INTERNATIONAL MONETARY FUND

REPUBLIC OF KOSOVO

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REQUEST FOR STAND-BY ARRANGEMENT AND AN ARRANGEMENT UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY—WORLD BANK ASSESSMENT LETTER FOR THE RESILIENCE AND SUSTAINABILITY FACILITY

WORLD BANK ASSESSMENT LETTER FOR THE RESILIENCE AND SUSTAINABILITY FACILITY

A. Country Vulnerability to Climate Change Including Human, Social and Economic Costs

1. Climate change poses a substantial risk to Kosovo's development progress. The country is prone to a wide variety of natural hazards—including droughts, wildfires, landslides, earthquakes, and floods—that could inflict considerable damage to economic activity, fiscal balances, and the well-being of vulnerable populations. Projections for the Western Balkans region show higher regional warming than the world average, especially for mountainous areas, resulting in a decrease in overall annual precipitation, but with contrasting increases in winter precipitation. In Kosovo, this could lead to a decline of 50 days per year of snow cover by 2050[1], and more frequent spring flooding. Based on projections of higher temperatures, population growth, and decreases in annual precipitation, four out of five water basins in Kosovo may become water-stressed or water-scarce by 2050. Climate impacts on water resources are expected to impact the agricultural sector, which is the source of seven percent of value added in the economy, providing income security particularly for rural households where poverty is concentrated. Recent floods associated to heavy rain caused damages for an amount equivalent to 0.9 percent of GDP[2]. Climate change is also expected to impact the forestry sector with rising temperatures associated with increased risks of wildfires, change in species composition and soil erosion.

2. Additional environmental degradation compounds the effects of climate change, with a disproportionate impact on the poor and most vulnerable. High levels of atmospheric pollutants, including dust and particulate matter from coal-fired

[1] USAID (2017). Climate Change Risk Profile for Kosovo.

[2] Based on estimation from WB's Global Rapid Post Disaster Damage Estimation (GRADE).

power plants, add to the negative impact of climate change on the population. Pristina and other cities already have among the worst air quality in Europe [3], with concentrations of $PM_{2.5}$ exceeding WHO guidelines throughout the year[4]. Close to two thirds of the population currently uses solid fuels for winter heating, especially wood. The annual estimated economic cost associated with mortality from exposure to air pollution is in the range of US$160–US$310 million, equivalent to 2.5–4.7 percent of GDP in 2016.[5] Given Kosovo's high reliance on coal for power generation (it accounted for close to 95 percent of electricity generation in 2020)[6] and widespread practice of burning solid fuels in homes, particulate matter (PM) emissions are not expected to decline markedly under existing policies. Furthermore, climatic hazards have a greater impact on Kosovo's population, particularly poor and vulnerable groups, in comparison to peer countries because of a) use of obsolete industrial technologies, especially in coal power plants and mining; b) unsustainable water management and agronomic practices, deforestation, and destruction of slopes by mining activities; c) socio-economic vulnerability due to a high incidence of poverty and limited protection provided by the social protection system; and d) inadequate land use, municipal planning and construction regulation, which increases exposure of the population to hazards. Based on the latest Census (2011), around 6 in 10 people lived in rural areas. Nearly two thirds of the poor and extremely poor residing in rural areas face falling agricultural productivity. Alternative economic opportunities are limited because of the unproductive agricultural sector and because natural resources (for example water and land) are increasingly threatened by unmanaged pollution and deteriorating infrastructure. Key climate impacts such as crop failure, loss of pasture lands and water resources for livestock would negatively affect the most at-risk and poor households.

