



**Republika e Kosovës**  
**Republika Kosova - Republic of Kosovo**  
*Qeveria –Vlada–Government*

# **2015 NATIONAL ECONOMIC REFORM PROGRAMME (NERP)**

## **PART I**

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## ABBREVIATIONS

<b>GoK</b>	Government of Kosovo
<b>OSP</b>	Office for Strategic Planning
<b>MoF</b>	Ministry of Finance
<b>DEPP</b>	Department for Economic and Public Policy (MoF)
<b>DMU</b>	Debt Management Unit (MoF)
<b>MoH</b>	Ministry of Health
<b>KPST</b>	Kosovo Pension Savings Trust
<b>SAK</b>	Statistical Agency of Kosovo
<b>CBK</b>	Central Bank of Kosovo
<b>TAK</b>	Tax Administration of Kosovo
<b>PAK</b>	Privatisation Agency of Kosovo
<b>PTK</b>	Post and Telecommunication of Kosovo
<b>EU</b>	European Union
<b>EC</b>	European Commission
<b>IMF</b>	International Monetary Fund
<b>EBRD</b>	European Bank for Reconstruction and Development
<b>WTO</b>	World Trade Organisation
<b>GIZ</b>	Gesellschaft für Internationale Zusammenarbeit
<b>PEFA</b>	Public Expenditure and Financial Accountability
<b>MTEF</b>	Medium Term Expenditure Framework
<b>SAA</b>	Stabilization-Association Agreement
<b>NERP</b>	National Economic Reform Programme
<b>CEFTA</b>	Central European Free Trade Agreement
<b>LFS</b>	Labour Force Survey
<b>LPFMA</b>	Law on Public Financial Management and Accountability
<b>GDP</b>	Gross Domestic Product
<b>FDI</b>	Foreign Direct Investment
<b>VAT</b>	Value Added Tax
<b>SME</b>	Small and Medium Businesses
<b>CPI</b>	Consumer Price Index
<b>PPP</b>	Public -Private Partnership
<b>NPL</b>	Non-Performing Loans
<b>IIP</b>	International Investment Position
<b>VECM</b>	Vector Error Correction Model
<b>SDR</b>	Special Drawing Rights

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## 1. Overall Policy Framework and Objectives

Kosovo has been one of the very few countries in Europe and the region of South Eastern Europe that had positive growth rates in every single year in the period since the 2008 outbreak of the global financial crisis. This strong resilience to the external shock was a consequence of limited trade and financial linkages Kosovo had with the crisis countries, and of the country's rather specific **development model**. It is based on strong remittances and FDI inflows from diaspora that boost domestic demand through household consumption and investments channelled primarily into non-tradable sector, such as real estate and services. Another pillar of Kosovo's growth model in recent years has been a strong pro-growth oriented budget structure with the share of capital investments significantly higher than in any country of the region.

With the euro as the legal tender and therefore in the absence of its own monetary policy tools, the country's macroeconomic **policy mix** has been focused strongly on sound fiscal policy. During the recent years when public finances of many countries have deteriorated significantly, Kosovo has succeeded to preserve its fiscal stability. The adjustments achieved under the 2012 – 2013 arrangement with the IMF followed by the adoption of the legally-binding fiscal rule in 2014 show the commitment of the Government towards a long-term fiscal stability. Under this rule, the ceiling for budget deficit is set at 2% of GDP – with some clearly articulated exemptions – what would be consistent with the legal requirement to keep public debt at a level below 40% of GDP.

A key objective of the policy strategy for 2015-2017 is to strengthen economic growth through accelerating economic reforms and improving further the business environment conducive to private sector growth. A particular priority will be granted to industries with employment potential and export capacities. To achieve this, Government is committed to implement a number of structural reforms aimed at improving overall Kosovo's economy competitiveness, in particular through strengthening the rule of law and reducing further business barriers.

The existing growth model of the country based on large financial inflows is associated with significant risks. On the short run, the main risk factor would be a sudden fall of these inflows – caused by unfavourable economic developments in countries with the largest Kosovo diaspora – and its negative consequences for growth, public finances, and external and financial sector stability. On the medium and long run, however, the main challenge for the country is how to establish conditions conducive to promoting self-sustained growth based on increased domestic productivity and export competitiveness, and aimed at reducing high unemployment, improving human capital and physical infrastructure. These objectives will have to be achieved within the framework of stable public finances what implies predictable developments with respect to public sector wages, and with maintaining the labour market flexibility. Both are of crucial importance taking into account macroeconomic policy options available to a country without its own monetary policy.

