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THEMATIC ROUND TABLE ON ECONOMY FINANCE AND STATISTICS KOSOVO 2020

REPORT

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This Report has been developed based on series of meetings conducted by the Thematic Roundtable on Economy, Finance and Statistics. As such this Report is part of a set of documents endorsed by Task Force for European Integration. The work of the Task Force for European Integration and its Thematic Roundtables, including the preparation of this Report has been supported by Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) through the Project "Support to the European Integration Process in Kosovo". The views, information and/or arguments do not necessarily reflect the official opinion of the MEI, GiZ or any other stakeholder to every detail.

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I. Introduction

This is a Diagnostic report of the Thematic Roundtable (TRT) on Economy, Finance and Statistics which aims to present the current state of affairs in this sector by reflecting the consensus achieved by all participants. To elaborate the current state of affairs, this report strives to summarise the achievements and challenges in this sector within the EU integration process. As such, it strives to offer an overview of opinions, points of views and assessments which were discussed in the meetings of the TRT, which were held between July 2012 and April 2013.

The report is a result of a discussion paper drafted on the basis of public documents of the governmental institutions, academia, business associations, civil society organisations as well as donor projects and international organisations in Kosovo. The report was complemented in particular by the representatives of relevant institutions of the Republic of Kosovo, engaged experts and participants in the TRT meetings.

The Diagnostic report is a working document and does not have the status of a policy document. The report is a document with detailed information for the covered areas which will serve as an input in drafting the Overall Diagnostic report for the entire Task Force for European Integration and the Draft National Strategy for European Integration. In this light, conclusions of the plenary meeting of the TRT (see Annex A) will provide particular contribution.

This report start with four chapters presenting the current state of affairs in the area of macro-economy, trade and fiscal policies as well as financial services elaborating their impact in the economic growth of the country.[1] Kosovo's economy during the post-war period is characterized with positive developments in the field of economic growth, but it continues to be challenged by the high rate of unemployment and trade deficit. Fiscal sector, on the other hand, is considered to have remained stable concerning both the revenues and expenditures. This sector has also contributed positively in economic growth, taking the primary role at time when private sector faced difficulties. Difficulties in the real sector were also reflected in financial sector, which slowed down financial mediation as a protective measure for business sector development.

Economic growth in recent years was between 4 and 5%, a growth which in the period 2005-2008 was driven by the private sector, while as of 2009 it is the public sector that has taken primacy in this growth, reflecting an anti-cyclical behaviour of government expenditure. Private sector also continues to play a positive role in this growth, but the impact of this sector is reduced, reflecting the overall macroeconomic landscape in the region. On the other hand, trade deficit continues to have a negative impact on economic growth, as it is characterized by a high rate of imports which are covered by only 10% of exports. The high level of trade deficit is reflected in the deficit of current accounts, which characterizes country's economy since the end of the war. There are

[1] The data presented in this report may change with the review of MTEF in the coming days.

other categories, however, that have an impact on reducing the gap in trade deficit, such as trade in services, in which Kosovo has a positive balance, the balance of revenues, as well as current transfers dominated by remittances. In financing (capital and financial account), it is foreign direct investments (FDIs) that have positive impact in funding the deficit of current account and other investments. Foreign direct investment have been continuously characterized with fluctuations as result of developments in recent years in euro zone countries, which at the same time represent main source of FDIs. In any case, the 2012 saw a slowdown of privatization process which had an impact in the lower flux of FDIs in the country (a decrease of 40%). Regarding other investments, this category mostly contains trade loans between local companies and companies from outside Kosovo's economy. This category to a large extent consists of loans in goods that local companies get from companies from outside the country. In addition to these two categories, an important category is also the portfolio investments which have only outward flux as result of lack of instruments for investment in Kosovo. Subsequently, this category is dominated by the Trust funds that are invested in international financial instruments.

Fiscal sector on the other hand continues to be characterized by stability as far as revenues and expenditure is concerned. In any case, the increase of tax base continues to be challenging, considering that revenues from customs dominate the revenue structure in the budget. The increase of internal tax base would provide for less reliance of the budget on customs revenues. Revenues in the second half of 2012 marked an increase of 12% compared to the first half of 2011. Concerning expenditure, the approved budget planning reaches expenditure level of 1.5 billion EUR, presenting an annual increase of 9.3%.

Financial sector continues to be characterized with stability and continuity in the financial mediation process in the country. Until December 2012, banking sector loans were 1.76 billion EUR, presenting an annual increase rate of 3.8%. The increase during 2012 was slower compared to previous periods, reflecting developments in real sector and resulting in a system that is better adjusted to environment with greater economic risk. As consequence, banks consider that in order to maintain the quality of credit portfolio they had to strengthen crediting criteria. On the other hand, deposits reached the amount of 2.28 billion EUR, representing a similar increase rate with previous years (annual increase of 8.3%). As result of these developments, the ratio between loans and deposits in December 2012 was 77.4 %, compared to 80.7% in 2011.

The interest rate is considered relatively high in Kosovo's economy. Average interest rate of loans during 2012 was 13.4 percent (compared to 14.1% in 2011). On the other hand, interest on deposits for 2012 marked an increase of about 3.6%, compared to 3.5% in 2011. Difference between interest rates of loans and deposits in 2012 was reduced to 9.85 compared to 10.65 in 2011.

As result of deterioration of performance in the real sector of economy, the 2012 marked a decrease of banking system profit, which was lowered to 19.3 million EUR (36.6 million EUR in 2011). The reduction of profit is attributed to a large extent to the increase

of expenditure of provisioning to cover non-performing loans. Until December 2012, non-performing loans as percentage of total loans were 7.5%, compared to 7.0% in September 2012. It is important, however, that the financial system remains well capitalized with adequacy level of capital reaching 17.9%.

In addition to banking system, pension fund is also an important part of financial sector in Kosovo's economy, which until December 2012 represented 18% of all assets of financial system. This pillar of financial system is dominated by the Kosovo Pension Savings Trust (Trust), which in December managed 739.8 million EUR (593.3 million EUR in December 2011). This system, in 2012 was characterized by positive performance considering that price per unit reached to 1.117 EUR. Insurance industry continues to be relatively simple in Kosovo and is dominated by mandatory insurance TPL for vehicles. The value of assets of this industry is 130.4 million EUR. Micro financial institutions in 2012 had a negative performance in crediting, marking a value of 98.8 million EUR compared to 104.7 million EUR in 2011.

The fifth chapter present the achievements and challenges in the context of statistics which continue to be present in Kosovo. Laws and regulations govern responsibilities for developing statistics in Kosovo. Subsequently, KAS is primary responsible authority for demographic/social statistics and population, economic sector including national accounts, trade balance, prices, etc., whereas the CBK is responsible for monetary statistics and payment balance. CBK statistics are considered to have reached a relatively high level of quality by upholding IMF standards presented in drafting manuals. Official statistics in Kosovo are in being consolidated, but the KAS continues to face lack of sufficient institutional and professional capacities. In the context of advancing statistics, there is a general conclusion that there is room for improvements in inter-institutional coordination, cooperation with users and in range and frequency of reported statistics in compliance with EU standards. Increasing the frequency would enable a more comprehensive analysis and better identification of economic developments.

Privatisation as a crucial part of the transitional process is in Chapter six. Privatisation process slowed down its activity in 2012 as result of the lack of the board. Anyway, in the process of privatization of socially owned enterprises until September 2012, the value of sales reached 572 million EUR and 60.5 million EUR from the liquidation of enterprises. 20% of proceeds from the sales is reserved for employees of privatized SOEs, 5% is reserved for PAK administrative services, whereas 75% is reserved to resolve creditors complaints/claims. The funds generated from privatization would contribute to economic growth if at least part of them would be made available for investment. Privatization process is expected to end in 2016, but this would require support from other institutions as well as higher efficiency from the Special Chamber. Process is perceived to be accompanied with misuses and lack of general strategy with measurable objectives and overall social consensus for the process. SOE management is generally improving, but a further reduction is required, particularly of technical and commercial losses.

The report ends with Chapter seven on public internal financial control (PIFC) with

a general overview on the institutional sustainability, efficiency and effectiveness of public finance usage. PIFC is regulated with legislation for different sectors which is comprehensive, including specific laws and policies for PIFC, financial rules and supplementary laws that contribute to wellbeing of public finances. National capacities are improving, but the certification programs should be localized and be made sustainable. While it is considered that general PIFC framework is in compliance with general EU principles, its implementation remains far from what is desired where budget organisations have not adjusted themselves to PIFC requirements and are not using as much as they should systems for planning and management of public goods in the existing legislative and institutional framework. Furthermore, more attention is required for performance audit and for indicator development for measuring the effect of utilisation of funds in order to improve the life of citizens.

Chapter I – Macroeconomic Stability[2]

Kosovo's economy has constantly experience positive economic growth rates, which were higher than the average rates in the region. However, despite relatively high growth rate (about 4-5% in 5 past years), high unemployment continuously challenges Kosovo's economy. This is because Kosovo's economy is mainly based on trade activity, which sector has limited capacities to create added value to the economy and to generation of new jobs. Still, remittances of those in the Diaspora play a major role in mitigating unemployment effects, and those remittances have reached the amount of nearly 600 million EUR in several past years.

Forecasts for improvement of Euro-zone economy provide positive signals for economic growth in Kosovo. Economic growth for the 2013-2015 is predicted to be about 4% while this growth for 2013 is expected to be 4.1% (IMF, 2012). Economic growth for this period is mainly predicted to be supported by increase of private consumption, investments and exports in general (IMF, 2012).

Private consumption is expected to increase with an actual average rate of 5.4% while private consumption per capita is predicted to grow at 3.2% on average, with the assumption that population is expected to grow at a rate of 1.6%. Even though consumption is expected provide the biggest support to actual growth of the GDP during this period, its effect to economic growth is expected to reduce gradually by being replaced with a higher level of private investments and exports of both goods and services. A significant contribution to economic growth during the period is expected from investments. Contribution of investments to GDP growth is expected to increase gradually by reaching a ratio of 33% of the GDP. From these, private investments are expected to maintain a relatively stable participation of GDP during 2011-2015 period at about 21-22% of the GDP. At the same time, public investments, which are expected to slightly increase during the predicted period, are expected to continue with a participation of 11% of the GDP.

Despite slower developments in the actual sector, it must be stressed that preconditions for a more stable development are underway, considering investments in infrastructure by the public sector as well as by privatization process. Kosovo's fiscal positioning is also encouraging which is continuously marked by satisfactory balance. In this context, during 2012, the implementation of the platform for emission of government securities, which platform reconfirms Kosovo's favourable fiscal position, considering that bidding of primary stakeholders has constantly been two times higher than the offer of government's securities, while interest rate of the securities reduced continuously which confirms the trust of the financial sector in the public sector (CBK, Q4 2012).

[2] For the most recent data, please refer to the MTEF which is currently being reviewed and is expected to be approved by the Government in May 2013.

Kosovo's financial sector, on the other hand, was continuously characterized with high level of sustainability and stability in liquidity and capital rates, while the quality of credit portfolio remains among the best in the region. The expansion of the financial system was characterized by satisfactory rates until 2012, while 2012 this growth was slowed down, which to a large extent reflects lower credibility of banks on performance of the private sector (CBK, RSF, 2012).

One of the biggest problems in Kosovo's economy continues to be trade performance considering that the deficit of the current account is constantly over 10% of PBB. This deficit was constantly caused by high level of imports and very low levels of exports (AKS, 2013; CBK, 2013).

1. Gross Domestic Product (GDP)

Data on Gross Domestic Product (GDP) were published for the period until 2011. GDP structure is continuously dominated by expenses of the final consumption, from which the largest part belongs to the private sector. On the other hand, deficit in the trade balance continues to be a negative contributor to economic growth in the country. However, despite fluctuations in regional and global economies, Kosovo's economy is constantly marking positive growth rate. Actual growth during 2011 was 4.5% (ASK, 2012). In nominal terms, GDP during 2011 was about 4.77 billion EUR. GDP per capita in 2011 was 2650 EUR, and compared to regional countries it is relatively low (1/2 of Bosnia, 1/3 of Macedonia and Albania and ¼ of Serbia). According to some estimation Kosovo must have an annual growth of 10% for one decade to achieve Albania's level of GDP per capita (WB, 2012).

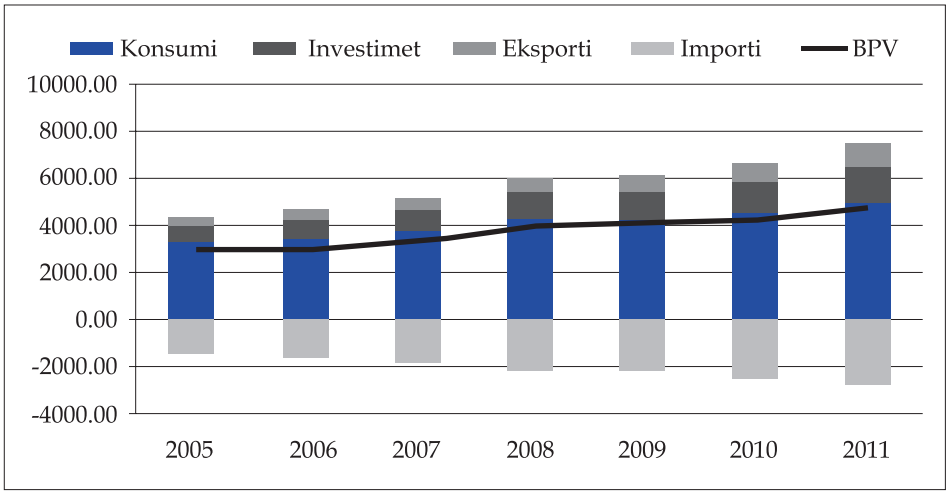

Figure 1: GDP structure according to expenditures approach

DP per capita according to Purchasing Power Parity (PPP) in Kosovo was above 7,000 USD, which is at the same level as in countries such as Albania and Bosnia and Herzegovina, but at a lower level compared to Macedonia, Montenegro and Serbia, whose GDP per capita according to PPP was higher than 10,000 USD (CBK, 2011).

The largest category within GDP has had positive growth rates since 2005 (with exception of 2009). Average general consumption growth rate during 2005-2011 was at 7%, which rate to a large extent was backed by private expenditure, while government expenditures were increased at a slower rate (ASK, 2012). In addition to remittances of emigrants, which are considered to have a major contribution for encouraging consumption, the increase of payments of the public sector may have had an effect on growth rate in recent years. Also, the increase of government expenditures for consumption in 2010-2011 has had an important role to the growth of consumption. On the other hand, crediting of the banking sector has also had a positive role on increase of consumption. In 2012, the consumption is not expected to be affected largely by slowing down of crediting of the banking sector, considering that crediting of the banking sector has continued with a relatively high rate of growth towards households, while the most significant decrease of crediting is observed among businesses.

Investments also pose an important component of GDP, considering that on average, in past six years has contributed with about 28% of the GDP. In 2010-2011, this ratio increased up to 32% of the GDP. Factors which affect the most the level of investments in the country include public investments, which in recent years have seen a considerable growth, but in 2012, this rate was negative at about 40%. Besides the public sector and external sector, the investments of private companies also affect general investments, which are also supported by crediting of the banking system. It is worth mentioning that during 2012, crediting of the banking sector towards companies was characterized by a positive rate of the growth but the rate of the growth was relatively low.

The real growth of GDP for 2012 was predicted to be 3.8% (IMF, 2012 and World Bank, 2013), which is lower than the previous year of 4.5%. The slowdown of economic growth is in large part due to the crisis in the Euro-zone. Predictions show that during 2013 and 2014 may have an increase of 4.1% and 3.2% respectively. Aggravation of situation in Euro-zone may slow down the growth through reduction of exports, foreign direct investments and emigrants' remittances.[3]

Ministry of Finance (MF) predicts that private investments and export of goods and services in the coming years will reduce the effect of total consumption on economic growth. Export of goods and services is expected to grow with an average rate of 7.6%, as a result of increased production and export capacities of Kosovo businesses. On the other hand, fluctuation of global prices of metals and demands for metals will have an important impact on Kosovo exports, since metals comprise the largest portion of exports. Export of services is expected to have an even more positive trend especially in

[3] WB - Kosovo Country Partnership Strategy 2012–2015, p. 3.

the sectors of construction, communication, information technology, etc. In the long run, imports are expected to be replaced with domestic products, but until the end of 2015 they are expected to contribute to GDP.

Since the raw material for production is imported, it is expected that with the increase of domestic production and export, the imports will increase too, despite assumptions for replacing exports with domestic products. However, the deficit of the trade balance is expected to drop slightly during the period of 2013-2015 with the fast growth of export of goods. Export of services has great potential for a quick economic growth, therefore it is predicted that during the period of 2013-2015 the export of services will grow with an actual rate of about 6.5% and thus creating the situation where export of services will be faster than the import of services.[4]

To maintain macro-fiscal stability and to support economic growth, development of private sector and decrease of unemployment, the MF and Ministry of Economic Development (MED) in the Vision for Economic Development and Midterm Expenditure Framework (MEF) 2013-2015 predict meeting objectives related to: Preservation of macro-fiscal sustainability through sustainable policies, reduction of informal economy, development and improvement of taxation and customs collection system, increase of the quality of the management of public expenditure, further development of relations with international monetary institutions, development of suitable policies for sustainable economic development, encouragement of sustainable use of mineral resources and frequency resources, safe, stable and high quality supply of energy, telecommunication services through competitive market integrated into regional and international systems, reforming and restructuring of POEs and increase of the level of public services for citizens.[5] The Government also has set the priority of developing agriculture sector, which currently has a participation of 35% of the total employment.[6]

Kosovo has considerable potential to move towards sustainable growth and creation of jobs led by the private sector, if it manages to overcome its investment-related challenges. Kosovo has several important comparative advantages for attracting domestic and foreign investments and creation of a successful exports sector. In this aspect, Kosovo has a number of important resources such as a young labour force, unused natural resources, good quality agriculture land and access to regional and EU markets. Policies feature a simple low-rate taxation system, a flexible labour market compared to the region, comparatively low salaries for (semi) qualified workers. But, on the other hand, there are some obstacles to investments, for example, i.e. those identified in "Doing Business" report, then those related to infrastructure, rule of law, inadequate labour force, limited access to finances, complicated procedures for entering and exiting business, etc.[7]

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4 KASH 2013-2015, p. 30-31.

5 KASH 2013-2015.

6 WB - Kosovo Country Partnership Strategy 2012–2015, p. 8.

7 Ibid.

2. Structure of the labour market

More sustainable labour market estimations are lacking and it is considered that there is a problem in terms of data comparison. This because the last labour market survey was conducted in 2009, while the results of the survey for the half of 2012 are being processed by KAS and are expected to be published in May 2013.

Since as of 2011 a new methodology is being applied, Kosovo Agency of Statistics (KAS) does not possess data on labour market based on age groups, gender and regional distribution for the last 5 years. Also, in previous questionnaires (2007-2011), KAS did not create statistics of population based on age and gender at the municipal level.[8]

Unemployment rate of 43% is the highest in Europe, where the young population (15-24 year olds) compose 73% of the unemployed[9], but a large number of the youth is still in the education system and is not part of the active labour force. On the other hand, older age groups have a higher rate of employment – about 34% of the 25-54 age group and about 27% of the 55-60 age group.[10] According to MLSW, the rate of those registered as unemployed at the end of 2011 dropped for 3% compared to 2010, out of which about 94% are long-term unemployed[11]. Kosovo has a significantly higher rate of unemployment compared to Macedonia (34%), Bosnia (23%) or Montenegro (17%).[12] Investments in the private sector are not reducing poverty, since new jobs created with these investments are usually of low salaries in a market exposed to informality, which creates difficulties in the estimation of the unemployment rate.[13]

Kosovo has a series of laws harmonized with the EU legislation on protection of rights of workers and labour safety, but their implementation is not successful and poses a high cost for everyone. However, it is considered that the Labour Law is expected to be amended in 2013 so that it is harmonized with the EU directives.[14]

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8 The data disaggregated on gender and rural/urban basis are expected to be available from May 2013.

9 UNDP – KHDR 2012, pp. 25-27.

10 ASK – Anketa e Fuqisë Punëtore, 2009, p. 15.

11 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, p. 340.

12 UNDP – KHDR 2012, pp. 25-27.

13 Ibid, p. 3-5.

14 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, p. 322.

Table 1: Long-term unemployed persons according to categories[15]

Category	2007	2008	2009	2010	2011
Long-term unemployment	93.%	93.5%	94.2%	94.0%	93.8%
Youth (15-24)	98,695	101,658	103,896	106,342	107,122
Females	156,679	158,120	161,131	160,856	157,922
Persons with disabilities	1,726	1,814	1,903	1,937	2,030
All minorities	30,133	30,509	30,695	29,860	29,711

Based on the completion of the high education, between 25,000 and 30,000 persons enter the market every year.[16] On the other hand, the data from the Ministry of Labour and Social Welfare (MLSW) indicate reduction of the registered jobseekers. The data of MLSW present the labour market as follows:

Table 2: Unemployment registration per gender and age group[17]

Indicators		2007	2008	2009	2010	2011
Unemployment registration		334595	335942	338895	335260	325261
Gender	Female	156679	158120	161131	160856	157922
	Male	177916	177822	177764	174404	167339
Age group	15-24	98695	101658	103896	106342	107122
Male		47398	48891	50404	52071	53172
25-39		147411	147995	149382	148059	142276
Female		70080	70639	72022	71796	69636
40-54		66286	65585	65819	63631	59995
Female		30071	29857	30176	29372	27857
55+		22203	20704	19798	17228	15868
Female		9163	8774	8551	7674	7349
Ethnicity	Albanians	304461	305433	308200	305400	295550
	Serbs	13428	13198	13190	13021	12810
	Other minorities	16706	17311	17505	16839	16901
	All minorities	30133	30509	30695	29860	29598

Active labour force in Kosovo, based on recent labour force survey of 2009 conducted by KAS is very low and is at about 48%. Employment is predominant in the private sector and during the years of 2007-2011 it comprised about 2/3 of the total employment.[18] It is considered that there is a significant number of employees in the informal sector.

15 Labor and employment report 2011, Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, p. 133.

16 UNDP - KDHR, pp. 11, 29-31.

17 MPMS - Labour market information in Kosovo, Monthly report/LED/MLSW.

18 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, p. 338.

Table 3: Employment in private and public sector, 2007-2011

Year	2007	2008	2009	2010	2011
Employed	225,037	218,231	233,338	245,502	251,510
Public sector	74,366	74,701	74,190	77,164	78,068
Private sector	150,671	143,530	159,148	168,338	173,442

Average salary in low skill sectors is about 260 EUR – close to the one in Albania, half of the salary in Serbia and Macedonia, and 1/8 of the salary in Montenegro.[19]

Table 4: Net average salary in public and private sector, 2007-201120

	2007	2008	2009	2010	2011
Average salary (EUR)	242	248	-	292	327
Public sector	208	237	270	268	368
Private sector	241	258	-	303	327

Despite economic growth and investments in infrastructure, Kosovo faces with relatively high rate of unemployment and poverty. Kosovo is among the poorest countries in Europe where estimation of poverty rate range between 34 to 48% (with less than 1.55 EUR/day) and between 12 to 18% for extreme poverty[21] (with less than 1 EUR/day). Regarding the income equality level measured through Gini coefficient Kosovo is at a good level by being at a comparable level with many European countries (Gini coefficient was at about 0.3 in 2009). However, there is a difference among regions, which vary from 18% up to 54%. Poverty is considered to be more present among younger age groups. [22]

Around 8% of the population are part of the social assistance programme. Furthermore, Kosovo does not have an insurance system that covers unemployment.

Minorities (especially RAE) are particularly exposed to poverty and marginalization in socio-economic aspect. Additionally, RAE, and RAE women in particular, have the highest rate of illiteracy due to school drop-out. [23]

19 UNDP – KHDR 2012, pp. 30-31.

20 MPMS - Research on Needs of Labor Market 2011, KBA/MLSW.

21 UNDP – KHDR 2012, p.11.

22 WB - Kosovo Country Partnership Strategy 2012–2015, p. 6.

23 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, pp. 347-348.

3. Inflation and prices

With adoption of Euro as its official currency, Kosovo is largely limited with regard to monetary policies in controlling inflation. During past 6 years, inflation has seen an average of 4.1%. Inflation in Kosovo fluctuates a lot, where two highest points of inflation were reached in 2008, with an annual average rate of 9.4% and in 2011 at a rate of 7.3%, (ASK, 2013) mainly due to increases of prices of fuel and food (bread and crops) in international markets.

Table 5: Annual average inflation rate (in %)

Year	2007	2008	2009	2010	2011	2012
Inflation rates	4.4	9.4	-2.4	3.5	7.3	2.5

Kosovo has constantly been characterized with the inflation caused by prices of imported products. Until September 2012, import prices marked a growth of 5.8% compared to September 2011, while prices of production were stable by marking an average growth rate of 0.8%. It is worth mentioning that during recent years in Kosovo, there was a change in weights in consumers' basket in some categories, for example food products, by decreasing to 37.8% of the total of consumers' basket compared to 42.7% in the previous year. The drop in the category of food products is expected to positively affect stability of prices in the country considering that the food products category in addition to high weights is characterized also with significant changes of prices.

4. Balance of payments

The Balance of Payments in Kosovo was constantly characterized by a high deficit of the current account and a surplus of the capital and financial account. High deficit of the current account which is constantly caused by high trade deficit is considered to be one of the factors with negative impacts on GDP growth. The deficit in Kosovo is considered to be chronic and long-term with an average of 11% of PBB per year (CBK, 2013). Funding of the deficit in the current account during recent years was supported by capital and financial account, especially the category of foreign direct investments (FDI) and other investments. On the other hand, it must be noted that remittances of emigrants is the component that has the highest influence in closing the deficit in the current account.

4.1. Current account

As part of the current account, trade of goods continues to be the component, in which Kosovo has a high level of deficit. As a participant of CEFTA agreement, Kosovo has an open economy and trade activity poses one of the main components of the Balance of Payments and Current Account. But, one of the core problems of Kosovo's economy is considered the lack of competition in trade of goods considering the deep trade deficit, thus making local economy dependant on imports and with low level of exports. Exports during years had an average rate of 10% of coverage of imports, which is the

lowest in the region and broader. While in the context of exports, basic metals are the ones that dominate the structure of exports.

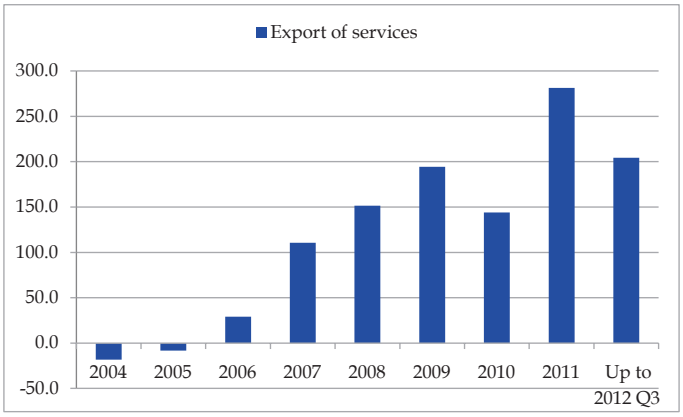

Figure 2: Export of services

Export of goods by the end of 2012 was up to 269.3 million EUR, while import reached up to 2.5 billion EUR, which at the same time poses a low coverage of imports with exports at only about 10.8%. Another important component as part of the balance of payments continue to be remittances of emigrants, which by September 2012 reached to 436.7 million EUR, which marks an annual growth of 2%. Other components of the current account, such as trade of services and revenues have a positive balance but their influence on closing the deficit remains limited.

Also, in the methodological context, it must be noted that since September 2012, ASK started to include statistics on trade of energy in its reports on foreign trade, by ending a long period of time with a methodological change.

Other components of the current account are export of services in which Kosovo's economy is characterised with a positive balance. Export of services can also represent one of the fields to which country's economy should be directed to, considering preconditions that country's flexible labour force creates. Balance of the account of services by September 2012 reached to 204 million EUR, thus creating the situation in which this account became one of the contributors for closing the deficit in the current account.

Another component with a positive balance is the revenue category which by September 2012 reached to 102 million EUR. However, one of the most important components continues to be the category of current transfers which by September 2012 reached to 819 million EUR. As part of this account, remittances of emigrants make the largest participation, which by September 2012 reached to 436 million EUR, while the average in past 4 years was about 590 million EUR, which is expected to be the same for 2012. It is worth mentioning that the influence of the remittances of emigrants in the context of GDP is mainly focused on funding consumption of households. This component is very important for Kosovo's economy, considering the high rate of unemployment and it is

considered one of the main factors that mitigates social pressure since it is especially households that face unemployment that receive remittances from abroad. However, it must be noted that their long-term effect may be dis-favourable for the labour market since remittances affect negatively the decisions of individuals to enter the labour market and the increase minimum wage that is required from those individuals.

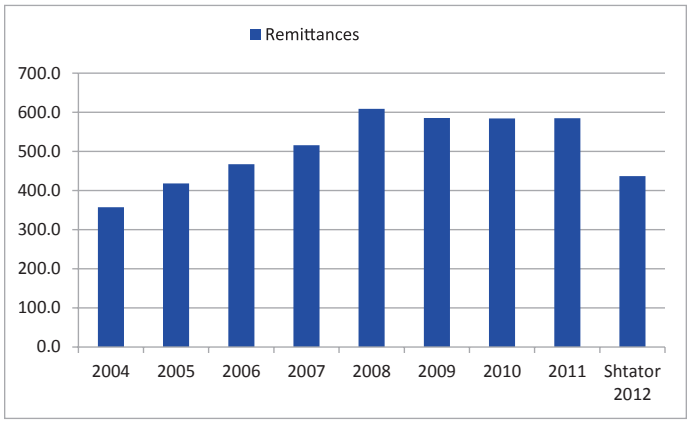

Figure 3: Remittances

4.2. Capital and Financial Account

Capital and financial account are an important part of the balance of payments. In Kosovo, it was the entries into this account that influenced maintaining a relatively high level of deficit in the current account. According to CBK data, by September 2012, the balance of the capital and financial account was 63.5 million EUR. This poses the lowest level since 2008. Factors that contributed the most that this account experiences a relatively high decrease were: low level of grants for capital investments, decrease of FDI and decrease of funding through other investments as well as more rapid increase of portfolio investments which pose an exit flux for Kosovo's economy.

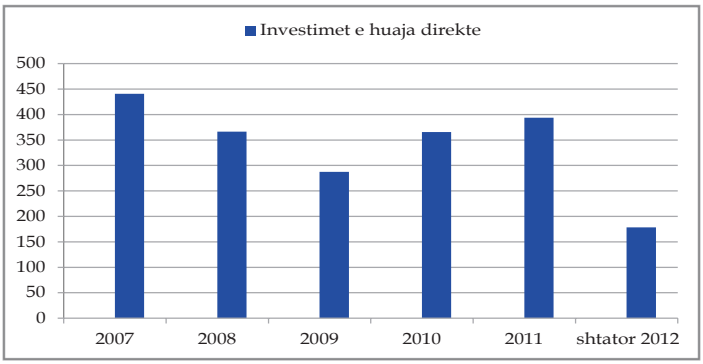

Figure 4: Foreign Direct Investments

Foreign direct investments in Kosovo represent one of the most important components for economic growth and for new sources of funding in the country. During years, Kosovo's economy had a satisfactory level of entry flux of FDI, which on average participated with 7.6% of the GDP. The data presented in the graph for 2012 only cover the period up to September 2012. But, during previous years, Kosovo attracted on average an amount of 370 million EUR of FDI per year (excluding 2012). Foreign direct investments according to CBK data are mainly in the form of capital investments during 2012, while on sectorial basis, FDI represented continuous change of participation (CBK, 2013). As is represented, FDI participation during 2012 increased in the real estate sector, while other economic sectors such as financial sector and transport and telecommunication decreased during recent years. The significant decrease of FDI is observed in the sector of construction, while the production sector as participation was marked with stability and positive trend in recent years. Regarding states, FDI come to Kosovo mainly from the EU countries, while in recent years, the FDI from Turkey have increased. It is worth mentioning that among factors that determine the most the level of FDI in Kosovo include economic growth in Euro-zone and privatisation process in the country.

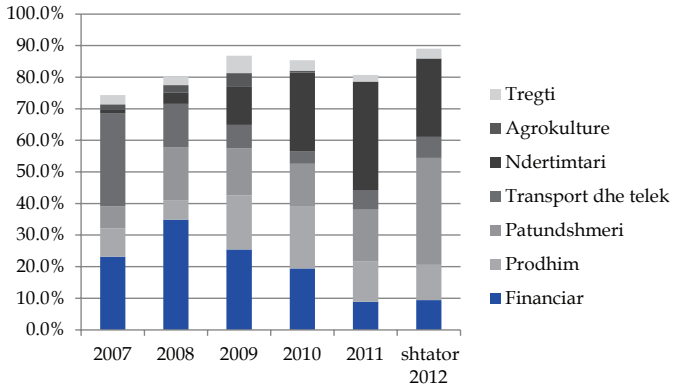

Figure 5: Structure of FDIs

Another important component as part of the capital and financial account is the category of portfolio investments. It must be emphasised that this category is composed of investments abroad with financial instruments in international markets. This mainly includes the investments of the pension fund in stock market as well as other forms of investment. As a result of instruments in Kosovo's market, this category constantly causes negative figures, which means that Kosovo's economy invests abroad, but it does not receive investments of this category. On the other hand, other investments represent other forms of investments which do not belong to the categories discussed so far. These categories include various deposits abroad as well as deposits of non-residents in the country, trade loans, etc. Subsequently, the main component as part of the entry flux of this category is trade loans.

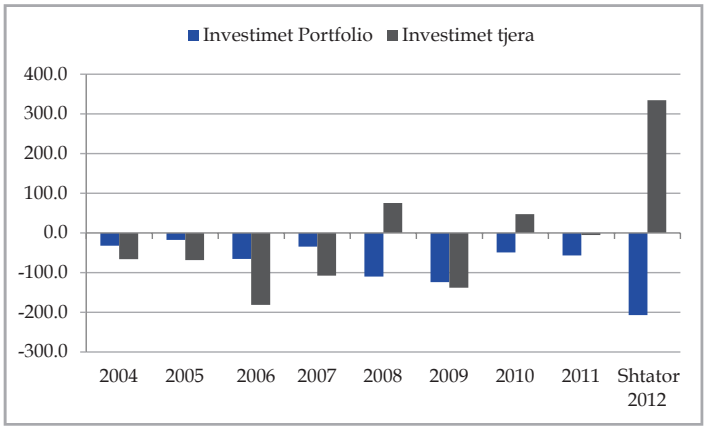

Figure 6: Portfolio investments

4.3. EU requirements

There are no specific requirements for the balance of payments in the Acquis, which means there are no requirements regarding balance of payments for getting the candidate status for membership. But article 119 of the Treaty on Functioning of the EU, which discusses Economic and Monetary Policies, reads that one of the principles is stability of the balance of payments, which is not applicable for Kosovo since despite the deep deficit in the balance of payments, Kosovo does not face the risk of exchange rates or currency since it uses Euro as its currency.

4.4. Legal and institutional framework in Kosovo

In Kosovo, the regulations in the field of macro-economic stability in the component of balance of payments are spread in several legal acts, including:

- Law on Internal Auditing
- Law on Central Bank and
- Law on membership of Kosovo to the International Monetary Fund
- Law on Public Debt
- Law on Management of Public Finances
- Law on Foreign Investments
- Law on Foreign Trade
- Law on implementation of international sanctions.

