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**Working Paper**

## Prospects for Economic Development in Kosova and Regional Context

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# The wiiw Balkan Observatory

Working Papers | 013 | December  
2001

*Muhamet Mustafa, Muhamet Sadiku, Isa Mustafa, Ymer Havolli and Isa Mulaj*

Prospects for Economic Development in Kosova  
and Regional Context





# The wiiw Balkan Observatory

[www.balkan-observatory.net](http://www.balkan-observatory.net)

## *About*

Shortly after the end of the Kosovo war, the last of the Yugoslav dissolution wars, the Balkan Reconstruction Observatory was set up jointly by the Hellenic Observatory, the Centre for the Study of Global Governance, both institutes at the London School of Economics (LSE), and the Vienna Institute for International Economic Studies (wiiw). A brainstorming meeting on Reconstruction and Regional Co-operation in the Balkans was held in Vouliagmeni on 8-10 July 1999, covering the issues of security, democratisation, economic reconstruction and the role of civil society. It was attended by academics and policy makers from all the countries in the region, from a number of EU countries, from the European Commission, the USA and Russia. Based on ideas and discussions generated at this meeting, a policy paper on Balkan Reconstruction and European Integration was the product of a collaborative effort by the two LSE institutes and the wiiw. The paper was presented at a follow-up meeting on Reconstruction and Integration in Southeast Europe in Vienna on 12-13 November 1999, which focused on the economic aspects of the process of reconstruction in the Balkans. It is this policy paper that became the very first Working Paper of the wiiw Balkan Observatory Working Papers series. The Working Papers are published online at [www.balkan-observatory.net](http://www.balkan-observatory.net), the internet portal of the wiiw Balkan Observatory. It is a portal for research and communication in relation to economic developments in Southeast Europe maintained by the wiiw since 1999. Since 2000 it also serves as a forum for the Global Development Network Southeast Europe (GDN-SEE) project, which is based on an initiative by The World Bank with financial support from the Austrian Ministry of Finance and the Oesterreichische Nationalbank. The purpose of the GDN-SEE project is the creation of research networks throughout Southeast Europe in order to enhance the economic research capacity in Southeast Europe, to build new research capacities by mobilising young researchers, to promote knowledge transfer into the region, to facilitate networking between researchers within the region, and to assist in securing knowledge transfer from researchers to policy makers. The wiiw Balkan Observatory Working Papers series is one way to achieve these objectives.



# The wiiw Balkan Observatory

## Global Development Network Southeast Europe

*This study has been developed in the framework of research networks initiated and monitored by wiiw under the premises of the GDN–SEE partnership.*

The Global Development Network, initiated by The World Bank, is a global network of research and policy institutes working together to address the problems of national and regional development. It promotes the generation of local knowledge in developing and transition countries and aims at building research capacities in the different regions.

The Vienna Institute for International Economic Studies is a GDN Partner Institute and acts as a hub for Southeast Europe. The GDN–wiiw partnership aims to support the enhancement of economic research capacity in Southeast Europe, to promote knowledge transfer to SEE, to facilitate networking among researchers within SEE and to assist in securing knowledge transfer from researchers to policy makers.

The GDN–SEE programme is financed by the Global Development Network, the Austrian Ministry of Finance and the Jubiläumsfonds der Oesterreichischen Nationalbank.

For additional information see [www.balkan-observatory.net](http://www.balkan-observatory.net), [www.wiiw.ac.at](http://www.wiiw.ac.at) and [www.gdnet.org](http://www.gdnet.org)

*Prospects for Economic Development in Kosova and Regional  
Context*



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**December 2001**

# *Prospects for Economic Development in Kosova and Regional Context*

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## THE VIENNA INSTITUTE FOR INTERNATIONAL ECONOMIC STUDIES

### - Long-term Development of South Eastern Europe –

### *Prospects for Economic Development in Kosova and Regional Context*

## SUMMARY AND CONCLUSIONS

- The present status of the economy of Kosova with inherited development conflicts represents many limiting factors to the prospects for development. The low level of economic development (750 USD per capita GDP) and the high rate of unemployment (50-55%) illustrate the limited opportunities to Kosovars to participate reasonably in social and economic life.
- The current economic situation is interrelated with the overcoming of the consequences of heavy war damages. By virtue of the swift return to Kosova of the population displaced during the war the income generating activities have regenerated and with the infusion of significant international assistance in the last two years of international administration Kosova, the economy has almost passed the emergency phase of reconstruction. A cycle of economic investment leading to a social transformation has started that is expected to bring about substantial changes.
- The reduced employment opportunities and large differences in salaries depending on the sector of activity are leading to generation of largest inequalities that have social implications, in the circumstances of an undeveloped social assistance system.
- The economic reforms are oriented towards building an enabling institutional environment through approval of regulatory laws that correspond to the appropriate standards for an open market economy aimed at transition in Kosova into a competitive environment for economic development. Although the international administration has carried out an intense activity for this purpose, the non-implementation of the privatization program and still a meager financial infrastructure have led to considerably low level of development opportunities for creating a more appropriate economic environment.
- Due to the lack of the corresponding mechanisms, creation of legal acts and economic policies has been so far below the required level, while the opportunities for influence of the civil society were sparse for the Kosovars for participation in this process.
- A sustainable economic development strategy requires emphasis on greater benefits to the Kosova's human capital that is characterized by the advantages of the young age, education level, entrepreneurship, energy and a very positive attitude towards reforms. A suitable combination of these advantages with the natural resources and international technical and financial assistance have a potential to make a positive impact on the economic viability of Kosova, as well as provide a foundation to consolidate its own

independent budget in a medium term period by reducing considerably the budgetary deficit and at the same time demonstrating capabilities for achieving that even in the present circumstances.

- Kosova's economic and social development will depend greatly on the rapid growth of economic activities that generate income and employment (stimulation of small family businesses, SMEs, privatization) and the development of the infrastructure that can cope with the new demands and facilitate such a development. In this regard, improving the critical infrastructure of telecommunications, roads and energy supply should receive priority in providing financial support. Inclusion of Kosova in the regional projects of the Stability Pact is an opportunity that correlates very well to the development strategy.
- Kosovar economy already demonstrates its capacity for regional cooperation since its main trade partners are countries of South Eastern Europe (SEE), including Turkey. In the new positive circumstances, Kosova could generate integrating projects for greater economic integration with the region and beyond. The stronger involvement of the international community is still needed in order to profit from these the potential for economic development and cooperation and create more space and capacities for regional economic cooperation within SEE countries.



# 1. INTRODUCTION

This research study and report on "Prospects for Economic Development in Kosova and Regional Context" is forms part of a regional project "The Long-term Development Perspectives of SEE", coordinated by the Vienna Institute for International Economic Studies and is prepared on the basis of the research activity of the Riinvest Institute during the post-war period.

The objective of this paper on the "Prospects for Economic Development in Kosova and Regional Context" is to present current economic problems that characterize post-war economic situation in Kosova and to analyze and present some of the elements that have potential to impact long-term development prospects for Kosova, particularly in the regional context of the long term development of the economies of SEE.

The research paper presents a focused study of the significantly relevant aspects of the economies of Kosova and SEES as follows:

1. Short presentation of the present situation in Kosova including the achievements in overcoming war consequences during the emergency phase of post-war period, the current economic activities and social situation;
2. Presentation of the elements of the strategy for sustainable economic development; and
3. Analysis of the regional context of development perspectives and integration processes.

Despite of several achievements in the reconstruction and reactivation of the economic process during the post-war period of two and half years, Kosova still remains the country with the lowest GDP in Europe. The post-war reconstruction of Kosova during the emergency phase was a very complex activity. It was oriented towards activation of the development resources and energies, surpassing the complexities of the economic problems inherited from the past, as well as towards permanent improvement over the possible shortcomings during this process.

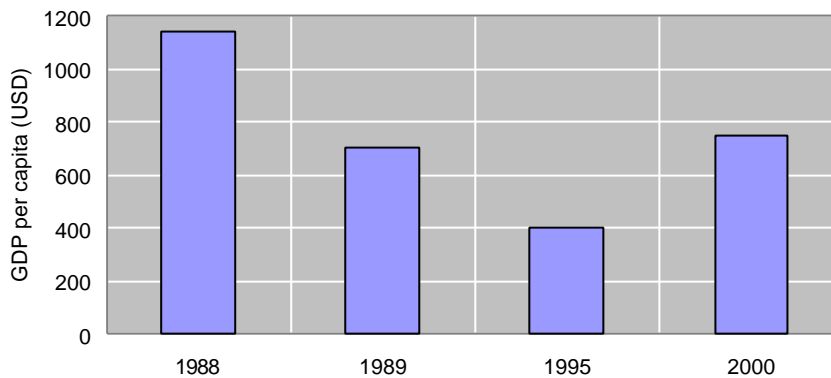
After two years of engagement of the local factor and the international administration, it can be considered that the most urgent problems have been overcome, while the problems related to a long term and sustainable economic development has still to wait for a more substantial reform of the economic, legal and administrative systems. As a consequence of the lack of a consistent strategy, initial inefficiency of the international support and the insufficient engagement of the Kosovar political process, the dynamics of progress has still not achieved a stage that could be considered satisfactory. After successful parliamentary elections, a new phase of democratic institutions building in underway that is expected to create a new institutional environment conducive for rapid economic growth. At this juncture, this research paper assumes considerable importance for shaping the policy development in Kosova in the context of the regional context of the long-term development of SEE.

