, supporting sector reform, promoting energy efficiency and renewable energy

Transition challenges:

- Restructuring the energy sector to enable investments is the most pressing priority for the government with 9 out of 10 firms citing electricity as main impediment to investment. Challenges in the sector are large, both in terms of **sustainable energy** and **capacity shortages.** Electricity supply options are constrained by the poor condition of ageing, high-polluting, and unreliable thermal power generation plants (TPPs), limited availability of renewable resources, subdued regional power interconnections that limit Kosovo’s ability to import electricity, and an absence of any natural gas resources or pipeline to import gas. This inhibits growth and deters investment, while Kosovo’s obsolete power generation plants (producing 97 per cent of domestic electricity generation according to our estimates) are the most carbon-intensive in the Western Balkans.
- As a signatory of the Energy Community Treaty, Kosovo has to comply with requirements specified in EU directives related to emission control. To address the energy supply and corresponding environmental challenges, Kosovo, in close collaboration with the World Bank and other development partners, has developed a **multi- pronged strategy covering its long-term energy needs** aimed at (i) ensuring adequate and reliable energy supplies; (ii) reducing the need for public subsidies to energy; (iii) limiting the environmental externalities; and (iv) attracting the private sector for electricity generation and distribution.
- The government’s plan for the **new lignite-fired plant Kosovo C** has been progressing slowly since 1999. The project is still under development with the close involvement of the International Finance Corporation (IFC), as transaction advisor, and the World Bank Group from which the government of Kosovo has requested a Partial Risk Guarantee (PRG) for attracting private investors to build the plant.
- Net electricity imports are very low at 152 GWh or 10 per cent of the electricity supply. As Kosovo’s **energy security should not be equated with domestic self-sufficiency** and progress in the diversification of energy sources is key, market opening and interconnections should be encouraged to take advantage of the abundant hydropower generation in the wider region. A new 400 kV transmission line to the border with Albania has been inaugurated and regional integration will also help increase development of renewables.
- **Renewable energy can help mitigate projected power shortfalls while enhancing energy security and environmental sustainability**. The main priorities regarding sustainable energy include the elimination of administrative barriers and the development of a robust and bankable framework for renewables. Kosovo presently makes insufficient use of renewable energy sources (RES), producing only 3 per cent or of its energy from renewable sources while it aims to increase the share of RES to 25 per cent of its gross final electricity consumption by 2020 according to its NDS. Kosovo’s Regulatory Office has already approved tariffs (‘Feed-in Tariff’) for all types of renewables. Key challenges include the need for proper concession and licensing procedures as well as robust PPAs. The government is also considering the establishment of a One Stop Shop to support the development of Renewable Energy Source projects in the country.

- Combined with the energy supply-side issues, **demand-side energy efficiency across all sectors** (private SMEs, residential buildings, public entities) presents an important challenge as the overall energy intensity of the country remains to be significantly above the EU average (and among the highest in the Western Balkans).
    - Infrastructure on energy efficiency has been unfolding at a slow pace. There is a very high energy savings potential for public buildings (of 38–47 per cent in municipal buildings and up to 49 per cent in central government buildings (World Bank). Currently, inefficient energy consumption increases the costs of doing business with direct impact on the companies' competitiveness. Kosovo has one of the highest ratios of residential sector energy consumption to total energy consumption in the Balkan region. Specifically, over 60 per cent of the country's total electricity demand is attributed to household consumption. Industries too in Kosovo remain energy intensive and non-price barriers to energy efficiency persist. The EU has planned technical assistance for the 2016-18 period to the Ministry of Economic Development and Kosovo Energy Efficiency Agency on upgrading the legal framework on energy efficiency and renewables as well as on enhancing the central level planning process (update of the long term national plan for energy efficiency and review of national targets for RES), as well as promoting sustainable development at local/municipal levels including energy efficiency measures and related cost of implementation.
    - The country needs to **further upgrade and modernise the energy transmission grid** and **reduce commercial and technical losses in the distribution grid**, which currently account for 28.46 per cent of gross electricity consumption. A considerable part of the losses is attributable to theft, which cannot be fully tackled without appropriate technical improvements. Also, one of the major constraints in terms of commercial and technical losses are bill collections in the North of Kosovo (ERP, 2016).
    - **Tariffs are well below cost-reflective levels** and the authorities are preparing a plan for gradually increasing energy tariffs to reflect actual costs, along with targeted support measures for vulnerable groups of consumers. The authorities have to strengthen the institutional capacity of the Energy Regulatory Office, the authority in charge of regulating the energy sector and tariffs in Kosovo as well step up payment enforcement.
- Finally, the country needs to ensure the **sustainable management of natural resources** as environmental infrastructure is generally underfunded in Kosovo.
    - The country has limited water resources divided into four main water basins and they are set to represent a constraint to the country socio-economic development in light of rising demand for water. There are no wastewater treatment plants in operation in Kosovo, adding to the challenges of water contamination.
    - The lack of adequate environmental protection measures has resulted in serious environmental impacts from industrial waste due to former mining and mineral processing activities. At present, there is no proper waste management for any type of waste.

Operational Response

- Kosovo's energy intensity is one of the highest in the EBRD's region of operation owing to several outdated lignite-fired power plants. In its efforts to help the government meet current and future energy needs to address a growing "*energy crunch*", while balancing corresponding economic, financial, and environmental costs, the Bank will consider investments in the construction of new **power generation capacities** in coordination with other IFIs and donors. This could include coal-fired generation if the infrastructure being considered meets the requirements of the Bank's 2013 Energy Sector Strategy.
- The Bank will seek to finance **renewable energy projects** through direct lending (including the Direct Financing Facility), or through dedicated credit lines with local financial institutions, including with SMEs.
- Aiming to encourage reduction of Kosovo's relatively high energy intensity, the Bank will continue to be involved in on-going discussions with the European Commission on the replenished WeBSEFF, as Kosovo will now be eligible for investments under this facility. Under this framework, the Bank is providing long-term finance combined with grant incentives and technical assistance for **sustainable energy investments** to sub-borrowers in the SME and private residential buildings (under the new REEP) sectors.
- The Bank will explore opportunities to deploy new financing products to support **investments in public buildings' energy efficiency** under the most suitable financing structure (ESCO, municipal or sovereign).
- The Bank will seek to market **Resource Efficiency** credit lines for water, waste and materials efficiency investments as well as climate change mitigation and adaptation investments.
- The Bank will also seek to strengthen and upgrade the **national network transmission infrastructure**.

Policy dialogue

- The Bank will actively engage in policy dialogue with the government and the ERO specific to the development of a bankable renewable framework. Through technical support and coordination with IFIs and donors, the Bank will advise on the development of robust and bankable solutions. This includes bankable and legally acceptable Power Purchase Agreements, affordability measures and ensuring a creditworthy offtake. Realisation of projects to exploit Kosovo's renewable energy potential depends significantly on sustained government commitment to developing the relevant regulatory framework.
- If requested by the authorities, the Bank will offer policy advice, and potentially co-financing, for the Energy Efficiency Fund that the Ministry for Economic Development is looking to establish with the potential contribution of EU funds for subsidising investments in energy efficiency in public buildings and the residential sector.
- Under the next phase of the Western Balkans Regional Energy Efficiency Programme the Bank plans to continue to implement policy dialogue activities in the Western Balkans countries (including Kosovo) aiming to improve the legal framework for energy efficiency with a particular focus on the buildings sector (including legislation and regulations related to homeowner associations and

collective management of residential buildings with the aim of facilitating building-level energy efficiency improvements).

Results Framework for Theme 2: Enhance energy security and sustainability by financing investments in the sector, supporting sector reform, promoting energy efficiency and renewable energy

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
2.1	Kosovo suffers from energy capacity shortages and frequent power outages	**Enhance sustainable domestic power supply by increasing use of local energy sources**	• Invest in new power generation capacities in coordination with other IFIs and donors, including in coal-fired generation subject to compliance with the Bank's Energy Sector Strategy. • Finance larger RE investments through direct lending. • Finance small RE plants through dedicated credit lines and risk-sharing products with local financial institutions with a focus on small-scale hydropower, biomass and biogas.	• Increment in generation capacity of renewable energy financed with Bank support (in MW) (*Baseline – 0)* • Examples of clients successfully introducing best available technology and/or environmental standards by the clients investing in new power generation capacities.(*Baseline - established at project approval)*
2.2	Kosovo's energy intensity remains one of the highest in the EBRD's region of operation	**Improve energy efficiency**	• Finance EE investments, including for residential buildings (REEP) and SMEs, potentially in close collaboration with the government's Energy Efficiency Fund (to be established), governance and operating principles of the fund permitting. • Explore opportunities to finance EE investments in public buildings under the most suitable financing structure (ESCO, municipal or sovereign). • Policy dialogue, including through technical assistance, to facilitate development of regulatory structure for EPCs.	• CO_2 emissions reduction as result of the Bank's operation in tCO_2e/yr (*Baseline – 0)* • Number of energy/resource efficiency projects successfully implemented and/or subprojects financed through local banks under energy/resource efficiency frameworks (e.g. WeBSEFF) (*Baseline – Established at projects approval)*
	Context indicator: Δ Kosovo Energy Intensity *(Baseline 2013: 0.46 TPES/GDP – toe/thousand 2005 USD)*. Source: IEA 2013			