Trade policies that are part of the competence framework of the MTI affect the balance of payments. On the other hand, CBK is responsible for statistics of the balance of payments, which besides regular publications of periodicals on statistics of the balance of payments, on regular basis, also published reports with analyses for all economic sectors and every year, it published the Report on the Balance of Payments.

4.5. Status and challenges

The balance of payments consists of three accounts: current account, equity account and financial account. Categories from which trade balance is composed of include: export of goods, reception of remittances, assistance provided by foreign governments, investments from foreign companies and revenues collected from investments made abroad. On the other hand, the balance of payments is reduced doe to: import of goods, issuing remittances, payables for foreign investments, assistance provided by the Kosovo Government and foreign investment of Kosovo citizens. Analysis of receivable and payable transactions in these categories enables creation of projections for the status of balance of payments in the future.

Përshkrimi	Llogaria rrjedhëse						Llogaria kapitale dhe financiare			Gabimet dhe lëshimet neto
		Mallrat dhe shërbimet			Të hyrat	Transferet rrjedhëse		Llogaria kapitale	Llogaria financiare	
			Mallrat	Shërbimet						
2004	-208.2	-1001.4	-983.1	-18.3	138.3	654.9	79.4	21.9	57.6	128.8
2005	-247.5	-1086.9	-1078.5	-8.3	139.1	700.3	72.7	18.9	53.8	174.8
2006	-226.1	-1144.1	-1173.1	-29.0	158.8	759.2	-14.9	20.8	-35.7	240.9
2007	-214.0	-1242.3	-1352.9	110.5	186.3	842.0	10.7	16.5	-5.8	203.3
2008	-460.9	-1498.2	-1649.7	151.6	164.0	873.2	298.9	10.5	288.5	162.0
2009	-412.1	-1457.2	-16517	194.5	61.8	983.4	213.3	100.3	113.1	198.7
2010	-558.6	-1608.1	-1725.1	144.0	67.0	982.5	297.2	21.3	275.9	216.4
2011	-673.6	-1777.8	-2059.0	281.3	113.8	990.4	419.6	42.0	377.5	254.0
T1	-52.9	-260.9	-319.5	59.6	20.9	187.2	-14.3	-0.5	-13.8	67.1
T2	-139.2	-365.9	-420.0	54.1	26.4	200.2	134.1	4.0	130.1	5.2
T3	-138.2	-406.2	-448.2	42.0	3.0	265.0	-35.2	5.0	-40.2	173.4
2009 T4	-81.8	-424.3	-464.0	39.8	11.5	331.0	128.8	91.9	36.9	-47.0
T1	-53.2	-272.1	-131.7	41.5	23.7	195.3	14.7	4.7	10.0	38.5
T2	-138.2	-391.1	-443.1	51.9	24.3	228.6	146.0	3.7	142.3	-7.8
T3	-241.0	-499.7	-514.6	14.9	-1.5	260.2	6.5	6.9	-0.5	234.6
20010 T4	-126.1	-445.1	-480.7	35.7	20.6	298.4	130.0	6.0	124.0	-3.9
T1	-39.0	-301.3	-382.0	80.7	41.9	220.4	9.5	13.3	-3.8	29.5
T2	-166.4	-440.3	-514.1	73.9	30.0	243.9	216.7	6.0	210.7	-50.3
T3	-213.0	-503.0	-557.4	54.4	21.2	268.7	-17.4	6.3	-23.8	230.4
20011 T4	-255.2	-533.3	-605.5	72.2	20.6	257.5	210.8	16.4	194.4	44.4
T1	-50.0	-332.6	-382.2	49.6	37.4	245.2	12.9	-0.9	13.8	37.1
2012 T2	-166.5	-485.5	-554.6	69.1	44.4	274.7	78.3	2.5	75.8	88.2

Figure 7: Balance of payments

5. Relations with International Financial Institutions (IFI)

5.1. International Monetary Fund (IMF)

Kosovo became the 186th member of the IMF in 2009; however, it was supported in the form of technical assistance by IMF since the end of the war. Fiscal situation in Kosovo continues to be characterised as stable despite significant growth of expenditures since 2008 compared to previous years. The period before 2008 was more characterised with a higher level of revenues than expenditures, by accumulating budgetary surplus for that period, while in recent years the budget is characterised with deficit, but a relatively low level.[24]

Despite fiscal instability, Kosovo during 2010 has joined the programme known as Stand-By Agreement (SBA) which is the first financial assistance by IMF to Kosovo budget in the amount of about 109 million EUR, equivalent to 157% of Kosovo's quota at IMF. This 18 month arrangement aimed at addressing budgetary needs for which IMF was expected to allocate the approved loan to Kosovo's budget in six instalments. In 2010, Kosovo withdrew the first instalment in amount of 22 million EUR after meeting the agreed requirements between the Government and IMF. The main purpose of the programme is maintaining fiscal sustainability and financial stability. To meet these objectives, government authorities have to: limit current expenditures and increase the level of revenues to accommodate the increase of capital expenditures, ensure considerable funding from privatisation to preserve debt sustainability, implement reforms that aim to increase tax basis and strengthen management of public finances , increase banking balance to ensure space for Emergent Liquidity Fund and improve financial situation of the energy sector (IMF Country Report No. 10/245, 2010). As part of this programme, disbursement of other budgetary assistance was envisioned by the European Commission and the World Bank, which funds were committed during the donor conference.

After the failure of SBA due to non-privatisation of PTK shares and increase of salaries the European Commission also decided not to pay 50 million EUR that were promised to Kosovo. This caused the Government to continue cooperation in July 2011, this time through the six-month Staff-Monitored Programme (SMP). SMP aimed to: i) adapt the situation of fiscal structure for 1.5% of the GDP within 2011 and 2012 budget in order to gradually create a fiscal sustainability, ii) improve budget planning and implementation, iii) empower flexibility of the financial system such as supplementing legal and administrative framework for provision of Emergency Liquidity Fund. SMP implementation has been mainly satisfactory, where most of the criteria have been met. Fiscal objectives have been exceeded with the overall fiscal deficit of 1.9% for 2011 (compared to the target of 2.9%).[25] During 2011, macro-economic situation improved significantly and Kosovo managed to make the adjustment of 1.5% of the GDP as part of the SMP (however, due to the failure in privatization of PTK, the balance at the end of 2011 was half-way

24 WB - Kosovo Country Partnership Strategy 2012–2015, p. 3

25 IMF - Republic of Kosovo: Request for Stand-By Arrangement—Staff Report; Press Release on the Executive Board Discussion, April 2012, pp. 3-5.

lower than it was needed to be safe of financial threats[26]). After successful completion of the SMP for the period of June-December 2011, IMF approved a new SBA in April 2012 for a period of 20 months in a total of about 106 million EUR (from which, 5 millions were disbursed immediately) to support the economic programme of the Government for the years of 2012-2013.[27] SBA's objectives include: i) restoration of fiscal sustainability and an adequate level of banking balance of the so-called 'cash buffer' to avoid potential fiscal threats, and; ii) introduction of a legally binding fiscal regulation; iii) better design and estimate expenditure initiatives; iv) improvement of the efficiency of fiscal decentralization; v) strengthening of legal framework for financial regulation and monitoring; and vi) provide CBK with necessary funds for emergency liquidity assistance.[28]

More specifically, for a more complete sustainability, a progress of 1.5% of the GDP is required until 2014 through limitations of the expenditure and measures for gradual growth of revenues (to achieve 3% of the GDP as it was identified as a need in SMP). To achieve financial stability, it is necessary that CBK possesses all means and uses them as needed without external interventions. In this regard, the Kosovo Assembly passed the Law on banks, micro-financial institutions and non-banking financial institution in April 2012 (LBIMIFJB) which empowers CBK. Also, reforms are needed to improve business environment, protection of flexibility of the job market, development of economic sector and development of infrastructure, all of these with the goal to improve competition and economic growth. Banking balance is expected to improve with completion of privatization of PTK during 2013 which would enable the Government to address potential financial threats. Use of Euro as the official currency in Kosovo is a premium not only for the fiscal discipline but also for the flexibility of the job market and structural reforms which increase competitiveness of the economy. The undertaken measures for improving Kosovo's ranking in 'Doing Business' are welcome, but further reforms are needed to stimulate local and foreign investors.[29] These reforms are expected to restore credibility of macro-financial policies to allow the Government to have sustainability in self-financing of banking balances and to contribute in creation of a suitable environment for attracting private and diaspora investments.[30]

IMF in its firs assessment of SBA in May-June 2012 noted that Kosovo met 4 out of 6 quantitative and structural criteria and that financial and macro-economic policies in general are in line with the SBA. Quantitative targets for April in relation to banking bal-

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26 Ibid.

27 IMF - Survey Magazine: Countries & Regions - Kosovo Receives €48 Million Instalment Under IMF Loan, 17 July 2012.

28 IMF - Republic of Kosovo: First Review Under the Stand-By Arrangement, and Request for Modification of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion, July 2012, p. 16.

29 IMF - Press Release No. 12/154 - IMF Executive Board Approves € 106.6 Million Stand-By Arrangement for Kosovo, 27 April 2012.

30 IMF - Republic of Kosovo: Request for Stand-By Arrangement—Staff Report; Press Release on the Executive Board Discussion, April 2012, pp. 14-15.

ance of the central government, primary balance, primary expenditure, net contracting and guarantee of non-concessionary debt and non-allocation of debts related to foreign payments have been met. The majority of structural criteria have also been met, even though in one case the structural criterion for inclusion of a standard provision enables control of costs in all new laws that require benefits has not be observed (for example, the law for KSF or the one on pensions). Correcting measures are being undertaken in this regard. Structural criteria related to submission to the Assembly of the revised Law for securing deposits has not been fulfilled for 3 weeks due to prolonged consultations with partners.[31] On the other hand, implementation of the budget of 2012 is in line with the SBA, where the collection of revenues has not met the target temporarily, but the balance has been compensated with lower expenditure for capital projects and acceptance of dividend from PTK earlier than envisioned. Target on collection of unpaid liabilities (arrears) also did not meet the objective for a low percentage which shows weaknesses in monitoring of payment of liabilities. Therefore, the Government together with the IMF are taking measures to address these problems such as additional savings to cover for the deficit, which might happen due to non-collection of sufficient revenues, including the opportunity to use reserves envisioned for 2012 budget (up to 60 million EUR unallocated as a reserve[32]). The budget for 2013 is expected to adapt to the situation for about 0.6% of the GDP, which would make fiscal situation even more sustainable.[33] As a result of good performance of the Government, IMF has paid more 48 million EUR by increasing the total amount paid up to 53 million EUR.

The IMF assessment at the end of 2012 noted that macro-economic and financial policies are in the right direction, where criteria of quantitative performance have been fulfilled for the August deadline (lower revenues have been compensated with reduction of expenditure), structural targets have also been met (with delay of tender for privatization of PTK), while indicative targets have not been met with regard to unpaid liabilities which highlight the weakness in monitoring of liabilities even though local institutions are working in this aspect. There is significant progress with regard to meeting objectives of the programme. Structural adjustment of 1.1% of the GDP was implemented in 2012 and the budget of 2013 contributes in this direction with another 0.6%, which is expected to create greater fiscal sustainability. The Government banking balance in 2012 ended with 40 million EUR more than it was predicted, while the revenues from privatization of the PTK in 2013 are expected to improve the situation furthermore and to assist in addressing potential fiscal burdens. On the other hand, the CBL special reserve fund for emergency liquidity assistance and approval of the law for insurance deposits

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31 MF - Misioni i IMF-së përmbyllë vizitën e tij në Kosovë - Politikat makroekonomike dhe financiare në Kosovë janë në rrugë të duhur http://mf.rks-gov.net/zyratkryesore/zyraperkomunikimpublik/komunikata.aspx?udt_458_param_detail=707.

32 IMF - Republic of Kosovo: First Review Under the Stand-By Arrangement, and Request for Modification of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion, July 2012, pp. 11-12.

33 IMF - Republic of Kosovo: First Review Under the Stand-By Arrangement, and Request for Modification of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion, July 2012, p. 3.

provide greater safety with regard to financial stability.[34]

As a result of these developments, several modifications to the programme have been proposed, including: adding two structural targets i) feasibility study for highway R6 by the end of January 2013 and ii) approval of fiscal framework by the Assembly by March 2013 which would pose legal sanctions for macro-economic management; performance criteria of government banking balance will be revised to reflect unplanned potential transfers from KPA, etc.[35]

5.2. European Bank for Reconstruction and Development (EBRD)

Kosovo became the 66th member of the EBRD in December 2012; membership to this institution is important for reforms and economic development, considering that EBRD is the largest financial investor in Eastern Europe, with significant investments in the Balkans. Currently, preparations are underway to open EBRD in Kosovo and the Law on EBRD branch in Kosovo is in approval procedures at the Assembly.

5.3. European Bank of Investments (EBI)

EBI signed an agreement with UNMIK on behalf of Kosovo in 2005, through which EBI would fund capital investments in Kosovo in order to assist sustainable economic development in the country, especially regional development and trans-European cooperation. Recently, Kosovo has become a member of EBI investment programmes.

5.4. World Bank (WB)

World Bank in Kosovo established its office after the war and based on its experience in the country so far, it has set three main priorities: i) economic growth that contributes to mitigation of unemployment, especially for youth and women, ii) improvement of business environment as a tool to encourage private sector and private investments, and iii) economic growth that allows for sustainable developments, including minimization of degradation of natural resources and human health. Through the agreement reached in June 2011, WB can operate as the leader of Western Balkans Investment Facility to prepare joint investment projects between the EU, financial institutions of the EU and WB, from which Kosovo may benefit. The Kosovo Government has applied for several energy efficiency projects, waste management, etc. Additionally, Kosovo can benefit from proposals of other regional countries for regional study projects that have to do with implementation of the Energy Community Gas Ring, etc.

WB, among others, has assisted in drafting two laws, the one on civil servants and the

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34 IMF - Second Review under the Stand-by Arrangement, Request for rephrasing of purchases and modification of performance criterion, December 2012, p. 4.

35 Ibid, p. 11.

one on salaries of civil servants, which define the uniform structure of promotion and salaries. Initial cost of implementation of these laws during their first year is supposed to be 9.1 million EUR, but it was noted that the calculation was very low. Increased number of civil servants since 2009 (as a result of establishment of new ministries and new municipalities), over-ranking and quick promotion only add to the risk of high expenditures. In December 2011, the number of civil servants was 75,000 (33,000 at central level and 42,000 at municipal level), while WB suggests that the total number of civil servants is 13% higher than it needs to be. Therefore, secondary legislation is required to be drafted carefully in order to control expenses in this aspect. Promotions need to be limited to 10% of the staff within a year (now it is 50%), overtime work must be limited to maximum of 10% of base salary, and advancements must be done through adequate differentiation between ranks.[36]

Kosovo is a member of the World Bank Group (WBG) in June 2009, which membership has its privileges as well as its responsibilities. Through the membership Kosovo agreed to take over former Yugoslavia debts to International Bank for Reconstruction and Development in the amount of 381 million EUR. In this case, a multilateral Trust Fund was established to assist Kosovo to pay these debts, and so far 125 million USD were paid by the USA and 5 million EUR by the European Commission.[37]

5.5. European Commission

In 2008, Kosovo and European Commission (EC) initiated a Mechanism for Fiscal Oversight in close cooperation with the IMF. The mechanism assists Kosovo in preparations for integration in existing framework of economic and fiscal monitoring of the EU established for the Western Balkans. In this regard, Kosovo must provide its economic and fiscal programme on annual basis.[38]

After the feasibility study, and EC requirements and recommendations, the Government of Kosovo is implementing required reforms for meeting short-term criteria that would enable opening of negotiations for Stabilization Association Agreement (SAA). Kosovo is preparing its negotiation structures and it is expected that the majority of negotiations will be focused on free trade issues.

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36 IMF - Republic of Kosovo: First Review Under the Stand-By Arrangement, and Request for Modification of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion, July 2012, p. 14.

37 WB – The World Bank in Kosovo, June 2012, p. 24.

38 Kosovo - Fulfilling its European Perspective, 2009, p. 8.

6. Conclusions

Advantages	Challenges	Recommendations
Central Bank of Kosovo presents statistics on the status of balance of payments every three months	- EU requires calculation of statistics on the status of balance of payments on monthly basis	- CBK to decide in its strategic plan to publish monthly statistics as is required by the EU
Presence of Euro as a currency for Kosovo eliminates the possibility that Kosovo is exposed to crisis of the balance of payments		
Positive balance of export of services affects reduction of trade deficit.	Trade balance of goods has a very high level of deficit.	For growth of experts, investments are needed for creation of capacities for production of final products.
Consumption Price Index (CPI) has marked positive trends during 2012 which has affected devalued Actual Effective Exchange Rate (AEER) and competitiveness of domestic products	CPI trends are unstable and being affected by international markets	Reduction of deficit of trade balance would have positive effects on CPI
Labour market in Kosovo has a young labour force with the best average age in the region and beyond	High unemployment accompanied with a labour force without adequate qualifications and lacking social protection programmes	
Kosovo is applying criteria defined by IMF that provide macro-financial sustainability.	Potential funding of the highway R6 without proper funding in place as well as social schemes may cause financial problems as well as discontinuation of agreement with IMF	More attention must be paid before entering into obligations for financing

Chapter II – Trade Policies[39]

Exchange of goods and services among states exemplifies one of the core concepts of the economy. Strong economic development cannot be thought of without the contribution of export and import. Therefore, this makes each state to have its own trade policies which subsequently results with entering trade agreements between two or more countries, where the goal is overall maximisation of profits. In this regard, trade policies and barriers often create conflicts between states, which as a result usually follow with taking measures of reciprocity. On the other hand, geographical positioning puts Kosovo in a key place for exchange of goods with other countries. As such, Kosovo remains a transit country for exchange of goods between different countries.

1. EU requirements in the integration process

Trade is a field that involves a large number of EU documents and regulations. Elimination of borders, as one of the core pillars of the EU, means that flexibility of the EU member states for developing trade policies is limited. In this aspect, movement of goods and services within the EU takes place without imposing trade barriers or customs duties among member states. This is stipulated in the first chapter of the Community Acquis, Free Movement of Goods, which among else reads: 'the principle of free movement means that products need to be traded freely from one part of the EU to another'. To achieve this, there needs to be in place a harmonised regulatory framework.[40] Therefore, Kosovo and countries that aspire to integrate must invest in measures for free movement of goods through border points. In addition to this, chapter 2 and chapter 4 of the Acquis address free movement of workers and capital which are of great importance for functioning of the free trade. Chapter 8 of the Acquis is also relevant to trade as is Chapter 29 on Customs Union, etc. For the later, rules on adoption of EU Customs Code, common customs tariffs, provisions regarding tariff nomenclature, and many other fields are envisioned.[41] Provision of capacities for customs services is of primary importance for implementation of these requirements.

Council of Europe Regulation no. 2658/87, for tariffs, statistical nomenclature and Common Customs Tariff is the key EU document in the area of trade.[42] This describes all requirements for the topics addressed here and it also stipulates regulation on how to fulfil requirements. In this aspect, Annex 1 of the regulation titled Common Nomenclature and Common Customs Tariff if important. This Annex describes different types of nomenclatures of goods, which is necessary for elimination of borders. On the other hand, Common Customs Tariff describes tariffs to be applied from EU member states for trade with other countries.

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39 For more detailed information on trade policies, please refer to chapter 1 and 2 of the diagnostic report of the TRT on Trade.

40 Chapters of the acquis, Enlargement Policy of the European Commission, Conditions for membership.

41 Ibid.

42 Council Regulation No. 2658/87, on the tariff and statistical nomenclature and on the Common Customs Tariff.

2. Legislative and Institutional Framework in Kosovo

Kosovo has quite an advanced legal infrastructure on foreign trade[43] which provides it with a considerable advantage in integration processes. The list below includes the laws that directly or indirectly regulate foreign trade:

- Law on Antidumping Measures and Anti-Balance Measures no. 03-L-097
- Law on Protection Measures in Imports, no. 04-L-047
- Law on Excise Customs Rate in Kosovo, no. 03-L-112
- Law on Foreign Trade, no. 04-L-048
- Law on Trade with Fuels and Fuel Derivatives, no. 2004/5
- Law on Trade of Strategic Goods, no. 03-L-232
- Law on Foreign Investments, no. 02-L33
- Law on Technical Requirements for Products and Conformity Appraisal, no. 04/L-039
- Law on Customs and Excise Code of Kosovo, no. 03-L-109
- Law on Changing and Amending Customs and Excise Code, no. 03-L-109, no. 04-L-099
- Law on Control and Supervision of State Border, no. 04-L-072
- Law on Trademarks, no. 04-L-026

The main institution at the institutional level is the Ministry of Trade and Industry. Established in 2002, MTI tasks and responsibilities included developing systemic conditions for trade, industry and commercial work as well as development of policies for work and implementation of legislation to support fair competition. Today, the Ministry has 4 agencies, 8 departments, 1 directorate, 4 offices and 2 units.

The Department of Trade is part of the Ministry of Trade and Industry which amongst else deals with drafting trade policies of Kosovo by harmonising them with EU and WTO trade-related legislation. Also, the Department of Trade deals with implementation of CEFTA agreement.[44] The Division of Trade Policies and Division of Market Regulation are part of the Department.

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43 Commission Communication on a Feasibility Study for a Stabilization and Association Agreement between EU and Kosovo, October 2012.

44 MTI - Departamenti i Tregtisë.

3. Status and challenges

High negative trade balance is a feature of Kosovo. Data on the value of exports, imports and difference between them is shown below.[45]

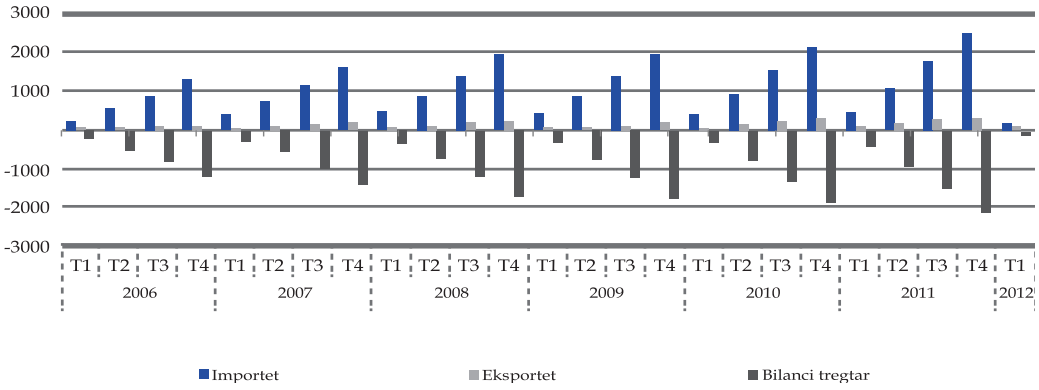

Figure 8: Trade balance

The situation of trade balance is worsening from year to year. Considerable growth of imports is not being followed with matching growth of exports. For more, during the first part of 2012, the number of exports dropped compared to the same period of time last year. Positive balance is shown when export is compared to import of services. Statistics show that the number of service exports is larger than the number of their imports.[46]

Non-membership of Kosovo to World Trade Organization remains a problem that is directly linked to considerable implications in country maturity for European integrations, especially in the field of foreign trade. Kosovo has not gone through necessary reforms for membership into World Trade Organization.[47] However, Kosovo is a CEFTA member, which is the Central Europe Free Trade Agreement. CEFTA enables free trade among member states, which at the moment include seven: Macedonia, Albania, Bosnia and Herzegovina, Moldavia, Montenegro, Serbia and Kosovo. Connection with chapter one of the Community Acquis (Free Movement of Goods) makes membership to CEFTA the best way to prepare for EU integration in the area of trade. However, the effect of CEFTA on reducing trade balance is minimal so far. Furthermore, Kosovo is different from other members who have signed the agreement since its products are not recognized by Serbia and Bosnia.

The Kosovo Government is committed to develop policies that are in line with EU Requirements. This is best reflected in the Action Plan of Economic Vision of Kosovo 2011-

45 CBK - Buletini Mujor Statistikor, shtator 2012.
46 CBK – Buletini Mujor Statistikor, qershor 2012.
47 Commission Communication on a Feasibility Study for a Stabilization and Association Agreement between EU and Kosovo, October 2012.

2014, where point 2.4 (Facilitation of development of trade in line with best international practices and EU requirements and principles to reduce trade cost and barriers) envisions nine activities. Amongst else, the activities include: Changes in new Customs Code based on the EU Customs Code model, changes of law on foreign trade activities in line with WTO standards and simplification of import and export procedures. Therefore, the Kosovo Government aims to create a European environment for trade, which will have positive implications in the integration process.

Strategy on Electronic Government of the Republic of Kosovo 2009-2015 includes customs system too. Point 3.1.11 of the strategy notes that during its implementation the existing customs systems will be advanced by fully entering in digital data. Thus, the data, including nomenclature of goods, will be managed through an electronic process.[48] However, the strategy fails to present an action plan, with activities and timelines for meeting the above-mentioned objective. Therefore, the effect of Strategy on Electronic Government in digitalization of the customs system is not expected to be significant.

Ministry of Trade and Industry has invested in simplifying documents for export and import. MTI has undertaken visible reforms by reducing the number of documents for trade services and by decreasing the costs.[49] This was positively reflected in the World Bank report for doing business in 2013, where the rank regarding the category on Foreign Trade jumped up for nine positions.[50] Simplification of export and import documentation becomes crucial with regard to the EU convention for simplifying formalities of trade of goods. This convention amends a number of previous decisions.[51]

EU offers Autonomous Measures for Trade (AMT) for countries that are not a member, and that are in the Stabilization Association phase. AMT, enabling free movement of imports and exports, offers high benefits for Western Balkans countries. Kosovo's AMT Agreement initially expired on 31 December 2010, but fortunately as a result of progress in the area of Stabilization Association it entered into effect again on 30 December 2011.[52] Feasibility Study for Kosovo 2012 provides a number of recommendations for Kosovo's institutions for acceleration of integration processes. Amongst else, the study envisions:

- Building administrative capacities to develop negotiations related to issues of trade. In this aspect, from the perspective of Stabilization and Association Agreement, it is required to clearly demonstrate that required reforms can be implemented upon signing of the agreement.
- In addition to establishment of administrative capacities for negotiations, Kosovo needs to assign a leader for the negotiating team and it must draft its priorities for negotiations. In this regard, the Government of Kosovo is preparing negotiation structures.

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48 MAP - Strategjia e Qeverisjes Elektronike 2009-2015, October 2008.

49 MTI- Reformat e të bërit biznes.

50 Doing Business Report 2013, International Bank for Reconstruction & World Bank, 10th Edition

51 EC - Convention on the simplification of formalities in trade in goods.

52 EC - Autonomous Trade Measures with Kosovo re-enter into force, EU Office in Kosovo.

- Also, the study highlights that Kosovo has marked progress in developing legal framework as is required with Acquis, by adopting EU standards and by eliminating regulations that are not in line with those of the EU.

4. Conclusions

Advantages	Challenges	Recommendations
- Kosovo is a CEFTA member and it enjoys the right of free movement of goods with CEFTA members. Membership to CEFTA is an important pre-condition for European integration preparations.	- Resolving problems with Serbia and Bosnia for full empowerment of CEFTA	- Increase of pressure on these states from CEFTA secretariat or EU
- Customs system is in the process of digitalization of its services.	- The process is not moving quickly.	- To accelerate the process by relying on the Strategy for Electronic Government
	- Non-membership into World Trade Organization implies challenges for fulfilling acquis requirements regarding "Free Movement of Goods".	- Membership to World Trade Organization to be set as a key priority of the Ministry of Trade and Industry.
- Advanced legal structure for regulating foreign trade	- Adoption of requirements of Annex 1 of Council of Europe Regulation no. 2658/87 (Joint Classifications and Common Customs Tariff)	- To simplify legal framework and to adopt Joint Classifications and Common Customs Tariff.

Chapter III – Budgetary Policies

Budget planning is one of the main challenges of each economy. The budget must reflect the over development strategy and accompanying policies of a country. In line with the law on management of public finances and responsibilities and in order to do mid-term planning of expenditures, the Government of Kosovo compiles Mid-term Expenditure Framework (MEF), which is a document of special importance in effective interrelations of policies, planning and budgeting, especially when lacking a national development strategy which would direct development of sectorial strategies and relevant allocation of the budget. In this regard, many organizations from international community have offered expertise and technical assistance for budget processes in Kosovo.

1. EU requirements in the integration process

Acquis summarized areas that need to be regulated by states aspiring to join the EU. Chapter 3 on Financial and Budgetary Provisions deals with the budget. The Chapter covers rules related to financial resources for funding the EU budget.[53] Mainly, the sources consist of: [54]

- Revenues from customs, taxes from agro-culture products and sugar
- Value-Added Tax (VAT) and
- A percentage that derives from national gross revenues.

In a more detailed form, there is Council Regulation no. 1150/2000 on the system of own sources of European Communities. On VAT, there is Directive 2006/112/EC on Joint VAT System. However, Kosovo is still in the initial phase of building the basis for budgeting processes, and as such it is not in the phase to work specifically for Acquis. Initially, authorities must create a more stable environment in order that Acquis has the basis to undertake required reforms.

2. Legislative and Institutional Framework

Each budget of respective year is based on the legal framework for the year. For example, for last year we had the law no. 04 - L - 079 for the Budget of the Republic of Kosovo in 2012. At the same time, this represents the most important legal act for the country for the issue under discussion here. Furthermore, all this is closely linked with budgetary planning which is regulated with the following laws:

- Law on Tax Administration and Procedures
- Law on Internal Auditing
- Law on Management of Public Finances
- Law on Finances of Local Government

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53 Chapters of the acquis, Enlargement Policy of the European Commission, Conditions for membership.

54 Where does the money come from?, Financial Programming and Budget.

- Law on Pension Funds of Kosovo
- Law on Customs and Excise Code of Kosovo
- Law on Public Enterprises
- Law on Excise Tax Rate in Kosovo
- Law on Value-Added Tax
- Law on Corporate Income Tax
- Law on Personal Income Tax
- Law on Foreign Trade

By regulating relationships in the financial, tax and customs field, the institutional framework is mainly located in the Ministry of Finances (MF). The Department of Budget is part of MF, whose mission is to complete budget allocations for other budgetary organizations.

The department through the budget that increases efficiency and effectiveness needs to produce impartial, and at the same time sustainable social results regarding potential sources.[55]

The main tasks of the Department of Budget include:

- Budget preparation
- Mid-term Expenditure Framework
- Budget implementation, and
- Assessment of requests for changes to budget allocations.

The Committee for Budget and Finances at the Kosovo Assembly should also be mentioned, through which all laws related to budget and budgetary proposals pass.

3. Status and challenges

In Kosovo's case, it wouldn't be right to analyse Acquis Requirements 33 (Financial and Budgetary Provisions) because there are voices that more advanced measures will be introduced for states that have the candidacy status. Therefore, we will identify challenges that will have implications at the time when Kosovo wins EU candidacy status.

The first pillar of goals of Action Plan of Economic Vision of Kosovo 2011-2014 is maintaining macro-fiscal sustainability. The government of the Republic of Kosovo will be committed to increase efficiency of public spending and growth of budget revenues.

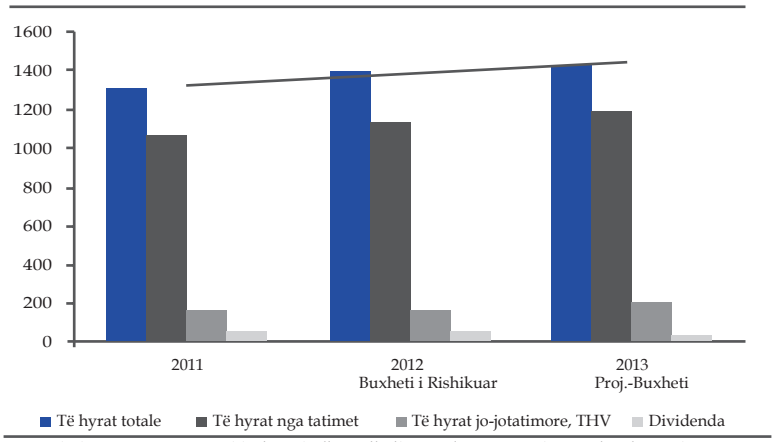
3.1. Structure of budgetary revenues

The revenues of the Kosovo Budget to a large extent depend from customs revenues. In 2011, this was the source for 63.4 % of the total revenues for our country.[56] The first and largest category of revenues is Value-Added tax (VAT) with approximately 51%

55 MF - Departamenti i Buxhetit.

56 CBK - Raporti Vjetor 2011, qershor 2012.

of the total customs revenues, while the second category is revenues from excise duty with about 34.4%. On the other hand, own revenues comprise only 9% of the total revenues. In this regard it is positive to see continued growth of customs revenues that are affected by growth of imports and growth of price of imports.[57] This affects the overall growth of revenues, as it can be seen below.[58]



Burimi: MF, Departamenti i Thesarit dhe Kalkulimet e departamentit të makroekonomisë

Figure 9: Structure of revenues

Dependency on collection of revenues from the borders remains a challenge as well as dependency of municipalities on Kosovo's revenues.

Membership to the EU means that the level of revenues from customs will drop significantly, as a result of the free movement of goods and services. Similarly the free trade agreement with Turkey is expected to have an impact on the revenues but the level of this impact it is unknown. Free movements of goods, as one of fundamental basis of the EU, would create the situation where the majority of goods that enter Kosovo would not go through customs. Finding alternatives pathways for funding the budget poses a key challenge for the country. Besides, another challenge is situation after ending privatisation of public enterprises. Kosovo is concluding privatisation of 75% of PTK shares and KEK distribution, while the airport has already been given in concession. The latter give a considerable contribution to government accounts and the challenge emerges when the funds collected through these privatisations are spent.

The Kosovo Budget is characterised with substantial deficit during recent years, adding up to an amount of 76 and 121 million EUR for 2011 and 2010 respectively for 2011 and 2010.[59] Coercion of budgetary expenditures has caused the situation for the first half of

57 Ibid.

58 MF - Korniza Makro-Fiskale 2013-2015, Draft Buxheti 2013.

59 CBK - Raporti Vjetor 2011, June 2012.

2012 where the ratio between the budgetary deficit and GDP dropped to 3.7% or 0.5 pp lower than when compared to last year.[60]

3.2. Tax policies and revenues performance

Generally public finances have marked progress, where just compared to 2011, in 2012 additional 13 million EUR were generated as a result of increasing excise on tobacco from 25 to 27 EUR (with a predicted growth of 7.2 million EUR), increase of property tax from 0.05 to 0.15 (with predicted growth of 3.0 million EUR) as well as increase of income tax for business from 5% to 9% (with predicted growth of 2.8 million EUR). But, with exclusion of tobacco excise, the other two interventions have not been implemented due to laws that had to be passed by the Government and the Assembly.

Besides, in compliance with the IMF, the Government is committed to increase revenues during 2012 in the amount of 20 million EUR and also additional revenues in the amount of 10 million EUR are envisioned to be collected from ecology tax which is planned to be implemented as of July 2012.

On the other hand, reforms in fiscal decentralization in the case of public expenditures and collection of revenues have progressed considerably, where during the planning of the municipal budget use BDMS and PIP systems and municipalities are allowed a higher leeway of planning and spending according to categories based on Article 45 of the LPFMA.

Presentation of fiscal regulation starting from 2014 (especially the criteria that the budget deficit should be under 2% of GDP) is considered as a mechanism that will assist in maintaining macro-fiscal sustainability and stability.