## 2. PRESENT SITUATION

During the second part of the last century Kosova's economic development, went through several phases. Its most propulsive development happened during the seventies when its autonomous status within former Yugoslavia was almost meaningful. During the nineties, when Kosova's autonomy was forcibly abolished, the Kosova's economy went through a continuous decline. Finally, during the war in 1999, Kosova's economy underwent considerable destruction too. The economic renewal of Kosova started with the establishment of the international administration in Kosova.

The above-mentioned trends of Kosova's economic development can be also seen from Fig. 1, that gives the trend in Kosova's GDP per capita (in USD) during the past 13 years.

**Fig.1. Kosova's GDP per capita trend (in USD) during the several years in the past**



Following the war, Kosova's population and the international community had to deal with many problems. Some of them required urgent solutions, while the others required long-term approach. The transition process and current economic reforms in Kosova are being implemented under very difficult and unparalleled circumstances consisting of:

- Post-war reconstruction, which included not only the infrastructure and destroyed the housing fund, but also the renewal of economic activities and the creation of conditions for a sustainable economic development;
- The lack of institutional infrastructure in all important areas;
- Heavy involvement of the international community - international administration and governmental and non-governmental organizations, that has operated without sufficient partnership with the Kosovars.

### *Box 1. War consequences on private and social economies*

The war had heavy consequences for family economies, private businesses and social welfare of the population in general.

According to a survey with 3,500 families conducted after the war by the Institute for Development Research “Rinvest”, the housing fund was reduced by 40 %, the income on the family budget decreased by 70 %, the households’ equipment was damaged or destroyed about 70- 80%, while 92% of private enterprises suffered considerable damages (above 200 thousand DEM on average).

Around 43% of the surveyed families have suffered damages from 2,500 to 10,000 DEM, while around 13 % of the families have suffered damages also in family businesses, equipment, products and cash (accounting for from 12,000 to 14,000 DEM). The population has suffered also during the massive deportation: only 12% of families had remained in their permanent living places during the war, 24 % were displaced inside Kosova, while 64% were deported outside Kosova. During this exodus, around 42% of the families money or valuables were plundered, with an average value of around 2,300 DEM per family.

Socially owned enterprises suffered during the war, too. The prevalent damage to these economies was done prior the war – during the ten-year period of their forced administration and management by the repressive regime during the past decade.

## **2.1. Achievements During the Emergency Phase**

A qualitative assessment of to date achievements and of the present state in the essential sectors of engagement during the emergency reconstruction phase are shown in Table 2.1.

Sector	Situation
Sheltering of the population	Relatively good
Energy	Serious problems ^
Telecommunications	Relatively good
Public services and municipal administration	Serious problems ^
Financial infrastructure	Relatively good
Legislation	Relatively good
Market supply	Relatively good
Unemployment	Serious problems ^
Revitalization of the production sector	Critical situation
Consolidation of the central administration	Serious problems^
Privatization of socially owned enterprises	Critical situation

^ = indicates tendency for improvement

A critical state still remains in the domains of the revitalization of the production sector and the transformation and privatization of the socially owned enterprises. Power production, public services, unemployment, and the consolidation of the administration and public services are characterized also with serious problems, but with a tendency of improvement.

Kosovar opinion perceives the success of reconstruction depending on the engagement of the Kosovar subject (31%), as well as of the international factor (29%), but gives advantage to

the joint action of both these factors (33%). The belief in a perspective is also quite high – around 90 % see the situation in Kosova to become better after five years (Survey of 3500 families, Riinvest 1999).

The above-mentioned opinions represent an important factor taking into account also the commitment of the international community for democratic institutions building and creation conditions for sustainable economic development.

## **2.2. The Level of the Economic Activity and the Present Difficulties**

The level of the economic activity in Kosova has already exceeded the prior to the war level. Based mainly on the estimation of the consumption, the GDP per capita in Kosova for the year 2000 is estimated to be about 750 USD. CFA (Central Fiscal Authority) estimates that GDP has been increased by 23% during 2001.

### **2.2.1. Private Sector**

#### ***Pre-War***

The history of private enterprise in Kosova started before 1989, but significant growth in their number took place between 1990 – 1993 followed by a period of declining start-up rate. The motivation of SME development can be attributed to a large extent to push factors, the most important of which were the massive layoffs in the socially owned sector. On the eve of the military conflict in Kosova, it is estimated that 16,500 private enterprises were registered, with most of them family-run and small businesses. Taking into account the destructive effect of the institutional environment at the time, only some 50 – 55% of private SMEs were actively carrying out business activity.

The main features of these enterprises were:

- Domination of trade enterprises in the overall structure (65%);
- Lack of institutional support for SME financing and development;
- Undeveloped managerial structures, lack of modern business partnerships (predominance of family business relationships, lack of formal business education);
- High degree of political and commercial risk.

#### ***Post-War***

In the aftermath of the war, most private SMEs were consolidated and many new business entities were founded and provisionally registered. According to the Business Directory of the Statistical Office of Kosova on business registration, as of May 2001 there were 29,564 business entities registered in Kosova. This total includes:

- 14,656 small and medium size enterprises (of which 14,177 are private small and medium size firms, and the remaining 400 or so either socially owned or state owned firms);
- 14,908 sole proprietorships.<sup>1</sup>

Riinvest estimates that about 11,000 (or 78.0%) of registered private enterprises are actively carrying out business activity.

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<sup>1</sup> Riinvest's survey of 300 private sector firms, carried out at the end of 2000, included firms registered as enterprises. The survey did not include sole proprietorships.

**Table 2.2: The Number and Proportion of Registered Enterprises in Kosova by Type of Ownership**

Type of Ownership	# of Enterprises	%
1. Enterprises with a single owner	13,284	90.4
2. Partnerships	550	3.8
3. Joint Stock Companies	80	0.5
4. Cooperatives	72	0.5
5. Private Limited Liability Companies	299	2.0
6. Public Utilities	24	0.2
7. State Owned Enterprises	98	0.7
8. Socially Owned Enterprises	285	1.9
<b>Total</b>	<b>14,656</b>	<b>100.0</b>

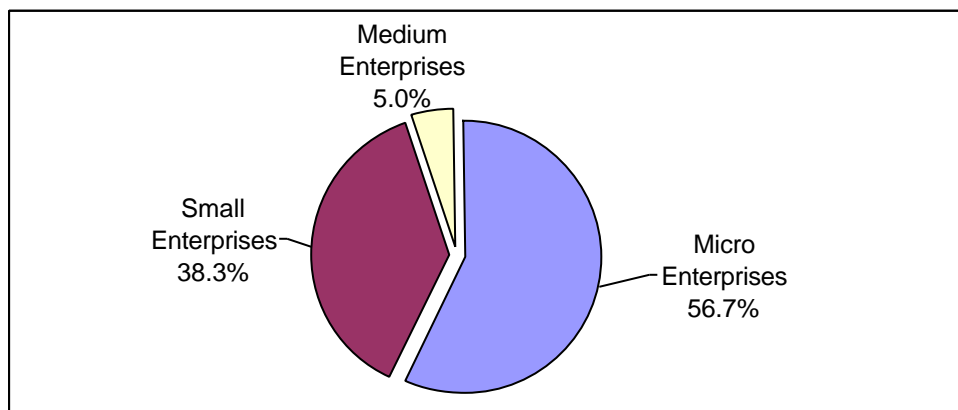
Source: Business Directory, Statistical Overview, and Statistical Office of Kosova, Prishtina, 2001.

While definitions of small and medium size enterprises can vary by country, the most common definition is based on number of employees. We have applied the employee size classes as used in the European Union for purposes of this analysis:

Micro enterprises: Less than 10 employees  
 Small enterprises: 10-49 employees  
 Medium size enterprises: 50-249 employees

The survey of 300 enterprises in 2000 showed that a majority of enterprises (56.7%) are classified as micro enterprises employing less than 10 people, while 38.3% are small enterprises employing 10 – 49 people. A further 5.0 % belong to the category of medium sized enterprises employing 50 – 249 people. Small and medium sized enterprises have the largest shares of total investment, fixed assets, and employment.

**Fig 2: The Structure of Enterprises by Number of Employees**



**Table 2.3: The Role of Enterprises in Kosova’s Economy, by Firm Size (%)**

Enterprises by size	Share of total enterprise population	Share in total enterprise investment	Share in total enterprise fixed assets	Share in total enterprise employment
Micro	57%	25%	16%	19%
Small	38%	55%	60%	55%
Medium	5%	20%	24%	26%
Total	100%	100%	100%	100%

Source: Riinvest survey data, 2000.

Despite the political and institutional barriers during the last decade, private SMEs have increased their share in all macroeconomic figures. Riinvest surveys and analysis showed that the private sector in 1997 contributed 50-55% to economic activity. The private sector share in some economic branches was very high: agriculture (96.4%), construction (75.6%), trade (67.3%) and handicrafts (73.3%), while industry was represented by only 13%.<sup>2</sup>

**Table 2.4: Sector Structure of Private Enterprises in Kosova by Economic Activity and Employment**

Sector	% of Total Enterprises	% of Total Employment
Trade	53.0	32.0
Industry	11.0	33.0
Transport	11.0	8.0
Construction	7.0	13.0
Agriculture	1.1	4.0
Services (hostelry and tourism, financial intermediation, rent)	13.0	9.0
Others	3.9	1.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>

Source: Business Directory, Statistical Office of Kosova, 2000.