Theme 3: Support connectivity and regional integration

<u>Transition Challenges</u>

- Kosovo's integration into regional markets is lagging behind. Major investments in the region's infrastructure, along with associated reforms, can help boost connectivity and therefore trade and investment with neighbouring countries.
- **Transports:** Furthering regional cooperation on the connectivity agenda, i.e. extension of the Trans-European Network to the Western Balkans, improvement and harmonisation of regional transport policies and technical standards, and enhancement of local capacity for the implementation of the investment programme, should be pursued.
  - In the **rail sector**, deep restructuring of current operations is needed to ensure that the network and operations remain viable in the long term and competitive with alternative transport modes. From a regional perspective, the key challenges include the improvement of linkages of the network in the TEN-T network planning and funding priorities, and the introduction of competition in the cargo railway businesses.
  - The support for the **construction of multimodal terminals** should contribute to fulfilment of EU environmental standards as the Government lags behind with the implementation of the Multimodal Transport Strategy (prepared with the EU funded support in 2009) which included:
    - Connecting the proposed multimodal transport system to EU relevant MMT networks through cooperation links with local/regional/International entities and strategic alliances with fellow companies.
    - Upgrade of the existing multimodal terminal in Miradi to receive 550 m long full trains coming from the EU.
    - Potential upgrade/develop additional terminals especially in the North of the country for further shorter connection to the EU Network (Railway Corridor X) through Belgrade (Serbia).
  - In the **road sector**, key challenges include road sector financing, establishment of a Road Agency with defined responsibilities, funding allocations and arms-length relationship between the government and the Road Agency, as well as more private sector participation, including through road PPPs in due course.
- **Energy**: Kosovo faces the challenge of connecting to the South and East European (SEE) energy market as well as upgrading and strengthening the transmission grid infrastructure to improve cross-border trade, reduce losses and allow for enhanced private participation in the sector, especially in the trading segment. Kosovo has finalised its part of construction of the high voltage interconnectivity line with Albania. Based on this interconnection Kosovo can start developing a joint energy market with Albania which would significantly increase energy security.
- Significant imbalances in the current and trade accounts are a cause of concern (ERP, 2016). Kosovo's capacity to export remains weak, although growing. One of the most notable, and persisting, weaknesses in competitiveness and capacity to export is the lack of compliance with EU quality standards and the inflow of FDI is considered too low to have a meaningful development impact. Despite a liberal trade regime with a flat customs rate of 10 per cent for imports and being Kosovo a member of the

Central European Free Trade Agreement (CEFTA), having a free trade agreement with Turkey as of January 2015 and enjoying duty-free access to the EU and to the US under the Generalised System of Preferences, Kosovo's firms have not been able to take (full) advantage of the opportunities provided by these export markets. In particular, measures on trade facilitation such as Non-Tariff Barriers, Technical Barriers to Trade as well as Sanitary and Phyto‑sanitary Standards need to be tackled in order to encourage greater flows of trade across borders, including coordination of activities at the national and regional level. Kosovo's authorities, particularly the Ministry of Trade and Industry (MTI), need to continue efforts in modernizing its Quality Infrastructure (including standardisation, conformity assessment, metrology and accreditation) to reduce barriers to trade and enable better access to the EU and international markets for Kosovo based firms.

Operational Response

- **Transports:**
  - EBRD's planned engagement in the Connectivity Agenda is strongly supported by the EU. The Bank will seek opportunities to promote and support development of cross-border transport infrastructure to strengthen regional economic links, working closely with the partners in the WBIF to mobilise both grants for investments as well as technical assistance. Against this background, it will be key to ensure consistency with the ongoing initiatives, such as the Single Project Pipeline and the National Investment Committee.
  - **Railways:**
    - The Bank will continue to support the modernisation and expansion of the railway infrastructure, with the view to connect Kosovo's railway network to the European network via Serbia and FYR Macedonia through Corridor X and Corridor VIII (the latter ultimately linking the Black Sea coast in Bulgaria to the Adriatic coast in Albania, as well as Turkey).
    - Equally important in view of new railways network investments underway, the Bank will promote sector reform via capacity strengthening of the key stakeholders, primarily INFRAKOS, TRAINKOS and Railways Regulatory Authority.
    - The Bank will explore opportunities to be involved in the implementation of the multimodal transport strategy (prepared with the EU funded support in 2009).
  - **Roads:**
    - The Bank will aim to finance the upgrade and expansion of the national and regional road networks, in particular regional and pan-European transport corridor sections in Kosovo, such as:
      - Kijeve – Peje road section which is part of the South East Europe Transport Observatory Route SEETO 6b running from Pristina to Peje;
      - Pristina-Merdare road section (part of SEETO Route 7) connecting Serbia, Kosovo and Albania (Niš – Pristina – Durres) in what has been hailed as the "Peace Highway";
      - Pristina – Gjilan – Dheu i Bardhe motorway.

        - The Bank will work closely with the EU and other IFIs in order to identify appropriate financing structure for such projects including private sector participation (also, through performance-based contracts in maintenance) where possible.
    - **Airports:**
        - The Bank will seek to support the investment plans of the air navigation agency with the aim to upgrade its operations, including through the provision of technical assistance to boost institutional capacity.
- **Energy:**
    - The Bank will seek to support private investments that aim to further improve the country's energy regional interconnections (Kosovo is nearing completion of its side of the 400 kV transmission line to Albania enabling Kosovo to exchange electricity and maximise the use of Albania's hydropower plants in winter).
- The Bank will continue to support **cross-border trade** through its Trade Facilitation Programme, as well as through business advisory to small businesses on export readiness. Through its Advice for Small Businesses initiative the Bank will support trade promotion to facilitate the region's close linkages to the EU market.

Policy Dialogue

- The Bank will continue to support the Ministry of Infrastructure in developing an appropriate mechanism and procedure for their internal approval of priority investments. In addition the Bank will assist the Ministry in enhancing its procurement capacity and environmental and health and safety management. Subject to commitment from the authorities, the Bank will assist in establishing a Road Agency as an independent body with defined responsibilities.
- The Bank will continue to assist the Ministry of Infrastructure in enhancing the financing of road maintenance with the aim to reach a sustainable level within a reasonable time frame, through reform and possible increases in road user charges. The Bank will assist in developing a road finance study to determine adequate and achievable funding levels and the revenue sources to finance road maintenance expenditure.
- The Bank will continue to assist the Ministry of Infrastructure and its Road Directorate in building up local road safety expertise so as to ensure that road safety audits are included as a standard component of all road projects and address any issues identified as part of the audits.
- Subject to government commitment, the Bank will help the air navigation agency to strengthen it institutional capacity and prepare the agency to operate properly once Kosovo takes over full control of its upper airspace in the future.
- The Bank will support Kosovo in harmonising legislation and procedures according to the SAA and coordinating with the European Commission and other IFIs on ways to support enhancement of soft measures including a reduction in Non-Tariff Barriers, Technical Barriers to Trade as well as Sanitary and Phyto-sanitary Standards around the EC connectivity agenda.

Results Framework for Theme 3: Support connectivity and regional integration

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
3.1	The quality of transport infrastructure lags well behind that of other countries in the region and is a hindrance to regional integration	**Support expansion and rehabilitation of transport links to facilitate cross-border exchanges and lower transport costs**	• Sovereign loans to support road cross-border interconnections and national road rehabilitation and upgrade (Kijeve – Peje road section; Pristina-Merdare road section; and Pristina – Gjilan – Dheu i Bardhe motorway. • Loans to support East-West Kosovo-Serbia rail link. • Support to the air navigation system. • TCs for appropriate enhancement of procurement capacity, road safety and appropriate mechanism and procedure for internal approval of priority investments. • Policy dialogue to establish a Road Agency as an independent body with defined responsibilities closely coordinated with the Ministry of Infrastructure.	• Number of projects and qualitative account of regional transport infrastructure services (Baseline – 0) • Establishment of a Road agency with the Bank's assistance through policy dialogue. (*Baseline – N/A)*
3.2	Kosovo's energy security is compromised by the limited domestic production (see also preceding section) and relative isolation of its energy market	**Enhance energy interconnections with neighbouring countries to improve regional integration and energy security**	• Strengthening and modernisation of the national transmission grid, as part of the project with KOSTT. • Investments and policy advice to improve Kosovo's cross-border interconnections, including the establishment of a common energy market with Albania.	• Number of projects and qualitative account of Bank's projects successfully expanding regional cross border energy infrastructure (Baseline – 0)
3.3	Difficulties in trading across borders remain, while investments across the region needs to be encouraged	**Support trade and investments flows with the extended region**	• Expansion of TFP • Support under the Advice for Small Business on boosting export potential of small companies. • Explore ways to support enhancement of soft measures including a reduction in Non-Tariff Barriers to trade.	• Total number and volume of TFP finance projects undertaken by client banks (*Baseline – established at projects approval)* • Δ in share of exports in total turnover of export-oriented ASB clients (Baseline – established at project approval)
	Context indicator: Δ Kosovo Trading Across Borders Rank *(Baseline 2016: 71th)*. Source: Doing Business 2016 (World Bank Group)			

3.3 Managing Risks to Country Strategy implementation

The proposed strategy for Kosovo is ambitious as it matches the Government of Kosovo's own very ambitious reform programme. The prospects of an incremental operational response in infrastructure, private sector lending and privatisations are related to reforms and progress in the project implementation capacity of the administration, the government's privatisation programme of remaining SOEs (including PTK and Trepca mining complex), utilisation of the additional fiscal room warranted under the IMF SBA and the political situation with Serbia.

The Bank's ability to deliver on its strategy in Kosovo will be influenced by a number of factors outside the Bank's control. Where feasible, the Bank will work to address and mitigate these risks through proactive and sustained engagement with clients, the authorities and other stakeholders.