### ***2014 as a milestone in Kosovo's European integration path***

The year 2014 represents a milestone on Kosovo's European integration path. In April, a bilateral agreement on normalization of bilateral relation was signed with Serbia under the EU auspices. Soon after that, in May, negotiations of a Stabilization and Association Agreement (SAA) were completed and the agreement was initialized in July. It represents the first comprehensive agreement between the EU and Kosovo. The SAA is not only a framework for enhanced political dialogue but it also institutionalises closer trade integration with the EU. Based on the SAA, European markets are becoming increasingly open for industrial and agricultural products from Kosovo as well as for other forms of economic cooperation.

An integral part of strengthened institutional cooperation between Kosovo and the EU in 2014 is also an invitation to the country to be included in the structured dialogue on economic governance that takes place on a regular and continuous basis between candidate countries on the one hand, and EU institutions, especially the Council and the Commission, on the other. A basis for this dialogue is a country's Economic Reform Program (NERP) and this document represents the first Kosovo's document of this kind. The NERP is a tool which aims to provide a clearer guidance on the implementation of reforms by bringing together a medium-term macroeconomic analysis, the fiscal framework and the overall economic policy priorities.

### ***NERP preparation: organizational issues***

Following the European Commission Guidance on 2015 NERP preparation from October 2014, this document consists of two parts. Part I outlines medium-term macro-economic and fiscal policy framework and discusses those structural reforms and policy measures that underpin this framework. In the Part II, structural reform measures of a more sectorial nature are addressed with one underlying objective – to strengthen international competitiveness of Kosovo and consequently to strengthen its economic growth. Taking into account a rather different character and focus of the two parts of the NERP, the coordination of the document preparation has been shared between the Ministry of Finance coordinating part I and the Office for Strategic Planning being responsible to coordinate preparation of the part II. As the subjects that are being addressed in the two parts of the document are strongly interlinked, an effective coordination has been established also between these coordinating institutions.

The very fact that the 2015 NERP is the first one of this kind produced by Kosovo has also implied that the European Commission Guidance has been taken with some flexibility. On the one hand, there are certain issues in the Guidance that are not relevant for a country preparing its first NERP. For example, there has been no targeted policy guidance for Kosovo articulated in 2014, so it is not possible to report on implementation of recommendations (chapter 5 of part I is therefore not included). It is also not possible to compare macroeconomic and fiscal projections to previous submission of the document (sub-chapters 2.2. and 3.6.). On the other hand, some basic features of the economy have to be presented in the first edition of a country's NERP.

And finally, the NERP represents a new generation of a document to be prepared by the potential candidate countries within the context of their economic governance dialogues with the EU. Now, the document puts much more attention on international competitiveness

issues, on obstacles to growth and on policy reforms / measures to address these problems. The text has been prepared in such a way that each of the two parts can be read and analysed as a self-sustained document. Therefore, for the purpose of internal consistency of each of the two parts, certain repetitions cannot be avoided. The text also includes a lot of cross-referencing between the two parts of the NERP as it is practically not possible to draw a clean line between the structural reforms underpinning macro-fiscal strategy (subject of the part I) and those of the sectorial character (subject of part II).

### ***NERP preparation: challenges faced and the way forward***

Within the process of the document preparation, the administration was faced by various challenges. Some of them are simply a consequence of the fact that this is the first document of this type ever produced by Kosovo. Consequently, some »beginners« problems were difficult to be avoided entirely.

Another set of challenges was associated with the fact that the document was drafted in a kind of an interim period as formation of the new government after the June election was delayed till December. The drafting of the NERP also coincided with the kick-off of the work on the overall National Development Strategy (NDS).

These challenges also limited the time available for public consultation. A roundtable to discuss draft NERP with NGOs, including business associations, was held on January 19, 2015.

### ***NERP and the National Development Strategy***

Preparation of National Development Strategy (NDS) started in 2014 and it is to be consulted with stakeholders and approved by the Government in 2015. The NDS is expected to focus primarily on unlocking Kosovo's economic growth potential and jobs. It is likely to have a multi annual planning cycle aligned to that of the EU, e.g. up to 2020. It will identify 5-year priority measures of Kosovo Government in such areas as

- Good governance and rule of law as the basic building block for economic growth covering efficient justice delivery, improved public administration, implementing anti-corruption policies;
- Human capital development covering basic education development, advancement of VET and tertiary education as well as involving diaspora and ensuring that the growth and its benefits are inclusive;
- Growth enabling infrastructure covering energy, transportation, exploitation of Kosovo's natural resources in an environmentally friendly way; and
- Private sector competitiveness covering priorities related to unlocking Kosovo's assets, promoting investment, and implementing industrial policy through clustering initiatives.

It can be expected that the next cycle of NERP updating will be already based on the approved NDS priorities and paralleled to Government's work on the NDS Implementation Roadmaps. This will allow the structural part of the NERP to be essentially the report on implementation of the NDS priorities while also allowing reflecting decisions taken within other strategic planning frameworks such as MTEF and sector strategies.