3.3. Structure of budgetary expenditures

According to 2013 budget, under the assumption that budgetary expenditure for 2013 will be executed at 100% rate, total budgetary deficit for 2013 (including interest payments) is predicted at €181 million EUR or about 3.5% of the GDP, while the primary deficit is expected to be at about 2.8%. For the period of 2013-2015, in compliance with the agreement of the Government signed with IMF, the primary deficit (excluding KPA) is expected to be not higher than 2%.

The budget for 2013 is in the amount of 1,591,118,599 EUR, where capital investments are in the amount of 621,318,384 EUR, which is about 39% of the total budget. Compared to 2012, an increase of expenditures of 4% is envisioned for 2013. This increase of current expenditures for 2013 compared to projected growth of capital expenditures is a result of two things: (i) considerable increase of the basis for capital expenditure (that reflects the construction of the highway and investments in infrastructure), (ii) increase of the need to address social demands.

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60 CBK – Buletini Mujor Statistikor, September 2012, p. 11.

Table 6: Expenditure per economic categories 2011-2015, as GDP percentage

Pershkrimi	2010	2011	2012	2013	2014	2015	2015 -
si % e BPV-së							
Shpenzimet e përgjithshme	30%	30%	30%	29%	27%	26%	27.4%
Rrjedhese	17.8%	17.8%	17.6%	17.7%	16.4%	15.5%	16.5%
Pagat dhe meditjet	7.4%	8.4%	8.1%	8.0%	7.7%	7.2%	7.6%
Mallrat dhe sherbimet	4.3%	3.8%	4.0%	4.1%	3.9%	3.7%	3.9%
Subvencionet dhe transferet	6.0%	5.6%	5.5%	5.6%	5.6%	5.3%	5.5%
Shpenzimet kapitale	11%	11%	12%	11%	11%	10%	10.9%
Deficiti primar	-2.3%	-1.5%	-2.6%	-2.8%	-3.9%	-2.7%	-3.1%
Bilanci Primar (rregulla fiskale)					-2.0%	-2.0%	-2.0%
Deficiti I pergjithshem	-2.5%	-1.7%	-3.0%	-3.2%	-4.2%	-3.0%	-3.4%

Source: MF, Treasury Department, Division of Macro-economy[61]

The Feasibility Report for Kosovo considers as concerning the budget allocation for sectors such as environment[62] and the level of expenditure in health is the lowest in the region as a GDP percentage.[63] On the other hand, the Ministry of Infrastructure receives 51% from the total budget of the Republic of Kosovo, which is allocated more than 810 million EUR.

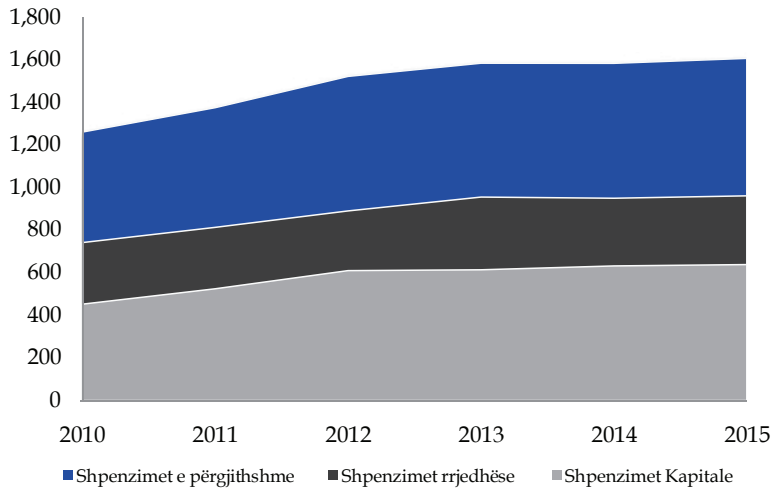

Figure 10: Overall budgetary expenditure 2010-2015, in million EUR

61 For the most recent data, please refer to the MTEF which is currently being reviewed and is expected to be approved by the Government in May 2013.

62 Commission Communication on a Feasibility Study for a Stabilization and Association Agreement between EU and Kosovo, October 2012.

63 WB - Kosova: Rishikimi i shpenzimeve publike, qershor 2010.

Supervision of budget spending, according to Progress Report 2011 as well as according to Feasibility Report 2012, is considered as a component that needs improvements. In this sense, it is necessary to have mechanisms for supervising budget spending during the financial year. Consultation of the Government with the Assembly regarding draft budget, as pointed out in the Feasibility Report, leaves room for improvement.

Also, there is no estimations on the effect of expenditures, particularly capital expenditure; and there is lack of coordination between inter-sectorial projects which would increase the effect of public expenditures.

Decentralisation process has created the situation in which expenditures for municipalities increased. However, decentralization creates opportunities and risks at the same time.[64] In the case of budget for education, capital investments remain under the competence of central government[65] which allows for room for investment inequalities in municipalities.

Public expenditures planned according to the law on budget for 2012 were 1.52 million EUR, while with transfers from previous year, this amount goes up to 1.58 million EUR.

There is also criticism about the process of budget review, mainly for small changes, changes not based on macro-projections and lack of debate in public institutions. Other challenges for the country include influences on the budget from changes in the governing parties as well as delays and postponements during budgetary processes. Different from 2013, other years since the end of the war experienced frequent changes to governments and the budget was affected from these changes. On the other hand, phases of budgetary processes are featured with postponements, and continuous delays both during drafting and reviewing processes.

64 Joshua et al.- Efficient allocation of resources for decentralised provision of social services in Kosovo.

65 WB - Kosova: Rishikimi i shpenzimeve publike, qershor 2010.

4. Conclusions

Advantages	Challenges	Recommendations
- Budget revenues are in positive trend.	-Privatization process, as an important source of revenues, is ending and this does not guarantee sustainability during the coming years.	- To take measures for long-term sustainability of revenues.
- Kosovo's Budget benefits a lot from customs revenues and they are increasing due to the growth of imports and import prices.	- Customs revenues will drop in time due to MSA.	- To compensate for the decrease of customs revenues, own revenues need to be increased.
	-There is a low budget allocation for health, environment, education and justice which is not in line with European requirements.	- To increase the budget for these sectors
	- Weak consultation between the Assembly and Government on draft budget.	- To create mechanisms to oversee budget spending.
- Decentralization has enriched the budget at municipal level	- Capital investments feature disproportional allocations for municipalities.	- For capital investments in sectors such as education, the budget line must be transferred from central to municipal level.
	-Budget review is not always based on macro-fiscal projections and it is not discussed and elaborated by respective institutions.	- To encourage the debate involving all stakeholders during the budget review in order to make adequate changes.
Kosovo is implementing criteria set by IMF, which ensure a macro-financial sustainability.	Potential funding of highway R6 and social schemes without proper funding might cause financial problems	More attention need to be paid before entering into obligations for capital investments

Chapter IV – Financial services

Kosovo's economy has been one of the fastest growing European economies over the last five years (together with Albania and Poland). In 2007 and 2008, it averaged about 7.3%, followed by a slower growth rate in 2009 and 2010 (3.4%), while 2011 and 2012 registered a slighter higher growth of around 4.1%. GDP projections for 2013 foresee further economic expansion along a 4% growth trajectory.

Special attention in this document is drawn on the legal infrastructure of the sector, and the regulatory (Central Bank of the Republic of Kosovo) requirements. The analysis is divided between the major sectors:

- Banking Sector
- Insurance Sector
- Pension Funds

1. Banking Sector in Kosovo

Kosovo's banking sector has been characterized with stable developments over the years. The sector represents the most important source of financing and is one of the most important pillars of stability for the country's economy. The core of the financial sector is represented by the banking system which is continuing to perform alike even when compared to many banking systems with more history in the region and beyond.

As of its establishment, CBK has a licensing, regulatory and supervising authority over all financial institutions in Kosovo, and as such it contributes towards the development and modernization of financial sector in Kosovo. Currently, the financial sector in Kosovo consists of banking industry, insurance industry, pension funds and other financial institutions (microfinance institutions, non-bank financial institutions, exchange bureaus for currencies and payments and money transfer institutions). Very recently, the Government of the Republic of Kosovo started issuing Treasury Bills – a new important sector added to the financial system.

CBK has recently updated its strategic plan for the year 2013-2015, which advances the corporate governance and licensing of the financial institutions. In addition, the CBK identifies the risks and the sustainability of the commercial banks in the country ensuring that they meet the minimum capital requirements.

Eight commercial banks operate in Kosovo's banking system, of which six are foreign owned and two domestically owned (in December 2012, the licenses to the 9th bank has been issued). In June 2012, the foreign owned banks dominated the market with a share of 89% of total banking system assets, while domestic banks managed the remainder of 11% (CBK, 2012). There are no specific conditions to open branches of/by foreign banks and consequently the foreign owned banks presence is very high. The CBK applies international practices in the area of licensing, regulation and supervision of the financial institutions.

The banking sector activity is characterized with e relatively basic functions given that it is a source of funding for the economy through loans which are widely financed through deposits taken within the economy. The growth rate of loans has continuously been high until the recent years when it slowed down, largely reflecting the developments in the real sector of the economy. Until the first quarter of 2012, the growth rate of outstanding loans has been double digit (average 14% for the period 2009-2011), while since second quarter of 2012, the growth rate averaged at 6%. On the other hand, deposits have continuously remained stable in terms of growth rate, reflecting the confidence of the economy towards the banking sector (2009-2012 average growth rate was 13%).

1.1. Legal and Institutional Framework

Kosovo's regulatory and supervisory framework has been gradually improved to meet EU standards, both for banks and non-bank financial institutions. Very recently, the Law on Commercial Banks, Microfinance Institutions and Non-bank Financial Institutions was passed and its implementation further strengthens and better regulates the supervisory capacity of the CBK in its role as the financial sector regulator. The law contributes to the reinforcement of the internal governance of financial institutions themselves and more importantly, the mechanisms of this law enhance the efficiency of licensing, supervision and financial sector regulation.

Adding to the legal framework of the banking sector in Kosovo is the Law on Deposit Insurance as well. Its approval has positively contributed to the growth of deposits with longer-term maturity. The guaranteed percentage is expected to be increased in the near future; the CBK and other relevant authorities are currently working on modifying the regulations. The Deposit Insurance Law (DIL) is being revised to ensure consistency with the new law. The revised DIL will allow purchase and assumption transactions and it will maintain the narrow mandate of the deposit insurance Fund, which limits its involvement in bank resolution, given that the law assigns this role largely to the CBK.

1.2. Licence granting from the Central Bank

Criteria and conditions to obtain a license for exercising banking and financial activities by banks and other financial institutions in the Republic of Kosovo are established under Law 03/L-209 on Central Bank of the Republic of Kosovo and other sublegal acts adopted by the CBK. Pursuant to legislation governing it statutory functions, CBK has the authority to set criteria for licensing of financial institutions and hence not to grant the license to the institutions that fail to meet these standards.

Licensing criteria established under legislation, aim at ensuring a fair financial market and regulated through a process based on the principle of justice, honesty and equality. Licensing conditions and criteria are of supervising character and do not intend creating barriers against investors.

The Central Bank adheres to its rules on granting licences to credit institutions and with the regulations in place it insures continuous supervision. The credit institutions are to report regularly to their regulator and adhere to the rules set forth by current regulations in order to sustain their license and carry on their activities as endorsed when the license was granted. With its continuous supervision the CBK ensures that the credit institutions are complying with the rules and other regulatory requirements (capital adequacy, investment policy, credit risk). The CBK has the authority to withdraw the licence at any time given such rules and requirements are not met.

1.3. Capital requirements

The regulatory framework of the banking system was reformed through the recommendations of Basel III package. The level of capitalization expressed by the capital adequacy ratio is one of the requirements set forth from the CBK regulations for the credit institutions to adhere. According to CBK rules, banks are obliged to maintain a minimum level of 12% of Capital to Risk Weighted Assets ratio. Kosovo's banking system continues to be characterized with a high level of solvency, with a Capital Adequacy Ratio (CAR) which has constantly exceeded the required minimum regulatory level.

Capital adequacy ratio represents one of the most important indicators of the banking system sustainability, taking into consideration the fact that capital is considered to be the main pillar for covering potential losses in case of negative shocks to the banking system. Furthermore, the structure of capital in banking system contains a considerable level of Tier 1 capital, which shows a good quality of Kosovo's banking system capital (CBK, 2012).

In addition to changes in calculation of the existing capital components, through Basel III it is recommended that reporting on the capital indicators should be supplemented with a new ratio, namely the Leverage Ratio. According to this recommendation, the ratio between Tier 1 capital and the total amount of assets and off-balance items of a bank should be preserved at a level of 3% at minimum. Through this ratio, banks will be forced to reduce the balance sheet financing through external debt (CBK, 2012). Although it takes time for these recommendations to be implemented, it is very important that Kosovo follows the international standards for ensuring a sustainable banking system.

The capital of Kosovo's banking system continues to have the shareholder capital and the profit earned by banks as the main sources of financing. Banks have also started to use alternative ways to finance the capital, where we can specify the increase of the use of subordinated debt, which is classified as a component of Tier 2 capital. In addition to the value, another important element for the banking system sustainability is the quality of capital possessed by the bank. The quality of capital, among the others, has an important role to the credit ranking of banks, having direct impact on the external financing cost as well as on the facilitation of banks to access external financing. The good quality of capital can also be one of the factors enabling Kosovo's banking system a constant increase of external financing, as in the case with subordinated debt as well.

1.4. Credit Risk

The high capital adequacy ratio continues to be a distinctive feature of Kosovo's banking system, contributing to the reduction of insolvency risk and strengthening the sustainability of this system. On the other hand, the Central Bank has made important advances in the area of financial supervision.

Lending activity of the commercial banks represents one of the main sources of financing for the consumption and investments in the country. For this reason, the measures to evaluate the credit risk and loan portfolio are essential. Initially, it shall be noted that CBK as the regulator of the banking system has insured that the most important international standards in relation to the recognition of non-performing loans and provisioning are in place.

Based on Basel Core Principle on effective supervision of banking system, in 2010, steps have been taken towards capacity building for risk profile-based supervision in banking sector, aiming at a supervising synergy which is expected to be reflected in a more effective coordination of micro-prudential and macro-prudential supervision. Also, with purpose to establish as fair as possible the risk-based solvency, important steps have also been taken in the insurance industry towards adoption of basic principles set forth under Solvency II framework.

CBK reports show that commercial banks operating in Kosovo continuously have applied prudent approach in risk management. In this context, banks proved to be cautious and conservative in the management of liquidity risk, credit risk and solvency risk. The liquidity indicators, although marking a slight decline, continuously have proved to be at satisfactory levels to make the banking system capable of fulfilling short term liabilities. Regarding the credit risk, deterioration in the credit portfolio quality was observed, but it should be emphasized that non-performing loans continue to be well covered by loan provisions (at 112% coverage in December 2012). This implies that the current level of non-performing loans does not represent any serious threat to the banking system sustainability.

1.5. Quality of Loan Portfolio

Kosovo's banking system continues to be characterized as one of the systems with the best quality of loan portfolio within the regional countries. The prudent approach applied by the banking system of Kosovo to maintain its sustainability is also expressed through the persisting high level of capital adequacy ratio, which kept the insolvency risk at low levels. Liquidity and credit risk are evaluated through loan to deposit ratio, the ratio between liquid assets and total assets, the ratio between liquid assets and short term liabilities, through liquidity gap analysis, the level of indebtedness, the share of non-performing loans. Solvency risk on the other hand is evaluated through the capital adequacy ratio, Tier I capital, and risk-weighted assets.

Parallel to the analysis of the actual state of banking system exposure to credit risk, liquidity risk, and solvency risk, the stress-test analysis represents an additional tool through which it is assessed the sustainability of the sector against potential shocks, both in credit portfolio and in liquid assets.

The superintendence of banks follows a risk-based supervision model under the framework of Basel I, assessing banks according to CAMELS indicators (capital, asset quality, management, earnings, liquidity, and risk sensitivity). For subsidiaries of foreign banks this assessment is carried out jointly with home country supervisors. It contains at least one comprehensive on-site inspection per bank each year as well as permanent off-site surveillance (IMF, 2011). In terms of stress-testing, the CBK since 2010 is implementing a sensitivity based stress-test model which evaluates the shocks to the banking sector based on assumptions. Currently, the stress-test model is developed to evaluate the credit and liquidity risks (CBK, 2012).

1.6. Review of the banking sector and loan portfolio

Kosovo's financial system has grown rapidly over the past decade. Financial sector assets reached about 97% of GDP by June 2012, from 33% in 2003. The system is dominated by banks whose share is at around 75% of total financial sector assets (CBK, 2012). In spite of rapid growth, banks have managed to maintain a prudent funding structure. By the end of 2012, deposits, mostly from households (72% of liabilities), accounted for about 80.5% of banks' liabilities of which the dominant part are short-term with a maturity up to one year. In terms of deposits, the credit to private sector represents 36.1 of as a share to GDP in 2012. The dominant part of loans are allocated to services sector which largely reflects the structure of Kosovo's economy. However, Kosovo banks have shown to be cautious by increasing screening criteria and by slowing down the crediting to the economy.

Overall, given Kosovo's relatively low degree of economic integration in terms of exports and international finance, economic growth performance over the recent years was only moderately affected by the global economic crisis and the crisis in the euro zone.

The total value of loans issued by the banking system in Kosovo amounted at EUR 1.7 billion in June 2012 (34.7% of GDP), which represents an annual growth rate of 3.8% compared with the growth of 1.6% in the same period of the last year. The figures show that there was a significant slowdown of lending activity during 2012 which largely reflected the perceptions of banks about the overall performance of the economy (CBK, 2013).

Conclusively, Kosovo's banking system has remained profitable, liquid, and well-capitalized, although financial strength varies across banks. Aggregate capital adequacy for the banking system stood at 17.9% in December 2012 compared to the 12% regulatory requirements. The Non-performing loans however, increased their share to total loans

until December 2012 reaching the record high level of 7.5%, however, provisioning of NPLs remains at a satisfactory level of 111.6%.

As regards microfinance institutions, the law assigns the CBK the responsibility for licensing and requires microfinance institutions to have a clearly defined ownership structure. According to CBK's financial stability report (2012), microfinance institutions hold 3.4% of the financial system's assets.

1.7. Banking sector sustainability

Kosovo's financial system has proven quite resilient to the global financial crisis, and its regulatory and institutional framework has been substantially strengthened. The financial system is largely deposit-funded which are extended as loans. However, structural financial sector vulnerabilities exist as bank assets are highly concentrated and with a relatively high interest rates. The CBK recommends the commercial banks to maintain a loan-to-deposit ration of around 80%, which was largely implemented by banks, while in December 2012 this ratio was at 77.4%.

In recent years, Kosovo's regulatory and supervisory framework has been gradually improved to meet EU standards, both for banks and non-bank financial institutions. However, the access to financial services, although is not yet at a desirable level, is considered to be the ninth obstacle to businesses (World Bank, 2011). Of total loans issued in Kosovo (1.7 billion EUR), 67.% are loans issued to enterprises, while around 30 percent are loans to households.

1.8. IAIS core principles

Licensing and Methodology Directorate in its licensing and regulating activity for commercial banks, insurance companies, intermediaries, supplementary pension funds and other financial and non-financial institutions, is guided by principles which are in compliance with the EU directives and the best international practice, as presented under "Core Principles for Effective Banking Supervision" published by the Bank for International Settlements (BIS), and Core Principles for Effective Insurance Supervision published by the International Association of Insurance Supervisors (CBK, 2010).

1.9. Interest Rates

Interest rates in Kosovo's banking sector have shown a relatively stable developments and a relatively high interest rate spread. By the end of 2012, the interest rate on loans declined to 13.4% (compared to 14.1% in December 2011), while the interest rates on deposits increased to 3.57 (compared to 3.5% in December 2011) resulting in an interest rate spread of 9.85% (CBK, 2012). The ex post decomposition of the interest rates suggests that risk and operational costs are the most important factors for the relatively high interest rates (CBK, 2012). In terms of risks, it is considered that the lacks of mortgage

market, execution of collateral and judicial system are amongst the main challenges to the banking sector. In terms of operational costs, it is considered that the infrastructure of the banking sector has improved at a satisfactory level and hence it is expected that the operational costs will decrease, resulting in a lower interest rate as well.

The interest rates reports produced by the CBK are in line with the ECB standards reporting the effective interest rates however, it has been recently regulated that the commercial banks are also required to report to their clients the effective interest rate.

Whereas the CBK is the main institution for financial market regulation and supervision in Kosovo, due to Kosovo's use of the euro as official currency, the CBK has only limited policy instruments at its disposal, such as reserve and liquidity requirements. In the absence of autonomous monetary policy and given the fully euroised economy, real interest rate and real (effective) exchange rate movements remain difficult to predict and affect. Uncertainties regarding property rights and weak rule of law continue to be the main factors for the high risk premiums demanded by the commercial banks (EC, 2009).[66]

According to the same report, while Kosovo's financial system has evolved rapidly, further progress was impeded by high risk costs, limited legal capacity, and limited availability of collateral for lending operations. These constraints keep interest rates high and prevent financial intermediation from spreading to wider parts of the population. Furthermore, market concentration may also contribute to elevated lending rates. However, the uneven distribution of profits across banks, relatively low fee income, aggressive attempts by new entrants to gain market share (notably subsidiaries of Turkish banks), and substantial increases in deposit rates during the financial crisis suggest insufficient competition may not be the most important factor.

On the other hand, the legal system continued to suffer from poor accessibility and efficiency. Weak enforceability of contracts remained one of the main concerns of companies and investors in Kosovo. It is also one of the factors explaining the relatively high interest rates charged by commercial banks to the private sector.

1.10. Electronic Interbank Clearing System

Development of an efficient, safe and sustainable national payment system, as a key standard of the financial infrastructure, is one of the CBK's primary functions. Electronic Interbank Clearing System (EICS) operated by the CBK is the only interbank payment system in the Republic of Kosovo. EICS functions as a hybrid system which enables interbank channelling of a wide range of payment instruments.

66 Progress Report, 2009, p. 23.

During 2011, an increase was marked in the volume and value of EICS transaction ratio and further advancement of the system was carried out. The constant increase of the volume and amount of EICS transactions reflects the relative payment increase without cash and the increase of confidence in the domestic banking system.

There are some specific types of EICS transactions, such as regular (individual and massive, priority (individual and massive), Kos-Giro and Direct Debit. Regular payments (individual and massive) compose around 87.5 percent of the EICS transactions volume and around 69% of the EICS transactions value.

Considering the general development of the system and its supervision, it must be noted that the National Payment Council (NPC) was constituted to support the development and growth of sustainable efficient clearing and settlement systems to settle payments and securities in Kosovo.

2. Insurance Sector in Kosovo

Developments in other financial sectors in Kosovo, namely insurance companies, microfinance institutions and financial auxiliaries, have a considerably lower impact on the overall developments in the financial sector, as a result of their low share in the total financial sector. The main activity of insurance companies continues to be the Third Party Liability (TPL) insurance, which generates the largest part of the received premiums.

In the context of further development of the insurance industry, the CBK signed several agreements with regard to the TPL, among which the agreement with Macedonia which recognized the TPL Policy of Kosovo (30% of the local policy, while Kosovo recognized the Green Card of Macedonia) and with Albanian which resulted in reciprocal recognition of the TPL policy. In this context, Kosovo also introduced the border policy towards Montenegro and Serbia.

2.1. Legal and Institutional Framework

In 2011 the Law no. 04/L-018 on Compulsory Motor Insurance liability entered into force. Upon entry into force of this law, in September 2011, the CBK in coordination with the insurance industry and other relevant actors established Kosovo Insurance Bureau (KIB).

According to IMF's latest Technical Memorandum of Understanding, Kosovo is moving ahead with the reforms of the insurance sector, for which the CBK is the regulator. IMF conducted a full assessment of the insurance core principles (ICP) with World Bank assistance. A new resident advisor, financed by the U.S. Treasury, is working with the Insurance Supervision Department of the CBK on reviewing the statement of duties for the CBK's insurance supervision department, reviewing prudential requirements (for current and future reports) as well as the legal framework, and implementing a new on-site supervision manual for life and non-life insurance, including implementation of key

actions as recommended from a World Bank report. 24.[67]

2.2. CBK Licensing

The Insurance Supervision Department of the CBK is responsible for the supervision and regulation of the insurance industry in Kosovo. Licensing criteria are established under the current legislation and general principles do not differ from the ones described above on the banking sector.

According to CBK Licensing and Regulatory Framework, the duty of the Licensing and Regulation Department is to complete the legal framework on financial supervision in accordance with the EU Directives and the best international practices, as presented under "Core Principles for Effective Banking Supervision" published by the Bank for International Settlement (BIS), and "Core Principles for Effective Insurance Supervision" published by the International Association of Insurance Supervisors (IAIS). In accomplishing this mission, the Licensing Department is responsible for receiving, reviewing and recommending the applications of institutions applying for licensing, respectively registration to operate in Kosovo, such as commercial banks, insurance companies and insurance intermediaries, pension Funds and all the other non-bank financial institutions.

2.3. CBK Supervision

Alongside the reporting conceived by the CBK rules, with the aim of in protecting the policyholders' interests, the insurance supervisory department actively performed a risk-based supervision, conducting on-site examinations and off-site examinations.

Monitoring of insurance companies is done through the Reporting and Analysis Division (RAD) in a systematic way and in standardized forms, issuing regular monthly, quarterly and annual analyses pursuant to the CBK internal regulations, based on the IFRS standards and IAIS practices. RAD prepares reports for the CBK Board on regular monthly basis, it monitors the financial performance of insurance companies, it calculates the minimum margin of solvency, liquidity and the other risk indicators.

2.4. Status and challenges

Although the system of insurance companies has continued to expand its activity, the share of insurance system to the total financial sector assets is at 3.4%. During 2012 the number of insurance companies that operated in Kosovo was thirteen, of which ten non-life insurance companies. The ownership structure is still dominated by companies with foreign-owned capital, where 10 insurance companies are foreign owned, whereas 3 others are domestic. The amount of the premiums received marked an annual increase

[67] IMF - Letter of Intent, and Technical Memorandum of Understanding, 12 April 2012, pp. 6-7.

of 4.4%, reaching a value of EUR 81.5 million. Most of the premiums received is comprised by the involuntary insurance policies, that is 54.2% from Third Party Liabilities (TPL) and 18% from border policies. The amount of the claims paid, on the other side, grew at a faster pace of 14.1 percent, amounting at 30.6%, where claims paid for TPLs and voluntary policies gave the highest contribution to growth. Consequently, the ratio between the claims paid to the premium received, grew at 37.5% in 2012 (34.3% in 2011).

3. Capital Markets

The capital markets in Kosovo are at the very early stage of development. Only recently, the Ministry of Finance together with the CBK issued the regulation on the Primary and Secondary Markets for issuance of Government Securities. Since the beginning of year 2012, the Government has been issuing T-bills with short term maturity of 91 and 182 days.

Government securities are issued on a competitive and non-competitive basis. In competitive tenders, successful participants are allocated securities at prices quoted, while in non-competitive tenders, participants are price takers, i.e. government securities are allocated at a pre-determined price.

The following documents, approved by the Central Bank and Ministry of Finance, represent the Fundamental basis for the start of operation: Regulation for Primary and Secondary Market of Government Securities, and Agreement on Primary Dealers.

Central Bank of Kosovo has established the Securities Division within Asset Management Department to implement the Government's Project on debt issuance. As fiscal agent, Central Bank of the Republic of Kosovo shall conduct auctions of government securities. This activity is enabled through CDS system. The Central Depository Securities (CDS) system will have the following functionalities:

- Issuance, registration, transfer, and management of dematerialized securities;
- Redemption;
- Settlement of transactions;
- Monitoring of participants;
- Payment of interest on government securities worth.

3.1. Status and Challenges

During 2012, 14 auctions for the Treasury Bills were held of which, 12 for 10 million EUR at a maturity of 91 days and two at 20 and 24 million at a maturity of 182 days. The bidding by the primary dealers continuously exceeded the offered amount by the Treasury at an average rate of 2.1 times, while the interest rate continuously decreased reaching at less than 1% in December 2012. Such development in the Treasury Bills market suggests that banking sector in Kosovo is considered liquid and in fact, the excess

liquidity of banks in Kosovo is higher than the required level by 54%. In addition, such low interest rate also reflects the slowdown of economic activity in the country during 2012 suggesting that the capacities of the private sector to absorb banks' capital remain limited, hence, banks compete for Treasury Bills at a very low interest rate.

4. Pension Trust Fund

Pension system is an important component of the financial sector in Kosovo contributing with 18.6% of the total financial sector assets (CBK, 2012). Around 99.4% of total pension system assets in the country are managed by the Trust, while the remaining 0.6% is managed by the Slovenian-Kosovo Pension Fund. Until June 2012 pension fund assets amounted nearly 659.1 million EUR, which represents around 13.4% of GDP and a growth rate of 19.5% (CBK, 2012).

The Kosovo's pension system is composed of three pillars, with the first pillar being financed by the government budget which covers the basic pensions for the entire population of Kosovo over the age of 65, pensions for persons with disabilities and early pensions for the mining employees. In addition, the first pillar also covers pensions of former members of the Kosovo Protection Corps (KPC).

The second pillar of the pension system in Kosovo is represented by Kosovo's Pension Saving Fund (Trust), which is an independent institution responsible for decisions regarding the investment of contributions and provision of individual accounts. Trust is licensed and supervised by the Central Bank of Payments (CBK). The Board of KPST is appointed by the Assembly of Kosovo.

The main function of Trust is that it collects and manages the mandatory contributions of all employees in Kosovo over the age of 18 years. This scheme is mandatory for the employee with a contribution of 5% of gross salary, and a 5% contribution from the employer.

In addition, there is Pillar III - a voluntary pension schemes whereby employers may also provide Supplementary Employer Pensions to their Employees, or individuals may purchase Supplementary Individual Pensions through Pensions providers. Vulnerary pension scheme presents an option for businesses and other financial institutions, and can be funded from employers' contributions and employees. Supplementary pension system (additional voluntary) is stimulated by tax concessions. This supplementary system in Kosovo that currently operates is represented by Kosovo Pension Saving Fund and the Kosovar-Slovenian Pension Fund.

Pillar III of pension system in Kosovo remains relatively low compared with pillar I and II, managing less than 1% of total pension system assets.

This pension scheme presents an option for businesses and other financial institutions, and can be funded from employers' contributions and employees. According to the Law

no. 04/L-101 on Pension Funds of Kosovo, only the Trust and Supplementary Employer Pension Funds or Pensions Providers licensed by CBK for this purpose may provide a Pension in Kosovo under pillar III.

4.1. The Trust – Legal and institutional Framework

The Trust was established in August 2002 in order to manage and administer the mandatory and voluntary pension contributions of employees in Kosovo. With purpose of advancing the existing legal infrastructure on licensing, supervision and regulation of Pension Funds, the Law no. 04/L-101 on Pension Funds of Kosovo has been approved by the Assembly and entered into force on 30 March 2012. The Trust is an independent legal entity, under the supervision of the CBK, established according to the model of defined pension contributions, where each contributor has its savings in a personal account. While savings remain a property of contributors, savings are to be used only for retirement purposes.[68]

The new law establishes the competences of the Trust in the management, administration and investments of participants' pension assets, and also prescribes licensing, supervision and investment of the additional pension funds of the employer and the additional individual funds. In this light, the Trust ensures a prudent investment and protection of pension assets and paying out flows from individual accounts for purchase of annuities for pension savings, as a trustee management acting on behalf of contributors and its beneficiaries.

The Trust has 5 departments: i) Client Relations, ii) Finance, iii) Public Relations and Training, iv) Human Resources, and v) Information Technology, whose functions are to keep records of the contributions, manage personal accounts, provide client services, and inform the public effectively. The Trust employs 27 professionals who perform functions in receiving and processing contributions and providing advice and support to contributors.[69]

The pension system in Kosovo is universal and includes all groups living in Kosovo, without discrimination on the basis of gender, race and nationality. Criteria established by legal acts do not exclude and there is no possibility of excluding certain group from the right to pension. However, due to general awareness on the benefits of the system and informal economy inclusion of all employees in the pension system remains a challenge, including the reconciliation of data between the TAK and the Trust.

In May 2010, Tax Administration has launched the electronic declaration service for declaration and payment of income tax and pension contributions. By the end of Q2 2010 around 90% of businesses have moved on to new monthly and electronically reporting system. The Trust has launched an electronic service (eTrusti) which enables easier and

68 Trusti - http://trusti.org/index.php/en/about-the-trust-.

69 Trusti - http://trusti.org/index.php/sq/funksionet-dhe-pergjegjesite .

faster communication between the Trust staff and its contributors (Trusti 2012).

The Trust is run by the Governing Board which oversees the functioning of the Trust, provides guidance, has the exclusive responsibilities over policies and investments, and is responsible for making all policy with the input and advice from the Managing Director and staff. The Board is composed of 8 members: 4 professional members, 2 representative members (each representing employees and employers), 1 representative of the Government with no voting rights, and 1 representative of ICO (position to be filled by the Selection Committee). In June 2012 Kosovo Assembly approved the member's reappointment and appointment of the Board members, with a 3-year term starting from August 2012 (Trusti 2012). The Board has published the annual report for 2011 and submitted to the Assembly.

The pension contributions are made with the aim of increasing the value of pension savings of contributors, and in the long run enabling the best possible pension on their retirement. The Trust investments are done in different asset classes, markets and industries, to reduce the possible investment risk. It is foreseen that the minimum payment of pension contributions can not be lower than the minimum wage in the country (i.e. there will be no pension contributions paid for salaries under 130 EUR for employees under 35 years, nor for the salaries of 170 EUR for employees aged between 35 and 65).

4.2. Structure of the Trust Investments

The structure of the Trust investments is guided by the investment strategy of the Trust Board (Trust, 2012). Decisions on investments are isolated from political influences and are made only on the basis of financial prudence.

The Trust has employed professional asset management firms (Vanguard, AXA GILB, BNY Mellon, Aquila, Schroders, CBK, State Street, European Credit Managment, Raiffeisen Bank, NLB Prishtina), who must themselves meet strict criteria in terms of professionalism, capital strength and independence. These asset managers are responsible for making individual investment decisions, which meet instructions given by the Board. Asset management firms are appointed following a selection process using best international practice.[70]

The investment structure is set forth by the Investment Policy which is formally reviewed at each Board meeting and the principles outlined are in coherence with the Law on Pension Funds in Kosovo.[71] The assets are invested in accordance with the following explicit criteria:

- Investing assets in a secure and safe manner;
- Investments are in various financial instruments in order to ensure diversifica-

[70] Trusti - http://trusti.org/index.php/en/principles.

[71] Trusti -http://trusti.org/index.php/en/investment-policy.

tion;

- Maximum return, consistent with security of Pension Assets;
- Maintenance of adequate liquidity, investing assets in easy-to-sell financial instruments.

The number of contributors (399,075 participants in second quarter of 2012) and the values of pension contributions continue to grow, followed by the positive rate of return on their investments. According to the Trust Investment Results the second quarter of 2012 was characterised with negative balance due to the debt crisis in several EU countries and large fluctuations in the global financial markets[72]; however for the first half of year 2012, there is a positive return in the value of 19 million EUR. Positive investment results, altogether with the new pension contributions, the total assets under the management of the Trust reached 654 EUR millions.

As of August 2012, the structure of Trust's investments is dominated by the investments in equities reaching a share of 40.3%. Bonds on the other hand are the second largest category with a share of 24%, of which 14.6 are bonds linked to inflation. It should be pointed out that the share of Trust funds invested in Kosovo remains relatively low with reaching at 7%, while nearly 5% remain univested at the CBK.