- **Sustainability of the Government's reform commitment.** Overall progress will crucially depend on the government's sustained reform momentum. This includes not only legislative reforms but, importantly, effective implementation despite very limited administrative capacity.
- **Macro-economic risks.** Kosovo's external sector is inhibited by an uncompetitive labour force. High wages, especially in the public sector and low human capital are substantial impediments to growth in the tradable sector. The country's use of the Euro removes the possibility of a devaluation to achieve relative competitiveness. The weak exports combined with significant remittance flows from the Kosovan diaspora have created large and persistent current account deficits (8 per cent of GDP in 2015). The emergence of a private sector capable of competing in the international market place, especially in manufactured goods, will require substantial structural reform.
- **There are some political and governance risks.** Progress has been made in resolving disagreements between ethnic groups, in particular in regards to the Association of Serb Municipalities in Kosovo (ASMK), whereby the Serbian northern region will have its own assembly and representation in Pristina. Nevertheless, opposition groups are contesting the legality of the agreement on the establishment of the ASMK. Kosovo remains unrecognized by a large number of countries, including Serbia, and the potential for tension between ethnic groups and political gridlock remains high. Political uncertainty may continue to be a headwind to the external investment required for the development of a vibrant private sector.
- **Lack of investment projects**. An increase in the investment volume in the private sector from its current low base to effectively support private sector competitiveness (Theme 1) will mainly depend on progress in the investment climate, as well as FDIs inflows. This includes, for example, combatting informality to enable the development of value chains in the country and expand the universe of companies eligible for EBRD financing. In addition, Kosovo's ability to attract new foreign direct investment will depend on strict adherence to existing agreements and respecting the 'rules of the game'. For the Bank to be able to support private sector development there needs to be a steady supply of quality investment projects with local or foreign investors as well as adequate channels for financial intermediation. However, it is likely that the majority of the business volume might still be in the public sector, especially given the importance of Theme 3.

- **Very limited fiscal space**. Many projects – ranging from infrastructure to SME promotion – will require significant donor resources, both as TC and investment grants.

3.4 Environmental and Social Implications of Bank Proposed Activities

Kosovo signed the Stabilisation and Association Agreement with the EU in October 2015 and will continue the ongoing approximation of environmental legislation with EU environmental acquis, which sets out a sound framework for structuring the Bank's operations to comply with its Environmental and Social Policy ("ESP") and Performance Requirements ("PRs"). These include social requirements where projects could have adverse impact on ethnic minorities, displaced or otherwise vulnerable people.

The Bank's activities relating to privatisation and private sector development will be an effective way to support the implementation of Kosovo's National Development Strategy for 2016 – 2021, which aims to form a basis for sustainable and inclusive growth. Due attention will need to be paid to ensuring pollution from past activities is investigated and managed so as to avoid the private sector operators becoming liable for containment and clean-up of historic pollution.

In the municipal environmental infrastructure sector, the investment needs in constructing, rehabilitating and modernising drinking water supply and wastewater treatment systems as well as solid waste management facilities are substantial. Financing projects in this sector will offer the Bank significant opportunities to achieve tangible environmental and social benefits and public health improvements. Affordability constraints related to any increase of utility tariffs will need to be taken into account, given that a significant number of people are estimated to live below the national poverty line and that a substantial part of the population, approximately 17 per cent, are extremely poor.

Projects involving construction and rehabilitation of transport infrastructure will allow the Bank to contribute to advancing mobility and social cohesion and inclusion. The Bank's environmental and social standards, requirements and processes will need to be rigorously adhered to so as to avoid or mitigate the potential adverse impacts associated with the construction of new transport infrastructure. Public consultation and information disclosure will be an important part of project development, in particular for projects that could adversely or disproportionately affect vulnerable groups and minorities. Transport infrastructure projects require EBRD to apply precautionary approach as these projects have the potential to adversely impact biodiversity through encroaching or fragmenting sensitive habitats, protected areas or proposed Emerald and Natura 2000 sites.

In the energy sector, the Bank may be requested to consider investments in new power generation capacities, including coal-fired generation. Any Bank assessment would be undertaken in close coordination with other IFIs and donors, and include a review of a comprehensive Environmental and Social Impact Assessment ("ESIA"). This would include an analysis of alternatives and carbon capture and storage feasibility. The Bank would also require that participatory public disclosure and consultations will be carried out. In addition, any Bank financing for coal-fired generation would need to comply with the specific requirements set out in the 2013 Energy Sector Strategy. In relation to power transmission and distribution projects the Bank will ensure its requirements relating to public health and safety and involuntary resettlement are complied with. Sustainable energy projects financed either directly by EBRD or via financial programmes with local banks focusing on small energy efficiency and renewable energy projects present significant opportunities to reduce air emissions and associated public health impacts. When assessing hydropower projects, the Bank will ensure that any potential direct, indirect and cumulative impact on the environment and biodiversity is appropriately assessed and mitigated.

Health and safety continues to be an important consideration in all EBRD projects. In transport infrastructure and urban transport projects the Bank will require road safety assessments and promote road safety initiatives. EBRD will work with clients in energy and power, mining and transport sectors to minimise the risk of accidents and fatalities through good project design and best practice in safety management.

3.5 EBRD co-operations with MDBs

Donor and IFIs coordination in Kosovo is led by the Ministry of European Integration, with the EU Delegation also organising regular donor meetings. The Bank is closely engaged in the coordination process through these institutions as well as through project-specific meetings and frequent bilateral contacts:

- In terms of significant future investment projects, the **World Bank** is heavily involved in Kosovo C and the Water Security and Canal Protection project that aims to improve the Iber-Lepenc Canal efficiency and strengthen the Iber Basin protection and management. These projects may also provide areas for the Bank's future co-financing with the World Bank.
- To date the Bank did not have an opportunity to co-finance any project in Kosovo with the **IFC** but such opportunities may arise in the future.
- The **EIB**'s involvement will facilitate the co-financing of projects with other donors and support the implementation of the WBIF and the Western Balkans EDIF. In the transport sector, the Bank is working closely with the EIB on a number of projects, including the Rail Route 10 Rehabilitation, the Kijeve-Peje road and the Pristina – Merdare motorway, part of the Route 7 linking Kosovo, Albania and Serbia.
- Over the strategy period, there may be potential for co-financing with **KfW** in the energy and water sector.

ANNEX 1 – POLITICAL ASSESSMENT

Kosovo is committed to and applying the principles of multiparty democracy, pluralism, and market economics in accordance with the conditions specified in Article 1 of the Agreement Establishing the Bank.

Kosovo proclaimed independence in 2008. The question of legality of this act was considered by the International Court of Justice (ICJ), to which it had been referred by the United Nations General Assembly (UNGA). The ICJ issued its decision on 22 July 2010, ruling that the Declaration of Independence "did not violate any applicable rule of international law".[4] Although this decision constituted an Advisory Opinion, which, as such, is not binding on any country, it was reinforced in September 2010 by the Resolution of the UNGA, which "acknowledged the contents of the decision of the ICJ". While many countries do not recognise Kosovo, and this will remain a political matter for each member of the international community to decide upon, the number of bilateral recognitions has been gradually growing and by mid-2016 exceeded 110. Continuing political controversy, stemming from different positions in the wider international community regarding Kosovo's status, affects assessments of the situation in Kosovo produced by different international actors.

The constitutional and legislative framework for a pluralistic parliamentary democracy, the separation of powers and checks and balances in the political system, the guarantees for fundamental rights and protection of minorities, and for the meaningful role of civil society are in place in Kosovo and are largely in line with international and European standards.

Kosovo's key weaknesses, which are common to the Western Balkans, include weak rule of law, the relatively low capacity of public administration, especially at the local level, complex inter-ethnic relations, and uneven culture of political dialogue and consensus building. The progress in these areas has been slow.

Efforts towards EU approximation remain the main external anchor for comprehensive reforms. The EU has repeatedly stressed that Kosovo shares the European perspective of the rest of the Western Balkans. Kosovo signed the Stabilisation and Association Agreement with the EU in October 2015. It was approved by the European Parliament on 21 January 2016 and formally entered into force on 1 April 2016. Kosovo and Serbia have been engaged in an EU-facilitated dialogue aimed at normalising their relations, which remains important in order for both to move forward on their respective European paths.

Free Elections and Representative Government

Free, fair and competitive elections

The existing legal framework, which is largely based on two pieces of legislation (Constitution of 2008 and the Law on General Elections adopted the same year), enables democratic elections, provided the authorities and political parties exercise sufficient will to implement it. Since 2010, there have been several unsuccessful attempts to change the electoral system, which failed due to lack of consensus among the key stakeholders.

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[4] Accordance with International Law of the Unilateral Declaration of Independence in Respect of Kosovo, Advisory Opinion, I.C.J. Reports 2010, p.53.

Elections in Kosovo generally allow for competition between different political parties, including parties representing ethnic minorities, and free choice for voters. The candidates are able to campaign freely. The Central Election Commission is an independent permanent body, appointed by the parliament for a four-year mandate, and operates in an efficient and transparent manner. The media provide voters with diverse and extensive coverage of the electoral campaign. The Electoral Code provides for domestic and international election observation at all levels of election administration.