Since the end of the military conflict, private SMEs have shown a significant vitality in renewing economic activity, and contributing to the economic reconstruction of Kosova and income generation. Riinvest surveys show a change in the structure of economic activity of private enterprises after the war. A fall in the proportion of trade companies is evident, while the share of production companies and some services is increasing. The number of people employed at production enterprises has increased (33.0%), construction (13%) and services (9.0%). It is estimated that during the post-war period the share of private sector to GDP has gone up to more than 65%. Some estimations in 2000, indicates that private investments were about 400 million DM, or 13% of GDP.<sup>3</sup>

These developments are extremely encouraging, all the more so in a situation without a fully developed institutional support environment and legal framework, no national strategy for SME development, insufficient organization of the business community, and a very young and undeveloped financial institution sector.

<sup>2</sup> Economic Activities and Democratic Development of Kosova, Riinvest, 1998.

<sup>3</sup> Macroeconomic Report, CFA, Prishtina, 2001.

### **(i) Average Monthly Turnover**

Turnover among the sample of enterprises surveyed by Riinvest <sup>4</sup> in late 2000 has increased almost 40% since 1997 despite a decline in turnover in 2000 by 25%. This decline between 1999 and 2000 could be explained by the simultaneous occurrence of two or more of the following:

- The excess demand for products of an emergency nature during the period June-December 1999;
- An increase in the number of enterprises, and hence greater competition;
- The reluctance of entrepreneurs to reveal their actual turnover due to the introduction of taxes in 2000.

### **(ii) Employment**

According to the survey of 300 private enterprises, the average number of employees per enterprise is 13.42, and that the private sector is experiencing an ongoing increase in employment. During the period 1997-2000, employment in the private sector increased by 41%, with an increase of 15% in 2000 alone. There appears to be an improvement in the education level, with a greater proportion of employees with high school and university education. The gender structure has also improved slightly, with the share of females employed reaching 23%. However, the number of females employed in private enterprises is still extremely limited.

### **(iii) Exports and Imports**

According to survey findings in 2000, only 15% of sampled enterprises were exporters, while 68.3% were importers. Survey findings showed that the average value of exports per enterprise was 25,000 DM, and if that sum is applicable to the overall number of active enterprises, it would result in a total export value for these enterprises of about 27 million DM, or just 7% of the total average export before 1989. The structure of exports is comprised mainly by: construction material (24.4%), food items (15.6%), and household equipment (8.9%). The same categories in different percentages dominate in imports as well: food items (28.4%), construction material (26.0%), machinery/equipment (16.7%), and household equipment (8.4%).

### **(iv) Business Environment and Barriers to Doing Business**

According to the Riinvest enterprise survey of 2000, barriers of the greatest intensity on the functioning of enterprises were:

- (i) The lack of legislation;
- (ii) Unfair competition;
- (iii) Lack of external financial sources;
- (iv) High taxes; and
- (v) Strong competition.

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<sup>4</sup> Riinvest has carried out its survey of 300 private sector enterprises three times since 1997, using largely the same sample of firms.

It should also be noted that Kosovar enterprises appear not to be taking seriously various internal issues, which can greatly influence the development of managerial capacities, the attraction of financial support, and the effective use of credit. Observing the table, we see that managerial (12) and employees' skills (14) are considered as the least intense barriers to development, which is very much in line with observations in other countries. It may mean that there is not yet a strong competitive environment in place where a good competitive position can be achieved through effective managerial skills. Or it may mean that other barriers are perceived as more urgent. Managerial skills and employee's knowledge are essential factors for an enterprise's success, and ignoring these issues may have negative consequences for firms' ability to access finance and effectively utilize the funds acquired.

**Table 2.5: Ranking of Business Barriers Among Enterprises**

Barrier	1	2	3	4	Intensity Indicator
Lack of legislation	208	57	14	15	85
Unfair competition	166	63	36	28	75
Lack of external financial sources	112	78	43	60	61
High taxes	96	53	51	93	51
Strong competition	73	69	76	74	49
Lack of information on business	76	72	45	96	48
Availability of raw materials and equipment	53	59	53	126	38
Insufficient capacity	46	54	67	120	36
Delay of payments	37	63	53	135	34
Lack of demand	21	51	72	145	27
Administrative procedures	21	51	68	149	27
Trade export barriers	37	35	28	163	26
Payment arrangements with other companies	20	45	53	167	24
Parity between exchange rate-inflation	21	25	36	202	17
Employees knowledge	11	16	53	210	14
Management skills	12	22	25	232	12

Source: Riinvest survey data, 2000 (SME Financing and Development, Riinvest, 2001)

(1 =causes very big problems, 2 = causes problems, 3=causes small problems, 4 = Does not cause any problems)

*Calculation of the indicator: respondents ranked the factor on a 0 – 3, 4 grade scale. Individual values were multiplied by the number of respondents and divided by the possible maximum value of the indicator. This yielded a percentage value of maximum 100 (all the respondents attributing maximum importance to the factor), and minimum 0 (all respondents attributing minimum importance to the factor).*

Economic policy plays a key role in creating a favorable environment for SME development, and like in all transitional countries is strongly linked to SME access to external finance. Some of the most important economic policy frameworks – taxation and privatization, for example - have not yet been fully formed. Strong sentiments have been expressed over the financial burden faced by the business community as a result of the high levels of business taxes collected at the border (a combined total of 26.5% of border tax paid on imports,



including on all raw material and capital imports), which may be restricting the development of the Kosovar production and manufacturing sectors and hence limiting their ability to enter into long term credit relationships with banks. Considerable pressure is being placed on the international administration to continue efforts to develop more sustainable policy frameworks in these areas.

### 2.2.2. Socially Owned Enterprises

The socially owned enterprises (around 350) encounter immense difficulties in absence of a genuine privatization program. Instead of generating employment and income, this sector is going under a technological degeneration process. Although 80% of the social sector enterprises were re-activated after the war, their average use of capacities accounts for only about 35%, and employ effectively only around 25% of people employed in 1989. The basic problem of these enterprises consists in their unresolved legal status and the hesitation of the international administration to privatize them, what creates great difficulties for financing the necessary investments needed for their technological regeneration. Around 200 most important industrial enterprises of this sector show a very modest investment activity. So far, their investment activity accounted for around 30 million DEM, what makes up only about 4% of their needs for investments, estimated to be around 800 million DEM (Socially Owned Enterprises and their Privatization, Riinvest, 2001).

## 2.3. Selected Aspects of Social Situation

### 2.3.1. Unemployment

As a consequence of the post-war circumstances, and of management failures during the emergency phase and later, the high unemployment rate has become an essential social and economical problem. Various sources estimate the unemployment rate to account for 50-55%. The unemployment affects mostly females and young people. Immediately after the war, in 1999, the unemployment rate was 74%. More than half of the population able to work (about 600 thousand inhabitants, or more than 25% of the overall population) is unemployed (see Table 4.4). The unemployed are practically exempted from the developments and the effects of the reform. So far, doesn't exist any organized institutional form of social or technical assistance for unemployed.

**Table 2.5. Estimation of the people employed and the unemployment rate**

<b>Business Entities</b>	<b>Number of employed</b>	<b>Structure</b>
Private enterprises	135,000	23.0
Other business entities	48,000	8.1
Socially owned enterprises	50,000	8.5
Public services	75,000	12.8
Farmers	90,000	15.3
Informal market	50,000	8.5
Employed in the Diaspora	140,000	23.8
<b>Totally employed</b>	<b>588,000</b>	<b>100.0</b>
<b>The unemployment rate (%)</b>	<b>51.0</b>	

Source: Riinvest's estimations based on its surveys

### 2.2.3. Poverty

Half of Kosova's population is at or below the poverty level, while 12 percent of the poor live in the conditions of extreme poverty. That is, 1 to 1.2 million inhabitants of Kosova live in poverty or extreme poverty. These Kosovars are poorly fed, poorly dressed, live in an environment of poor public health and services, and have little or no access to education.

*To date, two important studies on poverty assessment have been conducted in Kosova. These studies approach poverty from various angles. "Living Standard Measurement Survey" (LSMS) measures poverty based on consumption, while a CARE study has a multidimensional approach, specifically the concept of security of family assets. The first defines the extreme poverty of life "under the line of food poverty" in a family with insufficient resources for ensuring a basic food basket of 2100 calories a day for adults. In Kosova this would correspond to a daily consumption of US\$0.80 (DM 1.8539) for adults. A "full line of poverty" has been defined as a wider consumption, including non-food items, valued at US\$1.50 (3.499 DM) for adults.*

*Source: World Bank, "Kosova: Poverty Assessment." October 3, 2001.*

Among the very extreme social problems that must be addressed and resolved as soon as possible are the following:

- Former pensioners who have not received pensions since 1999.
- War veterans who are of working age, but unable to work.
- Disabled individuals who are below 65 years of age, and do not qualify for a basic pension.
- Orphaned children.
- Population living in extreme poverty.
- Families without a head-of-family, particularly the widows who have no educational or professional training, and are therefore not qualified for formal employment.
- 
- Rural population that has temporarily migrated to towns, and are without sources of livelihood, except for the assistance given by humanitarian organizations.

### ***Social Welfare***

As a consequence of war, many families were left with no family head, over 1,200 children were orphaned, and the material situation of disabled and war veterans deteriorated. Former employees of socially owned enterprises who lost their jobs and are left without a regular source of income are also strained economically.

The social welfare assistance in 2001 alone covered over 53,916 families with an aggregate of 186,308 members. The monthly benefit level of social assistance ranges between DM 60 and DM 120 per family. While in the year 1990, 1.7 percent of the population used social assistance, in the year 2001, 9.3 percent of the population already depended on social assistance. However, the social assistance network covers not all the population living in conditions of extreme poverty.