3. Annual GHG emissions are estimated at 9,613 Gg of CO_2 eq in 2019. CO_2 makes up most of all emissions in Kosovo (88 percent), followed by methane (10 percent). As such, fossil fuel combustion represents the key driver of GHG emissions. The 2019 GHG inventory identified the energy sector as the source of most emissions with 86 percent of the total, followed by the agriculture sector and land use (8 percent of the total) and the waste sector (5 percent of the total GHG emissions). In comparison with other countries in Europe, Kosovo has relatively low emissions per capita (5 tons of CO_2 equivalent per capita per annum), while GHG emissions per unit of GDP (0,5 kg CO_2 equivalent per EUR) are higher. Transport is the fastest growing contributing sector contributing to GHG emissions, with an estimated annual traffic growth of 4.4 percent and an increase in motorization of 80 percent between 2010 and 2020.[7] Kosovo's heavy reliance on fossil fuels for energy production, as well as for transport, underscores the need to support the energy transition.

[3] The World Bank (2019). Air Quality Management in Kosovo.

[4] IQAir 2022. World Air Quality Report 2021. https://www.iqair.com/world-most-polluted-cities

[5] The World Bank (2019). Air Quality Management in Kosovo.

[6] Source: IEA

[7] Envisaging a healthier, greener, and more inclusive urban future in Kosovo, UNDP, December 13, 2021

B. Government Policies and Commitments in Terms of Climate Change Adaptation and Priority Areas to Strengthen Resilience

4. Kosovo has prepared and approved several climate-related strategic documents with a specific focus on climate change adaptation. Efforts have also been made to align legislation to the EU climate acquis. The Climate Change (CC) Strategy for the period 2019–28[8] is the basic framework for adaptation to climate change. The CC Strategy aims to a) develop a framework for climate change policies; b) establish disaster risk reduction mechanisms for sectors exposed to climate change risks; c) enhance adaptive capacities of vulnerable communities, particularly of the poor farmers, marginal groups and women to address the climatic impacts and related risks on their lives and livelihoods and d) strengthen the institutional framework. A three-year action plan for the CC Strategy was approved covering the period 2019–21. The Ministry of Environment and Spatial Planning (MESP) is responsible for the monitoring of the implementation of the CC Strategy. In the water sector, Kosovo has a good policy, legal and strategy framework in place, which is mostly in line with EU requirements. An Intersectoral coordination mechanism through the Inter-Ministerial Water Council is in place which aims at integrating water issues in Government's development policies.

5. Despite the progress on the adoption of the CC Strategy and action plan, the advancements in the regulatory framework for climate adaptation and resilience strengthening remain limited. The adoption of the Law on Climate Change is pending although the target date for adoption was end-2022. In the absence of the Law on Climate Change, there is no legal basis for a National Energy and Climate Plan (NECP) as required by the Energy Community. Moreover, the country has not yet adopted a National Adaptation Strategy (NAS), and currently is working on a voluntary Nationally Determined Contributions[9] (NDCs) system, which will also include adaptation measures in the sectors of water, health, biodiversity and agriculture, forestry, and land use. With donor support, Kosovo has reestablished the Climate Change Council, initiating the process of developing the voluntary NDCs. In the water sector, key challenges lie in the implementation and enforcement of the existing policy framework and the practical development of integrated development plans based on national level coordination.

6. Adaptation measures to climate change are central to the reduction of risks and damages from the current and future impacts of climate change in a cost-effective manner. The aim of the NAS under development is to establish new and enhance present-day instruments and tools of disaster risk reduction that are important for sectors of economic significance which are particularly vulnerable to climate change impacts. The NAS also aims to improve the adaptive capacity of natural systems, in particular vulnerable ecosystems, and society (for example

[8] https://konsultimet.rks-gov.net/Storage/Consultations/14-13-59-04102018/Climate%20Change%20Strategy%20and%20Action%20Plan_sep_2018.pdf

[9] Given its status, Kosovo is not a party to the United Nations Framework Convention on Climate Change and the Paris Agreement, hence is not required to submit NDCs. Nevertheless, in 2021, Kosovo launched a discussion with international stakeholders to prepare a voluntary NDC.

marginalized groups and women, poor farmers), to address the climatic impacts and related risks on their lives and livelihoods.[10]

C. Government Policies and Commitments in Terms of Climate Change Mitigation and Priority Areas to Reduce Greenhouse Gas Emissions

7. Several strategic documents guide the climate mitigation agenda. Kosovo has prepared a GHG inventory for the period 2008–19[11], the CC Strategy 2019–28 and Action Plan on Climate 2019–21[12]. The CC Strategy is the basic framework for the reduction of GHGs. The 2019–28 National Strategy and Action Plan on Climate Change has been approved by the Government and a climate change concept paper was approved in December 2020. An Administrative Instruction for Monitoring GHG Emissions of 2016 defines the governance, inter-institutional arrangements, and sets out deadlines for providing data on GHG emissions.