In the past, elections in Kosovo were effectively organised by the OSCE. Since 2008, the local electoral institutions have been carrying out executive functions, while the OSCE retained a non-executive advisory role. The latest general elections, which took place in June 2014, were the second conducted under the sole responsibility of the Kosovo authorities and the first held throughout the country, including in the majority Serb-populated northern Kosovo. The observation was accomplished by the EU Election Observation Mission (EOM). EOM assessed these elections as transparent, stressed their peaceful conduct, and noted overall “significant improvement on previous elections”.[5]

Separation of powers and effective checks and balances

The constitutional and legislative framework for a parliamentary democracy, underpinned by the separation of powers and checks and balances in the political system, independent legislature and procedures of legislative oversight in prescribed domains of decision-making, is in place in Kosovo and largely in line with international and European standards. The Constitutional Court is independent and is playing an increasingly important role. Over the last years, it has issued a number of decisions with strong political impact.

The single-chamber parliament, which is the primary legislative institution directly elected for a four-year mandate, is composed of 120 seats, including 20 seats reserved for political entities representing ethnic minorities. The scope of powers of the legislature to hold the government to account and to exercise parliamentary oversight is largely in line with international standards, although the parliament and its committees need to strengthen their monitoring of implementation of policies by the government. There is space for improvement in strengthening supervision of independent institutions, regulatory authorities and agencies, with suitable reporting and accountability mechanism.

Recurring political crises of the last few years seriously hampered the work of the parliament. The new parliament could not convene for several months following inconclusive general elections in summer 2014. Since October 2015, the work of the parliament was repeatedly physically blocked by the nationalist opposition protesting against the recent agreements reached in the framework of the normalisation of relations between Kosovo and Serbia and against the border demarcation agreement with Montenegro.

Kosovo is progressing with the decentralisation of government, including the strengthening of local administration. In the last years, the number of municipalities was increased from 30 to 37, primarily in order to address the specific needs of ethnic minorities at the local level. The main remaining challenges include a relatively weak professional expertise at the local level, budgetary constraints and overall absorption capacity.

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[5] European Union Election Observation Mission, Final Report Kosovo 2014, 7 July 2014, p.1.

Effective power to govern of elected officials

Kosovo has established institutional, legal, and financial arrangements for elected officials to exercise effective power to govern and they are not constrained by any non-democratic veto powers or other undue influences.

Kosovo stands out in the region due to significant international presence, although it has nowadays limited role. After the proclamation of independence by Kosovo in 2008 the authorities invited an international civilian presence, as envisaged by the Comprehensive Proposal for the Kosovo Status Settlement (Ahtisaari Plan). The International Steering Group (ISG) established the International Civilian Office with the International Civilian Representative (ICR) at the helm, who was charged with the specific task of ensuring implementation by Kosovo of the Ahtisaari Plan. On 10 September 2012, the ISG, based on its assessment of the progress achieved by Kosovo, unanimously declared the end of the "supervised independence" of Kosovo and ended the mandate of the ICR with immediate effect.

The UN Security Council Resolution 1244 (UNSCR 1244), which in 1999 established the United Nations Interim Administration Mission in Kosovo (UNMIK), is still formally in force and serves as the basis for the status-neutral international presence both of the UN and the European Union Rule of Law Mission (EULEX). EULEX is the largest civilian mission ever launched under the European Security and Defence Policy. Its aim is to assist and support the Kosovo authorities in the area of the rule of law area, specifically in the police, judiciary and customs. EULEX mentors, monitors, and advises whilst retaining a number of limited executive powers. The current mandate of EULEX expires in June 2018.

Kosovo has also NATO-led foreign military presence - Kosovo Force (KFOR) - which, in accordance with UNSCR 1244, has been leading a peace support operation in Kosovo since June 1999. Today, significantly reduced KFOR (about 5,000 troops) continues to contribute towards maintaining a safe and secure environment and freedom of movement for all citizens.

Civil Society, Media and Participation

Scale and independence of civil society

There is a satisfactory legal framework for civil society organisations. The 2009 Law on Freedom of Association of Non-Governmental Organisations grants citizens the right to establish, join and engage with civil society organisations (CSOs), and provides an effective framework for protecting the rights of CSOs. The Strategy for Cooperation between the government and civil society for 2013-2018 and a respective 3-year Action Plan have been adopted thorough a broadly participatory process. Based on the new Strategy, a Council for the Implementation of the Government Strategy for Cooperation with Civil Society has been established. As elsewhere in the Western Balkans, CSOs remain heavily dependent on foreign funding and problems with funding are the greatest obstacle for their functioning.

While there are almost 8,000 registered CSOs in Kosovo, only about 200 of them are well established and functioning. Many SCOs are project-based, and relatively narrowly specialised. However, in contrast to many other Western Balkan countries, SCOs in general are spread evenly throughout the country, including the rural areas.

The right to form trade unions is enshrined in the law and respected in practice.

Independence and pluralism of media operating without censorship

Pluralism in the media, which operate broadly freely and without censorship and the access to public information have increased overall in recent years. The legal framework is largely in place and in line with international standards. The Press Council of Kosovo, which is a self-regulatory body for the print media, helps to promote the freedom of speech, the right of citizens to be duly informed and the respect for the Press Code of Kosovo. There are two Codes of Ethics that regulate the journalistic profession: the Kosovo Press Council's Code of Ethics, and the Independent Media Commission's Code of Ethics.

At the same time, more needs to be done to ensure that freedom of expression and media, which are guaranteed by the Constitution, are respected in practice, since there is a widespread perception among Kosovo citizens that media are over politicised and are under pressure from political parties. The Association of Professional Journalists of Kosovo, the Press Council of Kosovo, and the Independent Media Commission have raised their voices against political interference. Media ownership structures, in particular for print media, remain unclear. Although media are obliged to submit ownership reports on annual basis, if they are not registered as companies and do not pay taxes they are not compelled to report their ownership to anyone.[6] A total of 26 cases of attacks, threats and obstruction of journalists are under investigation as of the beginning of 2016.[7]

There are nine dailies operating in Kosovo, with a circulation between 25,000-35,000 copies each, which is relatively low by regional standards. Electronic media dominate the market, and television remains the main source of information. The main broadcasting outlets are three nation-wide TV channels (RTK, KTV, and RTV21). Recent years witnessed explosive growth in Internet access (from 5.4 per cent in 2009 to 84.4 per cent in 2014). The internet penetration rate in Kosovo today is comparable to Western European countries. Social media is playing an increasingly important role with Facebook being the main service used by Kosovans.[8]

Multiple channels of civic and political participation

Multiple channels of civic and political participation are in place. The government reports annually on implementation of its key strategic documents. The right to access public information is regulated by law. The parliament has in the last few years improved its outreach activities, including public hearings. The Government has put in place a mechanism for consultations with the civil society for the new draft bills. Since October 2015, civil participation in the work of the parliament (as the work of the parliament itself) has been hampered by the opposition blocking its work.

Freedom to form political parties and existence of organised opposition

The freedom to form political parties is both guaranteed by the Constitution and implemented in practical terms, as highlighted by the existence of a significant opposition able to campaign freely and oppose government initiatives. 30 political entities participated in the last general

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[6] Freedom of Media in the Western Balkans, European Parliament, Directorate-General for External Policies of the Union, October 2014, p. 33.
[7] Kosovo 2015 Progress Report, European Commission, 10 November 2015, p.22.
[8] Internet World Stats: http://www.internetworldstats.com/stats4.htm#europe; see also: STIKK, Internet Penetration and Usage in Kosovo, August 2013.

elections, and more than 10 different political parties are represented in the national Parliament. The coalition of opposition political parties currently holds more than 25 per cent of seats in the national Parliament.

Rule of Law and Access to Justice

Supremacy of the law

Necessary legislative and institutional safeguards for the supremacy of the law are in place. Over the past few years, Kosovo has adopted legislation for major judicial reform, and the core legal and institutional framework to ensure the rule of law is in place. Citizens have the right to a free and fair trial and are free from arbitrary arrest or detention.

The public administration modernisation strategy for 2015-2020 and accompanying action plan, adopted in September 2015, should be conducive to overcoming existing politicisation of the public administration and to the overall strengthening of the supremacy of the law.

Kosovo is actively assisted by EULEX, which has more than 1,500 people on the ground and whose current mandate runs through June 2018. Kosovo authorities have committed to cooperate fully with EULEX, including its Special Investigative Task Force, which investigated the allegations raised by the Resolution 1782 of PACE adopted in January 2011, and the new Specialist Court that is due to be established in the second half of 2016.

Independence of the judiciary

The independence of the judiciary is guaranteed by the Constitution and key safeguards are in place to ensure its impartiality, although enforcement is uneven. The Kosovo authorities are aware of the need to address this matter, as reflected in the 2014-2019 strategic plans for the judiciary, the 2014-2019 communication strategy and the national strategy for reducing the backlog of cases being implemented in order to tackle identified shortcomings.[9]

Strengthening the independence and efficiency of the judiciary has been, according to EU, which provides significant assistance to Kosovo in this area, one of the main objectives of the on-going comprehensive reforms. Both the EU and PACE have assessed that progress has been achieved to this end. The new comprehensive legal framework was adopted, including laws on courts, on the Kosovo Prosecutorial Council, the Judicial Council, and on Prosecution, and a new court system entered into force on 1 January 2013. The independence of the system is further supported by the functioning of the independent Supreme Court, the Constitutional Court, the Prosecutorial Council, and the Judicial Council. The latter two institutions have a direct mandate to ensure the independence and impartiality of the judiciary.

At the same time, relevant EU reports mention serious challenges to the independence of judiciary. The election procedure of the Judicial Council needs to be brought in line with relevant European standards to ensure that the majority is elected by peers, which has also been the recommendation of the Venice Commission.[10] Kosovo’s membership in the Venice

[9] Kosovo 2015 Progress Report, European Commission, 10 November 2015, p.13.
[10] Venice Commission, Report on the Independence of the Judicial System Part I: The Independence of Judges, 16 March 2010, p.8

Commission (obtained in June 2014) should be conducive to further improvements. According to EU experts, there is still lack of capacity in the Judicial and Prosecutorial Councils to draft necessary regulations and to monitor implementation of their decisions. There is no official court monitoring system in place, and the e-justice remains underdeveloped.