72 Trusti -http://trusti.org/index.php/en/rezultatet-e-gjysmevitit-te-pare-nga-investimet.

5. Conclusions

Advantages	Challenges	Recommendations
The financial system continues to be conservative		
The financial system continues to be stable and of positive performance	Preservation of this stability	
The business sector continues to be the main credit borrower in the economy	The interest rate continues to be high, especially for industries which have capacity to generate employment and added value in the economy	General developments in the country to be monitored, and to create more favourable conditions for the agriculture and production sectors
The household sector of the economy also holds a solid share of the credit borrowing in the country	The use of mortgage loans remains at a low level and is considered as one of the most underdeveloped segments	To support the development of the mortgage market which would enable increased functionalization of capital in the country
Financing from banks continues to be concentrated in the local economy	International credit lines are less developed	This trend should be followed, as it is considered one of the main factors that has ensured stability
The insurance industry is faced with problems in the political aspect	A challenge remains to be membership in the insurance green card	
The pensions system is considered to be quite modern and to have good performance	Directing part of these funds towards the local economy and the lack of instruments in the country for the investment of these funds	
Important regulatory changes during the end of 2012, which are aimed at ensuring financial stability		

Chapter V – Official Statistics

1. EU requirement in the integration process

Statistics are essential for policy making in any sphere of the society. In order to have a successful development, reliable and timely statistics should exist, in order to know the level of poverty, unemployment, education, health, different industrial development and economic trends, etc. All of these support the better informed decision making.

Within the EU, the European Commission is mandated to report to the EU Member States on the progress achieved by 5 candidate and potential states, including the Republic of Kosovo. Chapter 18 of the Acquis Communitaire concerns statistics and requires from candidate countries to have statistics based on the following principles: independence, transparency, confidentiality of personal data and dissemination of official statistics. National statistics authorities are the reference point for the methodology, production and dissemination of statistics. EURtat is the EU's statistics office and its main goal is to ensure qualitative data based on the international statistics practices and standards and which closely monitors the EU Member States and (potential) candidate countries acting in compliance with the EU regulatory framework in the field of statistics. The Acquis covers the methodology, classification and collection procedures of macroeconomic data, prices, demographic and social data, regional, business, transport, external trade, agriculture, environment, science and technology. Thus it is not necessary to transpose the legislation because the majority of the acquis in the field of statistics is in the form of regulations.[73]

The fundamental principles for the production of Community statistics are provided by the Council Regulation 322/97, also known as the "Law on statistics", regulating the issues concerning confidentiality, quality, transparency and access. The forms of organization differ between countries of the EU, but mainly the statistics authorities in every country are a coordination body responsible for the quality and compliance with the fundamental principles. These authorities produce and disseminate the majority of statistics even by using the sources of other institutions such as fiscal, social security, and the registers. Some type of statistics, like the balance of payment and other financial statistics, are usually produced by the Central Banks independent of or in co-operation with the statistics authorities. In this respect, the following criteria are used for the assessment of capacities:

- Legal structure and framework: mission, scope and coordination powers of the statistics authority, the role of other institutions producing statistics (line ministries), the Statistical Council, the annual programme;
- Relations with the Government: relations in the view of multiple functions as statistics user, provider of sources and provider of administrative data;
- Relations with the local and regional governments;

[73] http://ec.europa.eu/enlargement/enlargement_process/accession_process/how_does_a_country_join_the_eu/negotiations_croatia_turkey/index_en.htm.

- Safeguarding autonomy: nomination of the chairperson, access to personal data, etc;
- Relations with the user and dissemination policies;
- Internal organization;
- Planning and programming procedures within the statistics authorities;
- Finance and budget: budget in normal and extraordinary circumstances (population census), flexibility in using the budget, infrastructure (IT), etc;
- Staff: staff recruitment, gender/age composition, education, training and development, etc;
- IT: infrastructure determining the performance
- Internal performance oversight: monitoring and reporting on annual programmes and National Programme on the adoption of the Acquis in general
- External accountability; which external institution monitors performance, how is that done.

The EU monitors these criteria through evaluation reports, monitoring missions, whereas the EURtat continuously monitors statistics compliance and utilizes all these results to determine the priorities for technical assistance in order to overcome the challenges identified.[74]

The instructions on the production of statistics are included in the European Statistics Code of Practice for the national statistics authorities and the community adopted in 2005. The Code introduces the following 15 principles: professional independence, mandate for data collection, adequacy of resources, commitment to quality, statistical confidentiality, impartiality and objectivity, sound methodology, appropriate statistical procedures, non-excessive burden on respondents, cost effectiveness, relevance, accuracy and reliability, timelines and punctuality, coherence and comparability, and accessibility and clarity.[75]

In the integration process of Kosovo, the Government established 7 Executive Committees and one of them is the Committee on Economy, Finance and Statistics monitoring the progress of developing Kosovo statistics and their approximation with the EU principles and standards.

2. Legal and institutional framework

2.1. Data collection, production and dissemination of official statistics

The new Law on official statistics 04/L-036 is adopted by the Assembly of Kosovo in October 2011 and has entered into force in December 2011. The law is in line with the EURtat recommendations and it regulates the fundamental principles of the organization of official statistics, standards for development and quality, production and publication of official statistics. The Law states that the statistics shall be reliable, unbiased and regular

74 Guide to the main administrative structures required for implementing the acquis, pp. 61-62.

75 KAS - http://esk.rks-gov.net/kodi-i-praktikes.

and shall be covering the administrative, demographic, economic, social, health, education and agriculture areas.

The Law also provides the roles and responsibilities of different institutions related to official statistics, wherein the KAS has the mandate to require statistics from other organizations and this is encouraging compared to the situation prior to adoption of the Law.[76] The main producers of official statistics are KAS, CBK and MF, while KSA is responsible for coordination and harmonization of statistics aiming to identify the needs of beneficiaries and publish unbiased statistics. KAS is an independent institution which reports to Prime Ministers' Office. The EU legislation does not specify how the statistical agencies shall be organized so that their independency is maintained, but the practices of most of EU Member States show that the statistical agencies are accountable to respective Governments[77] and the case of Kosovo (according to EURtat recommendations) does not differ in this aspect. KAS main responsibility is to produce official statistics as well as other issues deriving from the official statistics programme. The tasks of KAS include also development of cooperation programme with local and international organizations with the aim to compare official statistics among different systems. KAS shall produce quality and reliable statistics which reflect the real socio-economic situation in the country and it shall provide them to different beneficiaries. This way, KAS provides services for the following statistical areas: economical and national accounts statistics, population statistics, agriculture, energy, external trade, social statistics, etc. which are divided in respective subsectors such as environment, quality of life, active population and wages, health, education, culture and sports, economic enterprises, prices, etc. [78] The objective of KAS is to improve further in terms of the volume and frequency of publishing statistics, ex. agriculture registration, more frequent publication of national accounts, etc.

The statistical system in Kosovo is expected to consolidate through the five year KAS statistical Programme 2013-2017 which is approved by the Government in January 2013. The Government has approved also the proposal of annual plan for 2013. The Law provides the general framework for organization, data collection, proceedings, production and publication of official statistics in Kosovo. Further it provides for preserving official statistics, data confidentiality and protection, international cooperation on statistics, etc. The Law also regulates the duties and responsibilities of producers of official statistics and Statistical Council and it provides instructions regarding the five year programme, annual plan and reporting.

The Regulation on internal reorganization and systematisation of jobs in KAS has been approved and is in the process of implementation, while the secondary legislation in the area of official statistics includes the following normative acts: i) administrative in-

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76 SIDA - Evaluation of cooperation with SOK, p. 9.

77 Bulgaria, Denmark, Estonia, Finland, France, Latvia, Lithuania, Malta, Netherlands, Romania, Slovakia, Spain, United Kingdom, etc.

78 KSA - http://esk.rks-gov.net/lista-e-sherbimeve-nga-esk.

struction no. 11/2012 for safeguarding and utilizing statistical material, ii) administrative instruction nr. 08.2012 on conditions and forms of providing statistical data gained through special processing of official statistics, iii) draft-decision for the establishment of the Kosovo Statistical Council and the regulation on the functioning of the Council, iv) regulation for implementation of standards on classification of economic activities in the NACE Rev. 2 version. KSA has also prepared street maps for 2012 and 2013.[79]

2.2. Coordination of statistical data

Pursuant to the new Law, the main responsible bodies for official statistics in Kosovo are KAS, MF and KCB, whilst the coordination responsibilities are split between the Statistical Council (as an advisory body) and the KAS. According to the above mentioned Law, the entire system of production of official statistics is clear and it is in the process of further consolidation. Due to the difficulties in the post-war years, the production of statistics in some important fields is carried out by other organizations/institutions for instance the education statistics are produced by the MEST, or economic statistics are collected and produced by different institutions.[80] On the other hand, KAS not only that does not collect and publish statistics in some fields, moreover it is not involved at all in the processes in question, such as in relation to the migration statistics.[81]

Currently coordination is carried out in a way that KAS consults other relevant institutions responsible for official statistics (part of official statistics system) prior to publication of macroeconomic statistics in order to ensure the accuracy and reliability of any statistical data; for instance KAS does not publish GDP data without prior harmonisation with other units of statistical system such as MF, CBK, etc. Within the restructuring process of KAS, a unit was established to coordinate among the official producers and users of data in order to ensure a better coordination is in the process.[82]

The main responsibility for the coordination, improvement and credibility of statistics lies with KAS, but the Statistical Council has an important role in giving advice, recommendations, monitoring and assessment in order to enhance the quality of official statistics. Statistical Council (SC) is established by a Prime Minister's decision. It has a 5 year mandate with aim to identify the needs of beneficiaries for official statistics, to provide advises and recommendations to KAS plans, etc. SC is composed of 12 members and the Chair (CBK), coming from the following institutions: KAS, MF, MTI, MEST, MH, MLSW, MAFRD, CBK, KTA, and Office for Strategic Planning, representative of academia, representative of civil society and the representative from business community. The selection of SC members from civil society and business community is made through public announcement and selection of proposals was done by voting. However,

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79 KSA – Raporti Vjetor 2012, pp. 6-7.

80 SIDA - Evaluation of cooperation with SOK, p. 10.

81 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, p. 334.

82 Ibid, p. 246.

some NGOs (such as KCSF) were not informed on this matter. The SC, up to October 2012 has held three meetings when the chair was also elected. SC has participated in the drafting of the Programme of official statistics 2013-2017 and contributed to better cooperation among the main institutions of official statistics and the users. Cooperation and coordination has also improved with other public institutions and donors and agreements were reached for important researches for users.[83]

2.3. Budget and staff

KAS has its organizational structure composed of the following main bodies: Chief Executive and Deputy Chief Executive, the Statistical Council with the group of experts, Department for policy, planning, coordination and communication as a new unit as part of the KAS internal reforms, Department of Administration, Department of survey and registration, Department of Economic Statistics and National Accounts, Department of Population Statistics, Department of Agriculture and Environment Statistics, Department of Social Statistics and Department of Methodology and Information Technology. KAS has 7 regional offices within the Department for surveys and registration.

The restructuring phase of KAS is ongoing, where 5 new job positions were approved, increasing the number of total employees to 139.

KAS covers almost all of Kosovo's territory according to the structure of statistical districts as the basic and single unit nationwide. The survey conducted use the sample in these statistical districts and apply the methodology in line with international recommendations. During its business, KAS co-operates with all government institutions (especially with the CBK, MF, MLSW, MAFRD, MEST and MH) as well as with international institutions like EURtat, IMF, WB, SIDA, DFID, UNFPA, UNDP, UNIVEF, and the statistics authorities of the countries in the region.[84]

KAS faces with different challenges, among which the major challenges remain the lack of the necessary budget and staff to face with the requirements for further development of official statistics. Kosovo is in a less favourable situation regarding this issue compared to regional countries, which have more budget and a higher number of staff (ex. Montenegro has 200 employees). In spite of the increase of budget of Kosovo, the KAS budget is currently similar to the budget of 2002 (see the table below), while the category of wages has doubled as a result of increase of wages by the Government. This indicates the necessity for better planning of the KAS budget.

83 KAS – Raporti Vjetor 2012, pp. 9-17.

84 KAS - GDP 2004-2010, p. 11.

Table 7: Budget of KAS

Yea	Salaries and allowances	Goods and services	Capital	Utilities	Total
2002	224,713	403,921	191,734		**820,368**
2003	313,596	545,404	141,000		**1,000,000**
2004	361,078	1,098,725	80,000	28,630	**1,568,433**
2005	387,533	530,000	30,000		**947,533**
2006	379,190	383,600		84,700	**847,490**
2007	373,159	197,776		49,631	**620,566**
2008	391,159	343,550	68,450	37,500	**840,659**
2009	438,331	471,525		37,500	947,356
2010	516,049	181,737	477,303	37,500	**988,354**
2011	540,298	232,000	270,000	37,500	**799,299**
2012	567,608	281,111	0	27,272	**875,991**
2013	608,798	302,000	0	37,500	**948,298**

Sources: KAS – based on the real situation at the end of calendar year and Law on Budget 2013

3. Status and challenges

Since 1999, former SOK restarted its business with UNMIK's assistance and once the PISG were established it was incorporated within the Ministry of Public Services, but without any capacity-building for the processing, examination and publication of data and on ad hoc basis it was requested to provide statistics from foreign agencies and whereby it was assisted with the same statistics from those agencies (EURtat, WB, EC, DIFD, SIDA, FMN, UN agencies or NGOs).[85]

Pursuant to Law no. 04/L-036 on Official Statistics the SOK ceased to exist and was thus transformed into the Kosovo Agency of Statistics and is under the Prime Minister's Office. The amendment to KAS status is considered a step forward and it is a priority of the Government of Kosovo to develop a sustainable statistical system. In spite of the progress marked in the recent years, international organizations assess that the actual situation of human capacities as well as the quality of statistical data is not considered

85 SIDA - Evaluation of cooperation with SOK, p. 9.

yet to be at a desirable level.[86] The lack of consistency in managerial positions, whereby a KAS Executive Director was replaced continuously (the average term of a Director was less than a year), has had its negative effects on the institutional development and such developments with delays and change of priorities based on the agendas of different Executive Directors. However pursuant to the new Law, KAS has lately appointed the new Executive Director for a three-years term.

KAS management pays special attention to the sources, production and technical aspects of statistics production. Based on past experience is was seen that the population census made the work of KAS more difficult because all other activities were stopped as a result of lack of sufficient human and financial resources but also due to poor planning. KAS suffered from a deficient planning process due to lack of information sharing between departments/employees in a structured way, joint planning (planning usually occurs in isolation, with few individuals involved), reporting mechanisms (even reporting is isolated to a small group of individuals), etc. On a positive note, KAS is aware of its challenges and is currently seeking solutions to its problems[87] and lately it is paying special attention to planning and management of human resources.

In addition, another major challenge to KAS remains the lack of continuous training of staff and lack of the possibility to work with the basic tools for to process the data, such as STATA and other software programmes used for data procession. Other challenges are the lack of a school providing superior training in statistics within higher education institutions and this creates an institutional gap for training new cadres, as well as the inability to attract young people educated abroad due to the low level of salaries in the public sector. The insufficient budget makes KAS focus its attention on issues related to daily functioning, making it quite impossible to attract professional staff and capacity building of existing staff.[88]

On the other hand, the reliability of KAS statistics is being improved but the quality is still not at a desirable level compared to European level standards and need further improvement, especially in economic statistics. In addition to quality, statistics must be useful and relevant for the users. In this light KAS has undertaken a number of activities in developing better relations with its users such as informative meetings, seminars, lectures, conferences, etc.[89] KAS welcomes the dialogue with the users of statistics even though it has difficulties in meeting all requests. The reasons for not using the data include the lack of information on the published data, users' low analytical capacities, KAS low budget in producing quality statistics and KAS restrictive policy in access to data. [90] In addition, a problematic issue remains the form of actual format of publication (an Adobe PDF Reader format) while, publication of data in MS Office and Excel for-

86 DFID - Business Case and Intervention Summary.

87 Ibid.

88 SIDA – Evaluation of cooperation with SOK, p. 10.

89 KAS – Raporti Vjetor 2012, p. 9.

90 DFID - Business Case and Intervention Summary.

mats would, to a great extent, ease the process of using the data.

Statistics in Kosovo improved in the fields of government, monetary policy and external trade, and in April 2011 KAS started using General Data Dissemination Standard (GDSS). KAS is marking progress in the aspect of production of statistics, for instance the quality of survey samples; survey data collection, data processing protocols[91], the methodology and calculations are accurate and is in close co-operation with EURtat to improve the quality of agro-monetary accounts. KAS statistics have improved in the aspect of reliability and comparability and the same are reported to EURtat on regular bases. However it is considered that KAS is unstable without foreign experts and if assistance from foreign donors were to be withdrawn then KAS would have faced serious consequences in the quality aspect (without thinking about the introduction of new methodology or production of new statistics).

3.1. Social/Demographic Statistics

Kosovo is divided into a local and central level of government and thus the demographic data are mainly collected at the local level and then aggregated at the national one.

Department of Social Statistics (DSS) has two divisions; division for social statistics and division for population statistics. The goal of DSS is to manage and produce reliable and timely social statistics in compliance with international standards.

Division of Population Statistics (DPS) has two sections: vital statistics and population statistics. The vital statistics section prepares, collect, analyses and publishes vital statistics on: births, deaths, marriages and divorces. The population statistics section prepares, classifies and analyses and publishes administrative data in various reports from the fields of internal migrations, external migrations, gender statistics, assessments, predictions, population projections and different surveys on populations. The most frequent statistics published by KAS are those related to marriages and divorces, births and deaths, gender.[92]

KAS does not have demographic data for the last 5 years broken down by age groups or gender as the surveys of 2007-2011 did not include these categories. Up to 2011, another methodology which included also the non-resident population has been used, while they do not match with the population census data.[93]

The data on the number of migrants are collected by KAS through surveys, while the other data on migration are owned by the Ministry of Internal Affairs (MIA) and are not sent to KAS as it is provided by Law 04/L-036 into force. The cooperation among KAS

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91 Ibid.

92 KAS - http://esk.rks-gov.net/statistikat-e-popullsise.

93 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement p. 109.

and MIA needs to be improved so that KAS can have access to migration data.

As regarding death statistics, the difficulty lies on death coding – around 25% of deaths are not reported at all, while causes of death are not reported in 27% of the cases (especially deaths at home) which at the end are considered as natural deaths. The data are taken from the civil registry, but due to deficiencies in the database, the quality is affected as well. KAS has prepared the project for digitalization of civil registry, the methodology of which contains around 50 questions compared to 15 that the actual register has, which would have substantially improve the quality of data. The digitalization project has lagged behind due to the lack of financial means, and it is expected to be completed once the financial means become available. This system would have replaced the door-to-door methodology used in the last population census.

Within DSS operates also the Division of Social Statistics which is responsible to prepare, plan, implement and oversee the labour policies; prepares statistical instruments, instructions, definitions and sets the samples and monitors all statistical stages such as collection, processing, analysis and publication of social statistics data. Division of Social Statistics coordinates the works with users, co-operates with government and scientific institutions, and provides comparability between the social and international statistics. Division of Social Statistics has four sections: living standards section, labour market sections, jurisprudence section and the section of other social statistics (education, culture and sports, welfare and health). DSS has a total of 19 employees and in the middle term plan needs to increase the number of staff and establish a Division of Living Standards and Labour Market. DSS conducts Household Budget Survey (HBS) and Labour Force Survey (LFS) in NACE Rev.2. To date, KAS has published HBS results from 2001 to 2011, with the aim to provide the statistical data related to expenditures, income, consumption as well as the data related to poverty. The poverty statistics are prepared in cooperation and in accordance with the World Bank standards; the latest statistics published in this area are those of 2010. To conduct HBS, COICOP nomenclature was used, but some assessments are carried out by the foreign experts because the KAS personnel do not possess the sufficient capacities to conduct it on its own. The surveys are conducted each month based on a sample of 200 participants (2,400 a year) where the data on incomes, expenditures, etc. are collected and published in annual bases. The quality of data of HBS is not of a high quality level; the contact with the beneficiaries is kept based on the needs, while the support from the Department of IT and Methodology is improving.[94] A new variable SILC (survey on the income and living conditions) has been introduced in 2012 which will help completion and comparison of data with other countries.[95]

Labour force statistics were published from 2002 to 2009. The Labour Force Survey (LFS) is carried out within the labour market section, which from 2002 to 2009 has been conducted in a classical form or through questionnaires in September as an optimal month

94 SIDA - Evaluation of cooperation with SOK, p. 17.

95 KAS – Raporti Vjetor 2012.

for this survey. The percentage of employees in agriculture from 2008 is lower, as KAS has implemented surveys according to EURtat methodology which has changed. The survey is not conducted for 2010 and 2011 due to the lack of financial means, while since 2012; the methodology has changed as regarding data collection. LFS is implemented according to CAPI methods (Laptop), while 3 additional surveys are conducted for each household. The results of LFS are expected to be published in May 2013, which will be used to draft the Employment Strategy.[96] On the basis of these data, DFID plans to issue 4 publications related to gender, education, qualifications, occupations, and their relation with poverty and unemployment.[97] According to survey 2009, there are around 265,000 employees in Kosovo[98], while a study conducted by Riinvest in 2003 shows around 550,000 employees. One of the reasons for this mismatch is as according to EURtat, the farmers who do not launch the products to the market are not considered as employed, while the other difference remains unexplained!

The samples of LFS 2012 include 600 registration counties (RC) where 4,800 households were surveyed and resurveyed per year. KAS has created the beneficiaries network who are consulted prior to starting the preparation of the operational plan for the upcoming year, in order to get the comments and proposals on improving the questionnaires. Besides development of LFS, thanks to good cooperation with MLSW, KAS uses the administrative data of this ministry on the number of jobseekers registered in regional offices. However, the data of KAS and MLSW differ, as the data of MLSW are not updated, leaving out the passive labour force or jobseekers who are already employed but are not registered yet. However, MLSW cannot publish official statistics as this responsibility is granted by law to KAS which follows a methodology that is in compliance with EURtat standards.

There are 2 employees and 12 regular polling officers contracted from companies but who are monitored by DSS that work in KAS on the Labour Force Survey. It is considered that only 2 professionals are not sufficient for the statistics of labour force, additionally having in mind that these statistics are required to be published on quarterly basis. Another challenge remains also the separation of labour market statistics from national accounts, which shall be closely linked to each other.

KAS plans to start with new research projects (ex. transition from school to the labour market, productivity of work, labour cost, etc.) and to increase the frequency of publications (ex. labour market statistics shall be published on quarterly basis), otherwise the annual data may not be useful very often. However, the lack of staff and budget causes difficulties for KAS to meet the requests for new and updated statistics.

Jurisprudence statistics were published on the basis of data received from the Kosovo court administration from 2003 to 2011, including adjudicated criminal cases disag-

96 DFID - Business Case and Intervention Summary.

97 Ibid.

98 For the most recent data, please refer to the results that are expected to be published in May 2013.

gregated according to municipal or district courts, persons indicted of criminal offences (municipal and district courts), persons convicted for criminal offences (municipal and district courts) and persons convicted for minor criminal offences (minor offences courts). Section of other social statistics includes statistics on education, culture, sports, health and social welfare.[99] Culture statistics are published from 2004 to 2011, while sports statistics are published from 2007 to 2010, based on the data collected with questionnaires which contain statistical data related to culture and sports activities as well as the number of employees in these institutions.[100]

Education statistics are published from 2002/2003 to 2011/2012 based on the data collected through questionnaires according to education levels ISDCED (preschool, primary, lower secondary and upper secondary, special schools), while collection of statistical data for universities is conducted by the University of Prishtina and University of Prizren. MEST is responsible for the EMIS system which contains data on the education section divided into regions, schools, age groups, gender, and ethnicity. KAS will get engaged in this system when it will have sufficient coverage. DSS has cooperated with MEST through specific working groups which prepared the document with questions that the system will contain. The data are registered at the school level in municipalities and then are submitted to MEST which analyses and publishes them in regular annual reports. It is necessary to mention that the data on private educational institutions, especially colleges, are deficient and there is no real overview of the situation in this field.

Health statistics published from 2003 to 2011 used the data of public health section provided by the National Health Institute and other public health institutions nationwide.[101] Health Information System (HIS) was established in 2002 and is governed by the Law no. 04-2004 on Health. The Health Strategy 2010-2014 views HIS as very important and this is also shared by HIS Strategy 2010-2020, E-Government Strategy, as well as the Administrative Instruction no. 18/2006 on the basis of data for health statistics. The responsible institutions in this field are: MH for policy development, MPA for access to health institutions in the government network, the National Institute of Public Health for data analysis and KAS for publication of health statistics. The data registration system is half-computerized, decentralized and the data are of low quality. Therefore the MH in its HIS Strategy 2010-2020 plans to complete the advancement of the system – to improve data collection through the consolidation of health, pharmaceutical and human resources health statistics modules for improved planning and production of quality data. In this respect, the MH is in the process of establishing a special department and increasing the number of staff to make the system operational. The first stage of consolidation is complete and 40% of public health institutions are now part of the system (regions of Prishtinë and Prizren). The second stage is expected to generate reports in compliance with EURtat (Directives 2002/22/EC, 2002/58/EC, (EC) Regulation

99 KAS - http://esk.rks-gov.net/statistikat-sociale.

100 Ibid.

101 Ibid.

no. 2006/2004 and EpSOS) and WHO standards.[102] KAS, supported by UNFPA and in close co-operation with the National Health Institute, has analyzed the causes of death in Kosovo for 2006-2009 timeline.[103]

Social welfare statistics are published from 2003 to 2011 based on the data received from the Ministry of Labour and Social Welfare, the Elderly Care House, Special Institute in Shtime and the house of orphan children.[104] The social data were mainly placed on the basis of data of central and local institutions providing social welfare services, such as MLSW, municipalities. Publication of statistical data of social welfare is done on quarterly basis since 2012. Data management is carried out according to the regulations in force, starting with the beneficiaries' registration and their analysis with the MLSW and finally they are shared with KAS. The main responsible institution for the management of the data is the MLSW and the respective departments that update, disseminate and process of such data. In order to integrate the different databases, the MLSW in the last two years designed web-based software that will assist and facilitate communication and exchange as well as informed decision-making.[105]

3.2. Population census

The population census was carried out according to the plans, the only exemption being the lack of participation of the population in north of Kosovo. The final results of population census were published in September 2012. The data are available in hard copies and electronically published in KAS webpage, including indicators according to ethnicities, gender, age, regions, etc. which may be downloaded and used in different ways. The database of population census is under the responsibility of KAS and it is not public, but the data can be provided based on special requests. Otherwise, the legislation into force does not allow direct access to the database. However, KAS has published more indicators compared to other regional countries (ex. Croatia has published only 10 indicators). These data are designated to be used only for policy making for planning purposes, for state institutions, researches, analysts, businesses, scientists and other users. Population census did not aim to replace the civil registry. Based on the Law on official statistics, KAS will present plans in cooperation with other relevant institutions to harmonize registers and to continuously update the population register. KAS plans to connect the database with GIS introduce NTUS based criteria and also plans to publish 13 other reports.[106] Despite some reactions (especially budgetary organizations which receive the budget based on the number of inhabitants) the population census results present the real situation of resident population in Kosovo and as such the results

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102 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, pp. 371-373.

103 Ibid, p. 375.

104 KAS - http://esk.rks-gov.net/statistikat-sociale.

105 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, p. 361.

106 KAS – Raporti Vjetor 2012.

are accepted from national and international institutions. During the process, building, apartments, households and individuals were registered through surveys in all of Kosovo (the classical census methodology – in compliance with EURtat recommendations) from 1 to 15 April 20011.

3.3. Economic statistics

Economic Statistics and National Accounts Department (ESNAD) is responsible for National Accounts, price statistics, external trade statistics and business statistics with the statistical business registers. ESNAD prepares surveys, collects and controls the quality of data, analyzes and publishes them on monthly basis for special publications (consumer price, export-import, production and consumption of electricity, production of coal, transport and post- telecommunications, vehicle registration and hotel services), quarterly and annually (production price, import price, national accounts, government accounts and business structure surveys).[107] ESNAD has 17 employees: 5 for national accounts (three times less compared to regional countries which have established departments for such statistics), 5 for prices, 1 for external trade and 6 for business statistics.

Lack of human resources and engagement of staff in population census has caused delays especially in publication of economic statistics. However, some improvement have been made in statistics related to fix gross capital, calculation of government and NGO amortized assets, creation of value added to transport and gastronomy activities. In order to further improve the economic indicators, there is a need to improve the data sources (business survey, household survey, agriculture survey, labour force survey, organization of other mid-term surveys as well as improvement of administrative data).[108] National accounts include the estimation of GDP based on production and expenditures, and national accounts. The analysis and compilation of national accounts was done by the ESA 95 and SNA93 methodology, and based on current and constant prices for 2006-2011. The sources of data for national accounts are the financial institutions (the Central Bank of Kosovo); non-financial institutions (KAS – enterprise structure survey), Kosovo Tax Administration as well as companies for the production of construction material; Kosovo Pension Trust Fund; government institutions (MF – Department of Treasury and Property Tax, Kosovo Budget – incomes and expenditures, Kosovo Customs, MIA – vehicle registration; households (Household Budget Survey) and non-profitable organizations (MPA – for data on NGO, OSCE - for political parties).[109] KAS has published GDP statistics according to expenditures based on the actual and constant prices (previous year prices) for the years 2004-2011, production according to economic activities on the actual and constant prices for years 2006-2011 and according to sectors/industries for years 2007-2011. The objective of KAS is to increase the quality through improvement of samples, to increase statistical products (quarterly surveys for produc-

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107 KAS - http://esk.rks-gov.net/statistikat-ekonomike/rreth-departamentit.

108 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, f. 245.

109 KAS - http://esk.rks-gov.net/statistikat-ekonomike/llogarite-kombetare.

ing industry, construction and construction prices, etc.) and to increase the frequency of publication of statistics (GDP is published every three months according to expenditures and production). But achieving this objective with the actual number of staff is difficult. In addition, the absorbing capacities of the existing staff are limited. Government accounts include government finances and are compiled on annual basis in line with ESA95 and the IMF Manual by dividing the category of government incomes and expenditures for the central and local levels. To date, KAS has published statistics on government accounts from 2002 to 2011.[110]

Progress has been marked in national accounts especially in relation to data quality of GDP according to expenditures, and KAS plans activities for the new methodologies SNA2008 and ESA2010 as well as publication of GDP on quarterly basis.[111] GDP according to incomes is not calculated by KAS due to lack of real data sources and lack of staff for this purpose.

Price statistics include the estimation of the indices of consumer prices (CPI), indices of production prices (PPI), indices of import prices (IPI) and the purchasing power parity. The CPI is build according to European standards and methodology and is published on monthly basis up to 15 days after the referring period and in annual intervals 175 days after the referring period. KAS monitors consumer prices as of May 2002 and on monthly basis it publishes: the monthly index with May 2002=100 as its basis; monthly difference in % – next month with previous month; annual difference in %- month of the current year with the same month of the previous year as well as the annual average in %. In addition, it publishes the average prices for some representative articles and services. KAS has published 8 publications on annual basis (2004 – 2011).[112] However the data in the Excel is unsecure for saving and analyzing data. KAS, supported by SIDA, since January 2013 has started to develop a platform for CPI with three modules: i) data insertion, ii) saving and analysis, and iii) data presentation (this platform will be tested for one year).[113]

PPI has been published since May 2009 on quarterly basis, 85 days after the referring period. The prices and value of industrial products are collected from production enterprises in Kosovo. The production value and the annual average price refer to 2007, whereas since the first quarter of 2008 the index was monitored and calculated continuously on quarterly and annual basis. The PPI is in compliance with NACE rev 1 standard classification of activities. IPI publications were launched in June 2009 on quarterly basis, 85 days after the referring period. The prices of import began to be collected at the outset of 2006 on quarterly basis and cover the most representative import companies for the relevant period. The publications contain the IPI table in Kosovo on quarterly basis, the annual average for 2006-2011 (2008 = 100) with the quarterly and annual dif-

[110] KAS - Raporti Vjetor 2012.

[111] Ibid.

[112] KAS - http://esk.rks-gov.net/statistikat-ekonomike/rreth-departamentit.

[113] SIDA - Evaluation of cooperation with SOK, p. 15.

ferences per sections according to the Harmonized System. IPI is compiled in harmony with the European standards and methodology and in co-operation with the experts from the Swedish Statistics authorities. IPI is currently being developed and in the future more price observations will be added.[114]

The harmonized consumption price index is expected to be published in the beginning of 2014. KAS has no publication related to purchasing power parity. KAS launched a pilot survey in 2009 as part of the European Comparison Programme and that is still undergoing. KAS has, however, compiled the price index for food, beverages and tobacco in 2009.[115] A new project supported by SIDA has started in respect to construction cost index, while the publication is expected in the first quarter of 2014. Improvement of the quality of prices statistics is in the continuous process dependent on the lack of staff and low capacities of KAS.[116]

Important users of statistics (MF, IM and WB) stated that there is an improvement of statistics but that further improvement is needed in the qualitative aspect and coverage. On the other hand, we should bear in mind that the quality of data depends on other institutions as well, such as the customs data on external trade statistics.[117]

External trade statistics concern import and export of Kosovo. The data sources are the Kosovo Customs and the Kosovo Energy Corporation. It is a concerning fact for trade statistics that since 2012 KAS does not include Kosovo Energy Corporation in trade statistics which leads to the breakup of time series and incomparability of data. In this context, it is important to develop and improve the inter-institutional relations. The external trade data are obtained on monthly basis whilst six monthly publications began in 2001 until March 2005, and then onwards on monthly basis 45 days after the referring period and on annual basis 6 months after the referring period. The data include export and import according to statistical procedures, export and import according to SITC international classification, export and import according to sections, chapters, countries and border crossing points.[118] The hotel statistics are published on quarterly basis (75 days after the referring period); Kosovo Energy Balance (80 days after the referring period); Kosovo Enterprises Repertoire (45 after the referring period) and Transport Statistics (45 days after the referring period). In addition, KAS has published the results of structural survey of enterprises for the period 2008-2010 (15 months after the referring period) and the results for 2011 (13 months after the referring period) and it is in the process of preparation of a webpage platform for distribution of these statistics which can be downloaded by users and generated as tables according to the needs. In relation to trade statistics, the main body responsible for the collection and analysis of trade data

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114 KAS - http://esk.rks-gov.net/statistikat-ekonomike/rreth-departamentit .

115 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, pp. 108-109.