### ***NERP and the Government Programme 2015-2018***

The Government of Kosovo which formed in December 2014 has drafted the ‘Government Programme 2015 – 2018’ to be adopted early in 2015 in which the policy priorities for the future years have been laid out. Various policy commitments stretch out among five major areas: (1) economic development, employment, and welfare; (2) rule of law; (3) the European agenda and foreign policy; (4) education, science, culture, youth, and sport; and (5) modern healthcare. By the end of December 2014 the Parliament of Kosovo adopted the Budget for 2015 as it was drafted by the previous government with few changes made by the new Government. This was done considering the specific political situation which prevailed in 2014, and in the spirit of going forward with normal, day-to-day processes which were necessary to begin in January 2015. These time constraints meant that the changes the current government could make to the Budget Proposal were limited, and as a result the recently-adopted Budget has remained, more or less, the one drafted during 2014.

As a result, the adopted Budget may not completely reflect the Government Programme 2015-2018. It is to be expected that the new government policies will be reflected through the budget review (by the end of the first half of the year) or through the Budget for 2016.

Considering the nature of the NERP, it is clear that its’ contents are inextricably linked with the adopted Budget of 2015; the budgetary outlook is presented in the Budget of 2015 upon which the NERP (as a medium-term planning document) is based. In other words, the 2015 NERP is written within the limits/forecasts set out in the Budget of Kosovo for 2015.

Considering all of the above, while the new Government Programme (and the differences in policy priorities it may entail) is acknowledged, it could not be fully reflected in the 2015 NERP for Kosovo. The following NERP (the 2016 NERP for Kosovo) will include all policy changes and report on their implementation and expected developments, as per EC guidelines.

#### *A brief overview of policy commitments as per the Government Programme 2015 – 2018:*

Concerning the NERP, the chapter of interest of the Government Programme is that on ‘Economic Development, Employment, and Welfare’, some of which are:

- Favourable fiscal policy including;
  - differentiation of VAT, in accordance with best EU practices
  - lowering the VAT threshold from 50.000 euros to 30.000 euros is estimated to broaden the tax base for 1.500 more businesses and generate revenue
  - depending on the level investment and number of employees employed, tax holidays will be offered for potential investors
  - internal VAT collection, as a result of the integration of the TAK and the Customs
  - customs exemptions for IT equipment, used in particular by young entrepreneurs in the IT services industry and as a result expand the industry by about 30%
- Competitive trade policy and an improved business environment;
  - furthering the WTO membership agenda
  - harmonising legislation and procedures according to the SAA
  - providing financial stimulus for products with export potential
  - functionalization of free-trade zones



- combating informal economy
- Support to SMEs;
  - support to investment in SMEs, especially in specific sectors such as IT services
  - functionalization of the Agency for SMEs (currently within the Investment Promotion Agency) to support young entrepreneurs through counselling and financial support
- Investment Promotion;
  - mobilising the Kosovo diaspora to become more active in investment opportunities in Kosovo
- Efficient spending, public sector size, and fiscal rule;
  - review of the public sector to identify organisations/agencies with similar functions, implementation of the electronic procurement and expansion towards e-governance (which is expected to reduce costs considerably)
  - negotiate a new programme with the IMF
- Stable financial system
  - begin utilizing citizen's, businesses', and diaspora savings
  - publish an official credit rating for Kosovo
- Investment and Employment Fund
  - support for the establishment or expansion of businesses, especially those involved in production (SMEs, corporations, PPPs are all included)
- Investment in Energy and Mining
  - regulate the status of 'Trepça' through its' own law
  - during the first year of governance, the tendering procedures will have come to a conclusion for the 'Kosova e Re' power plant, for which public funds will not be used
  - improvement and expansion of district heating in many municipalities, following the success of the co-generation project for district heating
- The development of Agriculture
  - increased budget and additional financing to support agricultural businesses, particularly in production
  - capital investment focusing on irrigation systems
  - no customs duties on agricultural inputs
- Infrastructure
  - continue the process of the implementation of Route 6
  - construction and expansion of the road from Prishtina to Vushtrri and Mitrovica
  - expansion of the road from Prishtina to Peja; and other roads the financing of which is planned from sources other than the budget
  - the rehabilitation of rail line 10
  - re-evaluation of the privatisation strategy for PTK
- The development of Tourism
  - the major tourism project remains the privatization of Brezovica Tourist Centre, in which over 400 million euros will be invested and 3000 jobs opportunities provided
- Water supply & management