8. The Government has recently approved a new Energy Strategy for 2022–31, targeting a 32 percent reduction of GHG emissions in the power sector. Moreover, Kosovo has an overall target to reduce GHG emissions by 8.95 Mt CO_2 eq by 2030 (i.e. a reduction of approximately 16.3 percent compared to 2016 levels)[13]. The strategy foresees that by 2031, 35 percent of total electricity consumption will be covered by Renewable Energy Sources (RES), with total installed RES capacity reaching 1600 MW, coupled with major energy efficiency investments. Implementation of this strategy will require significant mobilization of both private sector investment and public sector resources, which the strategy estimates at around Euro 3.1 billion. Kosovo has a Law on Energy Efficiency (2018) and a Law on the Energy Performance of Buildings (2016), which are currently being reviewed by the Government.

9. With the signing of the Sofia Declaration on the Green Agenda in November 2020, Kosovo committed to decarbonization by 2050. One of the milestones to attain this target is the adoption of targets on renewable energy, energy efficiency, and reducing greenhouse gas emissions by 2030. Kosovo has a working group preparing for the National Energy and Climate Plan (NECP) development and drafting has started, however, there has been limited progress on the NECP with only initial steps being taken to revise the modelling assumptions based on the incoming 2030 targets. The NECP is expected to be updated in line with the Energy Strategy 2022–31 in order to ensure consistency across the documents and also with the Energy Community 2030 targets for Kosovo[14]. A comprehensive framework for carbon taxation has not been developed yet. As part of

[10] Kosovo Environmental Program, Ministry of Environment and Spatial Planning (MESP) - Environmental Protection and Water Department, http://kepweb.org/state-of-environment/

[11] Authorities are in the process of updating the GHG inventory.

[12] http://kepweb.org/state-of-environment/

[13] Energy community: https://www.energy-community.org/dam/jcr:421f0dca-1b16-4bb5-af86-067bc35fe073/Decision_02-2022-MC_CEP_2030targets_15122022.pdf

[14] Kosovo Annual Implementation Report, Energy Community Secretariat, November, 2022

the new energy strategy, the government has committed to finalizing preparations for introducing carbon taxation by end 2025. Under the existing legal framework, royalties on coal extraction and excise taxes on fossil fuels are levied as part of the general budget. Yet, current royalty and tax rates are still not at a level that reflects the negative externalities produced and discourage demand away from energy intensive activities. Moving forward, pricing of carbon can contribute to reduce use of fossil fuels and promote a more efficient use of energy.

D. Other Challenges

10. After the war of independence ended in 1999, a focus on rapid reconstruction helped propel an economic recovery but has left the country exposed to climate and environmental shocks. Rapid construction since 1999 associated with poorly regulated land use planning and lack of adherence to building codes has increased the risk of exposure to natural and climatic hazards for the growing population. Mining of mineral deposits, lignite and inadequate wastewater treatment have contributed to key environmental degradation challenges that Kosovo needs to address.

11. Kosovo's economic integration with Europe, and the country's ambition to join the European Union (EU), provides both opportunities as well as challenges. The EU is Kosovo's largest trade and investment partners, and the share is expected to grow as neighbors in the Western Balkans join the EU. Close integration with the EU offers significant economic opportunities for Kosovo, to align with the EU on key economic and institutional criteria, and to integrate with value chains as part of Europe's green transition. However, there are a number of short-term policy challenges, including the risk that the EU's Carbon Border Adjustment Mechanism (CBAM) may undermine the competitiveness of Kosovo's exports in the EU market due to the emissions intensity of production and the concentration of exports in emissions-intensive goods (metals, plastics and minerals). Though the overall impact may not be immediately large, some of the manufactured goods exported to the EU could be significantly affected. Moving forward, Kosovo will need to prepare for the EU's CBAM. Diversifying into renewable energy sources will become particularly important both due to the CBAM and to ensure adequate energy supply.