### ***Family Income***

The deterioration of the social situation in Kosova can be seen in the reduction of average family income by 50 percent and decline to about 300 DM a month on average. At present, there is no pension system in place to compensate the pensioners for such a dramatic decline in their family and personal income. It is expected that starting from March 2002 a Three pillar Pension System will be introduced (Basic flat benefit pension for the population over 65 year age covered by budget, Individual savings accounts based on mandatory contribution of 10 % on wages, and voluntary pension accounts of individuals and firms).

While on the one hand, the number of families with wage earners, families with income from businesses, the families with other sources of income in the post-war period has decreased dramatically, compared to the pre-war period, on the other hand, the number of families living on humanitarian relief has increased 10 times. The number of those living on funds received from abroad has also increased several times. Remittances received from abroad represented half of the budgets of Kosovar families in the immediate post-war period. Following the war, a number of families had to liquidate their savings and often resorted to selling their real estate to ensure a minimum level of survival. Approximately 60 percent of the family budget had to be spent on food alone.

During the reconstruction and transition phase in Kosova, a differentiation regarding related benefits and effects came up, which can be illustrated by comparing the level of average monthly salaries in different sectors. Thus, the average monthly salaries in the socially owned enterprises are around 200 DEM, in the public service and administration 300 DEM, in private enterprises around 600 DEM, while Kosovars employed in international organizations or in UNMIK or OSCE around 2,000 DEM. Even the technical professions (driver or security guard) in international institutions can earn 3 times more than a professor in the University. This situation creates frustration and the feeling of inferiority, especially among intelligentsia, what could not pass without negative impact on the transition processes.

### ***Poverty in rural and urban areas***

Rural families with very low income constitute a major portion of the population living in extreme poverty. Some of the rural families whose economic basis and life sustenance resources were destroyed during the war have found shelter in towns. These families, which represent a particular segment of the society are unprepared for urban living, lack education and have no professional qualification for urban work.

The population in urban areas- only 40 percent of overall population - includes a major part of the poor population, including those in extreme poverty. While in rural areas basic livelihood may be scratched from a small piece of land, for urban families the unemployment means the complete lack of a livelihood. About 12 percent of the rural population migrated to urban areas after the war had destroyed their economic foundation; humanitarian relief organizations provided shelter for these 'economic refugees' there. Because of this internal migration, the proportion of population categorized as "extremely poor" increased in the urban areas.

## 2.4. To Date Contribution of the International Community

A considerable part of the post-war reconstruction of Kosova, including the emergency and rehabilitation phase, has been realized with the help of the international community. After the establishment of the United Nations Mission in Kosova (UNMIK), the international community made a strong commitment to help the people of Kosova. In the beginning, this commitment was focused in implementing the emergency phase (sheltering and food, electricity and water supply, social assistance, etc.), and later on in the revitalization and rebuilding of Kosova. To this purpose, two international donor conferences were held, in which the international community pledged to contribute with about 2.3 billion USD for the period 1999-2003 in order to fulfill the emergency, revitalization and reconstruction needs of Kosova.

The successful mobilization of donors was not immediately accompanied with creation of an efficient mechanism to that would coordinate activities among donor states' governments and the European Union, as well as within the UNMIK structures itself. Thus, in the beginning the donor states used to apply separately their own strategies for the reconstruction of Kosova. This approach was surmounted with the establishment of the joint administrative structures within UNMIK. In 1999 UNMIK drafted a document concerning identification and promotion of needs for urgent development and rebuilding until the end of 2000, as well as for the period 2001-2003 (see Table 2.6).

**Table 2.6: The program of the donor community for rebuilding Kosova (in million USD)**

	Until 2000	2001-2003 period	Total
Agriculture	94	141	235
Private sector development	120	110	230
Institutions	50	50	100
Residences	306	214	520
Water and waste	79	181	260
Mine protection	21	9	30
Education	49	36	85
Healthcare	40	45	85
Telecommunication	41	54	95
Energy sector	129	281	410
Transport	69	96	165
Subtotal	998	1,217	2,215
Support for the budget	128		
<b>Total</b>	<b>1,126</b>	<b>1,217</b>	<b>2,343</b>

Source: A Program for Reconstruction and Recovery in Kosova, EU/WB, 1999

and  
the

*Box 2. Main contributors to the rebuilding of Kosova*

- ❑ Great Britain 175 million DEM (19.5 %)
- ❑ Japan 163.8 million DEM (18.5 %)
- ❑ USA 134.2 million DEM (14.9 %)
- ❑ European Union 99.2 million DEM (11.0 %)
- ❑ Switzerland 74.0 million DEM (8.2 %)
- ❑ Sweden 51.0 million DEM (5.7 %)
- ❑ Denmark 46.3 million DEM (5.1 %).

*Source: Donor Pledges, Commitments and Spending in Kosova (Total Covering Donors' Conferences)*

Until the end of 2000, the donor community has engaged about 1.1 billion DEM for capital investment support to Kosova's budget. UNMIK has confirmed that capital expenditures for the period until the end of 2003, accounting for about 1.23 billion DEM, will be fully

covered by the donor community.

The realization of the donors support was extremely important for Kosova's physical reconstruction. Thus, from 130,000 destroyed or damaged houses, more than 60,000 were rehabilitated and rebuild - 20,000 by the donors community and 40,000 by the Kosovars themselves. Large investments were made also for the rehabilitation of the energy production, which was reflected positively in improving the energy situation in Kosova. It is estimated that more than 300 km of roads and a number of bridges were repaired and recovered. During this period, considerable investments were made in agriculture, such as investments of the World Bank and other international organizations (The Emergency Rebuilding of Farms Project - about 25 million USD, The Water Supply Project, etc.).

The real needs for the period 2001-2003 are estimated to account for about 2.8 billion DEM (see Table 2.7), while for the year 2001 around 1.3 billion DEM. The major needs come from the economy sector (52%), the social sector (32%), the judicial and security sector (10%), and the public administration sector (6%).

**Table 2.7: Real needs for the period 2001 - 2003 and donors pledges for rebuilding and capital investments (in million DEM)**

	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>Total</b>
Planned capital investments	1,346.50	878.20	601.70	2,826.40
Donors pledges	585.30	119.80	64.10	769.20
Additional financial needs	761.20	758.40	537.60	2,057.20

Source: Central Fiscal Authority, Kosova's budget for 2001, Prishtina, 2000.

### 3. SUSTAINABLE ECONOMIC DEVELOPMENT STRATEGY

The sustainable economic development includes strategic priorities such as:

- Building up economic sustainability through transition from an “aid based economy toward economic independence within regional and European integrations;
- Building up of institutions of the open market economy and the rule of law;
- Growth of the possibilities for income generation and job creation through private sector development and effective privatization;
- Rehabilitation and development of the infrastructure, and involvement in the Stability Pact regional projects on infrastructure;

A successful realization of these strategic orientations, as well as of the strategy of sustainable economic development in general, requires a maximal strengthening of the Kosovar development advantages and reducing the influence of negative effects of disadvantages in the future. The main advantages for a sustainable development of Kosova, as well as respective disadvantages, are presented in Table 3.1.

**Table 3.1. Advantages and disadvantages for a sustainable development of Kosova**

Advantages	Disadvantages
<ul style="list-style-type: none"> <li>• Human capital – the young population is relatively well educated;</li> <li>• The entrepreneurial energy and spirit;</li> <li>• Positive attitudes towards economic reforms and transition;</li> <li>• Natural resources (minerals, land, etc.);</li> <li>• Commitment of the internationals for technical and financial assistance;</li> </ul>	<ul style="list-style-type: none"> <li>• Low level of present economic and social development;</li> <li>• Lack of genuine institutions for a market economy;</li> <li>• Political aspects and security in Kosova and in the region.</li> </ul>

Some of the above-mentioned advantages have already started coming strong. As an indicator for this statement can serve the Kosova consolidated budget, which was self-financed with 50% in the previous year (2000), while for the 2001 it is expected that tax revenues will more than doubled and that since 2004 Kosovar budget will demonstrate significant capacities for self-financing and sustainability. (Annex 1). GDP growth rates are expected to be very high during 2001 (23%) and 2002 (14%), during following years 9-10% and for the period 2005-2010 between 6-7%. The share of Budget to GDP increase from 14% during 2001 to around 18 % after 2005.

Existing very high imbalances between export and import will be reduced slowly. Exports are currently at a very low level - about 43 million DEM, only 10 % of the pre 1989 Kosovar export. This is one of the main challenges toward building open economy in Kosova. Current Account deficits will be reduced in both directions. Import will decrease for humanitarian aid export will continue to increase its share in GDP. Remittances will continue to be very important in managing these deficits. These problems indicate that accelerating the export could be critical for the future development.

### 3.1. From an Aid Based Economy Towards Economic Sustainability

The road ahead toward economic sustainability would face many challenges especially necessity for elimination of current disparities in public consumption and budget constraints.

Kosova should project and manage its own economic independence- self generated budget and management of current account difficulties. The quality of the economic independence can be diverse, depending on the achieved annual income, respectively on the GDP per capita, the choice made as a consumer and as a voter, the responsibility shown in governing the society and economy and the nature of the economic system.

Based on various analysis carried out to date, it can be concluded that Kosova is in a position to manage its own economic independence, by building a modern economic system in accordance with the demands of an open market economy. Kosova's resources and potentials in certain areas represent an advantage within regional context.