Government and citizens equally subject to the law

The authorities have stepped up measures to prevent abuse of authority by public office-holders. The right to access public information is provided by law, with the number of unanswered or refused requests being relatively low. The laws on the declaration of assets and on preventing conflicts of interest were adopted by the Parliament. The recent initial reforms in public administration create conditions for the gradual establishing of a stable and professional civil service, which should be an important avenue to prevent abuse of authority and ensure that government and citizens are equal to the law. The reforms included the adoption of an advanced law on civil service, establishment of the institution of the Ombudsperson (Ombudsperson Institution of Kosovo), adoption of the new law on Ombudsperson (May 2015) and election of the new Ombudsperson (July 2015).

Effective policies and institutions to prevent corruption

According to the 2015 Transparency International Corruption Perception Index (CPI), Kosovo's score has remained stagnant in the last three years. It is currently placed as 103rd out of 168 countries, the worst position among South Eastern Europe countries. Despite progress in certain areas, significant weaknesses remain. The latest Progress Report on Kosovo by the EC qualifies corruption there as "endemic".[11] The Council of the EU stressed in particular in its Conclusions of 15 December 2015 the need to "build a track record of successful prosecutions in high-profile cases".[12] So far, there have been no convictions in the rare high-profile corruption investigations.

An assessment of Kosovo's compliance with anti-corruption international standards was recently made by the Council of Europe through the Project against Economic Crime in Kosovo (PECK). The assessment was based on methodologies and criteria used by the Group of States against Corruption (GRECO) and other relevant international bodies. In the Final Report, PECK concluded that out of the 62 recommendations that had been made, 5 were implemented satisfactorily or dealt with in a satisfactory manner; 25 partly implemented and 32 not implemented. However, it has been noted that the Kosovo authorities have made efforts to address the identified shortcomings in the senior management of the police; the public administration; the political party funding; the public procurement area; and the criminal field.[13]

The authorities have made important steps over the last few years in fighting corruption by adopting the necessary elements of the legal framework, including laws on the declaration of assets, preventing conflicts of interest, whistle-blowers, public procurement, and financing of political parties. There are currently four main institutions involved in the fight against corruption in Kosovo: the Anti-corruption Agency, an independent and specialised agency established in 2006; the National Anti-corruption Council, a consultative body chaired by the

[11] Kosovo 2015 Progress Report, European Commission, 10 November 2015, p.5.
[12] Council Conclusions, Enlargement and Stabilisation and Association Process, Council of the European Union, 15 December 2015, p.19.
[13] Council of Europe, Project against Economic Crime in Kosovo (PECK), Final Report, 2015.

President of Kosovo; the National Anti-corruption Coordinator, who is assigned by the Chief State Prosecutor; and the Directorate for Investigation of Economic Crimes and Corruption within the Kosovo police. There is certain overlapping in the mandates of these four bodies and lack of coordination.

At the end of 2014, the Anti-corruption Agency launched an anti-corruption awareness campaign, encouraging citizens to report corrupt behaviour to rule of law agencies. While civil society is involved in developing and monitoring anti-corruption policy, consultation needs to be improved through regular, transparent and constructive communication.

Civil and Political Rights

Freedom of speech, information, religion, conscience, movement, association, assembly and private property

Kosovo has a solid legal basis for the protection of fundamental rights and freedoms, which are enshrined in the new Constitution adopted in 2008. The Constitution lists the main international instruments, including the Universal Declaration of Human Rights, the European Convention for the Protection of Human Rights and Fundamental Freedoms and its Protocols, which are all directly applicable in Kosovo and, in case of conflict, take precedence over national laws. This is an important mechanism, especially given that Kosovo is not a member of the UN or of the Council of Europe with their monitoring instruments and is not a signatory party to any international instrument on human rights. The new Law on the Protection from Discrimination, adopted in May 2015, is a major step forward.

The Constitution provides citizens with the right to refer violations of their rights and freedoms guaranteed by the Constitution to the Constitutional Court. This can also be done by the Ombudsperson. Over the last few years, various additional structures were set up both at the central and local level to assist with the protection and enforcement of fundamental rights. The international community continues to be involved in the capacity building in this area.

Since Kosovo is not a member of the UN, it is not subject to assessment in the framework of the Universal Periodic Review (a process through which the human rights record of the UN Member States is periodically reviewed). The International Human Rights Working Group, established by UNMIK in September 2015, assisted in the implementation of human rights mechanisms and frameworks by the relevant Kosovo institutions, including in reviewing the draft of Kosovo Human Rights Strategy (2016-2020).[14]

While fundamental rights are broadly enforced by the state institutions and respected, the latest EU reports pointed to remaining deficiencies in the areas of the freedom of expression (protection against, and prosecution of, physical attacks against journalists) and property rights (both the legal framework and the implementation, which suffers from the backlog of cases). The weaknesses in the consistent enforcement of the guaranteed rights include also the unresolved fate of persons missing after the conflicts of the 1990s (according to the UN, more than 1,600 cases as of 2015), and the integration of persons with disabilities.

[14] Report of the Secretary-General on the United Nations Interim Administration Mission in Kosovo, 1 February 2016, p. 7.

Political inclusiveness for women, ethnic and other minorities

Due to a history of inter-ethnic conflict, as well as continuing differences of opinion in the wider international community regarding the status of Kosovo, the issues related to the rights of ethnic minorities in Kosovo are particularly sensitive.

Six ethnic communities are specifically mentioned in Kosovo's Constitution. According to the last (2011) Census, ethnic Albanians make up 93 per cent of the population; ethnic Serbs 1.5 per cent; ethnic Turks 1 per cent; Roma, Ashkali, and Egyptians (RAE) 2 per cent; Gorans 0.6 per cent; Bosniaks 1.5 per cent. It should be noted, however, that the Serbs totally boycotted the 2011 Census in northern Kosovo and their participation in the Census elsewhere was uneven. Unofficial estimates derived from the data used for practical purposes by the international presence in Kosovo put an estimated share of ethnic Serbs in the total population of Kosovo at 5-7 per cent. During the last general elections in Serbia, which took place in April 2016, Serbian electoral administration used the number of 106,000 of Kosovo residents registered to vote in these elections, but not all of them are necessarily ethnic Serbs.

The legislative framework for the protection of ethnic minorities is in place in Kosovo. Their rights are guaranteed by the Constitution and by the Law on the Protection of the Rights of Minorities. The Council of Europe Framework Convention for the Protection of National Minorities is directly applicable in Kosovo and takes precedence over Kosovo legislation. The interests of minority ethnic communities are protected by a complex mechanism in place at the central level.

By regional standards, minorities are well represented in the national Parliament and in the government. In the parliament, there are 20 seats set aside for minorities out of the 120 MPs, of which 10 seats are specifically set aside for ethnic Serbs. The 20 "guaranteed" seats are enshrined in the Constitution. The 2014 elections were the first when the system of "guaranteed" seats replaced the provisional system of "reserved" seats, which in practical terms allowed minorities in the past to have 25 MPs rather than 20 as in the current Parliament. Two of the five Deputy Speakers of the Parliament represent non-majority communities. The current governing coalition includes overwhelming majority of the political parties representing ethnic minorities, including ethnic Serbs, who have two ministerial positions and one position of Deputy Prime Minister. Serbian is one of the two official languages in Kosovo, alongside Albanian.

Efforts have been made to improve the situation at the local level, including through the establishment of municipalities where ethnic Serbs make up a majority of the population, in order to facilitate their access to basic services. Several new municipalities have been established specifically to accommodate the interests of ethnic minorities. As of today, out of a total of 37 municipalities, seven have either a majority or considerable Serbian population. One of the key elements of the EU-brokered agreement between Pristina and Belgrade on the normalisation of their relations envisages establishment of the Association/Community of Serbian majority municipalities, the work on which (and debates around which) continues.

Kosovo has taken steps to implement the UNESCO and Council of Europe conventions on cultural rights, as well as physical protection of the cultural and religious sites of the Serbian Orthodox Church. The EC recommended, among specific measures related to human rights, establishing a special body enabling direct consultation on the promotion and protection of religious and cultural heritage with minority communities.

The lack of trust between the Kosovo Albanian and some of the Kosovo minority communities persists. Various agencies report occasional incidents motivated by ethnic and religious hatred and cases of discrimination, as well as physical attacks against ethnic minorities. Nevertheless, according to the latest PACE Report, developments in the north of Kosovo demonstrate that tensions may decrease following progress in normalisation of relations between Belgrade and Pristina.[15]

The authorities will have to do more to ensure the genuine integration of ethnic minorities. The OSCE Community Rights Assessment Report, published in November 2015, concluded that despite positive developments in inter-community relations, many challenges remain that require committed action from Kosovo institutions.[16] More remains to be done to protect smaller ethnic minorities, particularly the most vulnerable RAE community. Several measures have been taken, notably to address the issue of persons without documents and to integrate IDPs and Roma refugees from Kosovo. 12 municipalities adopted local action plans for integration of the RAE community. The Roma health mediator programme started in 16 municipalities. Education projects continued to be implemented leading to certain increase in the enrolment rates of Roma children in secondary education. However, implementation of existing strategies needs to be strengthened. High unemployment rates persist, while access to unemployment benefits remains problematic. Stereotyping against RAE persists, including in the media.