116 SIDA - Evaluation of cooperation with SOK, p. 15.

117 Ibid, pp. 15-16.

118 KAS - http://esk.rks-gov.net/statistikat-ekonomike/export-importi .

statistics is the Division of Trade Policies within the MTI.[119] The negotiations for the free trade chapter with EU are led by MTI, whereas subgroups include the KAS, CBK, MAFRD and MF as competent institutions for the collection and analysis of statistical data. Moreover, a Committee on External Trade Statistics has been established and the committee in question covers export/import statistics.[120] MTI is faced with the lack of more advanced statistics necessary for negotiation of the SAA, which KAS cannot produce due to lack of staff. Business statistics with the statistical business registers in 2001 determined for the business the unique code of activities according to NACE Rev. 1 and has set the unique identification number for the registered business. As of January 2003, the MTI respectively the Kosovo Business Registration Agency (KBRA) took over the responsibility for business registration in Kosovo and currently the system is decentralized at the municipal level.[121]

The Statistical Business Register (SBR) operates within KAS and contains all businesses that have economic activities within the territory of Kosovo. SBR was built pursuant to Regulation 2001/14 on official statistics and EC Regulation no. 177/2008 establishing a common framework for business registers for statistical purposes as a tool for preparation and coordination of surveys, for the statistical analysis of business population and demography, for the use of administrative data, and for the construction and identification of statistical units. SBR is based on the administrative data obtained from the KBRA, TAK and statistical surveys conducted by KAS (hotel services, enterprise structure survey) and do not contain the public administration, non-profitable organizations or international organizations. Due to the lack of update of business registry, the data remain unreliable, while the analyses of the data from KAS surveys takes too much time, therefore the publications are delayed. On the other hand, businesses are obliged by Law on Business Organizations to send financial reports to MTI and National Council on Financial Reporting, but this is not happening in practice and MTI does not apply penalties, therefore the statistics remain incomplete. The number of businesses in business registry is around 100,000 businesses, while KTA since 2009 has issued around 65,000 fiscal numbers (53,000 for businesses and 12,000 for fiscal persons) and this huge difference shall be corrected. Through the one-stop-shop approach since last year, no business can be registered without previously getting a document from KTA regarding the past of the person. In addition, KTA visits businesses 5 days after their registration in order to ensure that the business exists in reality. In order to support this process, it is recommended to first confirm the personal data to civil registry prior to business registration in order to ensure that it is not a case of a phantom business. The main variables in the SBR are updated and grouped in identification variables (NRB, legal form, ownership, name, address, correspondence); stratifying variables (main economic activity, size per employees, geographic location); demographic variables (date of creation, date of termination) and turnover value variable (turnover value of the active businesses in a year, average number of employees in active businesses in a year). KAS has published

[119] Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, p. 179.

[120] Ibid, p. 247.

[121] KAS - http://esk.rks-gov.net/statistikat-ekonomike/regjistri-i-bizneseve.

four publications of the Statistical Overview of Registered Businesses in Kosovo 2001 – March 2003, and then on monthly and quarterly basis the indicators on transport, post-telecommunications, number of registered vehicles.[122]

KAS plans to update the business registry with local units, businesses' group and has started to work on transition from NACE Rev. 1 to NACE Rev. 2 according to EURtat requirements, which is believed, will contribute to solving the problems. It is decided that when the business registration with NACE Rev. 2 starts (planned to start in 2014), then KAS together with KBRA will jointly make the transition to corresponding tables of NACE Rev. 2. For the other part of enterprises that cannot automatically switch to corresponding tables, a direct registration of the businesses is being made. While KAS since 2010 has started to use double codes (NACE Rev. 1 and NACE Rev. 2) in business survey of the year 2009. This has continued in the survey of referring period 2010 and 2011, but no publication is done in NACE Rev. 2 as the sample framework was not in NACE Rev. 2.[123] Besides this, KAS plans to carry out general enterprises registration (non-agricultural part) in 2016. While regarding approximation of business statistics with European standards, KAS undertaken the following: i) the questionnaire on enterprise structure survey 2011 was improved according to the experts recommendations and regulations on enterprise structure statistics, ii) meetings were organized with regional office to improve data collection and iii) uncertainties in the quarterly survey on industry and construction were identified and eliminated.[124]

3.4. Monetary and financial statistics and foreign sector

Pursuant to Law no. 03/L-074 on the Central Bank of Kosovo, the CBK is responsible for compiling and publishing financial and monetary statistics and foreign sector statistics (balance of payments, international investments position, foreign debt). CBK has 10 employees in the Department of statistics. In order to discharge its competences and responsibilities, the CBK Board in 2011 was focused on the completion of the legal framework by adopting the Regulation supplementing Bank Regulation XVI, Regulation on Monetary – Financial Statistics and Financial Accounts, Regulation on Balance of Payments and International Investment Position, and Rule on Payment Instrument Statistics.[125]

The monetary and financial statistics include statistics of the CBK, other depository corporations, insurance companies, pension funds, other financial mediators and financial aids. Monetary and financial statistics are compiled and published based on international standards, respectively the Monetary and Financial Statistics Manual (IMF 2000), Monetary and Financial Statistics Compilation Guide (IMF 2008), Manual on MFI Inter-

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122 Ibid.

123 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, p. 246.

124 Ibid, p. 245.

125 CBK – Raporti Vjetor 2011, p. 21.

est Rate (ECB 2003), Systems of National Accounts (editions SNA 93 and SNA 2008) and the European System of National and Regional Accounts (ESA 95).[126]

The CBK is responsible for GDDS since April 2011 when the system was launched in Kosovo. In 2011 the CBK prepared some statistics projects which started to be implemented in 2012, such as the Statistics Report on Micro-financial Institutions, Reports on Interest Rates of Micro-financial Institutions as well as the Statistics Report on Money Transfer Agencies. This has increased the frequency of reporting from quarterly to monthly reports.[127] In April 2012, the CBK for the first time published the data on the International Investment Position and Kosovo's external debt which contain assets and obligations of Kosovan residents towards non-residents and include the period from 2007 on annual basis, while from 2012 on quarterly basis. KAS prepares the Harmonized Review of Direct Investments, the Review of Direct Portfolio Investments, while the statistics on import/export of goods are published by CBK by January 2012. Since January, CBK does not publish them any longer according to KAS request in compliance with official publisher of external trade statistics. The data regarding Harmonized Direct Investments are collected through direct surveys with foreign companies in Kosovo, based on business registry and through bank transfers. The data on migrant's deliveries are collected through bank transactions based on the description of the transaction and micro financial institutions as well as from declarations to the police (around 20% of the data). Besides these sources, CBK uses other sources as well, such as conducted surveys in the country, withdrawals from ATMs during the seasonal periods etc. The bank sector statistics are published by CBK on quarterly basis since 2000, while those of insurance since 2004 on quarterly basis.

During 2010, new versions of Bank Statistical Reports (BSR), Interest Rates Report (IRR) and International Transactions Reporting System (ITRS) are implemented. Implementation of new versions of these statistical projects was in function of developing a bank market in Kosovo which is consistent with international statistics standards.[128]

CBK has increased the frequency of publishing the foreign sector statistics by publishing the balance of payments on quarterly basis, as part of publications such as International Financial Statistics and Balance of Payments Statistical Yearbook.[129]

CBK statistics are in conformity with international statistics standards of the IMF, ECB and EURtat. The application of these standards ensures regularity and compliance of Kosovo's statistics with other countries. The steps that CBK undertook in this respect and which improved the reliability, regularity and adequacy are as follows: i) publication of methodology, publication of calendar and its adherence, iii) notification on revi-

126 CBK – Metodika mbi Statistikat Monetare dhe Financiare, V2.0, p. 5.

127 CBK – Raporti Vjetor 2011, p. 125.

128 CBK – Raporti Vjetor 2010, pp. 89-90.

129 Ibid.

sion of statistics and iv) transparency on publication of statistics.[130]Since August 2010, the CBK reports financial and monetary statistics and balance of payments to the IMF related to the monitoring of the 'Stand-By' programme[131] but also for some publications such as International Financial Statistics, Balance of Payments Statistical Yearbook, Financial Access Survey and the Global Financial Stability Report.[132] During 2011 CBK, for the first time, started to report to EURtat on statistical indicators related to balance of payments.[133]

The CBK statistical capacities have improved considerably and since 2010 the staff of the Department for Statistics the CBK was included in the IMF list of experts on financial and monetary statistics, and this makes the CBK not only the recipient but also provider of technical assistance for other countries in the region.[134] In 2011 the DS Director completed his first mission in the capacity of IMF expert on monetary and financial statistics at the Central Bank of Bosnia and Herzegovina, while in 2012 has successfully completed two other missions in Central Bank of Trinidad and Tobago. Head of the Balance of Payments Division was incorporated in the IMF list of experts on balance of payments statistics[135] and in 2012 has successfully completed his first mission in Central Bank of Botswana. On the other hand, a key challenge remains compilation of statistics for real sector non-financial companies (CBK is not officially responsible for this), which would help a lot in compiling more accurately the financial accounts within the statistics of balance of payments. In addition, also the harmonization and coordination shall be improved so that the statistics are published only by KAS, MF and CBK (other institutions may collect the data and compile statistics, but not publish them) and evidence the publication of double indicators which do not match.

- ***Regular publications of CBK and other statistics***

Directorate for Financial Stability and Economic Analyses (EFSEA) of the CBK during 2010 has published the first issue of the Financial Stability Report, which is a continuity of the Financial Sector Bulletin, but which offers a more completed overview of the financial sector stability in the country. Publication of financial stability report is done on regular basis and is appreciated by international institutions as one of the best reports in the regional countries. DFSEA has regularly compiled annual assessments within the Monthly Statistical Bulletin, while since the IV quarter of 2012; EFSEA has replaced this with Quarterly Economic Assessment. The main sources of data for these publications are CBK Time Series which present the main statistical publications such as monetary

130 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, p. 247.

131 CBK – Raporti Vjetor 2010, p. 90.

132 CBK – Raporti Vjetor 2011, p. 125.

133 Ibid, p. 126.

134 CBK – Raporti Vjetor 2010, p. 89.

135 CBK – Raporti Vjetor 2011, p. 126.

and financial statistics and those of balance of payments.[136] For internal use, CBK compiles also Early Warning Indicators (EWI) which is compiled on monthly basis in order to identify the possible risks for the economy.[137] As Kosovo uses EUR as its official currency, it is difficult to follow the transactions outside of the bank system which cause various continuous mistakes[138]

CBK drafted the Strategy for the Development of a National Payments System which is structured into nine pillars: i) legal framework, ii) large value and time-critical payments, iii) retail payments system, iv) government transactions, v) security depositories, vi) money markets, vii) international remittances, viii) oversight and ix) co-operation in the field of overseeing payments systems (pillar vii). The new regulation on payments instruments and harmonization of methodology on reporting payments instruments provides: i) collection and processing of periodic data and efficient maintenance of the database on the use of payments instruments in Kosovo, ii) monitoring of developments in the field of payments systems in order to assess the level of risks that they contain and to ensure transparency in agreements related to the payments instruments and services, iii) improvement of quality of reports, analysis and publication on payments instruments in compliance with the report by the European Central Bank and iv) analysis of developments in the area of payments instruments in Kosovo vis-a-vis the countries in SEE.

CBK in cooperation with Kosovo Police and Forensics Laboratory publishes the statistics on false banknotes and coins at national level. [139]

CBK publications are not based only on the information from the databases, but it carries out surveys in order to complete the overview of the economic situation in the country; for instance, the CBK carried out a survey on bank loans with banks operating in Kosovo The results of the survey were published in line with international principles by safeguarding the confidentiality of individual banks which responded to the survey.[140]

Regular analytical publications of CBK are:

1) CBK Annual Report
2) Quarterly Economic Assessment
3) Financial Stability Report (annual)
4) Balance of Payment Report (annual)

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136 CBK – Raporti Vjetor 2011. p. 90.

137 Ibid. pp. 89-90.

138 FMN - Republic of Kosovo: Request for Stand-By Arrangement—Informational Annex, 12 April 2012, p. 7.

139 CBK – Raporti Vjetor 2011, p. 107.

140 Raporti i Stabilitetit Financiar Nr 2, p. 83.

3.5. Agriculture and environment statistics

Department of agriculture and environment statistics is composed of two sections: agriculture statistics section and environment statistics section. The Department is focused on three main areas: agriculture statistics, agro-monetary statistics and environment statistics.[141]

In order to develop agriculture statistics in Kosovo, KAS has close co-operation with the Ministry of Agriculture, Forestry and Rural Development (MAFRD). MAFRD, respectively the Department of Developmental Policies and Statistics (DDPS) is responsible for agriculture policies and administrative statistics. However KAS is responsible for setting the methods, classification and standards for use of other institutions according to the programme on official statistics and KAS work plan. Pursuant to AI no. 06/2011 DDPS plans survey and organizes training for their implementation, collects, and analyses and publishes statistical data including the Farm Accountancy Data Network (FADN). Currently the DDPS is composed of four sections: FADN, trade (data on export/import), agriculture price statistics and GIS.

Due to lack of agriculture registration since 2000 KAS launched the annual Agriculture Household Assessment with 4,500 households where different indicators are included, such as: agricultural population and its structure, land surface utilized, agricultural products, livestock and livestock products, forestry, use of mineral and organic fertilizers, agricultural machinery, agricultural labour force, farm expenditures, etc. The data collection phase in the field for the survey of 2012 is expected to be completed in November.

Preparations for agriculture registration are under way. The law on agriculture registration is adopted by Kosovo Assembly and the proposal for agriculture registration and the draft activity plan were drafted. The present law prescribes KAS as management and implementing authority of registration and it incorporates the EURtat definitions and is in compliance with the EU (EC) Regulation no. 1166/2008.

A pilot agriculture registration was conducted in November 2012. The following documents were prepared and tested during the agriculture pilot registration: AR questionnaires, guidelines for implementation of pilot registration, training materials, list of households and printed labels, maps of registration of counties with buildings (from RPEFB 2011), programme (application) for insertion of data, etc. The objective of agriculture pilot registration was preparation and testing of the methodology and other instruments and their harmonization with the international standards. The agriculture registration logistic was tested as well. The necessary information for changes in questionnaires are received from the findings in the field (it did not result that there is a need to make changes). On the other hand for activities budget according to years was planned and secured while the complete registration door-to-door is expected to start in 2013.

[141] KAS - http://esk.rks-gov.net/statistikat-e-bujqesise.

In 2003 KAS together with MAFRD started to develop agro-monetary statistics which include the price index of outputs and prices in agriculture, price index of inputs in agriculture, the Economic Accounts in Agriculture, FADN, the Labour Force in Agriculture and the Incomes in the Agriculture Households Section. MAFRD is responsible for FADN whereas KAS is accountable for the other components[142] and it has published the output price index and prices in agriculture as well as the input price index in agriculture (on quarterly and annual basis, 45 days after referring period) for 2005-2012. Currently the prices for 68 different agriculture inputs are being collected and they plan to collect an increased number of agriculture inputs in the future.[143] The economic assessments in agriculture are published for years 2005-2009 on annual basis and are sent to EURtat. Economic assessments in agriculture for years 2010 and 2011 are prepared as a draft for publication in line with the regulation (EC) No 138/2004. The data on participation percentage of agriculture in economy of Kosovo, compared to industry and services, are collected with surveys, but these are incomplete. By registration of agriculture, the data will be completed and will be more reliable. KAS plans to develop agriculture labour force statistics and input in the agricultural sector.

KAS statistics on the land area per municipalities and cadastral zones were produced by using the register of the Kosovo Cadastral Agency (KCA). KCA and Municipal Cadastral Office are responsible for the registration of land used for agriculture. Land is registered as agriculture parcels including land classification (there is no separate register for agricultural lands). KCA possess pictures of 2004 and 2009 which provide an overview of the situation with agriculture land. [144]

In 2005, FADN was launched as pilot project and in 2009-2010 the database was developed which enables the calculation of the Gross Margin on different types of plants and animals. The farmers' data are divided according to the members of associations, level of education, age, production time, and type of expenses, value of land/building, depreciation of assets, debt and capital. However the system does not use the farm value 1 of the European Size Unit. The personal data are confidential and are used only for statistical purposes and development of agriculture policy. DDPS is mandated to update these data on annual basis. In addition to this the MAFRD issued AI no. 03/2009 which provides that the territory of vineyards are allocated according to regions, sub-regions, vineyards fields, locations, and all these are integrated in a single system which makes possible the analysis and publication of statistics in this field.[145]

Co-operation between DDPS and KAS is close; KAS has access to FADN data and vice-versa, KAS shares agriculture data with the DDPS and the latter processes them

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142 Ibid.

143 KAS – Seria 2: Statistikat e Bujqësisë dhe Mjedisit; Indeksi i çmimeve të inputeve dhe çmimet në bujqësi TM1 - 2012 (2005=100).

144 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, p. 268.

145 Ibid, pp. 269-270.

for MAFRD purposes and needs (price of agriculture products, export/import of agriculture products, etc). The Market Information System provides data on monthly basis related to the market prices of 400 agriculture products and therefore contributes to reliable statistics.[146] On the other hand, there is no specific scheme for export/import of agriculture products but Kosovo's trade data are standardized by MAFRD with that of other countries since 2009 according to the EU statistics data system.[147]

The collection of environment statistics began in 2004. A memorandum of understanding is drafted together with institutions that possess environment data, which harmonizes the production of environment statistics, regulates the exchange of data and shares responsibilities between institutions. The publication is done based on KAS surveys. In 2007, 2009 and 2011 Some Facts on Environment were published (every two years), and the results of the Municipal Waste Survey were published in March and December 2008, March and December of 2010 , 2011 and 2012 and the Industrial Waste Survey was published in 2011 and 2012 according to NACE Rev. 1.1 (regulation (EC) Nr. 2150/2002). Based on EURtat requirements, in five year programme, KAS plans to publish data also on release of greenhouse gases, but due to lack of staff, publication of new indicators remains a major challenge.

3.6. Information Technology

Department of methodology and information technology is established lately and it has only 1 regular employee from the area of IT who covers the needs of KAS in programming and software development, and 2 other employees: 1 employee paid by SIDA who covers programs such CPI and LFS, and 1 employee of census who is the key person in the area of electronic distribution of statistical data and supports KAS in transmission and distribution of data through eDAMIS technology. Even though it has a low number of staff, this section takes care of maintenance of the network and servers, management of databases and their security, provides support to KAS staff and takes care of back up policies of KAS servers, develops and updates the KAS webpage, etc. With the reorganization of KAS and Census webpage, the volume of statistical information has increased, in particular the number of excel tables for each statistical theme, time series which enables users to further use these statistics. KAS has uploaded the ESMS Metadata in the webpage for the first time, according to EURtat recommendations. In addition it has integrated the DaWinci and StatPlanet methodology in the census page in order to have direct and interactive access to census 2011 data. The IT office, even though low in number of staff, has provided the required services from other departments. KAS has a major lack of staff, in particular in respect to programming and intranet.

In relation to the software, KAS uses the following systems: Windows Server, SQL Server, MySQL, CSProx and CSPro, VB, dotNET, tabulation programmes such SPSS, Excel and Access, etc. However there is a need to develop capacities in the technology aspect

[146] Ibid, pp. 270-271.

[147] Ibid, p. 264.

and the use of new methodology for data collection (CAPI, CAWI and CATI), management of databases under a common system, designing of web application to extract reports and tables from the database, building new databases and applications, establishing VPN lines with regional offices.[148] Taking into account the low number of staff, it remains unclear how much KAS utilizes these systems and how it plans to meet the requirements for new software.

Co-operation of the IT and other departments presents serious problems, for instance the household survey covers a number of aspects (health, education, etc) which are not optimized by KAS.[149] The lack of software policies results in that certain personnel use a statistics system not used by anyone else within KAS (some use Excel, the others Word or other programmes/systems) and this hinders co-operation between departments/personnel and information sharing for a sustainable statistics system.[150] The five year programme foresees the unification of using the IT. It is expected that a project proposal prepared by KAS (to be financed by IPA) will help to develop an integration system and staff capacity building. In addition, by the end of the year, a web database is expected to be launched, where all the KAS information that could be downloaded by users for different purposes.

4. Conclusions

It is obvious that Kosovo statistical system has improved during the last years. However yet many major challenges remain. It is worth noting that the management of KAS, MF and CBK have identified the problems and have worked on solving them. While the lack of KAS staff is considered to be the major challenge, attention should be paid to management as well, as an effective management can achieve more effective performance of existing resources.

The legal framework is completed by secondary legislation to a great extent, while the reforms need to be completed as soon as possible. The Kosovo Assembly shall be informed regarding the problems being faced by these institutions and to consider if the respective requests and obligations can be performed with this level of financial means.

148 KAS - http://esk.rks-gov.net/ti-ja-dhe-metodologjija/teknologjija

149 SIDA - Evaluation of cooperation with SOK, p.14

150 Ibid, p.17

Advantages	Challenges	Recommendations
EURtat recommendations are always taken into consideration.	In general, statistics are not in harmony with EU countries in respect to range and structure.	Adherence and full implementation of EU statistics principles.
Law on Official Statistics provides clear-cut roles and competences of institutions. The law ensures institutional autonomy of KAs according to practices of EU members states.	Law does not ensure sufficient KAS budgetary autonomy.	Ensure KAS institutional and budgetary autonomy in compliance with EU standards. Use foreign organizations to assist in the 2-3 years transitory period for transferring capacities to the local staff.
Five years statistics programme is adopted.		Consolidate an integrated national statistics system.
New management appointed and development plans being drafted. Coordination among KAS departments is at a desirable level, especially after establishment of the new Department for Planning, Coordination and Communication	KAS management remained unstable during the years and the risk is that this will continue. KAS has insufficient staff and who need continuous professional training.	Continue with capacity development of staff and associate performance with career promotion. A special attention must be paid to the IT office.
Statistics Council supports coordination of statistics.	Coordination between different institutions which collect data and publish statistics is not at a desirable level.	Develop procedures for an overall coordination Kosovo-wide.
Increased volume of statistics and publications are published in a more timely fashion and plans are more frequent in the near future.	Statistics do not cover the necessary fields such as environment, migration and purchasing power parity statistics. Statistics must be published on quarterly and even monthly basis (the national accounts and balance of payments). Quality of data, sources, classification of registers, reliability, samples in specific areas are not in compliance with EU standards. Production of some statistics is supported by foreign experts.	Consolidate an integrated national statistics system covering all statistics fields. KAS is completed with sufficient staff and the staff is trained. Continuous improvement in various fields of statistics in compliance with EU standards and compliance, including coverage, reliability, regular publications, etc.
The level of co-operation with users has started to improve since 2012		Continue co-operation with users and produce statistics according to their needs.
KAS webpage is updated with new publications with formats according to EURTAT recommendations.	IT staff is limited in number. Coordination and cooperation in terms of software is not at a desirable level.	Complete IT policies and develop the necessary IT platforms. IT staff is completed and trained according to the needs of KAS.
CBK staff is included in the IMF experts list and provides expertise for the countries in the region.		CBK provides assistance to the relevant statistics authorities in Kosovo.

Chapter VI – Privatisation/Liquidation and Management of Socially and Publicly Owned Enterprises

1. EU requirements and standards for corporate governance and privatization

The EU member states approach towards privatization depends on socio-economic conditions of these countries, such as unemployment rate, economic growth, foreign investments, etc., therefore there is no single approach required by the EU legislation. Irrespective of this, privatization has been a key element of broader reformatory policies in the majority of EU member states during past two decades in order to grow economic efficiency, restructuring of economic sectors, increase of income levels, cutting subsidies and improvement of financial situation of publicly-owned enterprises, etc.

EU principles in the field of privatization are closely related with the fields of domestic market, competition, corporate governance, etc. EU has established its key principles through Rome Convention, and it has advanced them through subsequent conventions, which include: market opening and liberalization, transparency, open and fair competition without violating public providers of services on citizens' interest, elimination of monopoly and/or dominant position in the market, avoiding privileging approach in financial institutions, accountability, stopping national-based discrimination, stopping agreements on pricing, stopping limitation and control of production/market and investments, stopping application of unequal conditions during transactions to create competitive disadvantage, etc.

Competition may be avoided by EU relevant institutions only in cases when it is necessary to protect vulnerable enterprises due to structural or natural conditions, or when it promotes technical and economic progress that provides consumers with proportional benefits.

State assistance (grants, tax relief, provision of preferential conditions, etc.) is allowed as long as it is necessary for the public interest, economic development of underdeveloped regions or promotion of environment protection, research and development, etc. This assistance is not allowed in cases when it distorts or jeopardizes free and fair competition or joint interest of the EU.

Regarding corporate governance, the EU has started its debate in 2002 through a report from the Group of senior experts on corporate rights. The EU has established the European Forum for Corporate Governance which aims at good and transparent governance of corporates, which is essential for increasing competition and efficiency of businesses in the EU, as well as strengthening shareholders with rights and protection of third parties.

Through Communiqué on "Modernization of company law and enhancing corporate governance in EU – the Plan to move forward" in 2003, the EU initiated the process of harmonization of regulations on company law and corporate governance in order to

protect shareholders, increase efficiency and competition, regulate the proportionality between equity and control, increase of the role of executive directors, provision of freedom to establish companies, etc.[151]

The European Commission in 2010 has drafted a Green Paper in order to improve mechanisms of corporate governance. Some of the key principles of the EU in this field include:

- Boards must be balanced between executive and non-executive directors, while the roles of the Chairman and Chief Executive must be separated.
- Composition of non-executive of directors in the Board must be based on criteria of qualification, experience, professionalism, independence and diversity of candidates.
- Salary policy and remuneration of directors must be transparent.
- Companies must have a risk management plan and must be monitored by their boards.
- Conflict of interest must be avoided in every aspect.
- Companies in public interest must establish an Auditing Committee, which provides advice to the Board[152].

There is a large number of EU directives that are related to the principles of privatization and company management, which refer to specific sectors or even cases.[153]

As a conclusion, it can be said that EU core requirements regarding privatization of publicly-owned or socially-owned companies are for the process to be transparent, to guarantee an expected outcome and not to influenced by political interference.

2. Privatization and liquidation of socially-owned enterprises

2.1. Legal and institutional framework

The sector of socially-owned enterprises (SOEs) employed about 20,000 people while the number of people in the employee lists reaches up to 60,000 (for example, 40,000 were on unpaid leave). SOEs operated in a variety of sectors including metal processing, plastic, paper, hotels, mines, agro-industry, agriculture, forestry, construction materials, construction, textile, winery and vineyards, beer, tobacco, and retail and wholesale. It has been calculated that SOEs represented about 90% of the industry and mining in Kosovo, 50% of the sale for retail commercial sales and less than 20% of agricultural land – including commercial agriculture land and the majority territory of Kosovo's forestry. The majority of industrial assets in Kosovo, agriculture land, forests, urban commercial

151 The EU approach to corporate governance, 2008, pp. 3-5.

152 Ibid, pp. 5-8.

153 Full package of relevant documents can be found in European Commission website: http://ec.europa.eu/internal_market/company/official/index_en.htm

land and commercial properties were in possession of SOEs.[154]

Kosovo Privatization Agency (KPA) was established as a successor agency of Kosovo Trust Agency (KTA) regulated with UNMIK Regulation 2002/12 "on establishment of Kosovo Trust Agency" with amendments, all assets and responsibilities are assets and responsibilities of KPA. However, KPA did not inherit the KTA mandate over publicly-owned enterprises (POEs) which are now under the mandate of MED. KTA was established by UNMIK in 2002 and had started privatization process in Kosovo in 2003, although designed in the way that POE liquidation process will never end, because of initial assumption that ownership belonged to Serbia and that liquidation process takes 42 months.

KPA was established with passing of the Law on Kosovo's Privatization Agency (Law no. 03/L-067) which entered into force on 15 June 2008. The law includes relevant provisions of the Comprehensive Proposal on Status Settlement of Kosovo dated 26 March 2007 (Annex VII, Article 2), which became part of the Constitution of the Republic of Kosovo (article 145 of the Constitution of the Republic of Kosovo). KPA was established as an independent public institution and it exercises its functions and responsibilities with full autonomy.

KPA competences were granted to the Board of Directors, comprised of three international and five Kosovan directors, and one observer from the EU Office in Kosovo. Term of Board Members elapsed in July 2012 which had a negative effect in decision-making process, especially considering Trepça reorganization process. New members were appointed by Kosovo Assembly in February 2013. Board of Directors is the highest decision-making body and it has full jurisdiction over KPA, while KPA organization structure, as is envisioned by Law on KPA, in addition to the Board of Directors, also includes the executive section that is led by the director and two deputy-directors. The KPA executive section comprises of Division for Assets Sale, Division of Corporate Governance and Executive Branch under direct supervision of Agency's management[155].

The Special Chamber of the Kosovo Supreme Court on Issues related to KTA (Special Chamber) was established by UNMIK in 2003 as an international court to provide a strong, independent and impartial mechanism in privatization process in Kosovo. Upon deployment of EULEX mission to Kosovo, staff of 30 persons is engaged in the institution. EULEX judges in Special Chamber have executive functions and they comprise the majority of judges in every panel.

In August 2011, the Assembly of the Republic of Kosovo passed the new Law on KPA no. 04/L-034, as well as Law no. 04/L-033 on Special Chamber of the Kosovo Supreme Court with exclusive jurisdiction on suits against the Agency. KPA has full legal capac-

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154 KPA annual report - http://www.pak-ks.org/repository/docs/Raporti_Vjetor_i_AKP-s-alb.ver..pdf.

155 PAK - http://www.pak-ks.org/repository/docs/Information_to_Stake_Holders_august_2011_alb_ver_FINAL..pdf.

ity, especially to make contracts, to acquire, hold and dispose of property and have all implied powers to discharge fully the duties and powers conferred by this law;, and to sue and be sued in its own name. These laws have created the conditions for the liquidation of SOEs, the acceleration of the privatization process through cutting procedures to review creditors' and workers' claims, speeding the transfer of assets to the private investor and distribution of trust fund to creditors and rightful owners, enabling the engagement of service providers who together with KPA constitute the Liquidation Authority, etc. The Authority started operating in Peja, Prizren and Mitrovica, which during the liquidation process, enabled reviewing debts of SOEs to POEs for their services, debts of property tax, VAT, etc.

2.2. Status and challenges

Upon approval of the Law on Kosovo Privatization Agency (KPA), the privatization process of socially-owned enterprises (SOEs) restarted in the summer of 2008[156] (after temporary interruption as a result of ending of KTA mandate from UNMIK Pillar IV, known as EU Pillar, in June 2008), but at a slower pace and without producing any significant impact on Kosovo's economy. Since 2009, the process was more dynamic, but still with delays[157] and with a considerable number of enterprises still to be privatized[158].

Due to EULEX neutrality towards Kosovo's political status, Special Chamber from the very beginning refused to recognize KPA as a legal successor of KTA. For more, the Special Representative of the Secretary General (SRSG) had set exclusive authority over any issue dealing with KTA (even though KTA *de facto* didn't exist any longer). This situation created legal uncertainties and significantly influenced prolongation of the processes developed by KPA.

The methods used by Kosovo Trust Agency included: i) regular spin-off, ii) conditional spin-off, and iii) special spin-off. Enterprises and their assets were privatized with regular spin-off based on the highest bid during a wave, without any additional condition. Conditional and special spin-off included, in addition to the highest bid, required meeting conditions such as commitments for employment and investments; the process was organized in two waves, and only three bidders selected from the first wave participated in the second wave.

According to the Law no. 04/L-034, KPA does not apply special spin-off method since it proved to be a complex method and resulted with several privatized enterprises which prolonged meeting their commitments for employment and investments (furthermore contracts were entered based on England's laws which do not correspond to Kosovo's laws). Therefore, KPA decided to apply only regular spin-off method, and selling of

156 Progress Report, 2008, p. 30.

157 Ibid, p. 24.

158 SAPD: Sectorial meeting on Economy, 17 June 2010, Brussels, p. 6.

assets through liquidation.[159] The experience shows that direct sale of assets was the most effective method, however focus should have been placed on monitoring business operations, employment and output. Thus a standing monitoring body should be established for post-privatization investments and employment by investors.

Privatization of major enterprises was carried out by the KPA. The total number of tendered SOEs is 330, while the number of new companies is 727. On the other hand, assets of 297 enterprises were sold. KPA inherited around 200 unsigned contracts from KTA, while now there is no such contract standing. Up to date 675 sale contracts were completed, while KTA had not liquidated any SOE, KPA for relatively short time liquidated 4 of them. There are 180 SOEs in liquidation process, while their requests are under review by April 2013. 25 privatized SOEs with special spin-off employ 7,108 employees versus 8,340 committed.

Regarding privatization of agricultural land, it is done in compliance with the Law no. 02/L26 on agricultural land and the Law 2003/14 on spatial planning, to ensure that privatized agriculture land is not used for construction purposes. So far 28,842ha were privatized, and 17,303ha are in the process of getting privatized from a total of 46,145ha[160].

Until 30 September 2012, overall revenues from privatization were 572,040,806 €, while the revenues from liquidation were 60,565,419 €[161]. Due to different legislative and operational difficulties, complaints of creditors are not resolved, so KPA has contracted Deloitte Central Europe to accelerate resolving of complaints/appeals and it is expected that all complaints will be resolved by mid-2013 for 180 SOEs in the liquidation process.

Revenues from the process are held in a trust fund at Kosovo's Central Bank. 20% of the funds are reserved for SOE employees who are entitled to a part of shares, 5% are administrative fees for KPA, while 75% of the remaining funds serve for resolving complaints of creditors.[162]

Distribution of funds from liquidation process is to be completed according to list approved by the Special Chamber of the Supreme Court. In case the Chamber fails to perform, Board of KPA has approved the interim distribution of funds. So far, creditors were paid only about 45.000 EUR related to SOEs liquidated by KPA that may be used for capital investments. Special Chamber approved only 2 final lists for distribution of

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159 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, pp. 138-139.

160 Ibid, p. 266. 2,508ha were privatized through special spin-off; 25,334 through regular spin-off.

161 Liquidation has been less successful thus far, and revenues from this process are not included in budget planning. Latest information on revenues from privatization and liquidation are from KPA official sources.

162 IMF - Republic of Kosovo: First Review Under the Stand-By Arrangement, and Request for Modification of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion, July 2012, p. 13.

20% funds to the workers. In case the Chamber fails to perform, Board of KPA has approved a strategy for interim distribution of up to 15% of funds. Based on this strategy, KPA by 30 September 2013 has published 86 workers' lists, whereby around 33.000 workers benefitted total 67 million EUR.[163] On the other hand, it's worth mentioning that KPA has not enforced the decision of the Constitutional Court to pay 20% of funds to workers of a factory in Ferizaj!

There are around 40.000 claims for liquidating enterprises, including 20.000 claims that Serbia filed to KPA in three months only. Around 60-70% of claims are related to unpaid salaries from the former Development Fund of Serbia. Special Chamber is to review all such claims. In case of claims for enterprises that are not in the liquidation process, KPA is not bound to respond. Positive side of existing framework is that creditor claims may be satisfied only in the amount of sale, which means that distribution of funds to creditors may not exceed the sale price.

By 2011 KPA activities were mainly funded from donors' grants, while operations were supervised by the International Civilian Office (ICO). But, as part of Kosovo's transition from supervised to full independence, KPA is integrated into the overall government budget.[164] As of 2013 KPA funds capital investments from privatization-generated revenues. Furthermore, 5% of revenues from privatization process are considered administrative fees and it will be available for KPA to cover its administrative and operational expenses[165] for next five years[166]. Thus, KPA it is not part of expenditure limits determined by the government, because it is self-funded and it defines expenditures independently.[167] KPA budget for next three years is forecasted to be as shown in Table 8.

Table 8: Approved expenditure limits

	2013	2014	2015	Total
Total	6,857,010	9,894,880	9,849,880	26,601,770
Salaries and bonuses	3,600,000	3,600,000	3,600,000	10,800,000
Goods and services	2,889,010	5,971,880	5,971,880	14,832,770
Utilities	98,000	98,000	98,000	294,000
Subsidies and transfers	100,000	100,000	100,000	300,000
Capital expenditures	170,000	125,000	80,000	375,000
Number of staff	271	271	271	

Source: MTEF 2013-2015

163 Latest information on distribution of 20% of funds are from KPA official sources.

164 IMF - Republic of Kosovo: First Review Under the Stand-By Arrangement, and Request for Modification of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion, July 2012, p. 6.

165 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, pp. 138-139.