E. WB Engagement in the Area of Climate Change

12. World Bank engagement in the area of climate change has focused on strengthening climate change resilience and preparedness. The new **Country Partnership Framework for 2023–27** identifies environmental resilience as a key objective of the World Bank's program in Kosovo. The last Country Partnership Framework for Kosovo (2017–21) recognized that water availability and the treatment of wastewater are major bottlenecks to shared prosperity and poverty reduction in the country.

13. The World Bank has supported Kosovo's climate agenda through the Public Finances and Sustainable Growth Development Policy Financing (DPF) in the areas of environmental sustainability, renewable energy and waste management. A new programmatic DPF under preparation will support Kosovo's reform efforts in laying stronger foundations for greener growth.

The DPF will support policy measures in the areas of renewable energy, energy efficiency and climate change policy. Moreover, the DPF will support policy measures aimed at supporting vulnerable energy consumers during the energy transition. The DPF is expected to be used as a platform for coordinated policy dialogue and financing between development partners on Kosovo's climate action agenda.

14. In the water sector, the World Bank is supporting Kosovo's climate change agenda through the Water Security and Canal Protection Project, which aims at restoring the Iber Canal and the Fostering and Leveraging Opportunities for Water Security Program (FLOWS1) which has the objective of strengthening the national capacity for managing water resources. Also, the Bank has been advancing the energy efficiency and energy transition agendas through **Kosovo Energy Efficiency and Renewable Energy Project.**

15. The proposed WBG program for 2023–27 will continue supporting investments in water infrastructure to increase service network capacity and coverage, as well as to address the climate change-exacerbated risk. Thus, investments planned under the EU TF-funded **Improvement and Rehabilitation of Irrigation Systems project** will provide for increased efficiency of water utilization and the pipeline **FLOWS2** will finance construction of a dam in South-Eastern Kosovo - the country's most water scarce area. The CPF also envisages support to an innovative approach to contaminated land remediation and repurposing under the planned **Cleaning and Greening Kosova** Project. The project is expected to contribute to climate change adaptation efforts by undertaking "resilient remediation" approaches, whereby climate risks and impacts are integrated into the land remediation and redevelopment options, such as protecting water resources and agricultural land/food safety, mitigation of flash flooding and heat stress, carbon sequestration, and renewable energy development. The proposed **Livable Cities project** will help address the global and local emission challenges by improving the environmental footprint of urban areas with a focus on urban redevelopment, urban mobility and domestic heating.

16. The World Bank is planning to support Kosovo's authorities with analytical and advisory services, including through the Western Balkans Climate Change and Development Report (CCDR) under preparation which will emphasize the links between decarbonization and development, highlighting priority interventions, for both policies and investments, to build climate resilience and meet development goals. The **Pristina Infrastructure Assessment** informed policy and investment decisions that can lead to improving sustainability of domestic heating and urban mobility for improved air quality and greater livability. Through the Global Partnership for Social Accountability on **Climate Action and Civic Technology** the Bank will contribute by improving accountability of relevant Kosovo public institutions in the implementation of the Green Agenda. The **Western Balkans Green Transformation** analytical work will support the authorities in developing a framework for greening the financial sector, considering both how can it better manage climate risks, as well as help facilitate the green transition. The World Bank is also exploring possibilities to work with the authorities at addressing the impact of the floods, while boosting the country's preparedness and overall resilience.

Through advisory services and direct investment IFC, is planning to support the Government to attract the private sector for the development, financing, and operation of new renewable energy sources. MIGA will continue to support Kosovo's financial sector through providing guarantees to support climate finance-related activities.