The key legislative elements for gender equality, including constitutional provisions and a specific law on gender equality (approved in 2015), are in place in Kosovo. By regional standards, women have an impressive representation in the national parliament, exceeding 30 per cent. This is a result of “double positive discrimination” (guaranteed 30 per cent of the candidates and guaranteed 30 per cent of the seats in the parliament), which, strictly speaking, interferes with the free choice by the citizens, but has been accepted by most stakeholder as a necessary transitional measure. The previous President of Kosovo, whose mandate expired in the beginning of 2016, was a woman, and there are currently two female members of the Cabinet. On the local level, however, women remain underrepresented at the decision-making level. There are also very few ethnic minority women that have senior political positions. Discriminatory customs and stereotypes are still present in the rural areas, undermining women’s basic rights. A remarkable 14 per cent of rural women, according to UN data, are illiterate, compared to four per cent of rural men.

Freedom from harassment, intimidation and torture

Constitutional guarantees against harassment, intimidation, and torture are in place and are largely upheld in practice. Through amending the law on Ombudsperson in 2015, Kosovo has aligned with the requirements of the Optional Protocol to the Convention Against Torture. A delegation of the Council of Europe’s Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment (CPT) last visited Kosovo in 2015. Particular attention was paid to the treatment and conditions of detention of persons in police custody and the situation in penitentiary establishments (including the regime for juvenile offenders, remand prisoners and inmates held in a new high-security prison and the provision of health

[15] Parliamentary Assembly Council of Europe, The situation in Kosovo and the role of the Council of Europe, 8 January 2016, p. 14.
[16] Community Rights Assessment Report, Fourth Edition, OSCE, November 2015, p.35.

care).[17] The EU Special Investigative Task Force (SITF) has investigated allegations of a range of crimes in the period 1998-2000 contained in the Resolution of the PACE of January 2011 on the allegations of inhuman treatment of people and illicit trafficking in human organs. This work is due to be continued by a specialised Court, which is expected to be established in the second half of 2016.

[17] Council of Europe, European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment (CPT): http://www.cpt.coe.int/documents/kosovo/2015-04-28-eng.htm

ANNEX 2 – SELECTED ECONOMIC INDICATORS

*Kosovo uses Euro as its legal tender

	2009	2010	2011	2012	2013	2014	2015
Output and expenditure			*(Percentage change in real terms)*				
GDP	3.6	3.3	4.4	2.8	3.4	1.2	3.0
Private consumption	2.3	3.5	3.5	2.9	2.0	4.9	n/a
Public consumption	-5.4	-2.9	0.1	2.2	3.3	-2.5	n/a
Gross fixed capital formation	13.5	11.0	8.1	-13.6	-0.2	-3.3	n/a
Exports of goods and services	12.3	12.5	3.3	0.5	2.5	17.1	n/a
Imports of goods and services	5.4	9.1	3.5	-7.7	-1.5	8.4	n/a
Labour Market			*(Percentage change)*				
Gross average monthly earnings in economy (annual average) *(Budget sector, as provided by Kosovo Agency of Statistics)*	20.4	16.0	20.1	3.1	0.7	16.8	7.4
Real LCU wage growth	22.8	12.5	12.8	0.6	-1.1	16.4	7.9
			(In per cent of labour force)				
Unemployment rate	45.4	n/a	n/a	30.9	30.0	35.3	n/a
Prices			*(Percentage change)*				
Consumer prices (annual average)	-2.4	3.5	7.3	2.5	1.8	0.4	-0.5
Consumer prices (end-year)	0.1	6.6	3.6	3.7	0.5	-0.4	0.2
Fiscal Indicators			*(in per cent of GDP)*				
General government balance	0.1	-1.8	-1.1	-1.2	-2.5	-2.9	n/a
General government revenues	28.1	25.9	27.2	27.3	25.5	24.2	n/a
General government expenditure	28.0	27.7	28.3	28.6	28.0	27.2	n/a
General government debt	6.4	6.2	5.5	8.4	9.1	10.6	13.0
Monetary and financial sectors			*(Percentage change)*				
Broad money (M2, end-year) *	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Credit to the private sector (end-year)	8.8	12.3	13.5	4.5	2.6	6.3	7.3
			(In per cent of total loans)				
Non-performing loans ratio *(does not include sub-standard loans)*	4.3	5.9	5.8	7.5	8.7	8.3	7.2
Interest and exchange rates			*(In per cent per annum)*				
Policy rate *	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Deposit rate	4.0	3.4	3.6	3.7	2.4	1.1	1.2
Lending rate	14.1	14.0	13.3	12.2	10.9	9.3	7.7
			(EUR per US dollar)				
Exchange rate (end-year) *	0.69	0.75	0.77	0.76	0.73	0.82	0.92
Exchange rate (annual average) *	0.72	0.76	0.72	0.78	0.75	0.75	0.90
External sector			*(In per cent of GDP)*				
Current account	-9.2	-11.7	-13.7	-7.5	-6.4	-7.8	-9.2
Balance of goods and services	-34.9	-35.6	-37.2	-34.1	-31.6	-30.9	-30.8
Trade balance of goods	-40.5	-39.6	-42.5	-40.5	-37.5	-37.0	-37.0
Merchandise exports	4.2	6.8	6.6	5.6	5.5	5.8	5.7
Merchandise imports	44.7	46.4	49.1	46.1	42.9	42.8	42.6
Trade balance of services	5.6	4.0	5.3	6.4	5.9	6.0	6.2
Foreign direct investment, net	6.8	7.5	7.9	4.2	4.7	2.2	5.0
Gross international reserves *	n/a	n/a	n/a	n/a	n/a	n/a	n/a
External debt stock	n/a	n/a	29.7	30.0	30.2	31.2	33.8
Public external debt	n/a	n/a	6.6	7.9	7.2	7.1	7.7
Private external debt	n/a	n/a	23.0	22.1	23.0	24.1	26.1
			(In months of imports of goods and services)				
Gross international reserves *	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	2.18	2.21	1.80	1.82	1.82	1.80	1.80
GDP (in billions of EUR)	4.1	4.4	4.8	5.1	5.3	5.6	5.7
GDP per capita (in EUR)	1,866	1,995	2,677	2,786	2,926	3,085	3,170
Share of industry in GVA (in per cent)	19.3	20.7	19.7	19.9	20.3	19.3	n/a
Share of agriculture in GVA (in per cent)	15.4	16.2	15.6	14.8	14.4	13.6	n/a
FDI, net (in millions of EUR)	277	331	379	213	250	124	287
External debt (in million EUR)	n/a	n/a	1,428	1,517	1,608	1,737	1,932

ANNEX 3 – ASSESSMENT OF TRANSITION CHALLENGES

<table>
<tr><th>Market structure</th><th>Market institutions</th><th>Key challenges</th></tr>
<tr><td colspan="3">CORPORATES</td></tr>
<tr><td colspan="3">Agribusiness</td></tr>
<tr><td>Medium</td><td>Large</td><td>• improving land ownership structure to allow for consolidation and collateralisation;
• enhancing business climate to attract FDI to the sector.</td></tr>
<tr><td colspan="3">Manufacturing and Services</td></tr>
<tr><td>Medium</td><td>Large</td><td>• accelerating the privatisation process;
• enhancing the business environment by improving contract enforcement and reducing bureaucracy;
• improving overall corporate governance and business practices.</td></tr>
<tr><td colspan="3">Real estate</td></tr>
<tr><td>Large</td><td>Large</td><td>• ensuring effective enforcement of property rights and access to land and land information;
• increasing supply of modern commercial property in all sub-segments;
• introducing modern construction techniques and technologies, including energy efficiency and sustainability.</td></tr>
<tr><td colspan="3">ICT</td></tr>
<tr><td>Medium</td><td>Medium</td><td>• developing modern telecommunications infrastructure (broadband internet);
• privatising the fixed line incumbent PTK;
• further improving the implementation and enforcement of a modern regulatory framework (including competitive safeguards such as number portability, local loop unbundling or wholesale broadband access).</td></tr>
<tr><td colspan="3">ENERGY</td></tr>
<tr><td colspan="3">Natural Resources</td></tr>
<tr><td>Medium</td><td>Large</td><td>• completing restructuring and resolve legal ownership issues related to the Trepca mining complex;
• supporting the development of the regional and domestic gas market and strengthen the independence of the energy regulator;
• removing customs duty on petroleum products;
• strengthening the regulatory framework in the mining industry.</td></tr>
<tr><td colspan="3">Power</td></tr>
<tr><td>Large</td><td>Large</td><td>• modernisation of the transmission and distribution grid;
• reduction of losses in distribution network;
• implementing cost-reflective tariffs;
• reducing the carbon intensity of generation.</td></tr>
</table>

INFRASTRUCTURE		
Water and wastewater		
Large	Medium	• decentralisation of ownership of utilities; • significant improvements related to technical and commercial losses; • improvements in collection rates; • improvements in tariff setting to reach cost recovery levels; • introduction of service-oriented formal relationships between municipalities and operators; • introduction of PPPs in the water sector.
Urban Transport		
Medium	Large	• development of city-wide urban transport policy (i.e. integrated urban transport strategy); • increased autonomy of publicly owned companies and development of contractual arrangements with the municipalities; • sustainable improvements in quality of services and operational and financial performances.
Roads		
Medium	Large	• the establishment of the arms-length relationship between the government and road agency; • continued increases in road maintenance budget and predictable long term allocation of funding for maintenance; • more private sector participation, including through road PPPs in due course; • institutional reform and procurement improvements in road construction and maintenance contracts - introduction of performance-based contacts.
Railways		
Medium	Medium	• deep restructuring of current operations to ensure that the network and operations remain viable long term and competitive with alternative transport modes; • encouraging open access; • establishment of business oriented passenger services and full implementation of PSO contacts; • strengthening regulatory capabilities and independence of the regulator.
FINANCIAL INSTITUTIONS		
Banking sector		
Medium	Medium	• increasing deposits/GDP ratio; • improve quality of the legal and regulatory framework.
Insurance and other financial services		
Large	Large	• increasing insurance penetration; • improving insurance legislation, with an aim to bring it to IAIS standards.