166 IMF - Republic of Kosovo: First Review Under the Stand-By Arrangement, and Request for Modification of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion, July 2012, p. 13.

167 Ibid, p. 6.

Privatization is expected to be completed in next two years, however, liquidation of SOEs will continue[168], while according to latest predictions of the Government the entire process of privatization and liquidation will end in 2016.[169]

However, considering the pace of the development of these processes so far and knowing that the portfolio of remaining SOEs to be privatized/liquidated is more problematic due to lack of cadastral documents and other ownership issues, this prediction might not be realistic. For more, KPA performance is being affected largely from significant delays in nominating members to the Board of Directors, which makes its strategic decision-making more difficult.

During UNMIK administration, the commercialization process of some SOEs took place by signing ten-year concession contracts. From 18 contracts signed, nine of them are suspended due to non-fulfilment of contractual requirements, one is still in effect while other SOEs were privatized. Due to weaknesses encountered during application of this process and modest results in meeting requirements by investors, KTA had decided to stop that process and continue with privatization process.

In principle, privatization is expected to have positive effects on economy of the country, generating employment, establishing an enabling environment for businesses and investments, etc. Even though privatization of SOEs in Kosovo has its importance for property transformation, as an important component of market economy, this process has not achieved desired effects for Kosovo's economy. Probably many factors have influenced this, such as political uncertainties due to delay in definition of Kosovo's political status; hesitation of UNMIK administration to start the process before 2003 (and its interruption after second wave of privatization) which as affected in reduction of the value of assets, further loss of markets of SOEs and discouragement of potential investors; keeping privatization funds in a "frozen" status (on justification for legal-ownership uncertainties) which disabled use of those funds for important projects that would influence growth of economic development, etc.

Lessons learned from the process show that privatization was done with no measurable economic and social objectives, with commercialization that resulted detrimental for development of Kosovo. In this end, communication of KPA with other institutions was not appropriate, although with time the communication marked noticeable improvement. In the future more attention should be paid to improving communication with stakeholders. The process was assessed to have been accompanied with corruptive affairs and practices. Also as a result of absence of international recognition of Kosovo and control of Socially Owned Enterprises (SOEs) in enclaves and north of the country by

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168 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, pp. 138-139.

169 IMF - Republic of Kosovo: First Review Under the Stand-By Arrangement, and Request for Modification of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion, July 2012, p. 13.

Serbia, the process was continuously facing political interference and implications. KPA opened its satellite offices in enclaves and the north (Leposavic) where some small enterprises were privatized. Process has been accompanied with various barriers such as fiscal policies (VAT payment at the border), absence of legal protection of investments, and other bureaucratic barriers in central and local level that resulted in low level of investments by foreign investors.

Frozen funds in CBK (around 600 million EUR, equivalent to 40% of budget revenues in 2012) constitutes the worst experience of the process. It is a paradox for Kosovo to take IMF loans, while privatization funds are frozen. Moreover the interest rate applicable for the fund is 0.1% (in other countries this norm is 12 to 14%) or 3% for investments in bonds, while businesses face double figure interest rates from commercial banks. Other countries use privatization funds for capital investments in education, health, environment, science, technology etc. Therefore these funds should be unfrozen as soon as possible since reviewing all claims by the Special Chamber will take long. The most frequent justification for keeping these funds frozen is that the international community raises the need for financial safety and stability. While really maintaining financial stability, one should consider socio-economic development of the country, while learning from experiences of other countries; one alternative is to reserve 15% of funds for creditors (and supplemented by the Government if needed), while the rest to be used for economic development. Despite privatization of about half SOEs, social – economic effects of the country are unnoticeable: economic growth relies on unsustainable public investments, unemployment and poverty are high, coverage of export with import only about 10%, and contribution of production sector to BDP is very low. Moreover the process is challenged in political, economic and social aspect by various parties and faces absence of wide consensus.

A brief description of some of the SOEs that have strategic importance and which have not been privatized yet is given below.

2.3. Trepça mines

Trepça is a conglomerate in Mitrovica region with assets and branches spread in different regions of the Republic of Kosovo and former Yugoslavia. In the past, it has been one of the largest enterprises of former Yugoslavia and at some point it had more than 20,000 employees. Trepça conglomerate has three key elements: mines, industrial park in Mitrovica, and metal fusion premises in which the conglomerate is established. Also, there are many accompanying activities for which processes lead, sinc, cadmium or silver is used. Overall, it includes 42 sites, including a number of those that are located outside the Republic of Kosovo.

During 1990s, Trepça went through a number of suspicious transformations. In 1990, Serbia's Government imposed violent measures on 14 out of 19 companies that belonged to Trepça at the time. Violent measures resulted with firing and replacement of Albanian managers with Serb ones. This incited broad-based protests and strikes of employees,

which resulted with the loss of workplaces for many Albanian employees, especially in the period between 1990-1992.

In 1999, after NATO forces entered Kosovo, Trepça continued its business in the northern part, while in southern part Albanian employees could not return to their workplaces until December 1999 when an agreement was signed between UNMIK and Trepça Trade Union which allowed 214 employees to enter Stantërg to prepare the mine for production. In August, KFOR and UNMIK were forced to close down metallurgic capacities in Zveçan due to environment pollution.

In November 2005 UNMIK issued Regulation 2005/48 (similar to Chapter 11 in USA) which in principle allowed appointment of an administrator who would complete re-organization of the company (in order to select productive assets that could be reactivated and to define assets that would have to go through liquidation). In December 2005, KTA Board authorized Special Chamber for administration of Trepça and then later in Mars 2006, Special Chamber issued "Decision for Moratorium" for re-organization of "Trepça under KTA Administration".[170]

This means that up to the moment of administrator appointment, Special Chamber agreed to a temporary moratorium to freeze actions in Kosovo courts and to prevent payment and execution of filed complaints from courts outside Kosovo against the company. Regulation on Re-organization also determined the schedule within which KTA was obliged to organize the tender for services of an administrator. The final authority for appointment of the Administrator was placed within Special Chamber and not KTA. However, KTA was not able to present its report with recommendation to Special Chamber for the suitable bidder for administrator and the process of re-organization has been stuck since then.[171]

Law Nr. 04/-L-035 on Re-organization and Liquidation of Certain Companies and Their Assets has been adopted and entered into effect in October 2011, but it is concerning that the law still contains UNMIK language. The new law made way to privatization of Trepça, however the organization and restructuring of Trepça depends on efficiency of the Special Chamber. According to applicable laws in the Republic of Kosovo, and in compliance with article 50 of the Lawno. 04/L-035 with regard to the Decision of the Special Chamber no. SCR-05-001, dated 9 March 2006, as well as subsequent decisions of the Special Chamber no. SCR-05-001-R008, R009 and R011, dated 19 May 2011, Kosovo Privatization Agency has published the announcement on Essential Enterprises of Trepça and other Enterprises of Trepça.[172] From 8 November 2011, all actions, procedures and any type of actions dealing with determination of valuation, implementation or fulfilment of requirements or interest related to enterprises mentioned in the

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170 KPA annual report - http://www.pak-ks.org/?page=1,9.

171 KPA annual report - http://www.pak-ks.org/repository/docs/Raporti_Vjetor_i_AKP-s-alb.ver..pdf.

172 Announcement on Moratorium - http://www.pak-ks.org/repository/docs/Moratoriumi-shq.pdf.

announcement[173], or their Assets, were suspended and can continue only with permission from Special Chamber on Issues related to KPA. From 8 November 2011, Kosovo Privatization Agency serves as an Administrator of the Enterprises mentioned in the Announcement during the entire re-organization process.[174]

In compliance with Article 17 of the Law, KPA within 360 days will publish another announcement ("Announcement on Requests' Deadlines"), which will provide details for the way to submit Evidence of Request and Evidence of Interest and setting timelines for their submission.[175] This should sever to collection of necessary information about creditors, debt level, time of entering the debt, etc. that would help in reviewing all claims. So far we know that there are creditors from Greece and France.

Prolongation of moratoriums negatively affects the value of assets and increases the cost of maintenance and insurance of Trepça assets. Also, delay in re-organization of this mining conglomerate is an obstacle to attraction of investments to replace the out-dated technology and re-activation of production capacities which would enable opening of new jobs and revitalization of mining industry. Proceeding with privatization of Trepça requires studying reserves, for which working groups have been established in cooperation with GIZ (Germany has the experience in rehabilitation of mines of former East Germany).

2.4. Brezovica Ski Centre

Brezovica Ski Centre SOE is the only winter touristic centre in Kosovo and has incredible natural conditions for skiing. It offers attractive views over Sharri Mountains as well as excellent climate conditions that enable skiing from November to May. It is located in an altitude of 900m to 2.500m above sea level. Only skiing area is calculated to be around 230 ha. As an attractive touristic winter and summer destination, amongst else, it consists of two hotels, five cable cars, ski tracks of average length of 3.000m and 300 different villas.

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173 List of enterprises in the Announcement: Trepça Essential Enterprises that consist of: (a) NSh Minierat dhe Flotacionet Stantrg Fi 690/89, (b) NSh Minierat dhe Flotacionet Kishnicë dhe Novo Berdo Pristhinë, (c) NSh Minierat dhe Flotacionet Trepça Kopaonik, Leposaviç Fi 804/89, (d) NSh Metalurgjia Plumbit Zveçan Fi 684/89, (e) NSh Metalurgjia Zinkut, Mitrovicë Fi 983/90, (f) NSh Industria Kimike, Mitrovicë (g) NSh Industria Akumulatorëve Trepça, Mitrovicë Fi 697/89, (h) NSh Fabrika e Pajisjeve Përpunuese, Mitrovicë Fi 683/89, (i) NSh Trepça Energjitika, Zveçan - (j) NSh Intituti Trepça, Zveçan (k) NSh Trepça Trans, Zveçan (l) NSh Qendra Llogaritare, Mitrovicë, (m) NSh Trepça Komerc, Mitrovicë Fi 669/89, (n) NSh Standard Trepça, Mitrovicë Fi 666/89, (o) NSh Laboratori Trepça, Zveçan Fi 762/89, (p) Mjekësia e Punës, (q) Banka Trepça, Institucion Financiar, Zveçan Fi 85/77 dhe Fi 705/89, (r) Mbrojtja Pronës, Zveçan – së bashku me entitetin që i referohen si "KXMK Trepça" (Kombinati Xehtar, Metalurgjik, Kimik Trepça) Fi 881/89, and Trepça Other Enterprises that consist of: (s) PTP Proleter, Leposaviq.

174 KPA - Announcement on Moratorium - http://www.pak-ks.org/repository/docs/Moratoriumi-shq.pdf.

175 Ibid.

Kosovo Trust Agency had started efforts for privatization of Brezovica in 2006, but after strong reactions from the Republic of Serbia at United Nations, UNMIK asked KTA to cancel the privatization process. Former UNMIK Pillar IV head Paul Acda, stated in September 2006 that "privatization of Brezovica was postponed upon request of the Mayor of the Municipality (Shtërpca) and managers of Brezovica resort" and that "privatization of the resort would not take place until Kosovo's status is defined".[176]

In wave 40 of privatization in Kosovo, KPA had put into tender process cafeteria "Shtërpca", restaurant "Kasollja Brezovicë", and small cottage "Murzhicë-Brezovicë". With this KPA announced beginning of privatization of the resort which at that time had attracted the interest of many potential bidders, but KPA withdraw these three units from wave 40 and the same were transferred for the next wave of privatization. However, they were withdrawn again thus proving one more time that privatization of assets of Brezovica resort requires a broader consensus of central and local institutions of the Republic of Kosovo as well as the support from international institutions present in Kosovo to undertake required steps towards bringing private capital in the resort.

Meanwhile, in 2012, the EU office in Kosovo has funded a Master-plan, which will serve as a basis for development of a touristic centre in Brezovica, on the western part, close to the existing ski centre. The new centre will have the capacity to accommodate more than 10 thousand visitors. The plan aims to make Brezovica an attractive place for investors, at the same time paying attention to the unique natural environment.[177]

3. Corporate governance, corporatization, restructuring, concession and privatization of publicly-owned enterprises

3.1. Legal and institutional framework

Publicly-owned enterprises (POEs) are of strategic importance for the country. They offer vital services for the citizens and they employ around 14,000 employees, from whom 88% are male and only 12% female[178].

Since 1999 POEs have been under supervision of UNMIK, while upon establishment of Kosovo Trust Agency, in June 2002, POEs were put under KTA supervision. KTO has incorporated all POEs (a total of 25) that were in its portfolio and KTA established a new structure of corporate governance, by establishing Boards of Directors as highest decision-making bodies in all POEs. Upon completion of KTA mission, the majority of members appointed by KTA resigned and due to delays in new appointments by Government, the POE Boards remain *de facto* non-operational. As a result, at the moment when the Government took over POEs' management, in July 2008, POEs (with exception of KEK) didn't have boards.

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176 http://www.eciks.org/english/lajme.php?action=total_news&main_id=460.

177 http://www.eciks.org/english/lajme.php?action=total_news&main_id=1217.

178 Raporti i NP-ve 2010, pp. 19-20

In 2008 the Assembly of Kosovo adopted the Law on Public Enterprises and clarified the ownership of POEs; central POEs are owned by the Republic of Kosovo (i.e. public), while local POEs are owned by municipalities. The government has exclusive competence for the exercise of shareholder rights in the central POEs. About local POEs, municipalities monitor and appoint members of the Board of Directors. Percentage of shares in these POEs depends on the number of customers of the respective municipalities, as defined in the Government Instruction.

Law on POEs was amended in mid-2012 and has improved the level of communication between the central and local level. Now POEs cannot approve business plans in violation with strategic plans of municipalities and relevant ministries. Now municipalities can create local POEs, according to a regulation adopted by the Government in January 2013, after finding that municipalities have met the provided criteria. POE Law amendment has provided for the participation of municipalities in the Board of Regional Water Companies (RWC), and the participation of the majority population. The nomination of municipal representatives is regulated by the Regulation adopted by the Government.

POE Law stipulates that a shareholder cannot manage a POE, but has the right to exercise continuous and rigorous oversight of the activities of the Board of Directors and Audit Committees of POEs. But supervision will not be exercised in a manner that interferes with the activity or the independence of the Board of Directors or the Audit Committee.

The legal basis for full or partial privatization of a POE in the Republic of Kosovo is found in the Law on Publicly-Owned Enterprises. Selling of shares is enabled by the Law on POEs, article 4 in particular, according to which all POEs need to organize themselves as shareholding companies (SCs). According to the Law on Trade Companies, article 126 respectively, a SC is "a legal entity that is owned by its shareholders, but which is legally separate from its shareholders". The Law on Trade Companies does not limit the transfer of shares from the Government of the Republic of Kosovo to another entity. Specifically, article 9 of the Law regulates privatization of central POEs. These Laws, in addition to defining the ownership, also define functioning of POEs, funding models, appointment of Board members, recruitment of director and managerial staff and definition of salary levels, etc.

Transformation of POEs into private ownership can occur in two ways: i) through the regular privatization process (selling of POE shares to a private entity through a public tendering process), and ii) through public-private partnership and/or granting through concession to construct, use and/or utilize public property infrastructure, and to offer public services.

According to article 9.1 of the Law on POEs, procedures for privatization of a central POE include the following: 1) The Government approves a decision in writing which authorizes a Government Privatization Commission (GPC) to continue thereafter with tendering process and selling of POE shares; 2) The decision of the Government must

be approved by the Assembly of the Republic of Kosovo, and 3) GPC continues with the tendering process and selling of shares, respectively with full or partial privatization of the POE.

Based on this Law, tendering process and selling of shares of a central POE must take place through an open, transparent and competitive procedure, but the format of this procedure is determined by GPC. The Law stipulates that this procedure must be at least in compliance with procedural requirements of the Law on Procedures for Granting Concessions.

KPA is eliminated from the privatization procedures of POEs, irrespective of its experience in privatizing big enterprises. POE privatization is an exclusive competence of the Government.

Public-private partnership is another way to have a POE privatized for a certain period of time by granting it through concession. Procedures and other issues for public-private partnership are stipulated in the Law on Public-Private Partnership.

The goal of the Law on PPP is to set define legal framework for granting public-private partnership and concession to construct, use and/or utilize public property infrastructure and to other public services. In particular, the Law on PPP "regulates the rights to use and/or utilize public property infrastructure and/or to offer public services for all economic and social sectors".

As envisioned by article 2, the Law on PPP is implemented for a broad range of fields, including, but not limited to, transport, energy, heating, water, telecommunication, education, health and many other fields. Subsequently, agreements may be made between the Republic of Kosovo and a private entity to enter a partnership in relation to taking ownership and management of a certain public-private partnership, or in a simpler way granting through concession the entity to a private person, and each for a period up to 45 years. The process of implementation of a PPP or granting a POE through concession to a private party is strictly determined to be under the authority of the Government.

The main issues dealing with the POE, in order to prepare the debate at the Government, are reviewed by an Inter-ministerial Commission on POEs (that is composed of respective ministers of MF, MESP, MED, MI and MTI)[179] and acts as the authorized shareholder in annual General Assemblies and other meetings of shareholders. While the Unit for Policies and Monitoring of Publicly-Owned Enterprises (UPMPOE) supports the Minister and the Government in discharging legal responsibilities related to POEs; supervise and monitor POEs, collect data, do analyses and provide recommendations in relation to POE issues that are under the competence of the Ministry and Government, provides support for budget department on budgetary issues of POEs, etc. UPMPOE operates under the MED, it is run by its director, and it has one assistant and 5 economic analysts

[179] Ibid, p. 1.

trained in a high professional level.[180] UPMPOE publishes the annual POE monitoring report; annual report of 2011 is in adoption process and shall be published soon. Delays in publication result from delays in audit reporting on POEs which should be incorporated in the UPMPOE report.

POE activities are monitored and influenced in another way by independent agencies such as Public Procurement Regulatory Commission (PPRC) and Procurement Review Body (PRB) in the area of public procurement; Office of the Auditor General of Kosovo (OAG) which conducts auditing of the legality of the Kosovo's consolidated budget, its budgetary organizations and other institutions that receive more than 50% of its budget from the Kosovo Budget; Kosovo Commission on Competition (KCC) as a quasi-legal body that monitors competition rules of all institutions in Kosovo.

3.2. Status and challenges

Kosovo has a quite large public sector which has a significant influence on Kosovo's economy with an average of more than 20% during past five years.

Table 9: Participation of public sector in economy

Description	2007	2008	2009	2010	2011
% of GDP					
Total revenues	29.0%	24.2%	29.3%	27.8%	28.4%
Tax revenues	21.2%	20.6%	20.8%	21.3%	23.0%
Total expenditure	19.5%	24.5%	29.0%	30.1%	29.9%
Actual expenditure	14.9%	15.4%	18.4%	17.8%	17.8%
Capital expenditure	4.6%	9.0%	10.2%	10.9%	11.5%
Public consumption	9.6%	9.7%	10.5%	11.5%	12.2%

Source: Ministry of Finances (Answers to the questionnaire for the feasibility study for the SAA, p.142-143)

KTA was the sole shareholder of all POEs by keeping in trust 100% of POEs' shares. Even though incorporation has not changed the status of the ownership status of POEs (since UNMIK did not have a clear position on POE ownership due to non-definition of Kosovo's political status, KTA was not given the mandate to privatize POEs), the process has put them into a clear legal framework by bringing them one step closer to privatization.

The process of appointment of members to POEs Boards of directors, as the highest decision-making body of a POE, has been quite challenging and it experienced interferences from various stakeholders, such as political parties, government, municipal leadership, ICO, etc. A closer look to the process, analysed by different non-governmental and gov-

[180] MED - http://mzhe.rks-gov.net/npmnp/?page=1,2.

ernmental, has concluded that appointments of new members to Boards did not result always with professional and independent boards. The current process of appointing members to boards is being accompanied by numerous delays stemming from delays in adopting amendments to the Law on POEs and Regulation which provide for the nomination of municipal representatives to the board of RWCs that have negative influences in strategic decision making and efficient functioning of POEs. Vacancy has been already published for all boards of central POEs, and soon new boards are expected to get appointed. .

The Constitution of the Republic of Kosovo states that "the Republic of Kosovo is owner of all enterprises in the Republic of Kosovo, that are recognized as POE ... All obligations that derive from this ownership will be obligations of the Republic of Kosovo … Ownership rights of a POE that provides services only in a specific municipality or in a limited number of municipalities will belong to that/those municipalities, ... as well as respective obligations …".

POEs in Kosovo are divided into Central Publicly-Owned Enterprises (CPOEs) which Government can privatize, grant through concession or rent, and Municipal Publicly-Owned Enterprises (MPOEs) where the municipalities have ownership, as defined by Law 04/L-111 on changing and amending the law no. 03/l-087 on publicly-owned enterprises. The government and municipalities administer POEs in their ownership only through mechanisms envisioned by the given above-mentioned law, and they have no rights to interfere with the management and property of POEs.

The current POE portfolio includes 60 POEs, 18 of which are Central POEs while 42 are MPOEs.

Table 10: List of CPOEs and MPOEs

Sector	Central POEs	Municipal POEs
Telecommunication	Post of Kosovo Sh.A. Vala and Kosovo Telecommunication Sh.A. (PTK)	
Energy	Kosovo Energy Corporation Sh.A (KEK) KEDS Kosovo Operator System, Transmission and Trade Sh.A (KOSTT) NPH Ibër Lepenci Sh.A [the same company as the one on irrigation below]	City Heating Termokos Sh.A (Prishtinë) City Heating Sh.A (Gjakovë) City Heating, Mitrovicë [not operational]
Transport	International Prishtina Airport "Adem Jashari" Sh.A (ANP) [divided in two companies: i) flight and passenger services company (in concession), and ii) air traffic control company (under state ownership and management)] Kosovo Railways Sh.A [divided into two POEs: TrainKos and Infrakos]	22 bus stations Urban traffic (Prishtina)
Water and waste	Kosovo's Company for Landfill Management Sh.A (KMDK) Regional Water-Supply Company Prishtina Sh.A (Prishtinë) Regional Water-Supply Company Radoniqi Sh.A (Gjakovë) Regional Water-Supply Company Hidromorava Sh.A (Gjilan) Regional Water-Supply Company Hidroregjioni Jugor Sh.A (Prizren) Irrigation Company Drini i Bardhë Sh.A Irrigation Company Radoniqi-Dukagjini Sh.A Regional Water-Supply Company Hidrodrini Sh.A (Pejë) Regional Water-Supply Company Mitrovica Sh.A (Mitrovicë) NPH Ibër Lepenci Sh.A [the same company as the one on energy, above]	Regional Waste Company Ambienti Sh.A (Pejë) Regional Waste Company Çabrati Sh.A (Gjakovë) Regional Waste Company Ekoregjioni Sh.A (Prizren) Regional Waste Company Higjiena Sh.A (Gjilan) Regional Waste Company Pastërtia Sh.A (Ferizaj) Regional Waste Company Pastrimi Sh.A (Prishtinë) Regional Waste Company Uniteti Sh.A (Mitrovicë) Waste Company JKP Standard (Mitrovicë) Waste Company JKSP (Zveçan) Water-supply and Waste Company, Ibri (Zubin Potok) Water-supply and Waste Company, 24 Nëntori (Leposaviq) Hortikultura (Prishtinë)
Trade		NP Tregu, Mitrovicë Sport-Marketing (Prishtinë)
Accomodation		Apartment Publicly-owned Enterprise, Prishtinë Apartment Publicly-owned Enterprise (Podujeva) Apartment Publicly-owned Enterprise (Peja)

Source: UPMPOE – POE report 2010 (with amendments from recent decisions on restructuring)

In terms of corporate governance, POEs have selected and appointed Boards of Directors; property has been carried to the books of business from former KTA on behalf of the Republic of Kosovo; all POE Holding that were created at the time of UNMIK have been disbanded; Audit Committees were formed; by-law templates drafted (statute and code) which have been approved by the Boards of POEs; pledges to respect the law and the Code were signed by the Board and senior officials, and annual General Shareholder Assemblies were held.

Strategic POE documents adopted by respective boards of directors' include:

- Statute of POE;
- Code of ethics and corporate governance;
- Business plan;
- Quarterly and annual reports;
- External auditor's report;
- Internal POE regulations

Business plans are drafted every year and adopted by 30 October for next year. Boards of Directors also approve the external auditor's report.

Despite significant improvements in the POE management, there remain a number of challenges that must be addressed in the near future. POEs have started operating since 1999 with a hereditary condition that is not good due to the low level of investment and mismanagement of assets during the period 1990-98. POEs have a high level of bad debts, technical and commercial losses and face low collection rate. All these result in low level of investment in POE which consequently is unable to improve services to citizens.

Many POEs continue to a burden for the government budget due to impossibility to achieve required level of financial sustainability by them. POEs are given direct subsidies, grants for capital investments or loans to cover operational costs, funding for specific projects, etc. Based on projected policies in the Midterm Expenditure Framework (MEF), subsidies to POEs are in a downturn trend as of 2009 for 35% as a result of increased financial sustainability of these enterprises[181] (see table below) and the governmental support in coming two years is expected to further diminish. This is very important in terms of expected negotiations for a Stabilization and Association Agreement, because according to the EU standards, the state aid is allowed only when it is in the public interest and when it does not distort competition.

[181] Raporti i NP-ve 2010, pp. 9-10.

Table 11: POE and Trepça subsidies during past 5 years

Description	Expenditures 2011	Expenditures 2010	Expenditures 2009	Expenditures 2008	Expenditures 2007
Energy– KEK	27,350,000	29,035,995	64,221,073	23,000,000	11,451,000
Energy import – social cases	4,483,494	4,499,979	4,499,764	-	4,500,000
Kosovo Railways	500,000	500,000	500,000	-	45,581
Central Heating	1,947,996	1,403,289	1,933,000	999,962	2,486,904
Water and Waste	1,266,111	587,896	780,892	651,335	1,862,057
Trepça Mines	1,911,380	3,082,870	4,739,431	984,058	3,089,431
Total	37,458,981	39,110,029	76,674,161	25,635,355	23,434,973

Source: MF (Answers to the questionnaire for the feasibility study for the SAA, p. 210)

Regarding operational performance, there are noticeable improvements in various sectors. Irrespective of this, many POEs despite subsidies and investments from the Government are still not able to maximize investments or to improve the quality of services as per citizens' demands. Also, the level of collection from consumers for the provided services is very low, especially in the sector of waste where collection fee rate is around 60%, in water-supply sector around 67%, while KEK has increased its collection rate significantly during 2011, by collecting around 13% more than in 2010 where collection rate was 88 %.[182]

In order to structure the country's economy and to provide a larger space for the private sector, as a precondition for establishing a market economy in all economic sectors, the Government is concluding the privatization process of two most important POEs in the country (PTK and KEK), and has granted through long-term concession Prishtina International Airport. Involvement of private sector in public sector is based on the Law on POEs and on the Law on Public-Private Partnership[183] as well as on the Kosovo's Economic Vision Action Plan 2011-2014.

Brief descriptions of main publicly-owned enterprises are given below.

3.3. KEK

KEK is a CPOE which owns and operates assets for generation and distribution of electrical power and lignite mining. In the long-term plan lignite is the main source for energy production in Kosovo. Operational and financial performance of KEK since 1999 has been improving with regard to coal production, energy production, reduction of losses

[182] KEK - http://www.kek-energy.com/defaultdetails.asp?ID=141.

[183] Raporti i NP-ve 2010, p. 17.

and increase of collection rates. Despite these improvements and technical and budgetary assistance, KEK still suffers from many technical problems (out-dated technology), personnel issues (large number of employees) and managerial issues. Commercial losses are high, level of stealing and non-payment is high which causes increase for energy demand (disproportional to economic growth), energy import and reduction of KEK revenues.

Construction of New Kosovo will not end by 2017, and it is expected that until then Kosovo will be faced with a difficult situation in energy sector with potentially negative consequences in the development of private economic sector. Meanwhile KEK continues to be supported by the Government for increasing financial performance, capital investments and funding a part of energy import, as preconditions for stabilizing energy system. For a more sustainable energy sector, the Government as part of Energy Strategy 2009-2018 has set ten-year strategic targets in compliance with the EU directives for promoting renewable energy, use of bio-fuels and other renewable fuel for transport, environment protection, etc.[184]

Kosovo Operator System of Transmission and Trade of Energy (KOSTT) was established in 2006, in compliance with the Law on Electrical Energy and requirements of Convention on Energy Community. KOSS is a POE responsible for operation, planning, maintenance and development of distribution network and interconnections with neighbouring energy systems, in order to maintain energy supply in Kosovo. Kosovo is part of Regional Energy Community and it is connected to the regional system through interconnections with Serbia, Macedonia, Montenegro and Albania. The main source of revenues for KOSS comes in the form of fees for distribution that are paid by KEK and set by Energy Regulatory Office.[185]

In 2008 Government approved new separation of KEK and establishment of a new company for distribution and energy supply (KEDS), according to EU requirements, for the purposes of privatization.[186] With privatization of KEDs it is aimed to increase collection rates, reduction of losses in distribution, stopping of government subsidies and opening of energy market.[187] Signing of sales agreement with the winning consortium Çalik-Limak (with the financial bid of 26.3 mil.) took place on 17 October 2012 while operation is expected to start in May 2013.

Regarding New Kosovo, Energy Strategy 2009-2018, for the purpose of sustainable development of the energy sector, envisions involvement of expertise and capital from abroad. According to the Strategy "New Kosovo" Project must be constructed in phases, where the first phase (1000 MW) would enable replacement of the power-plant Kosova

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184 Strategjia e Energjisë 2009-2018, pp. 10-16.

185 Ibid, p. 12.

186 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, pp. 142-143.

187 SAPD: Sectorial meeting on Economy, 17 June 2010, Brussels, p. 7.

A (its de-commissioning), would fulfil local needs and it would enable rehabilitation of Kosova B power-plant, in order to increase its reliability and to bring it to compliance with EU environment standards. A production unit of New Kosova power-plant could used for export. The second phase (1000 MW) would fulfil the growing demand and would enable later closure of Kosova B thermal power-plant.[188]

Bidding invitation and agreements on the project have been finalized during 2011 and the plan was to announce the winner during 2012. But the Government's approach on this has changed several times and this has caused delays in the process and it has resulted with the loss of interest by renowned companies in energy sector. However, it has been decided to separate Kosova B from the New Kosova project due to the crisis in the EUR zone and non-willingness of investors to invest in Kosova B, but also in order that the new investor does not create monopoly in energy production. The plan now is to build New Kosova with capacities of 600 MW and to rehabilitate two blocs of Kosova B and to open a new lignite mine in Sibovc, all through PPP where the state ownership will be 31% in generation and 49% in mining.[189]

In March 2012 the Government announced the request for bids for four pre-qualified investors, and it planned to end the process by mid-2013[190]. While the plans are to complete all three projects by the end of 2017 in full compliance with EU directives dealing with environment protection, energy efficiency, etc.

Even though the Strategy envisions closing down of Kosova A, the Government has decided to complete rehabilitation of several blocs for supply of about 40% of overall production of energy in the country, and to continue using them until 2017. The decision was made due to delays regarding New Kosova, increase of energy demand, reduction of import, etc.[191]

Prices of electrical energy and central heating are determined by Energy Regulatory Office (ERO) based on the authority granted by the Law on Energy Regulatory 03/L-185 and based on the Regulation of the Principles for Calculating Fees in Electrical Energy Sector (Pricing Regulation). ERO determines electrical energy fees for the domestic consumers. ERO set energy fees for other consumers only if its concluded, based on ERO criteria, that the competition of energy market is not effective. Currently there is no effective competition in the energy sector, therefore ERO has determined fees for all consumer categories. Based on the Pricing Regulation, electrical energy fees include: Fees for Selling Electrical Energy to Public Supplier; Transmission Fees (Transfer); and Distribution Fees. Due to KEK financial issues, ERO decided in August 2012 to increase electrical energy fees and it is expected that in the near future there will be another in-

188 Strategjia e Energjisë 2009-2018, p. 25.

189 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, p. 447.

190 Ibid.

191 Ibid, pp. 459-460.

crease, especially for domestic consumers, which results with amnesty for non-payers and punishment for regular payers of fees. High invoices of two-three recent months incited major dissatisfaction and citizen protests. Fees for central heating are set based on the Law 03/L-116, according to which ERO sets prices and fees based on an annual proposal of the distributor. ERO Board of Directors is run by Chairman and it has five members. Each one of them is appointed for an alternating period of five years.

One part of KEK activities is regulated by the Independent Mines and Mineral Commission (IMMC) which regulates mining activities in Kosovo in line with the law and by-laws. Its authority is defined by the Law on Mines and Minerals. IMMC ensures regular examination and exploitation of mining resources in Kosovo: it issues, transfers, extends, suspends and revokes licences and permits; it establishes and maintains a database of geographic information on mines. IMMC provides technical assistance for the Government in its areas of expertise. IMMC has a Board of Directors of five members and a directorate run by a Director.

3.4. PTK

In December 2008 the Government established the Intergovernmental Commission to analyze privatization options for PTK. All aspects of PTK and potential market have been estimated. Upon the proposal of this Commission and the Government, in July 2010 the Assembly of Kosovo adopted in principle to privatize 75% of PTK while in March 2011 granted its final approval for privatization. Simultaneously, in 2010 the Telecommunications Regulatory Authority (TRA), upon the recommendation of the Government imposed a five-year moratorium on issuing new licenses for mobile telephony in order for the privatization process to be transparent. However, based on the European Commission assessment, this TRA Decision disregards the interests of customers and diminishes the competition in the sector[192].

Out of the five companies that had applied in the pre-qualification phase, in June 2011 Hrvatski Telekom and Telekom Austria have been selected to continue the competition. Following the withdrawal of Hrvatski Telekom, the Commission proposed to start over the process and in the meantime conduct some reforms to add the value of PTK, such as divide the Post, cost-effectiveness etc. The division of Post started in November 2011 and ended in August 2012, while retendering of PTK was initiated in March 2012. In the meantime, the Government has drafted the implementation plan for the privatization and has contracted a new transaction consultant. [193]

In June 2012, the call on pre-qualifying potential investors was announced. The pre-qualified companies are: Albright Vaptial Management LLC (USA); Avicenna Capital LLC in consortium with Twelve HORNBEAMS (United Kingdom and Poland); Columbia

[192] Progress Report, 2010, p. 29.

[193] Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, pp. 142-148.

Capital in consortium with ACP Axos Capital Gmbh (USA and Germany); M1 International Limited (United Kingdom and Virgim Islands); Turkcell (Turkey).

The Government has planned to complete the privatization process for PTK by the end of 2012, but the governmental committee decided to postpone the deadline for application until the end January 2013. In April 2013 the consorcium Axoc Capital was announced as a winner with the offer of 277 milion EUR (much less than expected), and the conclusion of the privatization is in process. This is expected to contribute not only on increasing foreign direct investments in Kosovo, it will improve bank balance during 2013 and it would enable the Government to absorb any potential financial turbulences.

From August 2012 PTK is divided into two companies that operate independently: i) Posta e Kosovës (Post of Kosovo) and shall remain under the state ownership, and ii) Telecommunications that includes services of mobile and landline telephony and Internet is in the privatization process.

The Mobile Telephony Service covers round 99% of the population and 88% of the Kosovo territory, out of which Vala covers over 67% of the Kosovo market; Internet Services (broadband) cover round 34% of the market, while Telekomi i Kosovës cover round 93% of the market for landline telephony services. On the other hand the Post offers local and international postal services. PTK closed year 2010 with 34 mil EUR of net profit, or round 11 m EUR less than the previous year. Hence the net profit for 2011 was round 46 m EUR.