#### *Box. 3. Sustainability and Economic Viability*

Every country could reach a certain level of its economic viability. However, the quality of its survival, or better saying of living well or bad, depends on the ability to use appropriately its own resources and potentials (first of all the human resources - knowledge and people's skills), the capability to have enough information at disposal, the choice made regarding the governance system, etc. On the other hand, the sustainability development of a country depends on the extent to which the positive effects of the reforms and the economical welfare are distributed within a society.

On the way towards building economic sustainability, the technical and financial assistance of the international community is still needed because of the immense war damages, as well as consequences of colonial position over 90s.

The foreign technical and financial assistance is important also for activating local development resources through a modern development concept, since the current Kosovar capacities are still insufficient for such a mission. The development of these capacities has a vital importance for avoiding the shock that might be created by decreasing the present international financial assistance, in case that domestic managerial and other capacities for income generation are not in place. During the last two years Kosova achieved an increase in the share of tax revenues in its consolidated budget. According to current projections, during the next three years, Kosova's budget should be provided entirely by local sources, and should increase in order to substitute the present activity of many humanitarian and non-humanitarian international organizations, which are presently compensating the existing budgetary gaps. In addition, present incomes of employees in many sectors (education, healthcare, public services, etc.) are under a level that secures a minimum of living standard, so that the budget should be increased in this aspect too. Therefore, in order to fulfill these requirements as well as other needs, the real budget of Kosova would increase faster than GDP especially during the period 2001- 2005.

## 3.2. Building Up of an Open Market Economy

Building up an open market economy, based on the entrepreneurship philosophy, is coming up as an imperative for the future development of Kosova. Amongst the elements that determine such an orientation are:

- Needs of the market economy;
- Kosova's market size and its resources and the needs to promote export strategy;
- The need to build a competing and efficient economy.

The concept of liberalization of trade and the regulation of the free competition would lead to an increase of economic efficiency and increase of export possibilities. In this manner, a pressure would come up for lowering of prices. Consequently, this would lead to the development of domestic production, enabling it not only to face competition faced by import within liberal trade regime, but also to compete in foreign markets.

Building up of a free market and a genuine competitiveness represents one of the most difficult segments of the reforming process in Kosova, similar to other countries in transition. The competition and free market do not depend only on the extent to which the market is controlled by the state and on the existing import and export regime. As a typical example is Kosova, where the trade is completely free and where import restrictions do not exist. Nevertheless, the unfair competition comes up as one of the main problem for private entrepreneurs in Kosova (Table 2.5). The origin of this inequality in the market seems, first of all, to be related to the fiscal evasion, respectively to the inequality of economic subjects regarding tax payments, where one part creates an advantage in the market by avoiding taxes.

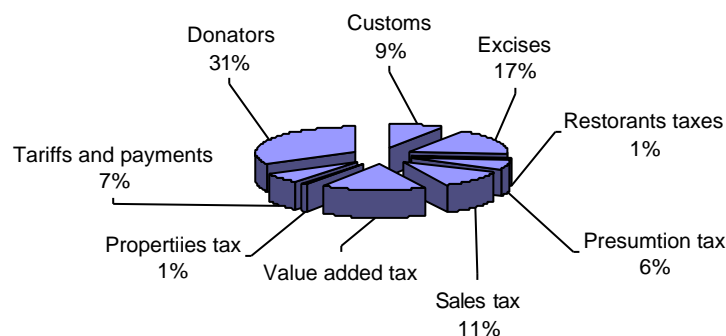
It is clear that free market and fair competition, as a suitable environment for economic development and as a fundamental value of modern civilization, can be achieved only through adequate economic and social reforms in general, where building up of the rule of law is of the key importance. In this sense, in the post-war Kosova were established fundaments for:

- A tax policy system appropriate for business development and budget constraints;
- A modern banking system;
- A completed legal frame.

### 3.2.1. Taxation Policy

Participation of tax instruments in creating the budget for 2001 is shown in Fig. 3.

**Fig. 3. Share of different taxes in Kosova's budget in 2001**





The taxation structure is going under necessary changes as tax on profits and tax on wages are going to be introduced during 2002. The VAT and Excises will be main source of tax revenues. The tax structure should be reasonable one, and acceptable for the major part of business people.

According to a study conducted with the business community in Kosova, 60% of this community consider current taxes to be high or impossible to cope with. The possibilities of this community to influence the current tax regime have not existed, so that this element might have influenced the present fiscal evasion.

*Box 4. Fiscal Policy in Kosova*

The fiscal policy in Kosova is being created on a completely new basis compared to the ones applied until 1999. Thus, new fiscal instruments have started to be applied, and a new tax and customs administration is being created and trained.

The tax system used until now was focused only on taxing businesses. Since July 2001 has been applied the Value Added Tax (VAT) with a 15% rate on all imported and domestic products. It is expected that by applying the VAT a considerable part of tax burden will be transferred to the consumption. The success of this transfer will depend on the purchasing power of buyers, the power of firms to withstand this burden, and their ability to substitute a part of this tax by cutting costs.

The business community is requesting differentiated and lower tax rates, and adaptation of the tax policy to the development needs. A low rate tax policy, but applied in a broader base, would secure a higher volume of budget income and at the same time would narrow the fiscal evasion.

The broadening of the tax basis in Kosova could be carried out by applying taxes on profit, property, wages, individuals' income, real estate transactions, and with a clear definition of the fiscal role of the municipalities. Broadening of the tax base could be realized simultaneously with reviewing and possible decreasing of the existing tax and customs rates, especially for equipment and reproduction materials that are not produced in Kosova.

The current fiscal policy in Kosova is burdened by the presently existing fiscal evasion. Its elimination could be achieved by raising the efficiency of tax and customs collection, building the fiscal discipline, creating a wide opinion in favor of tax paying and budgetary sustainability of Kosova, reducing imports exempted from customs and taxes, raising the fiscal culture within the business community and the population, and by applying the equal preferences to the neighbors.

Raising the responsibility for paying taxes is one of the elements that could contribute considerably to the Kosova budget increase. The tax policy should be better structured and designed in such a way as to avoid fiscal evasion. The Kosovar society should develop protective mechanisms in this sense. The pressure done by the public opinion, media, civil society and political parties should create an environment where the transition effects and costs should be better distributed among different actors of Kosovar society.

### 3.2.2. Banking System

A new banking system for the support of Kosova's reconstruction and economic development is being built. Following licensing of the first bank with foreign capital (MEB) in February 2000, during 2001, six other banks started their operation: the New Kosova Bank began its activity with domestic capital, the Private Business Bank (90% domestic private capital), Economic Bank with domestic capital, the Prishtina Credit Bank with local capital, American Bank of Kosova established by the USAID-KBFF, and Kasabank of mixed Kosovar and Slovene capital. These banks have been established with an initial capital reaching 3 – 4 million DM succeeding to sensitively increase their deposits. About 15 other non-banking financial institutions conduct their activities mainly within micro credit schemes.

Credit activity of banks (09/2001):

▪ Deposits	364.5 mill. DM,
▪ Credit amount	26.8 mill. DM,
▪ <u>Share of loans in deposits</u>	<u>7.3 %</u>

(Riinvest Survey, September 2001).

It is obvious that a huge gap between deposits and credit activity exist. Certainly it is not because of the lack of credit demand but more due to incomplete legal frame, which should bring more security in loans guarantee. Mortgage law is still waiting for approval, and pledge registry started only recently.

Strategic objectives of banking system development could include first of all;

- Resetting a standing banking meditation and reestablishing public trust as a precondition for mobilizing financial resources of population including Diaspora and businesses,
- Support of financing of projects of the Donors Community through Kosovar banks by respecting basic commercial principles and standards,
- Staff development through implementation of technical assistance and training system based on modern standards and application of international technical assistance.

Basic elements for developing a steady banking system include:

- Introducing stimuli for savings mobilization,
- Strengthening transparency, introducing contemporary accounting and auditing standards,
- Increasing human capacities of risk management portfolio,
- Improving loan administration.

Developing a steady banking system would require credit market and competition, which should act as a pressure for improving loan conditions.

### 3.2.3. Legal Framework

Establishing the legal and regulatory framework of a market economy was difficult in other transition countries as well, but Kosova has been in an unprecedented situation of a legislation vacuum, caused by the inoperative function of the old laws at a time when new laws have not yet been created. In any case, while other countries inherited some elements from the old laws, in Kosova a new institutional framework is needed, but the creation of the new legislation system and its implementation is moving slowly. The UNMIK administration has taken very important steps towards developing the legal framework, but still has not approved some key regulations such as: (i) Regulation on Accounting; (ii) a Law

on Privatization, and (iii) Regulation on Bankruptcy, (iv) Mortgage Regulation which together will help facilitate the creation of an adequate environment for SME business activity. Beyond the regulation itself, also lacking in several areas are the implementing mechanisms that would make the regulations operational.

It should be emphasized that its influence of Kosovar business community and civil society, in the process of promulgating these laws is negligible. On the other side, the information provided to the business community on these laws is scarce, too. Based on a survey conducted not so long ago, around 60% of businessmen consider that they are not informed on the promulgated laws by UNMIK.

### 3.3. Private Sector Development and Privatization

#### 3.3.1. SME Financing and Development

Lack of external financial sources is the third most intense problem for sampled enterprises (Table 2.5). The problem of lack of business financing, in spite of the development of a support system during this period, clearly remains a serious issue (approximately 63% of surveyed enterprises consider that the lack of external financial sources is a barrier causing serious problems, while only 20% think that this does not present any problem).

**Table 3.3: Intensity Indicator for Lack of External Financial Sources as a Barrier to SMEs, by Sector**

Barrier	Production	Trade	Services	Total
Lack of External Financial Sources	61	59	67	61

Source: Riinvest survey data, 2000.