Private equity		
Large	Large	• improving business environment to make it more attractive for inward private equity investment by regional funds; • developing a local institutional investor base.
Capital markets		
Large	Large	• completing the establishment of basic financial infrastructure; • further developing government bond market; • exploring regional partnership with Balkan exchanges.
SME development		
Large		• increasing bank lending to SMEs which are underserved despite well capitalised and liquid banks; • strengthening creditor rights, in particular regarding lengthy and uncertain enforcement processes in case of default; • developing non-bank financing options such as leasing and factoring (which could benefit from a clearer legal framework); • improving financial literacy and accounting skills which are among the lowest in the region; • supporting formalisation of the sizeable informal sector in order to promote a more level playing field among businesses.
SUSTAINABLE RESOURCE INITIATIVE		
Water efficiency		
Large	Large	• Enforcing and further increasing tariffs for abstraction; • Developing load-base effluent discharge fees; • Introducing required by-laws and strengthening institutional set-up (e.g. river basin authorities); • Addressing water loss and outdated wastewater infrastructure.
Materials efficiency		
Large	Medium	• Allocating higher priority to waste management in terms of capacity and financing, including the development of by-laws and action plans; • Increasing landfilling tariffs and closing down illegal dumps; • Developing Extended Producer Responsibility and recycling schemes;
Sustainable energy		
Large	Large	• Eliminating administrative barriers and improving regulatory frameworks to attract investments in renewable energy; • Developing and implementing a clear action plan to meet energy efficiency and renewable energy targets; • Developing a strategic climate change framework.

ECONOMIC INCLUSION[1] GAP RATINGS

ECONOMIC INCLUSION		
Inclusion gap dimension	**Inclusion gap**	**Key challenges**
Youth		
Youth Employment	Large	▪ Establishing training and work based learning opportunities for young people (e.g. apprenticeships) by improving the collaboration between private sector employers and education providers to ensure adequate progress routes for young people into formal employment.
Skills Mismatch	Medium	▪ Supporting initiatives to enhance private sector participation in the setting of national skills standards that reflect labour market needs, particularly at vocational level.
Gender		
Access to Finance	Large	▪ Continue to build the capacity of local Banks to develop credit lines aimed at women-led SMEs, combining access to finance, training and business advisory services.

[1] The EBRD Economic Inclusion gaps rate the institutions, markets and education systems across all EBRD's countries of operation in terms of their capacity to extend economic opportunity to individuals regardless of their gender, age or place of birth. These gaps measure *differences* in opportunities – between 15 to 24-year-olds and older workers, and between women and men – rather than opportunity *levels*. Gaps are reported in this Country Strategy where there exists an Inclusion Gap above Small. These gaps are consistent with the EBRD 2015 Inclusion Gap update. Please note that regional inclusion gaps are from 2013, to be updated by the end of 2016.

ANNEX 4 – LEGAL TRANSITION

Introduction

This annex offers critical analysis on selected legal topics relevant to the Bank's investment strategy in Kosovo during the forthcoming period. It is based on the assessments of commercial laws conducted by EBRD Legal Transition Programme.[18] For ease of reference, the analysis is presented along the main strategic orientations defined in this country strategy, in particular the actions proposed under 'Policy dialogue and TC'.

Theme 1: Support competitive development of the private sector through investment, enhancing internal capacity of companies and improving business environment

Corporate Governance

The 2015 EBRD assessment on the corporate governance legislation and practices of companies in the EBRD region highlighted a framework under need for reform in most areas under consideration.

The law requires large companies and banks to have independent directors, but in practice no company among the ten largest companies disclosed having any independent board member. Moreover, the definition of independence is provided in three different laws and regulations, which does not help clarity in this respect. A stock exchange has not yet been established resulting in limited and minimal information disclosure requirements for companies. Current disclosure requirements oblige banks and publicly-owned enterprises (POEs) to publicly disseminate financial statements and annual reports.

In connection with internal control, the law requires that the Banks and POEs establish an internal audit function as well as audit committees. In POEs the audit committee must be made only of board members. In banks at least one member of the audit committee must be an outside expert in the field of accounting or audit. The practice of having outsider members in the audit committee should be carefully considered. Firstly, It is important that audit committees include only board members if the functions delegated to the committee are typical board functions. Secondly, it is essential that those members sitting in the committee and recommending specific actions to the board, do actually follow up on such recommendations and vote on the committee's recommendations at the board, therefore reinforcing their position and the board "objective judgement". Finally, committees that include outsiders might create problems with confidentiality and accountability issues, since such "outsiders" might not bound by duties of loyalty and care of board members. One sensible approach is that the structure might be more effective if the board is composed of an appropriate number of independent non-executive members, who should also sit on committees. Instead, in Kosovo there is no requirement that the audit committee be made of independent board members with due qualification.

[18] See www.ebrd.com/law

As regard shareholders right, the full provision in the law allows for major corporate changes to be adopted by simple majority, which if not otherwise regulated in the article of association, might jeopardise minority shareholders rights.

Although there is no functioning stock exchange in Kosovo – and therefore no enhanced corporate governance framework - it appears that the Policy and Monitoring Unit at the Ministry of Economic Development is quite active in the promotion of good corporate governance in POEs. The Ministry has developed a model corporate governance code for POEs and requires all POEs to adopt their own codes transposing the model code. Rulings of regulatory agencies are documented and generally publicly available but often not easily accessible. International audit firms have a significant presence in the country; however the presence of international law firms is limited.

Access to Finance

Taking and enforcing security over immovable property (mortgage) and movable property and intangible rights (pledge) is regulated by the 2009 Law on Property and Other Real Rights (The Property Law). Generally speaking, the Property Law provides a developed framework for taking security. Both mortgage and pledge can secure present, future and conditional claims and can be executed even if the limitation period for the claim has expired.

Although the procedures for registration are formally simple and registration of mortgages does not take long (around a week), a substantial problem arises from the fact that lots of land plots are not registered and the historic land documentation is missing due to the turbulent past.

The 2012 Law on the Registration of a Pledge in the Registry of Movable Property (The Pledge Registry Law) sets out procedure and requirements for registration of pledges in the Pledge Registry System. A registration in the Pledge Register is valid for three (3) years from the time of registration but it can be extended. An electronic registry is operated by the Kosovo Business Registration Agency (the Agency) and is accessible on line for registering and searching pledges. Searches are available on line against the name of the debtor or the serial number of the pledged asset.

As far as the enforcement procedure is concerned, in case of delay or another breach of contract by the debtor, the mortgage creditor can acquire the right to sell the mortgaged property through court procedure regulated in the general 2013 Law on Executive Procedure (Enforcement Law). The creditors can initiate the enforcement procedure by submitting an enforcement proposal with the Private Enforcement Agent. Nevertheless, given that the Enforcement Orders of the Private Enforcement Agents may be appealed in court and that the debtor can file for counter-enforcement, the judicial enforcement procedure may be lengthy. On the other hand, the Property Law provides the pledgee with the right to file an application with the competent court to issue an order, *ex parte* and without notice to the pledger, ordering the pledged item to be seized and delivered to the pledgee.

Theme 2: Enhance energy security and sustainability by financing investments in the sector, supporting sector reform, promoting energy efficiency and renewable energy

Energy Efficiency and Renewable Energy

As a signatory of the Energy Community Treaty, Kosovo has to comply with requirements specified in EU directives related to energy and environment. In June 2016, Kosovo adopted laws on energy, energy regulator, electricity and gas aimed at transposing of the EU Third Energy Package. It is expected that the new set of legal rules will liberalise the energy market and will address existing bottlenecks such as unbundling and elimination of cross-subsidies between different categories of customers. It is expected that the Energy Regulatory Office would be granted further independence in setting energy tariffs and gradually introducing price deregulation. In the months to come the government should coordinate the implementation of the recently adopted legal framework by developing secondary legislation.

The existing renewable energy sources (RES) support schemes aimed for small hydro power plants, wind, biomass and biogas and solar photovoltaics include guaranteed transmission and distribution of electricity generated from RES through the grid as well as priority dispatch. Nonetheless, there is limited electricity generated from renewable energy sources based on the feed-in tariff because of existing regulatory barriers. The country should further facilitate integration of new renewable producers into the grid and implementation of the procedures for guarantees of origin.

Although Kosovo has made significant progress in terms of developing its policy framework on energy efficiency with the adoption of the second National Energy Efficiency Action Plan in December 2013, a substantial amount of work remains to be done to ensure compliance with EU acquis. Energy intensity of Kosovo remains relatively high. Although the Law on Energy Efficiency was adopted, implementation of a number of EE measures, such as metering, billing, energy management, energy auditing, ESCOs financing instruments, the exemplary role of the public sector are still under development. Further, a Law on energy performance of buildings and implementing regulations remain to be adopted for compliance with Directive 2010/31/EU**.**

Theme 3: Support connectivity and regional integration.