PTK operates on a competitive market. On the market of mobile telephony Vala for several years has been the sole operator of services in Kosovo. In December 2007 entered the market the new operator IPKO which gained a considerable share of the PTK market. In addition to IPKO, there is another mobile telephony that operated in the market: Z-Mobile established as an MVNO in partnership between PTK and a private operator. Additionally, in some parts of Kosovo territory operate illegal operators as well as operators of neighboring countries that operate in some areas using trans-border devices. Such operators do not have customers in Kosovo, but due to the great coverage they have a considerable part of roaming users.

The telecommunication market is regulated by TRA, who is responsible for licensing and supervising service providers on telecommunication in Kosovo. It sets the standards for service providers of telecommunication, encourages market competition and ensures protection of customers. Its role is defined on the Law on Telecommunications. The Board is comprised of five members each of them enjoys a five-year term.

3.5. Prishtina International Airport

Prishtina International Airport (PIA) "Adem Jashari" is an enterprise that operates in the area of civil and military transport, enabling flights to and from Kosovo in many countries of the world. In addition to flights, PIA offers other services such as cargo -

transport of goods, duty free shops and restaurants/other shops, banks and post offices, etc. PIA as a strategic asset for the citizens of Kosovo and for the development of the country has been included in the PPP from the Government in 2010 to create a better environment, infrastructure and high quality services, in accordance with international standards. [194]

Prior to concession, The Airport was divided into two companies: i) the flight operating company and services to passengers that is under the concession for 20 years by the consortium Lion Limak and ii) the company that controls the air space, that is under the state ownership and management. The concession of the Airport is the first PPP project in Kosovo and the investor is expected to construct new terminal, new runways for airplanes, new parking area, etc. The investor is committed to secure employment for all the current employees for the next three years.

The operation of Kosovo aviation is regulated by the Kosovo Civil Aviation Authority of Kosovo (CAAK), established by Law on Civil Aviation is a regulatory agency. It is responsible to safeguard the security of civil aviation, economic regulation of airports and air navigation services in Kosovo. It issues licenses and ordinances of air navigation as provided on the law. The Supervisory Board is comprised of five members; two of them have a two year term (including the Chairman), while the rest of them (three) have a four year term. The members of the Board are appointed by the Government. It reports directly to the Assembly.

3.6. Kosovo Railways

Law 04/L063 and AU 2-2012 on the Railways provides an open and non-discriminatory access to operators that provide services in the area of railways. The Transport Model Strategy was approved in November 2009 and envisages the development of railways up to year 2030, including division of railway infrastructure in two Enterprises: Train-Kos and Infrakos (that was completed in September 2011) and capital investments on about 252 kilometers of railway network.

Railway transport provides transport of goods, passengers and container transport. The Railways in 2010 succeeded to reduce operational losses for 75% and net financial losses for 82% compared to 2009.[195] The annual or financial/audit reports in Trainkos and Infrakos are not available in their respective web pages (as their division took place in September 2011 and their financial performance appraisal compared to 2010 is not possible.

Railways sector is regulated by the Railways Regulatory Authority (RRA) that works as an independent body and reports to the Assembly of Kosovo. RRA defines the rules and criteria to have access in the railways market and licenses railway operators, issues security certificate for railways operators and issues security instructions, in accordance

[194] SAPD: Economy, Financial Issues, Statistics, 1 June 2011, p. 11.

[195] Raporti i NP-ve 2010, pp. 29-30.

with European Licenses and SEETO. The current operators in Kosovo (TrainKos and Infrakos) are in the process of being licensed and certification of security[196]. The security of Railways is monitored by the Department of Security of Railways within RRA, while railways accidents are investigated by the Commission in the sector of aviation and railways in Prime minister's Office based on the Prime minister's Office 03/68 and Law on Railways 03/L076. [197]

In 2011 the transport of goods in Kosovo Railways boosted for 24%.

3.7. Bus Stations

Bus Stations are considered as socially-owned enterprises and subsequently have been under the administration of PAK. In some cities in Kosovo such as Prizren, Ferizaj, Gjilan they have been privatized: transport, maintenance of premises out of the bus stations that belong to SOE "Kosovatrans", while all SOEs "Kosovatrans" that had organized transport, are not operational currently due to the competition of private operators that have grabbed their market share they used to have. Following the privatization, in some cases, bus stations have lost their previous designations and they were sold more as a real estate, as no guarantee to sustain the bus station services after the privatization.

Based on Law No 04/L-11 on Amending Law No 03/L-087 on Publicly-Owned Enterprises, 22 bus stations were transferred to municipal ownership. It would be of interest that the municipal leadership in cooperation with the Government work out the most suitable option to maximize profit for such important assets, aiming to provide the best possible conditions to operators that would have impact on improving the quality of services for citizens. A possible model to achieve such objectives would be a PPP.

3.8. Water and Waste Companies

Based on the law on water, management of water resources is a competence of the Republic of Kosovo implemented through ministries, municipalities and other relevant institutions and public enterprises. Regardless that the main responsibility lies with the Ministry of Environment and Spatial Planning (MESP), the amended law on POE-s provides for that half of the members of the POE Board of Directors for water is to be appointed on the proposal of municipalities and such POEs send their reports to the Mayors of the respective municipalities, hence giving municipalities the opportunity to be more involved in the management of water services.

The operations of water and waste companies are regulated by the Water and Waste Regulatory Office (WWRO) that supervises the water and solid waste services in Kosovo, licenses service providers for water and waste and sets the fees. It also sustains the

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196 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, pp. 443-444.

197 Ibid, pp. 437-438.

standards of services provided to customers. The Office operates based on the legal framework on the Law amending UNMIK Regulation 2004/49 on operations of service providers for water, sewage and waste. It is managed by a Director and Deputy Director that are appointed by the Assembly for a five year term.

WWRO has licensed all POEs that provide water services and currently there is no private operator in this area. [198]

Performance of POEs for water has improved on the last years, (about 6 mil m^3) and collection (3%), but losses were deteriorated (1%) however a lot of improvements are necessary as there is a great loss of water (round 60%; 30% only in the north of the country), low collection rate (round 65%), customers dissatisfaction, overall negative balance from the financial aspect. [199] Recent years there has been major investment by various donors. Moreover the Kosovo Association of Water Supply and Sewage (SHUKOS) is developing a strategy for the reduction of water losses. The feasibility study for the construction of wastewater treatment plants has started in Peja, Prizren and Gjakova and it is expected to build the plant in the amount of 22 million EUR in Prizren. It is expected to conduct the study in other municipalities in the near future. These plants will help improving the environmental situation in Kosovo, although no material benefits are expected for their companies.

Law on waste provided two levels of responsible authority on waste management: Ministry of Environment and Spatial Planning (MESP) with other central level institutions responsible for drafting policies, licensing and identifying the methodology on setting fees, monitoring etc. and municipalities on the waste administration and establishing the conditions for the provision of services by public and private companies. [200]

Landfill Management Company and 7 regional POEs are central POEs, while all other enterprises in waste sector are local POEs. 7 regional POEs owe KMDK 2.5 mil EUR that makes the operation of the latter very difficult. Inability to treat wastes in the landfill (because of non-payment) may lead to environmental issues. Apart from the above, this sector faces the same problems - low investments and collection rate. 47% of the overall population is covered by municipal waste collection. [201]

WWRO has licensed POEs that provide waste management services and no other private operator has been licensed, but according to the new Law on Waste this function belongs to the MESP. Waste collection operators may be contracted by POEs and this was the case in some municipalities. Sanitary landfills are central POEs; however it is

198 Ibid, pp. 143-144.

199 Raporti i NP-ve 2010, pp. 45-47.

200 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, pp. 491-492.

201 Ibid, p. 491.

expected to be transferred as a municipal competence.[202]

Like water POEs, POEs providing waste collection and management services are subsided by the Government as a result of the negative financial balance. Additionally, these POEs face low investment and revenues due to poor collection. Waste in Kosovo need to be recycled in order to meet European standards (the amount of waste in sanitary landfill is increasing every year). IFC (International Financial Corporation) has been contracted by the Government to analyze the situation and possibilities to involved private capital in this sector. [203]

3.9. Central Heating Companies

Heating Companies operate in Prishtina, Gjakova and Mitrovica as Local POEs (the latter is not operational). Altogether they generate only 3% of the heating demand in Kosovo (only Prishtina comprises round 80% of this capacity). They supply the most populated areas of the cities and pubic premises such as hospitals, schools and administrative buildings. Such systems suffer from out of date technologies, poor management, great commercial losses caused by non-payment of bills that leads to unsustainability, no state subsidies[204]. The co-generative project between Kosovo B and Termokos is on the implementation stage, and it is expected to be environment-friendly, to reduce costs for Termokos and reduce demand for electricity and heating. [205]

4. Conclusions

Despite the progress so far in improving physical and legal infrastructure in Kosovo, more needs to be done to establish a more favourable environment for investors. Some of the key challenges that need to be addressed, which are discouraging for foreign investments, are:

- Legal and regulatory environment: the legal environment in Kosovo still faces major deficiencies, with an emerging and inefficient judiciary that does not provide enough security for investors. There as some important laws still missing or need to be amended[206]. Although the independent Regulators have been established during the UNMIK era, after June 2008, there some tendencies of line ministries to interfere in the mandate of regulators by transferring particular competences from such regulators to the Government[207]. Some regulators had

202 Ibid, pp. 491-492.

203 Raporti i NP-ve 2010, pp. 82-84.

204 Strategjia e Energjisë 2009-2018, pp. 6-14.

205 Answers to the questionnaire for the feasibility study for the stabilisation and association agreement, pp. 448-451.

206 Communication from the Commission to the European Parliament and the Council on a Feasibility Study for a Stabilization and Association Agreement between the EU and Kosovo, p. 7.

207 ICO: Economic Regulators in Kosovo – An overview of the state of their independence, p. 11.

difficulties operating due to gaps caused by delays in appointing board members by the Assembly[208]. Vacancies remain open for prolonged period of time seriously hampering the functioning of respective institutions. Furthermore, there is not sufficient political support for the work of independent institutions that consequently leads to diminished legitimacy and week reaction from the executive branch[209]. Practices have proved that political interferences in appointing managers and members of the board weaken corporative governance in POEs, while lack of adequate protection of customers, has negative impact in market liberalization and economic development in general.

- Restricted access of POEs in non-majority settlements: in some Kosovo settlements, inhabited mainly by Serb population, POEs have restricted possibility to conduct their activities or do not operate at all. For example, KEK has not been able to invoice and collect for the electricity provided to Serb population in the north of the country. Due to political reasons, KEK was not able to disconnect customers on such settlements. Addressing this issue would positively affect in attracting credible investors.
- International Status of Kosovo: Kosovo still did not manage to obtain membership in some important international organizations, such as the International Union of Telecommunications (IUT). This did not allow Kosovo to have its international call code that has an impact not only to diminish interest of potential investors, it also has great commercial implications for PTK.

Despite these challenges, the overall argument in favour of privatization of POEs that operate in a normal commercial environment is that private owners have more opportunities to manage more profitably a business. This is particularly important for the case of PTK, where restrictions in the area of public procurement present an extraordinary impediment for the company to operate profitably considering that PTK operates on a competitive environment. In addition, it must be stressed that POE management is often subject of political interferences and instructions that have a negative effect on the overall image of POEs and affect the commercial efficiency.[210] Private management is for sure more immune in this regard.

Some of the most important aspects for the privatization of POEs in Kosovo are:

- Attaining a higher financial profit than the dividend paid by the POE (and surely, receiving the funds as a lump sum as "in advance"), funds that may be used to implement important strategic projects aiming to increase economic development and open new jobs.
- Providing better services for customers and reduce the likelihood for corruption that is perceived to be high for the companies under the public management.
- Cut subsidies for POEs.
- Enhance attractiveness of Kosovo as a place for foreign investments.

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208 Ibid, p. 6.

209 OSBE: The Situation in Independent Institutions in Kosovo, July, 2012, p. 4.

210 In 2010, the Government decided to cut some important capital investment in PTK on the justification that the POE was pending privatization.

Nevertheless, it is important that privatization be carried out properly and transparently in order not to disrupt operations in POEs.

Strengths	Challenges	Recommendations
Privatization/liquidation of SOEs and POEs		
Strategic assets and properties of enterprises that may directly contribute to socio – economic development of the country Legislative framework in line with EU principles Considerable experience of KPA in privatization process Process dynamised, especially after establishment of the KPA, and finalization of contracts inherited from KTA Liquidation claims of 180 SOEs to be reviewed by April 2013 SOE privatization and liquidation process to end in 2016 KPA opened satellite offices and privatized some small enterprises in the north	Lack of suitable privatization/liquidation strategies with clear measurable objectives resulted in failing to achieve desired effects in socio – economic development of the country Difficulties in extending managing control in all units, assets and properties, especially for those located in the north of the country Delays in enterprise reorganization and restructuring process and implementation of tendering process. Process followed with various barriers that resulted in diminishing value of assets, loss of markets and discouraged potential investors Privatized enterprises are not monitored to ensure that investors meet all obligations/commitments (employment, investment, use, etc.) Failure of Special Chamber in resolving claims and approving fund distribution lists is causing delays Incomes from privatization remain blocked in CBK, with very low interest rate, not used for significant investments and promotion of economic development Process does not enjoy wide social support and is perceived as political interference and corruption Insufficient human resources to speed up the liquidation process Privatization/liquidation process may not end until 2016 considering the portfolio of enterprises and lack of cadastral documents, absence of property documents and old cadastre registers.	Privatization needs to be planned and clear and measurable objectives set Institutional support of the new buyers and monitoring compliance of conditions and contractual obligations Special Chamber should speed up the procedures for disposing cases in order to allow efficiency of KPA operations At least a considerable amount of incomes from privatization should be unblocked as soon as possible and injected in the economy of the country, because reviewing process by the Special Chamber may take long. To comply with EU principles and standards for a transparent process and improve communications with stakeholders in order to ensure a wider social consensus and avoid eventual mistakes regarding enterprise property, that would enable speeding up the privatization and liquidation process. To continue financial and institutional support to KPA in order to complete the whole process in 2016 Local institutions should add up efforts in providing original documents of property Lessons learned from privatizations so far and apply for future processes

POE Corporate Management		
Legislative framework of corporate governance that clearly defines POE functioning, funding, assigning board members, recruitment of directors and managerial staff, setting basic salaries, distribution of shares by management, etc. POEs have started complying with legal obligations (establishment of auditing committees; drafting and approval of statute and code; signing commitment for complying with the law and the Code by the Board and senior officers; annual general assemblies; business plans are drafted and approved annually, etc.) POE performance is improving and financial support by the government is reducing in coming two years. Sound and functional structure has been established for all economic regulators, especially in line with EU principles. Room for introduction of private capital in various sectors (e.g. waste management and recycling, telecommunications, etc.)	Delays and eventual interference in appointing members in the Board of Directors and POE management and regulators, which not always results in having professional and independent boards, which has negative effect in strategic decision making and efficient functioning of POEs. Supervision of boards and POE management is not rigorous nor transparent in publishing regular annual reports Article 7.6 of the law provides for independence of the board and often hinders effective supervision POEs have high level of bad debts, great technical and commercial losses, and face low level of collection, which result in low investments in POE and inability to improve services to citizens. Interference in the mandate of regulators, transfer of certain competencies from regulators to the government through amendments of the laws Insufficient political support to independent institutions Insufficient financial support to regulators	To comply the respective legal provisions in the process of appointing board members and key officials in POEs to ensure professional appointments based on merit and without political interferences. More efficient monitoring of POEs requires higher number of staff within UPMPOE To comply with EU and OECD principles and standards on corporate governance. To ensure the most objective and proper assessment of the performance of SOE Boards and management to enhance their efficiency. To identify practical ways to ensure higher operational and financial performance of POEs, that would allow for greater investments and improving services. More should be done to strengthen the rule of law, perhaps even establishment of a special chamber for the POEs' cases. Halting the support of the government which is important in SAA negotiation process Improve cooperation with the Assembly of Kosovo aiming at finding a sustainable financial model that preserves the independence of regulators.

Chapter VII – Public Internal Financial Control (PIFC)

1. EU requirements in the integration process

The concept of Public Internal Financial Control was developed by the European Commission during the 1990s and is nowadays used to guide and support candidate countries attempting to develop modern public internal control systems in line with international standards and EU good practice. PIFC is a general system of financial control which aims to ensure that the management and control of the budget is in line with the legal framework and the principles of sound financial management as transparency, efficiency, effectiveness, etc. PIFC comprises all measures for control of revenues, expenditures, assets and government obligations. PIFC represents internal control in a broader sense, including, inter alia, ex ante financial control and ex post internal audit. There are many reasons for implementing PIFC. A properly functioning PIFC system should, amongst other things, ensure sound financial management, increase public confidence in national governance, facilitate management to achieve organisational objectives, provide stakeholders with clear expectations of budgetary management capacity and provide Parliament with a clear overview of the control environment and performance in the public sector. In this regard, PIFC provides a systematic management approach, and develops the responsibility and accountability of management.

PIFC is very important system to support structures within the decentralized system of implementation of EU funds.

1.1. Public Financial Management (PFM)

Improvements in public financial management systems are seen as essential for the proper implementation of EU policies and for the lasting achievement of development objectives.

Improvements in public financial management are viewed by the European Commission as both an eligibility criteria for – and objective of – budget support.

The European Commission adopts a rigorous and dynamic interpretation to its assessment work in this area – no attempt is made to establish minimum conditions; instead the emphasis is on a partner country's commitment to change and the future direction of its public financial management systems.

PFM should be understood within a social, political and economic context that includes institutions, enablers and a governance framework. That context, including other factors such as macro-economic stability and cultural norms condition its effectiveness. PFM is also closely related to the sphere of effective public management more generally, including leadership, performance management, transparency and accountability; and to cross cutting themes such as sustainability, efficiency and ethical standards.

1.2. Chapter 32 of the Acquis Communitaire

Chapter 32 covers two main policy areas: (a) public internal financial control (PIFC) and external audit (EA); and (b) the protection of the EU's financial interests and the protection of the EUR against counterfeiting.

With regard to the PIFC and External Audit area, there is no specific EU legislation to be used in the approximation of national laws. Instead, countries commit themselves to adopt international control and external audit standards and EU best practices. For this purpose, the candidate country should discuss with the Commission and adopt a PIFC Policy Paper with a short and long term action plan having realistic deadlines.

Chapter 32 relates to the adoption of internationally agreed principles, standards and methods of PIFC to be introduced in the entire public sector, including the spending of EU funds.

In particular, the acquis requires the existence of:

- effective and transparent financial management and control systems (including adequate ex-ante, ongoing and ex-post financial controls or inspections);
- functionally independent internal audit systems;
- relevant organisational structures (including central co-ordination); and
- operationally and financially independent external audit, amongst others, assessing the quality of the established PIFC systems.

1.3. EU Commission Communication on a Feasibility Study for a Stabilisation and Association Agreement - 2012

Cooperation with the EU under an SAA would, according to the Communication, focus on public internal financial control and external audit. The objective of the cooperation would be "to set up and implement internal control and internal audit in the public sector and to strengthen the role of external audit in line with international frameworks and standards'.[211]

The EU Commission's definition of and expectation on a PIFC system may be found in Annex 1.

The following is the European Commission's conclusion on how to address the PIFC sector (the report on Feasibility Study):

[211] International standards for the external audit may be found at www.issai.org and for internal audit at https://na.theiia.org.

"To meet its obligations under an SAA, Kosovo needs to improve the day-to-day practice of internal control. More needs to be done to develop a risk-based control environment, to improve the efficiency, effectiveness and economy of operations, to increase the reliability of (financial) reporting and to do better planning and budgeting arrangements. There is also a need for a greater understanding and acceptance of accountability within budget organisations to establish a culture of delegation of responsibilities and authorities. Kosovo needs to pay particular attention to the independence of the internal audit function, particularly at local level."

Further on, OAG "needs to improve its capacity to deliver performance audit" and as OAG "is part of the civil service, the implementing legislation of the civil service law is too prescriptive and limits in practise functional independence of the OAG".

It should be noticed that the Commission in the report on the feasibility study addressing the current challenges in a broad PFM perspective, including areas that in general are not covered in the more narrow PIFC definition. More concretely, the European Commission requires from the Government of Kosovo to address the following challenges:

- Capacity Building of CHU FMC and BOs
- Updating practices of internal control.
- Improve the effectiveness, efficiency and economization for public money
- Greater understanding of acceptance of responsibility and accountability
- Creating a culture of the delegation of responsibilities
- Creation and implementation of internal procedures for risk management in achieving the determined objectives
- Harmonization of primary and secondary legal acts with both the EU and international best practices
- Increasing the credibility of reports
- Better planning and expenditure of budget, etc.

2. Legal and Institutional Framework in Kosovo

This section considers the present situation in Kosova regarding the existing PIFC related legal framework and the institutions for its implementation.

For PIFC to function effectively there must be a coherent control environment in place which covers both the financial management responsibilities of managers and organisations and a skilled and value-adding internal audit function. In Kosovo, this framework is provided by legislation and an institutional apparatus for implementing the legislation. These are outlined below.

2.1. Legal Framework

In Kosovo, there is a comprehensive legislative framework that governs PIFC, encompassing: EU guidelines; other authoritative standards; policy of Kosovo Government; primary legislation; and, supportive secondary and tertiary legislation, as follows:

- EU policy foundation: Acquis Communitaire (primarily Chapter 32)
- Other authoritative standards: INTOSAI and COSO standards for control and risk management and CIPFA Financial Management Model;
- Government of Kosovo policy: PIFC Policy Paper 2005, revised in 2011
- Primary legislation: Law on Public Financial Management and Accountability (Law no. 03/L-048, amended and supplemented by Law No.04/L116) and Law on Internal Audit (Law no. 03/L-128), which was revised in 2009; this has established a solid legal basis for the functioning of the PIFC.
- Secondary and tertiary legislation: Treasury Rule 1 on Financial Management and Control, Treasury Financial Rule 2- Expenditure of Public Money and Treasury Financial Rule 03- Revenues; Treasury Procedures Manual; Administrative Instruction for the creation and functioning of the Internal Audit Units No.23/2009; Administrative Instruction for the establishment and functioning of Audit Committees No.11/2010; Administrative Instruction for Licensing internal Auditors No.22/2009; Administrative Instruction No.05/2012 on the procedures for professional licensing of internal auditors of the public sector; Updated and harmonized standards of internal audit with professional EU best practices; Internal Audit Manual updated in 2011.

In addition, other laws have a connection with PIFC, including:

- Law on Publicly Owned Enterprises (Law no. 03/L-087, amended and supplemented by Law no. 04/L-111);
- Law on Local Governance Finance (Law no. 03/L- 049);
- Annual Laws on the Approval of the Kosovo Budget;
- Law on Public Procurement (Law no. 04-L-042);
- Law on State Administration (Law no. 03/L-189);
- Law on Establishing the Office of the Auditor General (Law no. 03/L-075);
- The Anti-Corruption Law (Law no. 2004/34);
- Law on the Civil Service (Law no. 2010/03-L-149);
- Law on Salaries of Civil Servants (Law no. 03-L-147); and
- Law on Access to Public Documents (Law no. 03/L-215).

In addition various laws that establish public institutions and the governing of labour conditions are of interest.

PIFC concepts are relatively new, especially in the region and Kosovo, however, they are included in the national legislation and policies, but implementation of these concepts and standards is facing numerous challenges and remains to be improved.

2.2. Institutional Framework

The Government has established an institutional framework comprising public sector organisations working with the guidance of the Central Harmonisation Units respectively for Financial Management and Control and Internal Audit and under the oversight of the external auditor to create a chain of accountability as described below.

- ***Public sector subjects***

Accountability consists of a chain of participants each responsible for achieving certain goals and each accountable to a higher level authority for achieving those goals. The highest level of authority in this chain is held by citizens who are represented by members elected to the Assembly and to municipal governments. Thus the Assembly or municipal government becomes the constitutional representative of the citizens. The actual chains of accountability for these two levels of government are somewhat different, reflecting their constitutional arrangements.

In the case of the national government, the Government emerges from the Assembly and operates as its trustee. Government then assigns responsibility to its Ministers to carry out Government policy who in turn, and within the discretion allowed by the legislature, further assign power and responsibility through regulation, policy and administrative arrangements to the senior management of budget organisations. The Government has adopted PIFC Policy requiring public sector subjects to implement PIFC and for establishing the legislative framework and institutional capacity to implement that policy.

Ministers are responsible for the actions of their Ministries and accountable to the Assembly for those actions. This principle is essential to ensure elected representatives are accountable for every government decision. At the same time the daily businesses are delegated to the highest civil servant, the General Secretary.

Subordinate to the Ministers are civil servants and others who carry out public undertakings.

This accountability chain is illustrated in Annex 2 (figure 1), which also shows the different roles played by the Auditor General, who provides oversight on behalf of the Assembly, and the internal audit units which support senior managers.

The internal audit function has been delegated (in line with PIFC principles) so that each public sector subject is responsible for establishing an Internal Audit capability, generally by setting up an Internal Audit Unit that reports to senior management. The possibilities exist to share internal audit services as well as Audit Committees in small budget organisations.

For municipal government, the Mayor is elected by the people and is therefore directly

accountable to the people. This is demonstrated in Annex 2 (figure 2).

Unlike a central budget organisation, where the political role of the Minister is separate from the CAO's responsibility for administration and operations, the Mayor leads both the municipal government and its administration/operation and is accountable to the people, for the actions of both.

Each senior manager in a public sector subject bears total responsibility for implementing PIFC and is accountable for their performance in using public resources to achieve organisational objectives. The senior management of each public sector subject must also establish a functionally independent internal audit unit which will provide an objective assessment of the adequacy of the design and of the FMC systems.

It is evident that the citizens of Kosovo are key stakeholders as they will be the ultimate beneficiaries of improvements in PIFC. Modern PIFC theory suggests that "a new public management approach is needed to create a focus on the public service customer and on performance, issues to which the internal auditor should be alert".

- ***Support in the introduction of PIFC***

As required under PIFC, the Government has established two Central Harmonisation Units to promote the development and propagation of effective financial management and control and internal audit in the public sector.

- ***CHU-FMC***

The Central Harmonization Unit for Financial Management and Control (CHU-FMC) was established in 2007, initially as an advisory body and in 2009 as a subordinate unit within the Treasury Department of the Ministry of Finance. The CHU-FMC reports to the Minister through the General Director of Treasury Department. In 2012 the CHU-FMC has prepared for the first time annual report on FMC (for 2011) based on self-assessment carried out by Budget Organizations (BO), which was discussed by the Government. The report for 2012 has not yet been made public.

The responsibilities of the CHU-FMC encompasses developing detailed Financial Management and Control policies, and rules and procedures for operating the government's financial management and accounting systems, and it coordinates the implementation and further development of the principles of FMC in all BO, monitors the implementation of FMC through self-assessment checklists of FMC good practice for managers of budgetary organizations, etc. Further, CHU-FMC is responsible for training (training programs for Chief Administrative Officers – accountable officers, and managers - budget holders), and providing technical support to all parties concerning the implementation of the FMC rules. In this capacity, should act as the focal point for implementing FMC, and in order to achieve this, the CHU-FMC should be supplemented with a very

senior task force to provide the policy-level support and promotion that FMC needs. It should have more active role in securing ownership of the FMC reform as well as its consistent implementation throughout the public sector. Better coordination of different donor projects in the FMC field is also needed.

- ***CHU-IA***

Since 2000 the Internal Audit (IA) has started functioning under the Central Fiscal Authority. With the approval of the Law on Internal Audit by the Parliament in April 2008 CHU-IA was established as a separate department within the Ministry of Finance and for its scope of activity shall report directly to the Minister on a quarterly basis. CHU-IA annually collects audit plans and reports from all BOs and produces an annual consolidated report to the Minister of Finance, including issues related to developments in the sector and statistics on the number of audits and recommendations released and implemented in BO, etc. This report is then forwarded by the Minister to the Government, Parliament and OAG.

The role of the Unit is to put in place an effective and efficient system of IA across the entire public sector that shall support the chain of accountability and transparency related to the public money. CHU-IA is responsible for the development of legislation, policies and methodologies for the operation of IA according to standards and international best practices; supervision and monitoring in order to increase the quality of IA; development and implementation of mandatory training and professional certification program, etc. This is separate from the Internal Audit Unit in the Ministry that is responsible for auditing the FMC systems of the Ministry itself.

- ***Parliamentary Oversight and External Audit***

The Auditor General is a Constitutional institution. In general the Constitution gives the Auditor General a clear and independent mandate. The Office of the Auditor General (OAG) is mandated under the law on the OAG. The Auditor General is appointed by the International Civilian Representative. The current Auditor General will be in place till September 2014. Thereafter the Assembly will appoint a new Auditor General - an exit strategy that aims to secure ownership and sustainability.

The OAG closes the accountability chain between the Assembly and the Government by preparing an annual audit report on the Government's budget execution and operations. The OAG is empowered carry out other audits according to its mandate, the results of which it reports to both the audited bodies and the Government. In addition, the Assembly is regularly informed about the OAG's activities and audit findings. OAG reports are publicly available, giving citizen's information about the performance of the Government. The Committee for Oversight of Public Finances of the Assembly regularly discusses the audit reports prepared by the OAG.

The OAG's own development strategy has the same conceptual base as the PIFC policy to ensure consistency between Government and OAG initiatives. The Law on the Office of the Auditor General is currently under revision by a committee lead by the MF.

Despite fulfilling the expectations of a Supreme Audit Institution, the OAG is not eligible to join INTOSAI as a member due to the fact that Kosova is not recognised by the United Nations. However it participates in various INTOSAI working groups as well as in external audit forums as an observer.

- ***Relations between the actors***

Actors work together under the PIFC framework as follows:

- EC sets the principles of PIFC and recommends the legal and institutional framework for its introduction.
- Government is responsible for development of policy and legal instructions, along with institutional organisation to implement the PIFC.
- CHUs interpret legal requirements by delivery instructions to managers and internal auditors with respect to standards and professional/technical methods that need to be applied.
- Senior management is responsible for establishing internal audit and FMC capacities in every budget organisation in order to implement PIFC.
- Internal Audit in every budget organisation is responsible to assess the functioning of the FMC systems and issue recommendations for their improvement.
- Auditor General deals with the Ministry of Finance and Parliamentary Commissions to promote effective management of state budget resources.

3. Status and challenges

Kosovo faces ambitious objectives and a limited budget compared to the needs - to meet these needs and objectives the public financial management is necessary to be more efficient and effective.

In 2005 the Government of Kosova adopted the first PIFC Policy with the aim to establish sound management systems of public financial resources. This policy was then amended in 2007. A new PIFC Policy was approved in 2011. The process of creating the secondary legislation relevant to PIFC is now completed and the revised legal and institutional framework now is in place which allows further development of the sector.

It is well recognised that the existence of laws and institutions does not represent effective implementation of FMC, and in fact FMC has a long way to go before it can be considered an integral part of managing government operations in Kosovo. While laws and policies are in accordance with the general requirements of the EU, these often do not coincide with the needs and the administrative capacity of the country.

FMC is implemented through the Integrated Financial Management System developed in accordance to the accounting standards harmonized with the Public Sector Accounting Standards based on cash and the Government Financial Statistics of International Monetary Fund. This means recording all financial and budgetary transactions since the approval of the budget, revenue collection and spending of public money by: source of funding, budgetary organization, program, economic classification of expenditure, functional classification and projects. As such, this system represents an important element in terms of control by sharing tasks and providing the right and authority to execute various stages of the process.

At the end of 2010 the registration of expenditures has been delegated by the Treasury to BOs, which is considered as a step in the right direction. BOs record from their offices all purchase requests, commitments, purchase orders, goods receiving, recording expenditure, expenditure approval for payment, issuing financial reports on the status of their accounting accounts, etc. Responsible for establishing procedures for the collection and spending of money is the Chief Administrative Officer (CAO). However, estimates show that the delegation of responsibilities to BOs is not performed in accordance with the government's new approach to FMC and increases the level of risk. While this system has reached a very high level, there are opinions that the Internal Control systems in some cases are not designed on an efficient manner and in a few other cases were not effective in practice. Moreover, the OAG constantly emphasizes negative opinion on the BOs' financial statements BO due to irregularities in the procurement and accounting process.

The Government so far has developed the basic preconditions for a strong financial control in relation to the budget organisations. But application of the PIFC policy is not yet delivering intended results, which also are highlighted in the annual report of CHU-FMC. FMC is difficult to implement because there is no clear definition of the concept easier to understand. This concept is not only applicable to a certain group of professionals and requires a commitment of a wide range of management practices. However, FMC is more than a technical method: it is a particular cultural perspective on the strategic management of organisations and the responsibilities of individual managers within them. It is concerned with establishing managerial accountability (for the use of public resources in achieving formal performance objectives) in all budget organisations.

The process of implementing FMC is a fundamental change in the way of doing government business. . It needs to be addressed through a comprehensive, sustained change management programme championed by the highest levels in government, their advisors and the international community. Implementing FMC requires fundamental changes to the behaviour of civil service managers, their understandings of their roles and the purposes of the institutions they work in, and the underlying bureaucratic culture that pervades the way GoK is administered, this change will not happen easily or quickly and require a sustained period of intervention. This means that a new focus is required on: BO's internal rules for planning, delegation, risk management, transparency, accountability, personal responsibility and empowered decision-making for the effective

and efficient of specified objectives

To individuals who grew up in a "modern" results-oriented management environment FMC concepts are so commonplace as to need no expansive explanation. To people from task-oriented bureaucratic structures, FMC represents a major departure, not just of methods, but also in the way of thinking about management.

Senior managers throughout the BOs are not adjusted yet to the PIFC requirements in relation to the managerial accountability for value for money, results and impact. The current Financial Management approach is more oriented on control and regularity (compliance with budget allocations, cash flow plans, administrative regulations, etc.) and far less focused on efficient and effective cash management and performance measurement related to objectives and results objectives and results. BOs are required to report on their performance in relation to objectives and specified indicators, but top management reporting is not carried out in accordance with legal requirements and as a result the progress in the implementation of projects and programs is not followed up effectively. Risk management plans of BOs are not developed properly and institutions are faced with poor budget management transferring debt and unused funds from year to year, entering into debt without prior commitments, etc., which also poses a particular challenge in terms of absorption of EU funds that are expected to be increase with advancing the process of European Integration. Entering into obligations without prior commitments is the responsibility of the Public Procurement Regulatory Committee, which must require a proof of the commitment of funds by the BOs when they do procurement announcements. Treasury Rules clarify that no payment can be made without the commitment of funds, and the system does not allow such a thing. Moreover Treasury is under the process of advancing the FreeBalance system which is expected to be operational in the first half of 2013.

Therefore, much more needs to be done to build up both technical and professional capacities and securing more focused implementation of the FM/C approach. A focus must be on the results in forms of service to citizens and the market. In this regard, more remains to be done to improve transparency and accountability, operational planning, procurement, internal control, reporting of own source revenues, oversight of Public Enterprises (selecting qualified members in the Boards commercial losses, etc.), capital investment management, etc.. Serious challenge is improper registration and depreciation of assets (more pronounced in municipalities and PE), where OBs depreciate assets at zero value, but still continue to use them! Therefore is required from the Treasury to be more aggressive in enforcement of rules.