The impact of lack of external financial sources differs somewhat by firm size and sector, with this perceived as a barrier more acutely by micro and small enterprises, and more so by production and service firms.

Some important conclusions can be drawn concerning the real needs for SME financing and also for setting up of an effective financing system. About 90% of surveyed enterprises declared that they require credits to realize their investment plans.

#### Planned Investment

**Table 3.4: Current and Planned Investment (DM)**

Description	Investment to Date	Planned Investment
Average per enterprise	164,642	562,000
Mode	50,000 – 100,000	200,000-500,000

Source: Riinvest survey data, 2000.

From the table above we see much greater investment plans in the future, with planned investment exceeding investment to date by 2.5 times.

**Table 3.5: Planned Investment by Amount and Percentage**

Amount in DM	%
Up to 10,000	1.3
10,000 – 20,000	2.3
20,000 – 50,000	10.0
50,000 – 100,000	16.3
100,000 – 200,000	14.7
200,000 – 500,000	26.7
500,000 – 1,000,000	12.3
Over 1,000,000	9.3
N/A	7.0
<b>Total</b>	<b>100.0</b>

Source: Riinvest survey data, 2000.

The greatest magnitude of planned investment is between 50,000 – 500,000 DM (58%), with just 13% of surveyed enterprises planning to invest less than 50,000 DM (13%). About 9% of firms plan to invest more than 1 million DM.

**Table 3.6: Planned Investment by Sector and Firm Size (%)**

Sector	Micro	Small	Medium	Total	%
Industry (production)	7.6	42.3	31.4	32.5	33.0
Construction	5.5	4.0	2.3	4.1	4.0
Agriculture	0.8	0.5	0.0	0.5	0.0
Trade	68.2	52.5	64.4	58.0	58.0
Transport	10.9	0.6	0.0	2.9	3.0
Hotels and Tourism	3.4	0.2	0.0	0.9	1.0
Tourist agencies	3.2	0.0	1.9	1.1	1.0
Services	0.3	0.0	0.0	0.1	0.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Riinvest survey data, 2000.

By sector, planned investment is highest in trade (58%) and industry (33%), with all other sectors taken together representing only 8%. By firm size and sector together, the largest proportion is recorded in small (42.2%) and medium (31.4%) enterprises. In other sectors like construction, trade and transport, micro enterprises have the greatest proportion.

**Table 3.7: Credit Demand by Sector (DM)**

Sector	Credit Demand per firm	Credit Demand per employee
Production	428,843.8	21,331.1
Trade	338,945.8	32,674.2
Services	180,921.1	26,341.0
<b>Total</b>	<b>347,696.7</b>	<b>26,657.0</b>

Source: Riinvest survey data, 2000.

The findings above are shown in the table below from another perspective.

**Table 3.8: Distribution of Firms, Employees, Fixed Assets and Credit Demand by Sector(%)**

Sector	% Of firms	% of employees	% of fixed assets	% of credit demand
Production	32.0	49.3	54.4	39.5
Trade	55.3	44.0	41.3	53.9
Services	12.7	6.7	4.2	6.6
Total	100.0	100.0	100.0	100.0

Source: Riinvest survey data, 2000.

Total credit demand for the sample of 300 surveyed enterprises is estimated at 104 million DM, or 347,967 DM per enterprise. The average credit demand in the production sector is 428,843 DM, or 22.4% higher than the total average, while the average credit demand in the service sector is 180,921 DM or 49% below the average. The share of production in overall credit demand is 39.5% (proportionally higher than its 32% share in the number of firms), while trade has a 53.9% share.

**Table 3.9: Credit Demand vs. Supply**

Description	Amount in DM
Average investment made per enterprise in 2000	164,642
Planned average investment per enterprise	562,000
Declared credit demand per enterprise	347,696
Total credit demand for actively operating enterprises (extrapolated to cover 11,000 enterprises)	3.5 billion DM
Most frequent range of credit need of enterprises (Mode)	200,000 – 500,000 DM
Estimated credit supply to all business entities from financial institutions (credits and micro credits):	
2001	136.7 million DM
2002	214.2 million DM
2003	409.3 million DM
<b>Total estimated supply 2001 – 2003</b>	<b>760.2 million DM</b>

Source: Riinvest survey data, 2000, and the questionnaire for banking and non-banking institutions, Riinvest, 2001).

We are aware that estimates of credit demand by enterprises, influenced to a significant degree by post-war reconstruction needs, seem to be high. A comparison with transitional countries at a more advanced stage of development may provide further insight. Using as a comparative yardstick the proportion of total bank credit to GDP, we find a ratio of 10% in both Poland<sup>5</sup> and Hungary. Using the same rate of 10% of the Kosova GDP estimate of 3 billion DM, this suggests that total bank credit on the balance sheet of Kosovar firms could be up to approximately 300 million DM. While this figure is obviously several times lower than the estimates from enterprises and comes much closer to the estimated credit supply figures above, we still see a significant gap; We would calculate total credit to GDP in Kosova as 4.1% in 2001, 6.5% in 2002, and 11.1% in 2003, with the ratios for bank credit alone being 1.9%, 3.2% and 5.2% respectively. It is clear, from this perspective, that there is

<sup>5</sup> Total bank credit of 48.5 billion PLN and total GDP of 469 billion PLN in 1998. However, bank credits typically represent only half of total enterprise debt in Poland, with supplier credit also contributing significantly. Total enterprise debt in Poland is therefore closer to 20% of GDP. Another useful statistic is total bank credit in comparison to total SME assets (15.4% in Poland).

currently an enterprise credit gap and will probably be in the medium term as well, and which policy makers should address.

### 3.3.2. Privatization of Socially Owned Enterprises

Further perspective of the socially owned enterprises is conditioned by their technological regeneration, which depends on the restructuring, privatization and partnership with domestic and foreign private investors. This depends on a complex program of privatization, which should be based on the relevant experience of the countries in transition.

The problems associated with the privatization of the socially owned enterprises are mainly based on the opinion that “the social ownership in Kosova is unclear” - an opinion which, to a certain extent, is present within some segments of the international administration. As far as legacy is concerned, such a dilemma should not exist, because social ownership as a specific category of ownership in the former Yugoslavia’s economic system existed, and was governed on the same basis in Kosova as well. At that time, Kosova had equal competencies and authorizations with the other constitutive units of the former Yugoslav federation, including the indisputable right to govern its own social property. The experience from the other states that came out from the dissolution of the former Yugoslavia shows also that the social ownership does not represent any specific barrier for privatization. Neither the Resolution 1244 of the Security Council of the United Nations, on which basis Kosova is governed today, represents obstacle concerning this issue.

The current dilemmas related to the methods and the model for privatization of socially owned enterprises should be solved, first of all, on basis of the effects of given models as regarding:

- Economic efficiency (development, restructuring, and corporate governance performances);
- Attracting direct private investments (domestic and foreign);
- Impacts on economic reform, and market economy and democratic institutions building.

On the other side, the majority of socially owned enterprises belong mainly to the category of medium enterprises, for which the application of the model of transparent sale to private investors (foreign or local) is suggested. As the table shows, the majority of these enterprises has a fixed capital lower than 50 million DEM (88%), while the number of employees of the major part is smaller than 400 (86%).

Table 3.10. Structure of socially owned enterprises according to their fixed capital and the number of employees

<b>Fixed capital (in mil.DEM)</b>	<b>%</b>	<b>Number of employees</b>	<b>%</b>
Under 2	18	Up to 100	38
2 to 10	33	100 to 200	24
10 to 50	37	200 to 400	24
Over 50	12	Over 400	14

The existing number of employees in these enterprises cannot be considered as a big problem that would hinder the privatization, which obviously represent a positive circumstance in given conditions. Due to that, privatization of these enterprises through their sale to private investors has many advantages in comparison to commercialization (long term leasing), or transforming them to share holding companies, with the majority of shares owned by the employees and managers. Creating an efficient market economy is essential for the democratic institutions building, which cannot be achieved by conserving the existing socially owned property, but by its efficient privatization and management. The international community undoubtedly is interested for larger effects of its investment in Kosova. Consequently, a successful privatization should be considered as an important factor for future economic development of Kosova. An exceptionally favorable circumstance in Kosova is the positive attitude of the public opinion, private entrepreneurs and managers of socially owned enterprises, being around 80% in favor of privatization.

### **3.4. Development of the infrastructure**

Following the completion of the emergency phase, which has improved the functional level of the existing infrastructure, the medium term program should aim the development of the infrastructure in accordance with the following basic requests:

- The need of the economy which are being expected to increase, and for which the present development level of the infrastructure is not adequate;
- The inclusion in the regional infrastructure networks, expected to be promoted through the Stability Pact and other initiatives.

The energy supply to the population is being almost entirely done with electrical energy, which is mostly produced in the thermal-power plants Kosova A and Kosova B, while only a small percentage is produced by hydro-power plants. Although the installed power of these producers is over 1,500 MW, a chronic lack of supply was present in the last two years, even though the part the industry representing main users of the electric energy is still not functioning. Despite great efforts to stabilize the production and supply of electric energy, in this aspect has not been yet reached a satisfactory level. For this reason, as a priority issue come up the needs to enlarge the open pit lignite mines, complete reparation of the thermal-power plant Kosova B, improve the functional level of the thermal-power plant Kosova A, and to start with building of new production capacities, including hydro-power plants. Otherwise, if these activities would not be dimensioned properly and not built in time, the critical situation in this sector would continue, with heavy consequences for the economic development of Kosova.