Public Private Partnership (PPP)

Overall, the Law on Public Private Partnerships (Law on PPP) represents a modern and fairly advanced piece of legislation that benefits from a further set of improvements made to an earlier law, which itself was regarded as a solid legal basis for PPP projects. A specialised PPP unit (Public Private Partnerships Committee, the “PPPC”) has been established within the Ministry of Finance to oversee and coordinate PPP projects. The PPPC is responsible, among other things, for the development and management of the national PPP programme, development of PPP policies and issuance of implementing regulations, reviewing, approving or disapproving project proposals, as well as for oversight and review of performance compliance and project implementation. In addition, a Central Public-Private-Partnership Department (the “PPP Department”) has been set up within the Ministry of Finance to assist and advise the PPPC, the Minister of Finance and other public authorities on all activities related to PPPs.

The legal framework constitutes of the Law on PPP which was drafted with a view to further harmonising the national legislation with EU rules as part of the country's efforts towards becoming an EU member candidate. The EU Progress report acknowledges that the PPP Law is "largely compatible" with EU legislation. A PPP may be implemented through either contractual (a concession or a public contract) or institutional form, to be selected by the public partner based on the optimal allocation of risks and responsibilities. The PPP Law also contains a number of appropriate safeguards, such as the right of parties to determine the governing law of the PPP agreement and the possibility for the lender to exercise step-in rights.

Public Procurement (PP)

The review of legislation reveals a relatively advanced framework with respect to integrity, accountability, transparency, enforceability, proportionality, stability, and enforceability. However, the process is not fully regulated and several key decisions not standardised are at the full discretion of contracting entities. The 2011 Law on Public Procurement (as amended) introduces price preference and mandates the selection of domestic bids as long as the domestic bidder's price is no more than ten points away from the lowest foreign bid. This price preference for domestic suppliers is clearly not in line with international best practices. Note that eProcurement has been introduced in early 2016; however in order to have a streamlined eProcurement procedure, substantial revisions in the legislation and/or issuance of implementation regulations are necessary.

The Draft Kosovo National Public Procurement Strategy for 2015 – 2020 prioritises, among other things, the introduction of green and socially responsible public procurement; the support of SMEs in the procurement process; and the further harmonisation of the legal framework for procurement, specifically along the lines of EU directives. This harmonisation is yet to be completed.

ANNEX 5 – GENDER PROFILE

Gender Inequality and Human Development[19]

The constitution of Kosovo guarantees equality for men and women before the law. Men and women have equal ownership and inheritance rights to property. There are no laws restricting the industries in which women may work. While Kosovo has a fairly comprehensive legal framework and several mechanisms in place to advance gender equality, including a Law on Gender Equality in 2004 followed by a revised version in 2015, implementation and enforcement of legislation remain a challenge.

Labour force participation

The country has one of the lowest female labour force participation rates in the world at 21.4 per cent. According to the Kosovo Agency of Statistics (2015), the share of women in employment aged 15 to 64 was 21.4 per cent as compared to 61.8 per cent for men, which is below the EU average (59.6 per cent for women and 70.1 per cent for men). Unemployment rates are exceptionally high among the youth, which is of particular concern, given that the country has the youngest population in Europe.

The labour market in Kosovo shows a pattern of vertical and horizontal segregation. Women are overrepresented in administrative positions, and according to the BEEPs survey (2015), only 4 percent of employed women advance to management positions. Women are more likely to build their careers and have supervisory roles in the public sector than in private companies: 79 per cent of all female supervisors work in government institutions or state-owned companies. According to the Labour Survey of the Kosovo Agency of Statistics (2013), women are underrepresented in energy, construction and transportation. In Kosovo, education contributes to gender segregation in the labour market as female students tend to choose education, philology, medicine and philosophy while men comprise almost two-thirds of those studying economics, construction, architecture and computer engineering.

Table 1. Labour Force Participation by age

	Labour Force Participation Rate, age 15-64, %		**Employment Rate, age, 15-64, %**		**Unemployment rate, age 15-64, %**		**Youth unemployment rate (15-24 years), %**	
	Female	Male	Female	Male	Female	Male	Female	Male
Kosovo	21.4	61.8	12.5	41.3	41.6	33.1	71.7	56.2

Source: Kosovo Agency of Statistics (2015). *Kosovo 2014 Labour Force Survey*.

Access to finance and entrepreneurship

The gender gap in relation to access to finance is large due to women's limited access to collateral on loans. This is due among other things to inheritance law and the usage of the

[19] Please note that given the status of Kosovo amongst the international community, some data usually used for the Gender Annex are missing for this country.

'clause on renunciation'; as well as cultural practices where women waive their rights in favour of male relatives. According to BEEPs, women are much less likely than men to have a bank account at a formal financial institution (36 per cent of women have bank accounts compared to 59 per cent for men). The gap in savings is slightly smaller with 26 per cent of women having formal savings, compared to 29 per cent for men according to the World Bank Financial Inclusion Data.

Women's participation in entrepreneurship and formal business ownership in Kosovo is also extremely low by regional standards. According to 2015 BEEPs data, only 11.1 per cent of firms have women among the owners, while the proportion of firms fully owned by women stands at 7.8 per cent, one of the lowest in EBRD's countries of operation. Similarly, in the companies surveyed, only 7.2 per cent of firms have women in top management.

Other gender indicators

Kosovo has made some progress in improving political representation of women in the last decade, introducing a 30 per cent quota for women both at the parliamentary and local government levels. Currently, 32.5 per cent of members of parliament are women. In the judiciary branch, out of the 9 justices on the constitutional court, four are women – one of them being the President of the Court. However, women remain underrepresented in national and local elections where there are no quotas. Despite lack of data, prevalence of Gender Based Violence (GBV) remains high in Kosovo. The legislation against violence against women in Kosovo is for the most part in line with European standards and the government passed a law on domestic violence in 2010. However, challenges remain related to quality and availability of services for survivors.

Despite lack of data, prevalence of Gender Based Violence (GBV) remains high in Kosovo. The legislation on violence against women in Kosovo is for the most part in line with European standards and the government passed a law on domestic violence in 2010. However, challenges remain related to quality and availability of services for survivors of gender based violence.

ANNEX 6 – EBRD AND THE DONOR COMMUNITY

Donor funded technical cooperation (TC) in Kosovo has allowed the Bank to undertake early diagnostic work, including the preparation of infrastructure investment opportunities, building capacities of prospective clients and sharing transition experience from policy makers and private sector stakeholders from EBRD Countries of Operations in Central and Eastern Europe. Further, TC funds have been provided to support the transfer of skills and the growth of local private MSMEs, including through local and international consultants under the Advice for Small Businesses, which is part of the Small Business Initiative.

Kosovo has also benefited from co-investment grants in the form of financial incentives and first loss cover in the sustainable energy and financial sectors.

The focus of donor grants is expected to remain on developing core infrastructure, enhancing energy security and increasing the competitiveness of SMEs. To sustain these needs, the EBRD will rely on a number of donor funds administered by the Bank, in addition to resources made available by its shareholders:

- **The European Union** supports Kosovo through the Instrument for Pre-Accession Assistance and has channelled over €3.6 million through the Bank in TC and co-investment grants. Under IPA II (2014 – 2020) it is also expected that the EU will continue to play a major role in supporting national and regional priorities which target the socio economic development and competitiveness of SMEs, environmental improvement, regional connectivity and progress towards EU accession.

  In October 2010, the Kosovo Sustainable Energy Projects was established to supporting partner banks and non-bank financial institutions operating in Kosovo that meet sound banking and high corporate governance standards to on-lend in the form of SME and/or residential sector sub-loans to the final beneficiaries to finance eligible sub-projects in the area of energy efficiency and the use of renewable energy resources in the residential and commercial sectors through TC and co-investment grants in the form of financial incentives. Support is expected to scale up in the regional context through funds provided to a second phase of the Regional Energy Efficiency Programme for the Western Balkans (REEP Plus).

  Financial support under the WBIF will grow and be increasingly used for co-financing projects of regional interest, namely those which support connectivity between the countries of the region and between the region and the Member States of the European Union. To this end, in 2015, the EU confirmed financing via the WBIF of an investment grant of € 38.5 million to complement EBRD financing of € 80.9 million for the rehabilitation of the railway route 10 interconnection from the border with Serbia in the north of Kosovo (Lekshak) to the border with FYR Macedonia (Hani i Elezit).

- **Bilateral donors**: grant funds will be sought from bilateral donors who hold accounts administered by the EBRD, who have expressed interest in supporting activities in Kosovo across all sectors and whose funds will be leveraged to complement activities supported under the WBIF.

- **EBRD Shareholder Special Fund (SSF)** endowed by the Bank’s net income. The SSF is a complementary facility to donor resources and will provide TC and non-TC support in areas where there is shortage or lack of support, however the area remains a priority for the Bank to advance transition.

TC COMMITMENTS BY DONOR THROUGH EBRD, 2011-2015*

Donor	TC Commitments (€)
EBRD Shareholder Special Fund	4,960,483
European Western Balkans Joint Fund under the WBIF	1,840,000
EU	1,288,224
Czech Republic	599,000
Norway	901,000
Luxembourg	63,510
Total	**9,652,216**

TC COMMITMENTS BY COUNTRY STRATEGY THEME THROUGH EBRD, 2011-2015*

Country Strategy Theme	TC Commitments (€)
Sustainable Infrastructure and Energy Security	3,585,000
Green Economy Transition	2,883,987
Entrepreneurship and SMEs	2,776,819
Strong Resilient and Effective Financial Sector Developed	268,000
Good Governance	138,410
Grand Total	**9,652,216**

Note: Commitment values based on year end or period end data for each year.

* Reflects commitments status as of 31 December 2015