Registration of assets is regulated by the Administrative Instruction on the Management of Government Assets, where assets worth over 1,000 EUR should be registered in the PIFC system, while assets under this value should be recorded in internal BO registers, and both registers compose general statement of assets. Two committees were established to advance the process as follows:

- Committee for the registration of assets, status (assets that are in use, sold assets, donated, etc.). Registered assets shall be incorporated into the financial statements and their status can be verified through FreeBalance system.
- Asset Valuation Committee

Treasury organizes regular annual seminars through which requests from BOs to adhere and apply the specified. It is the responsibility of the CAOs to ensure their accurate application. On the other hand, the Ministry of Public Administration (MPA) two years ago has created an e-Government platform with an module of E-Asset System, but which does not work properly (especially the parts relating to the amortization of assets) and moreover is not compatible with the PIFC system. According to this it appears that BOs should record twice their assets that create opportunities for errors. While other systems like E-Asset can be used within institutions, FreeBalance is the key financial management system in Kosovo, and the assets will not appear on the financial statements if they are not registered at FreeBalance.

Together, budget organisation managers with support from the CHU-FMC should be responsible for addressing the change issues and for executing the change management activities identified in the PIFC Policy Paper.

CHU/FMC was primarily focused on developing FM/C related to the legislation and to a less extent it was involved in supporting its practical implementation throughout BOs. To this end, it has developed a new set of financial rules and organised training sessions for senior managers related to new FM/C requirements with the purpose of informing about the FMC importance upon management about decision-making process related to expenditure of public money. CHU-FMC encourages continuously Chief Administrative Officers of BOs to implement the FMC accurately. In the context of supporting FM/C practical implementation, it carried out its first FM/C pilot projects in two different BOs reviewing their established systems and practices. In addition to this it supported senior managers carrying out a self-assessment of FM/C systems in seven municipalities.

In addition to this, CHU/FMC has committed itself to undertake actions to strengthen managerial responsibility and change leadership attitudes; to further develop the FM/C methodology; and improve training arrangements for senior public managers. It has developed a detailed action plan specifying objectives, priorities, responsibilities and timeframe to achieve this.

Kosovo is much run by international partners, who develop systems that sometimes contradict each other (i.e. self-assessment tools developed by the EU for the Treasury are in contradiction with those developed by the World Bank for the municipalities). The public procurement system is decentralized where there have been established 160 contracting authorities and licensed over 5,000 procurement officers - is this necessary or the system can function better in other ways? In November 2011 was established Central Procurement Agency, which is expected to reduce the administrative burden and increase economies of scale (i.e. maintenance of official vehicles can be done with one

procurement). However, there is required from local authorities to take full responsibility and guide the development process in the public finance sector.

Internal Audit in the public sector is going in the right path and significant improvements have been made so far. Internal audit function is carried out by 67 internal audit units (IAU) at both central and local level with over 133 internal auditors. 9 public sector entities, despite meeting the legal specified criteria, did not establish independent internal audit units. There are on-going estimates to create a central internal audit unit just for these BOs and on the other hand there is taken into the consideration the possibility for the Assembly to create an audit unit for subordinate authorities. Special challenge remains creating IAUs mainly in three municipalities in northern Kosovo. Some IAUs are very small and largely ineffective with one or two auditors, therefore SIGMA recommends consideration of the establishment of larger IAUs for some BOs. Some IAUs have only one internal auditor, although they meet the criteria to increase their number according to the AI 23/2009 for the establishment and the functioning of IAUs in the public sector.

Most IAUs (over 92%) have prepared strategic plans and annual audit plans, but it has been identified that IA plans do not always determine priorities in high-risk areas. During 2011/2012 are conducted 451 internal audits by the IAUs, and the number of recommendations implemented is growing. However, these recommendations have to do more with regularity issues leaving aside more important issues such as risk management, efficiency and cost effectiveness, system functionality, etc. The failure to apply recommendations is mainly due to the lack of accountability of managers.

Number of established Audit Committees is increased (a practice that does not exist in the countries of the region), and currently they only are missing in 9 BOs. All these data are positive indicators for the implementation and development of the IA, but the functionality of the Audit Committees (the lack of qualified members, their independence, irregularity of meetings, no follow up of recommendations, etc.) and internal audit capacities are deficient, especially at the local level, and this raises the question whether Kosovo is ready for such an advanced IA system? Maybe the Audit Committees modality should be considered, especially given the low administrative capacity?

CHU-IA is showing progress in delivering its responsibilities as a central coordination unit for internal audit throughout the Governmental Budget Organisations. Its main achievements are: approval of Strategic Planning 2013-2015; annual reporting for 2012 update and publication of the manual for internal audit; updating and harmonizing the internal audit with international standards; upgrading the database of CHU-IA from Excel into Access; seminar for chairman's and the audit committees members and also with BOs' senior management, in cooperation with OAG and other relevant partners, in order to address recommendations of both internal and external auditors; promotion of the role of the internal audit to the financial officials of the public sector through the USAID projection implemented by the Society of Certified Accountants and Auditors of Kosovo (SCAAK); trainings and professional certification for internal auditors, etc.

In Kosovo exist two systems of certification of auditors in the public sector as follows:

- the external auditors certified by the SCAAK in coordination with the IFAC. INTOSAI has developed new standards and Kosovo is the first country in the world that is developing a new certification scheme according to these standards. OAG has outsourced SCAAK to develop the scheme which will begin this year.
- internal auditors are certified in cooperation with CIPFA.

Certification of auditors also can be done by institutions abroad whose certification is valid in Kosovo. There should be mechanisms in place to monitor private sector auditors, because there are cases when public institutions outsource the audit company which sometimes fail to perform the required work standards (i.e. the case when the KPA has outsourced a company to audit if investors have fulfilled the obligations stemming from privatization with special spin-off).

Out of 54 internal auditors involved in the certification program by CIPFA (UK) in collaboration with the Slovenian CEF, 32 are certified and 22 auditors are in the process of certification; whereas CIPFA courses certified 12 local trainers to continue training and certification program. But there still is necessary to specify the modality of the local partner for the provision of training and organization of examinations in accordance with the CIPFA. CHU-IA regularly provides training for new auditors at central and local level, directors and internal auditors in the public sector and for chairmen and members of audit committees.

While this is considered a great success of the IA system in country, there are opinions that Kosovo does not need so many certified internal auditors, because other bigger countries have proportionally smaller number of auditors. Despite this, CHU-IA started this year continuation of the certification programme for the second group by local trainers in cooperation with CIPFA. CHU-IA is trying to become independent from international institutions and create a sustainable system of local ownership rooted in international standards for the provision of continuing professional education for certified/licensed auditors.

In addition to capacity building of auditors, there is necessary to undertake institutional capacity building by completing IAUs with sufficient number of staff necessary to perform the function of IA (some institutions have replaced internal auditors), then the establishment of Audit Committees in 9 institutions where these bodies are missing, capacity building for performance audits which are currently minimal, the creation of a common unit of IA for independent agencies under the Kosovo Assembly which in total manage around 2.6% of the total budget of Kosovo.

In regard to external audit - The Office of Auditory General (AOG) has made a solid progress. Nowadays OAG has around 136 employees and it carries out around 100 annual audits of regularity covering most of public institutions. Since 2011 OAG has begun to reduce the number of outsourced audits, and has established interim audits in order

to prevent and ensure that audit recommendations are addressed appropriately.

An Annual Audit Report (2011) was lately discussed by the Assembly in plenum. The AG presented it for the first time. The OAG has established good relations with the Assembly's Committee for Oversight of Public Finances (COPF) which is using the OAG as an input for holding the public managers to account and developing forms of inter-institutional cooperation. However, discussion of these reports to the Assembly is focused more on problems than on the achieved results and their impact on the lives of citizens. Law on Public Financial Management and Accountability (2008) requires from BOs to prepare a report on the achievement of objectives until June, and that report is sent by the Government to the Assembly by August of each year. For four years, as the law is in force, this was applied very little!

On the other hand, cooperation between internal and external audit is not at the high level, although there are common interests in improving financial efficiency, training and certification.

OAG has updated Quality Management System for audit reports that has contributed significantly to the quality of audits and reports in terms of clarity, understanding and compliance with international standards and European best practices. Despite the progress, there remains a lot be done to achieve the desired quality level, thus the quality remains a priority of OAG without damaging the volume of audits. OAG has updated the Regularity Audit Manual based on the experiences obtained from the field work; it has put in place specific analytical reviews related to the annual financial statements and a regime for discussion of the findings with the Ministry of Finance in order to reduce the risk for errors and omissions; it has integrated cooperation with local and central level institutions, etc.

OAG strategy focuses on creating a stable platform with local ownership, with a clear mandate and complete independence in accordance with the principles of INTOSAI that would contribute to the empowerment of good governance. More specifically, OAG plans to consolidate its regularity audit and empower the performance auditing, increase the volume of high-quality audits by increasing the number of staff and level of professionalism.

OAG during auditing tries to identify the reasons behind the findings, which are usually associated with systemic problems where different partners should contribute to this. Addressing the recommendations of the auditors is growing and has a positive impact on the performance of the institutions. Findings show that there are improvements in expenditure management, but there are serious deficiencies that are identified consistently for many years. RTK represents the most obvious case without reporting back on addressing the recommendations of the auditors' report; on the other side, municipal financial management in general is improving but at a very slow pace where three municipalities did not submit appropriate data and two of them have marked regress.

OAG has started last year with a performance audit, and this year is expected to have more. The success of the use of the budget is not measured by appropriate indicators to assess what is the impact/outcome of the use of tools in order to improve the lives of citizens. For evaluating the achievement of objectives/outcomes is required to develop not only the input measurement indicators but also cost unit indicators which now do not exist.

In this regard, of particular importance is the budget planning by the BOs (capital investment projects - PIP), a system that is used during the budgeting process, but it seems that is not functioning properly. Competition/ranking of projects according to both the priorities and quality (cost-benefit analysis) is not done properly. Thus, projects are entered into the budget subjectively/arbitrary, and also there are cases when their feasibility study is planned to take place a year later. Therefore, public finance expenditure fails to reach objective/expected results. There are clear systems and procedures on this issue (Strategic Planning Office in Prime Ministry, PIP system that includes cost-benefit analysis of EU standards, etc.) but they are not used properly due to poor capacity and lack of rigors of the CAOs to ensure that only the best projects enter into the budgetary plans. This will help to avoid not only the financing of bad projects, but also reduce the level of the transfer of unused funds.

Some relatively easy steps can be done to address these problems: they should be planned in the long term (not just annual planning) and that can be provided by PIP; one should check what are the biggest expenditures in each BO and based on analysis to come up with unit costs as measurement indicator (which can be inserted as an annex to the financial statements).

Despite the progress made, external audit independence and capacity needs strengthening. To this end, a Committee for a new Law on the Auditor General is now finalising a draft that will be sent out broadly for comments.

The OAG has started a 30 months twinning project that will provide support for the current Auditor Generals exit strategy, the induction of the incoming Auditor General, mentoring and coaching regularity audit and for audit of public services carried out outside budget organisations. Besides this, a cooperation project with the Swedish NAO will go on for 3+2 years and mainly address performance audit. Another two year partnership is in the pipe-line with the World Bank addressing the audit of procurement systems.

4. Conclusions

Advantages	Challenges	Recommendations
There is a comprehensive (primary and secondary) legislative framework that regulates the field of PIFC which allows the further development of the sector. There is no specific EU legislation in the field of both PIFC and auditing that would be used in the approximation of national laws, and countries commit themselves to adopt international standards and best practices of the EU. Chapter 32 of the Acquis Communitaire sets criteria relating to financial control FMC is developed properly in general CHU/FMC is functional; it has developed a new set of financial rules and organized a training session for senior managers related to new FM/C requirements. In 2012 CHU-FMC has issued for the first time the annual report on FMC. Many of budget execution functions are delegated to users of budget in line ministries and local government Public Investment Program (PIP) is used during budgetary process. Internal Audit in the public sector is going in the right path and significant improvements have been made so far. IA framework is updated and completed including the Strategic Plan 2013-2015, IA Manual, etc. in accordance with international standards and best practices. CHU-IA has been an active in quality improvement of the internal audit units in Kosovo and in developing the necessary technical skills for internal auditors.	Kosovo faces ambitious objectives and a limited budget compared with its needs The effectiveness and consistent application of financial management still remains a challenge. While laws and policies are in accordance with the general principles of the EU, these often do not coincide with the needs and the administrative capacity of the country. Kosovo is far from application of the criteria set out in Chapter 32 of the Acquis Communitaire, and it will play a very important role in the process of preparations for the establishment of the Decentralised Implementation System of EU funds. CHU/FMC primarily have been focused on developing FM/C related legislation and in supporting its practical implementation throughout BOs. Delegating responsibilities to BOs is not performed in full accordance with the government's new approach to FMC and increases the level of risk. Implementation of FMC policies is not yielding the targeted outcomes because the current approach is more process-oriented and less focused on objectives and results; Senior managers in all BOs are not yet adapted to the PIFC requirements about managerial accountability to achieve value for money, results and impact. Risk Management in BOs is not developed and requires further support; Internal control systems in some cases are not efficiently designed and in practice were not effective. BOs fail to report on their performance in relation to set targets and indicators as required by law	There is required for public financial management to be more efficient and effective. One should work towards raising the level of transparency, responsibility and accountability Kosovo should have a vision for the development of financial control in terms of management of EU funds CHU-FMC should increase its efforts towards ongoing reforms of FMC. It should have ownership and coordinate centrally intergovernmental functions of FMC CHU-FMC should focus on dissemination of professional information and exchange of best practices; CHU-FMC should be supplemented with a high-level task force to provide policy support and promotion necessary to FMC. Implementation of FMC requires fundamental changes in the behaviour of managers in how they understand their roles and purposes of the institutions where they work, as well as bureaucratic culture There is required a new focus on: BO's internal rules for planning, delegation, risk management, transparency, accountability, personal responsibility and empowered decision-making for the effective and efficient implementation of specified objectives. Effective development and implementation of internal control systems needs further development; Capital project planning should be done according to applicable procedures and systems and with complete analysis before taking decision on funding and that would avoid spending on unnecessary projects and the transfer of unused funds due to inadequate planning.

Out of 54 internal auditors involved in the certification program, 32 are certified and 22 auditors are in the process of certification; 12 local trainers are certified. CHU-IA plans to continue the program for the certification of second group of internal auditors in 2013. CHU-IA provides continuous seminars for chairmen and members of audit committees and for the senior management in order to address auditors' recommendations. Most of BOs have established internal audit unit with more than 133 auditors in total. Most of BOs has established audit committees. Assessments are being made to create a central unit for internal audit only for BOs that have not established CHU-IA and also there is taken into consideration the possibility for the Assembly to establish an audit unit do subordinate authorities. Most of IAUs (over 92%) have prepared strategic plans and annual audit plans Number of recommendations implemented is growing and it has a positive effect on the performance of institutions. The OAG has made a solid progress and it carries out around 100 individual audits per audit season. Law on Office of the Auditor General is under review, inter alia, to ensure the organizational, operational and financial independence. OAG participate in INTOSAI forums and external audits as an observer. Since 2011 OAG has begun to reduce the number of outsourced audits Training and certification of external auditors is under local ownership	Budget planning, execution and monitoring is not yet in line with Government FMC requirements. Poor management and insufficient control over budget planning and budget execution particularly in respect of capital investments. The budget accumulation and increased commitment to spend it at the end of the year in order to avoid the under spending; it poses a specific challenge to absorption of EU funds in the future. Centralized procurement through the CPA is still limited. The Management of Budgetary organizations did often not pay due attention to need analysis, the progress of the procurement process and the quality of project execution. Asset management system is not efficient yet (more pronounced in municipalities and PE), where BOs depreciate their assets with zero value but they still continue to use them. CHU-Ia shall continue strengthening the auditors' technical capacity, as well as improving the usefulness of their work and promoting sustainability of the internal audit function Internal audit capacities need to increase significantly through certification and continuing professional education programs, especially at the local level The training and certification of internal auditors is dependent on international institutions and as such it does not ensure high sustainability. 9 BOs did not establish internal audit units. A particular challenge remains the creation of IAUs in three municipalities in north of Kosovo. Most IAUs are very small and largely ineffective with one or two auditors Audit committees are missing in 9 BOs.	Ensuring the independence of the independent institutions in the budget process and developed processes of accountability in relation to the Assembly; Based on the analysis of actual expenditures one should come up with unit cost as measurement indicator for efficiency and effectiveness of the budget. Public procurement should be improved since the preparation of the dossier up to the contracting, evaluation and audit in order to reach effectiveness, efficiency and economization of public money; responsible procurement authorities together with the Treasury should be more insistent on not allowing institutions to enter into obligations without committing the funds. Centralized procurement and framework contracts should be applied properly for common goods in public authorities, where economy of scale is obvious. Registration systems and assets register should be harmonized and the register must be complete and accurate, otherwise there can be no development in efficient management of assets/public funds. Treasury is required to be more rigorous upon application of the rules. Refocus the CHU-IA from developing regulations and procedures to becoming networking within the IA profession, providing practical guidance, sharing best practices and continuing professional education. To continue building the capacity of internal auditors, and at the same time to consider the possibility of covering internal audit with a smaller number of auditors in order to economize the budget. CHU-IA shall continue its efforts to create a sustainable system of training and certification under local ownership.

OAG has raised the quality of the data presentation in the financial statements and it has a large number of unqualified audit reports. OAG has begun with audit performance and is expected to increase gradually the number of audits Addressing the recommendations of the external auditors is increasing and it has positive impact on the performance of institutions Assembly's Committee for Oversight of Public Finances (COPF) are using the OAG reports as an input for holding the public managers to account.	Functionality of the Audit Committee is staggering due to a lack of qualified members, their independence, irregularity of meetings, failure to follow up recommendations, etc., and this raises the question whether Kosovo is ready for such an advanced IA system. IA plans do not always determine priorities in high-risk area. The audit focuses more on processes/ systems than on performance Implemented recommendations are related more with regularity issues neglecting more important issues such as risk management, efficiency and cost effectiveness, functionality of the system, etc. Failure of applying recommendations is the result of the lack of accountability of managers OAG cannot join INTOSAI because Kosovo is not a UN member. Training is not in accordance with ISSAI for certification of regularity auditors The OAG needs to improve its capacity to deliver performance audit work and improve the quality further Success of using the budget is not measured by appropriate indicators to assess what is the impact/outcome of the use of funds in order to improve the lives of citizens. Audit reports show that there are serious deficiencies that are identified continuously for several years. Three municipalities still do not present the required information and two of them marked regression Discussion of reports at the Assembly is focused more on problems than on the results achieved and their impact on the lives of citizens	There should be continued efforts to establish larger IAUs to cover some BOs. Assembly should continue its efforts to establish an IAU for agencies under the Assembly's subordination. Modality of Audit Committees should be reviewed, especially taking into consideration the weak administrative capacity Capacity development for performance audits which are currently minimal. There is required greater pressure to senior management in BOs to ensure implementation of all audit recommendations A new law on the OAG should be adopted securing organisational, functional and financial independence; A new, ISSAI compatible, Certification scheme for public sector Regularity Auditors shall be put in function. The external audit except financial side/regularity also should include performance, return of investment, the impact on employment and welfare of the citizens. Procedures for risk management shall be created and implemented in achieving objectives and develop indicators and unit costs to allow for comparisons. There is required greater pressure to senior management in BOs to ensure implementation of all audit recommendations The Assembly shall focus on supervision of achieving the objectives/ outcomes.

Annex 1: EU Commission's Expectation on PIFC

A Public Internal Financial Control system represents a structured model for guiding national governments in establishing a state-of-the-art control environment in their income and spending centres. It aims to ensure that their FMC system comply with the principles of sound financial management, transparency, efficiency, effectiveness and economy, as well as with relevant legislation and budget descriptions. It represents the wide sense of internal control. It includes but is not limited to ex an ante financial control (EAFC) and ex post internal audit (EPIA).

The goal of the modern internal control system is to make sure that public funds are being used for the intended purpose and in accordance with economy, effectiveness and efficiency. It is focused on transparency, which is a manifestation of the principle of the government being held accountable towards the public that has elected it to raise income and spend on its behalf.

PIFC does not focus on the techniques of budgeting or accounting (although internal control may well recommend improvements in these systems), nor does it include inspection tasks such as the investigation and punishment of individual cases of fraud or serious irregularities. Public internal control is preventive in nature and aims to ensure that adequate systems are in place to thwart as much as possible the occurrence of corruption and fraud. Public internal control itself is subject to external assessment by the Supreme Audit Institution.

PIFC is based around 3 pillar - managerial accountability (financial management and control systems), functionally independent internal audit (IA systems) and a central harmonisation unit (CHU) for developing methodologies and standards relating to the first two pillars.

Managerial accountability (financial management and control) – Financial Management and Control is about strengthening the organisation's performance in order to:

- take better decisions (better decision making);
- deliver better services; and
- Ensure the best value for money.

Government managers of all levels should be accountable for the activities they carry out - not only in operational policies but also in financial management and control policies. Each public manager is responsible for establishing and maintaining adequate financial management and control (FMC) systems to carry out the tasks of planning, programming, budgeting, accounting, controlling, reporting, archiving and monitoring.

It is important to note that FMC rests on a foundation of "managerial accountability". "Management accountability" is the expectation that senior managers across government are responsible for setting and meeting performance targets for their programmes,

controlling their costs, mitigating adverse risks to their operations, and ensuring that programs are managed with integrity and in compliance with applicable laws.

Accordingly all managers should be aware of their operational objectives and should report on (a) their achievement of these goals, and (b) on their use of resources in achieving their goals. These goals go beyond the purely financial, such as staying within budget or complying with financial procedures, to include ensuring that resources are consumed in the achievement of organisational objectives.

Functionally independent internal audit - Budget and spending centres should be equipped with a functionally independent internal auditor in order to support management through the provision of objective assessments of the internal control systems in place. Auditors report directly to the top manager in the hierarchical sense, but are independent of the manager's opinion on how they should audit. This is illustrated by the fact that the internal auditor is not part of the Financial Services Department, but is directly attached to the highest level of management. The auditor's role is to assess the adequacy of the internal control systems that have been put in place by management, to highlight weaknesses/provide recommendations for improvement where necessary.

Auditing is not to be confused with inspection functions. The auditor looks at the adequacy of the systems in place in terms of efficiency, economy and effectiveness, with a view to highlighting any potential weaknesses that could jeopardize the fulfilment of the organisation's objectives.

The auditor then makes recommendations to the manager on where/how to improve the systems.

Auditors should never get involved in managerial tasks (other than their own) for which they cannot bear responsibility. The auditor assesses and recommends; however, it is the manager that decides whether to follow the auditor's suggestions. Thus it is the manager that is ultimately responsible. The auditor does not sanction or punish; this is left to the manager in cases of human or systemic errors, or to the judicial authorities in case of serious irregularities and/or fraud.

The Central Harmonisation Unit as a driver for change – The primary objective of The CHU is to secure PIFC approach is harmonised throughout the Public Sector. It is responsible for developing and promoting internal control and audit methodologies on the basis of internationally accepted standards and best practice and for co-ordinating the implementation of new legislation on managerial accountability (financial management and control systems) and internal audit. The CHU is best placed in the Ministry of Finance. A CHU is such a fundamental condition to the successful introduction and development of PIFC that in reality the concept has become part of PIFC itself.

External Audit should make sure that PIFC works well - The preceding remarks refer to PIFC as the government's internal control framework. However, it is essential that

the PIFC system and the quality of its functioning be subject to an external audit or independent assessment by a Supreme Audit Institution (SAI) that is accountable to the members of the legislature.

The SAI should actively adopt and implement appropriate public sector auditing standards and ethical principles. The SAI should regularly inform/discuss its activities and audit findings with Parliament and may propose legislative changes aimed at the more effective use of budgetary resources. The SAI reports should be published, since public scrutiny and opinion can greatly help in focusing attention on necessary remedial action.

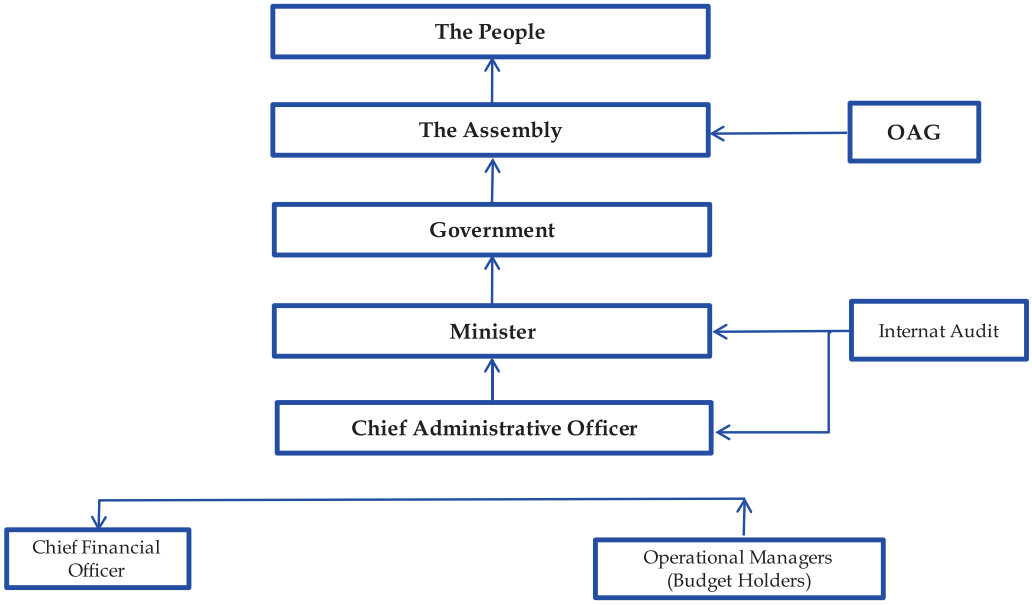
INTOSAI has adopted Guidelines on Auditing Precepts, the so-called "Lima Declaration5" which provide institutional principles for SAIs. These address, inter alia:

- The requirement for independence of the SAI and its staff. This independence should be guaranteed by the Constitution and protected by the Supreme Court;
- The requirement that SAI audit powers be embodied in the Constitution and legislation. The mandate of the SAI should cover all public financial operations;
- The relationship with the legislature – including the fact that the SAI should be empowered and required to report annually to the legislature;
- The requirement that the government remains fully and solely responsible for its acts and omissions and cannot absolve itself by referring to audit findings.

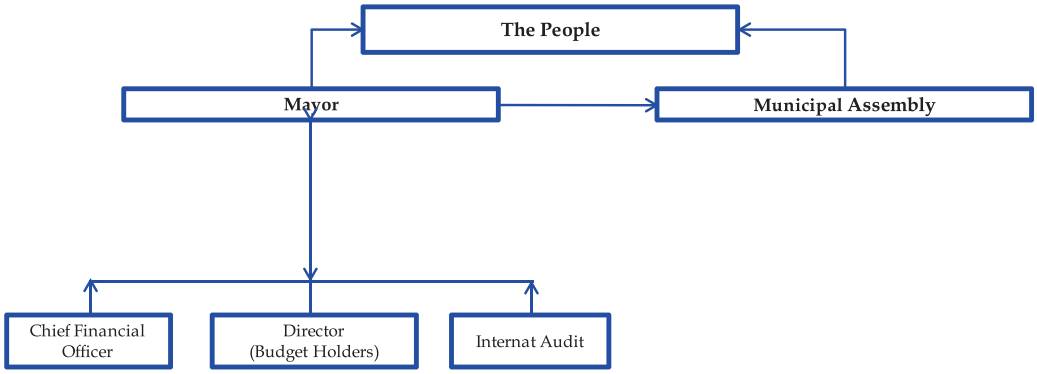
A common understanding is needed between the SAI and PIFC = The Ministry of Finance, in its role as the government's principal financial management agency, should - through the CHU - act as the interface between the SAI and the PIFC system. Close cooperation and the pursuit of a constructive dialogue between the SAI as external auditor and the Ministry of Finance as the apex of the PIFC system is essential in order to arrive at a comprehensive and effective system for managing and controlling the resources of the state budget. In order to achieve and sustain such cooperation and dialogue, it is suggested that contacts between the SAI and the Ministry are covered by a high-level advisory working group that would meet regularly to discuss problems of government financial management and internal control as they arise and devise appropriate solutions.

Annex 2: The Accountability Chain

1: FMC Accountability Chain for Central Budget Organisations



2: FMC Accountability Chain for Municipalities



Annex A

1. Decline of economic growth – growth generation is displaced from the private to the public sector. There is a decline of foreign investments as well as low levels of investments in the real sector.
2. High trade deficit and low levels of competitive offers. There is a reduced offer for export of products and services as a result of local companies' lack of ability to compete.
3. Inadequate level of economic governance and decision-making for key projects.
4. Prioritisation within MTEF and the Budget of Kosovo is unsustainable.
5. High level of unemployment and poverty rates with negative effects on the social stability and cohesion.
6. There are limited sources of financing with high interest rates that effect negatively production capacities and economic growth.
7. Still insufficient capacities of the KSA for publication of statistics on regular basis in shorter periods, especially in terms of national accounts and unemployment necessary for design and monitoring of economic and development policies.
8. Although stable, the financial sector is still not capable to supply the market with means for investments, especially having in mind that a considerable part of financial means are immobilised outside the country.
9. Inadequate level of efficiency in the privatisation process, especially by the Special Chamber, which represents a challenge for the completion of the process in envisaged time schedule.
10. Inadequate level of corporate governance with the lack of full independence of Boards, transparency and accountability as well as inefficient monitoring.
11. While the public financial management is in line with international standards, internal and external audit reports do not find adequate response in order to improve the financial management and follow the effects of investments.
12. Competitiveness not always fair followed by inadequate role and independence of regulators.
13. There is a limited mobility in terms of business and employment in the EU.
14. Lack of an integral strategic document for economic development that would interlink all existing strategic documents such as MTEF, Economic-fiscal programme, etc.
15. There is no clear economic model which would serve generation of economic development.
16. There is lack of donor coordination for e more effective implementation of MTEF.
17. Social schemes have the potential to cause financial instability in 2014 and problems in terms of social cohesion.
18. There is an apparent lack of sectorial/industrial policies which cause lack of potential for ri-industrialisation of the country.
19. Inefficient judiciary and deficiencies in contract protection, where a Special Chamber could perhaps help in overcoming this situation

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List of Participants

Adem Ahmetaj	Ministry of Economic Development
Aferdita Grapci	Municipality of Peja
Afrim Shala	Ministry of Finance
Agim Demukaj	World Bank
Agim Krasniqi	Ministry of Finance
Agron Istogu	Assembly of Kosovo
Ahtere Loxha	Assembly of Kosovo
Alban Fejza	Ministry of Finance
Albulena Bektashi	Ministry of Finance
Alejtin Berisha	University College Universum
Ali Sadriu	Assembly of Kosovo
Almir Hyseni	RDA East
Alush Sejdiu	UITUK
Ardiana Qela	Association of business women SHE-ERA
Ardit Berisha	University College Universum
Arlind Limani	Kosovo Privatisation Agency
Armend Ademaj	Assembly of Kosovo
Artan Mehmeti	Ministry of Finance
Artan Venhari	Office of the Auditor General
Avni Jashari	Kosovo Privatisation Agency
Avni Kastrati	Kosovo Agency of Statistics
Bajram Rexha	Kosovo Customs
Bashkim Bellaqa	Kosovo Agency of Statistics
Bashkim Ibishi	KAAD
Behije Tahiri	Ministry of Economic Development
Behxhet Haliti	Tax Administration
Bekim Canolli	Kosovo Agency of Statistics
Besfort Rrecaj	Ministry of European Integration
Besnik Dermaku	Kosovo Agency of Statistics
Besnik Vasolli	GIZ
Blerim Ahmeti	Ministry of Trade and Industry
Daniela Zampini	UNDP
Dardan Fusha	Central Bank of Kosovo
Dielleza Arifi	Ministry of Finance
Elis Qyqalla	
Enis Spahiu	Ministry of Finance
Ertan Munoglu	GIZ
Esin Muzbeg	Kosovo-Turkish Chamber of Trade
Fatime Qorri	Assembly of Kosovo
Fatmir Curri	KCSF
Fatmir Haxholli	GIZ

Fatmir Plakiqi	Ministry of Finance
Fatmir Sylejmani	GIZ
Fatos Azemi	Municipality of Prishtina
Fetije Begolli	Ministry of Local Government Administration
Florije Zabergja	Ministry of Finance
Granit Voskhi	Kosovo Privatisation Agency
Hafiz Leka	Ministry of Labour and Social Welfare
Haki Kurti	Kosovo Agency of Statistics
Hakile Xhaferi	Ministry of Agriculture
Hasan Neziri	RDA Centre
Ibrahim Gjylderen	Office of the Auditor General
Ibrahim Rrustemi	Kosovo Agency of Statistics
Ilir T. Berisha	Kosovo Agency of Statistics
Ilire Daija-Buza	Office of the Auditor General
Irfan Lipovica	Ministry of Trade and Industry
Isa Krasniqi	Kosovo Agency of Statistics
Ismail Muqiçi	Humanitas
Ismail Xhaku	Ministry of Finance
Jeton Gashi	Ministry of Finance
Jeton Karaqica	Ministry of European Integration
Jose Sulemane	IMF
Kimete Zekaj	Ministry of Finance
Kosum Aliu	Ministry of Finance
Lage Olofsson	Office of the Auditor General
Levent Koro	Freelance
Lindita Daija	Association of Kosovo Municipalities
Lindita Toçi	Ministry of Finance
Luan Sylaj	KAAD
Lucas Fischer	GIZ
Luljeta BerishA	GIZ
Lulzim Karaxha	Ministry of Labour and Social Welfare
Lumbardh Zagragja	GIZ
Lumir Abdixhiku	RIINVEST Institute
Lumnije Hetemi	Ministry of Finance
Medain Hashani	University AAB
Mentor Geci	Central Bank of Kosovo
Michael Wolff-Mors	GIZ
Mirjana Cvetic	Ministry of Finance
Muhamet Mustafa	Assembly of Kosovo
Muhamet Sadiku	RIINVEST Institute
Nahit Sharku	Tax Administration
Naim Huruglica	Kosovo Customs
Nehat Islami	Ministry of European Integration

Nikson Mirdita	Tax Administration
Nysret Koca	Ministry of Finance
Olivera ceni	Kosovo Chamber of Commerce
Petrit Popova	Ministry of Finance
Petrit Gashi	Prishtina University
Ramadan Islami	GIZ
Ramadan Sejdiu	Ministry of Economic Development
Ramiz Krasniqi	WWRO
Ramiz Ulaj	Kosovo Agency of Statistics
Rexhep Vasolli	Ministry of Finance
Ruzhdi Halili	Office of the Prime minister
Ruzvellt Frrokaj	Ministry of Foreign Affairs
Ryzhdi Baloku	UITUK
Safete Hadergjonaj	Assembly of Kosovo
Samir Hyseini	GIZ
Samir Lleshi	Kosovo Chamber of Commerce
Sanije Uka	Kosovo Agency of Statistics
Selim Thaci	IMF
Shar Kurtishi	Freelance
Shkelzen Kuqi	Ministry of Economic Development
Shkelzen Lluka	Kosovo Privatisation Agency
Shkëlzen Morina	Ministry of Finance
Sokol Havolli	Central Bank of Kosovo
Teuta Sahatqija	Assembly of Kosovo
Valbona Dibra	Assembly of Kosovo
Valdete Krasniqi	Kosovo Customs
Valentin Hoxha	RDA South
Valmira Rexhëbeqaj	Ministry of Finance
Vehbi Zeqiri	START
Vilson Ukaj	Assembly of Kosovo
Vjosa-Rogova Damoni	IKS
Witold Sartorius	GIZ
Xhevat Meha	Luani sh.a.
Ylber Sela	University AAB
Zef Dedaj	Ministry of Trade and Industry
Zilif Lufi	Ministry of Finance

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