The absorption capacities of the roads have decreased, beside others, due to damages and lack maintenance for a ten years period of time. These circumstances made the transport difficult and expensive. In this sense, beside the rehabilitation of the existing main roads that is being done for two years, priorities in the medium term program should be aimed at:

- Enlarging with one more track the main road Mitrovicë – Prishtinë - Shkup (Skopje);
- Improvement and enlargement of the main roads Prishtinë – Prizren and Prishtinë – Pejë, on which road is included the way toward the Prishtina airport;
- Construction of the main road through Prizren, as the shortest and the most rational connection of Kosova with the sea, respectively with the Durrës port in Albania.

The railway system of Kosova currently in a low level of functionality, which has caused an overload on the main roads. The modernization of the railway within the medium term program should also include its electrification and increase of transporting capacities.

Air transport is more and more gaining in importance, due to frequent travels of the Kosovar Diaspora currently living in western Europe, as well as for the reason that in current political circumstances in the Balkans air travel has become the safest way to travel. Therefore, the only airport for passenger travel – the Prishtina Airport – needs to be modernized and enlarged, supplied with equipment for flights in bad weather conditions too, enabling thus more stable traffic and more successful business for the airport.

Telecommunication in Kosova has still not achieved to fulfill the needs of the citizens and the Kosovar business for genuine communication. Beside the need for increasing of the telecommunication capacities, the increase in the quality of services is also needed, as well as the inclusion in the digital telecommunication networks. At the same time, in order not to influence negatively in the Kosovar business and the citizens' living standard, lowering of the services' prices should be aimed at.



## 4. KOSOVA AND REGIONAL ECONOMIC COOPERATION

### 4.1. Reform Processes and Economic Situation in SEE

In the last ten years the region faced numerous problems and contradictions. The dissolution of former Yugoslavia was followed by armed conflicts among the former federal units resulting in destruction and considerable material damage, human losses, and particularly in population displacement. Consequences of war are great and a serious hindrance to the region's democratization. In the same time, in the region old aspirations of domination and imposition of old-fashioned mentalities prevailed. While the Central Europe was making strides towards implementing transition and democratization, the Balkan region was facing conflicts and wars consequences of which are still having grave negative impacts. They are reflected in lagging behind in regard to implementation economic reforms, in an increase of poverty and unemployment.

The international community during these years was focused in particular in reconstructing Bosnia and Herzegovina and Kosova. In Bosnia and Herzegovina the international community ensured over 5 Bill. USD, although it has been estimated that insufficient effects have been reached considering the level of economic development.

**Table 4.1: Development trends in the region and Kosova's position (Basic Indicators)**

Country	People (mill)	GDP in USD	GDP per capita	Private Sector in GDP (%)	FDI 1990/99, USD	Unemployment Rate (%)
Kosova	2.3	1.5 (*)	750	60 – 65	-	50 – 55
Albania	3.4	3.6	1.149	75.0	425	18.1
Bosnia	3.7	4.4	1.179	35.0	-	39.0
Croatia	4.5	20.1	4.485	55.0	3.707	19.1
Bulgaria	8.2	12.4	1.510	50.0	2.294	16.0
FYROM	2.0	3.4	1.699	55.0	203	32.4
Romania	22.4	34.0	1.515	60.0	5.503	11.5

Source: Prospects for Development in Southeast Europe: Business Opportunities, The Vienna Institute for International Economic Studies, 2000)

The region is characterized with a low level of economic development. This is best seen on per capita GDP, which is the lowest in Kosova. Many problems and obstacles in implementing transition processes have negative impact in functioning of market economy that is proved also by the low level of privatization. A lowest share of private sector in GDP has been shown in Bosnia (35.0 %), and a most satisfactory level was in Albania and Romania. As obstacles for introduction of foreign investors are delays in privatization, corruption and the security situation. All countries in the region rank high on world corruption. In the meantime, the question of unemployment and foreign debts continue to be a problem.

The Stability Pact on which hang many hopes for overall transformations in the region has not yielded expected effects and now it seems has to go under the period of reconsidering objectives and implementation strategies.

## 4.2. Integration Processes and Cooperation with EU

All countries that began implementing transition processes had an accentuated aim of joining the EU as soon as possible. Survey outcomes published at Euro-barometer testify strongly this fact. However, only few regional countries succeeded in formalizing their status and fulfilling the criteria used by the EU. In post-war Kosova within the UNMIK Mission the presence of the European Commission has been ensured through the Pillar IV – Reconstruction and Economic Development of Kosova. The European Union has been carrying out its support in realization of projects of post-war reconstruction through the operation of the European Agency of Reconstruction of Kosova. Within the Agency an important support is being materialized through reconstruction projects and technical assistance.

### 4.2: Relations of countries with the European Union

Countries	Relations with EU
Bulgaria / Romania	European Accord
Albania / Macedonia	Agreement on Association
Bosnia and Herzegovina	Participation on certain EU projects
Serbia	Support / Unclear Status
Montenegro	Support / Unclear Status
<u>Kosova</u>	<u>Special Relations</u>

Source: Prospects for Development in Southeast Europe: Business Opportunities, WIIW, 2000

Some countries of the region have in the meantime advanced their position with the EU. Thus, Macedonia and Croatia have in the meantime signed Association Agreements. In regard to further perspectives of the region dilemmas arise as to the EU arrangement development for the region, namely on the way the arrangement of involving the region as a whole or separately country by country in its structures. Interaction between both approaches means country arrangements with EU but also stimulation of regional cooperation and integrative processes having in mind that each country in SEE is impacted by the situation in a region as a whole.

### 4.3. Kosova's Position in Regional Co-operation and Barriers from Company Perspective

Regional Economic Cooperation and trade are facing many obstacles. A joint project on a network of five regional think tanks have evaluated the "Obstacles to Trade, Growth, Investment and Competitiveness" (Chesapeake Assoc. 2001), seen from the company perspective in Albania, Bulgaria, Kosova, Macedonia and Montenegro. The sample included 25 companies from each country, all together 125. The main obstacles ranked by their intensity is presented below:

Custom related problems – procedures, customs, delays, is seems to be the most common obstacle for all countries in the region ( 1) including also Kosova ( rank 2). The difference is in estimation of the impact of the low level of infrastructure development which in Kosova case considered as a min obstacle (rank 1), while for other countries in the region the intensity is lower (rank 5). The difference also is about banking system: the rank in Kosova – 3 and for other countries 6. Surprisingly the political situation is not considered as a significant obstacle in the region and also in Kosova.

**Table 4.3: Rank of Obstacles for Trade and Cooperation from Company perspective**

Description	Kosova	Other Countries
Custom related problems	2	1
Taxes	7	2
Contracts and payments	4	3
Lack of information	5	4
Infrastructure (telecomm., energy, roads...)	1	5
Administrative procedures	6	6
Banking System	3	6
Political Risk	8	8

For stimulating regional co-operation it is necessary to overcome these barriers. The European Union offer establishing a free customs and trade zone between countries in the region which could have the positive impacts in strengthening economic ties and establishing a strategic partnership. This creates benefits for Kosovar exporters considering the fact that it will eliminate custom and quote limitations. However, an immediate inclusion of Kosova and some other countries with high budget depending on customs within this regime would have a negative reflection on the macro-economic stability, as an immediate decrease of customs revenues would create budget difficulties. Because of that a specific solution for certain countries including Kosova with limited export capacities should be considered.

Priorities for improving regional cooperation in Kosova case are development of infrastructure, improve customs procedures and development of banking system.

#### 4.4. Kosova Trade Relations in the Region

According to the UNMIK customs service, Kosova has very intensive trade relationship with neighboring countries (excluding Serbia). About 62% of imports have the origin from SEE countries. The EU (including Switzerland) is the second trade partner following Macedonia. Turkey is the third partner.

**Table 4.4: The structure of Kosova import by country of origin**

COUNTIRES	%
Macedonia	31
EU+ Switzerland	17
Turkey	14
Slovenia	8
Bulgaria	8
Montenegro	8
Other countries	5
Albania	4
Bosnia and Herzegovina	2
Croatia	2
Serbia	1
TOTAL	100

Kosova's co-operation with Macedonia is being realized under the conditions of an Agreement between Macedonia and the "FRY" on free trade. Establishing and realizing this co-operation within such an agreement for Kosova has been placed under a United Nations administration, as a new trading and customs identity of Kosova has been established. According to statistical data nearly 60% of Kosova's imports are realized through Kosova's border crossing points with Macedonia. and, the import of goods originating from Macedonia reaches about 31% of country's overall imports. This overcome possibilities of Macedonian exporters and includes goods from other countries covered by Macedonia certificates of origin. This have a distortion effect in Kosovar market and it is considered as a source of fiscal evasion. This import is subject to transit and other specific taxation, which considerably effect the import cost. These circumstances impose a need for new trade agreement based on reciprocity and cooperation in eliminating mentioned problems.

A considerable part of foreign trade is also realized through the territory of Montenegro. A specific transit taxes and other duties are applied. In contrary for goods originating from Montenegro no customs duties are paid. This is being used also four counterfeiting the origin of goods not produced in Montenegro. Kosova's economic co-operation with Serbia is very low. The increase of this co-operation will depend of Serbia's democratization and other political circumstances in the region.

Kosova's economic co-operation with Albania has been increased slowly in a post – war period. Around 4% of Kosova's imports are realized through the territory of Albania mainly in the form of transit, considering the low level of participation of Albanian products in its export. This co-operation is becoming more difficult by lack of appropriate of road infrastructure.

Kosova has established good tradition in an economic co-operation with Turkey and Bulgaria. In the recent years special contribution to this co-operation has been given by the private companies of Kosova, particularly through a continued increase of import of wide consumption products from these countries. Economic cooperation with Turkey and Bulgaria also lack more advanced relationship, especially joint ventures and FDI.

## 4.5. New Circumstances in the Region

A more organized involvement of Kosova in the Stability Pact represents an important condition for the realization of the infrastructure projects for effective participation in regional cooperation. Currently, regarding Kosova's representation in structures and plans of this Pact, there is a huge gap, as the overall Kosovar situation belongs very much to regional context. It is in the interest of Kosova and the region that Kosova be substantially present with different projects, especially in the infrastructure.

Unresolved political status creates limitations in this sense. Due to its present political and administrative status, Kosova cannot benefit from international financial institutions in regular base. For the same reasons, as well as due to present hesitations of the International Administration to legalize privatization of socially owned enterprises, chances for private foreign investments look very tiny.

Two main moments could bring more optimism in terms of regional cooperation:

(1). Kosova is entering in a phase of building institutions of self-governance after successful and free parliamentary elections. Although International Community is currently avoiding to open the issue of final status, institutions such as the Parliament and Government in case of successful functioning and good regional cooperation will have positive impacts for solving this issue within a relaxed atmosphere;

(2). Prevention of the escalation of armed conflict in Macedonia and opening the process of building sustainable interethnic relations based on Ohrid's Agreement, could have positive impacts in the region and Kosova.

International Community should act in enhancing effectively these new circumstances, as the region itself have not yet shown enough affinity towards regional economic cooperation and integration processes.

Development of open economies within SEE countries and regional and European integration and cooperation present important components for sustainable economic development of Kosova and other countries in the region. It opens new perspectives for activating its resources, potentials and development energy. In this aspect, the Stability Pact represents a chance to create new circumstances in the region, to overcome the historical burdens in the Balkans, and to intensify the development performances of all countries in the region. Prolongation of the current situation makes the economical perspective problematic not only for Kosova, but also for the other Balkan countries.

## Annex 1. Basic Macroeconomic Projections

	Period – Years										
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
GDP +	3,000,000	3,700,000	4,300,000	4,700,500	5,200,000	5,564,000	5,899,000	6,253,000	6,628,000	6,960,000	7,308,000
GDP Index	100	123	114.00	109.00	110.6	107.00	106.00	106.00	106.00	105.00	105.00
Population (*)	2,000,000	2,034,000	2,069,000	2,103,700	2,139,500	2,175,900	2,212,900	2,250,000	2,288,700	2,327,600	2,367,200
GDP/Per capita	1.500	1.820	2.078	2.235	2.431	2.558	2.667	2.780	2.896	2.990	3.087
Budget	235,000	538,000	681,000	792,000	871,000	975,000	1,053,000	1,137,240	1,227,960	1,301,680	1,367,100
Budget Index	100	229.0	126.6	116.3	110	112	108	108	107	106	105
Budget/GDP	7.83	14.54	15.83	18.41	16.75	17.52	17.85	18.18	18.52	18.70	18.70

Notes: + Gross Domestic Product (GDP) in 2000 has been estimated by the IMF at around 3 billion DM, or per capita approximately 1,580 DM (estimated for a population of 1,9 million which exclude migration component of about 400,000 Kosovars, temporary living in other countries). The GDP growth rates are based on CFA estimations up to 2004, for following years Riinvest estimation a

(\*). Excluded Migration Component (Overall growth 1.7 %, Birth rate 2.2 %, Mortality Growth 5.5 %)

### Structure of GDP, 2000

	DM Million	% Of GDP
GDP, 2000	3,000	100.0
Consumption	4,380	146,
- Private,	4,078	136
- Public	303	10
Investment	1,161	39
- Foreign,	756	25
- Domestic	405	13
Exports	43	1.4
Imports	2,540	85
- Reconstruction,	680	23
- Energy	54	2
- Humanitarian,	312	10
Dutiable imports	1,496	50
National income	4,512	150
- GDP,	3,000	100
- Remittances and foreign financial assistance	1,200	40
- Humanitarian assistance	312	10

Source: Economic and Social Reforms for Peace and Reconciliation, World Bank, 2001

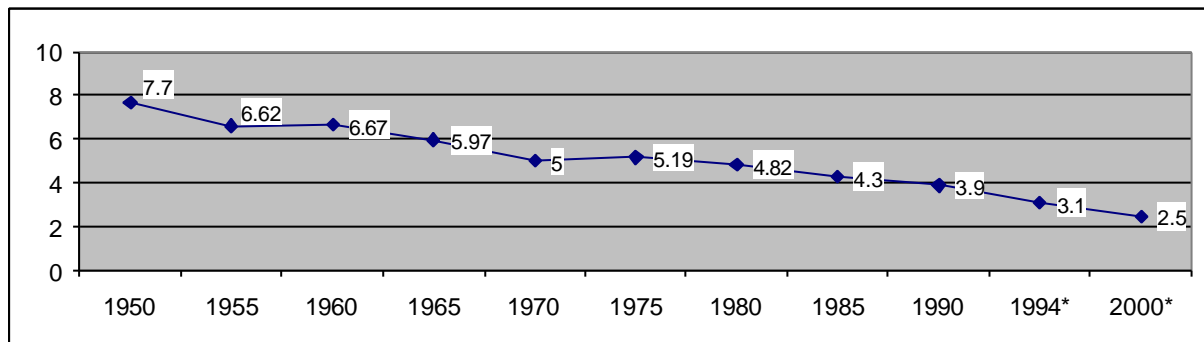
## Annex 2. Demographic Developments in Kosova

There are various estimates of the current population of Kosova. Research by the Riinvest Institute indicated that in 1997 Kosova had a population of 2.3 million, including Kosovars working temporarily abroad; it is estimated that in 2001 the population is over 2.4 million.<sup>i</sup> Estimates made by international institutions put Kosova's population at around 2.2 million. Out of this number over 5.7 percent, or around 130,000 individuals, are of age 65 or more. There are around 1.4 million people of working age (16–64 years).

The fact that Kosova's population is experiencing the start of an aging trend is supported, in particular, by the fertility data. While in 1950, the fertility rate was 214.4 children per 1,000 women, in 1985 the fertility rate for the same number of women declined to 133.2 children.

**Figure 1. Fertility Rates in Kosova**

Number of live births that average women gives during her life



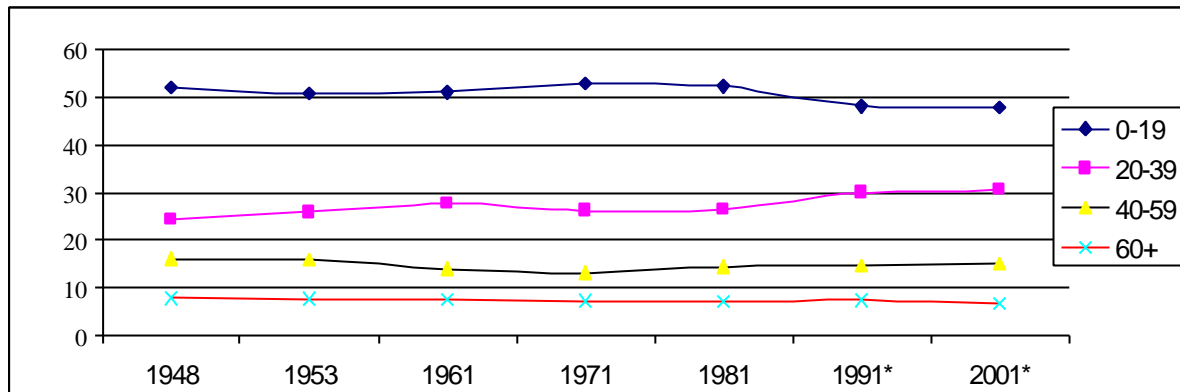
\* Riinvest Institute assessments.

Source: Documentation of Secretariat for International Development, Planning and Scientific and Technical Cooperation of Kosovo 1989.

One of the important factors that have contributed to the fertility reduction in recent years is the heavy emigration of Kosovars to other countries during the period from 1990 to 1999; this emigration has resulted in delayed marriages, and a consequent decline in births.

The demographic dependency ratio in Kosova (defined as the ratio of the elderly to those who are employed) between the elderly and those at the working age is comparable to other countries (see figure 2). There are 11 working age persons in Kosova for each person over 65 years of age. However, considering all those employed domestically, the effective dependency ratio is much higher at 1: 3.5, and it is only 1: 2.5, if we limit ourselves to considering only those in the formal economy.

**Figure 2. Structure of overall population in Kosova**



\* Riinvest Institute assessments.

Source: Kosovo Demographic Data.

From figure 2, we can see that the share of the young population in the overall population has begun to fall in recent years. Riinvest's estimate is that, since 1981, because of the effect of emigration of young people and their families from Kosova, the share of the 19-year-old age group in the population structure has fallen from 52.3 percent (in 1981) to 48 percent (in 2001). At the same time we observe a slight fall in the age groups of those over 60-years-old prior to 1991, and a slight increase of this age group in the following years, which is an expected trend. An increase of those over 65 years of age is expected, with an annual rate between 2 percent and 5 percent. Such trends of relative increase of aged population underline the need for building a consistent pension system that, within the conditions of a market economy, would be able to provide sustainable support to the retirees. However, contrary to the situation in many countries where an aging population exerts pressure on the pension funds, in Kosova the share of persons 65-years-old is projected to continue to remain relatively low. This should impact positively on the prospects for developing a financially sustainable pension reform program.



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