- various water-treatment plants throughout Kosovo will be contracted and financed through the budget, international financial institutions, and donors
- Social policy, social welfare and inter-social solidarity
  - among the many support schemes which will be continued, the financial support in the amount of 100 euros for families with special-needs members aged 18 and lower will be doubled
  - promoting entrepreneurship as a way of lowering the dependency on social assistance
- Modern healthcare
  - 2015 is the year in which the Public Health Insurance Fund is planned on being introduced in Kosovo- combined funding from the budget and private health insurance will allow: budget increases for institutions (of all levels) offering public health services, 100% supply of basic medicaments from the Essential Medicaments List, improvement in the quality of services
- Two other developments to characterize the upcoming years to which the government is also strongly committed are the Reform on Public Administration and the Law on the Special Court

## 2. Macroeconomic framework

This point in time finds most economies revising their growth rates downwards, mainly due to the global financial crisis, as many countries are yet to recover from debt and unemployment. Recent geopolitical developments have been identified as a potential risk for the global economy. For the time being, the macroeconomic effects of the tensions in Ukraine and those in the Middle East are contained within the respective regions, but due to the potential risk they pose they should be monitored closely.

**World output** is forecasted by IMF to increase by 3.8% (year on year) in 2015, which represents a -0.2 p.p. revision from the previous (Spring 2014) forecast. The largest contributors to global growth are the *Emerging Markets and Developing Economies*, where growth is forecasted to increase by 5% in 2015, mainly driven by Emerging and Developing Asia. Advanced Economies are projected to grow by 2.3% in 2015, the largest contributors to which are the *United States* and the *United Kingdom*, which appear to be recovering more quickly than other advanced economies.

Considering that inflation remains low in advanced countries, there is risk of inflation turning into deflation for the forthcoming period; these countries are striving to reach their set targets so inflation is projected to gradually increase. Inflation in Advanced Economies is forecasted to reach 1.6% in 2015, with a slight increase of up to 1.8% until 2019. Of these, the United States is expected to experience the highest rate; 1.8% in 2015.

In comparison, the **European Union** has been experiencing weaker recovery. The weaknesses such as a slowdown in economic activity and lower-than-expected output and trade growth have continued to persist so that they are expected to extend to 2015 and possibly beyond. A growth rate of 1.5% is projected for the year 2015 in the EU, and 1.1% in the Euro area, as labour markets and financing conditions only gradually recover.

Depreciation of the euro is forecasted to gradually increase inflation to rates of 1.0% in the EU and 0.8% in the Euro area in 2015, which are then projected to converge to 1.6% and 1.5% respectively in 2016.<sup>1</sup>

## **2.1.Recent economic developments**

The year 2014 has seen the economy of Kosovo grow at an estimated rate of 3.3%. The economy is highly dependent upon economic developments in the euro zone, but this particular year has been characterized by an unwanted political situation in Kosovo (government formation was delayed after the elections in June 2014) which has affected investor confidence.

**Consumption** continues to be the main factor of domestic demand in Kosovo. It is evidenced that price levels in Kosovo largely follow world price levels, which is particularly true for food prices. This, in combination with the 25% increase of public sector wages and pensions in April 2014, has increased the real disposable income of the citizens, resulting in an increase in consumption. During this year it was mainly private consumption which has led the increase in consumption for 2014. Remittances are another factor which is taken into account in this regard, since a considerable amount of these inflows goes into consumption. In this sense, the recent recovery of the euro-zone has also impacted the recent increase in consumption in Kosovo.

**Investment** has shown a slight decrease in real terms in 2014. This has been observed in particular in private investments, mainly because of the uncertain political situation which persisted during June-November 2014, thus influencing the behaviour of economic agents. The latter may be opting to save instead of invest while standing by for a resolution of the political situation. This reaction is signalled by the (observed) increase in deposits within the banking system, as well as the fact that the import of investment goods (mainly construction goods) has fallen. In addition, companies' declared turnover has fallen compared to the same period of 2013, especially in trade, construction and the processing industry. On the other hand, a part of remittances goes into private investment in the form of investments in real estate, which has alleviated the effect of the aforementioned negatively contributing factors.

The **external sector** remains a challenge for Kosovo, given that the trade balance continues to be negative, although slight improvement has been observed.

Given that Kosovo uses the Euro as the legal tender, it cannot control its nominal exchange rate to respond to any kind of adverse shock facing the economy as well as to stimulate exports. The only way to develop sustainable export growth therefore, is through a relative price adjustment by holding the inflation rate of domestic costs below that of world trade prices in euro. In other words, the increase in competitiveness requires promotion and maintenance of flexibility in the labour market. To this end, any fall in net international assets which leads to a monetary contraction, will be adjusted through a lower economic activity (and hence, lower imports) and either lower wages or higher unemployment<sup>2</sup>.

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<sup>1</sup> We are aware that the EC prefers the assumptions on the international environment to be taken from EC forecasts. However, the 'European Economic Forecast Autumn 2014' only provides forecasts up to 2016, whereas this document includes the year 2017. IMF forecasts are usually used because this institution provides data on Kosovo.

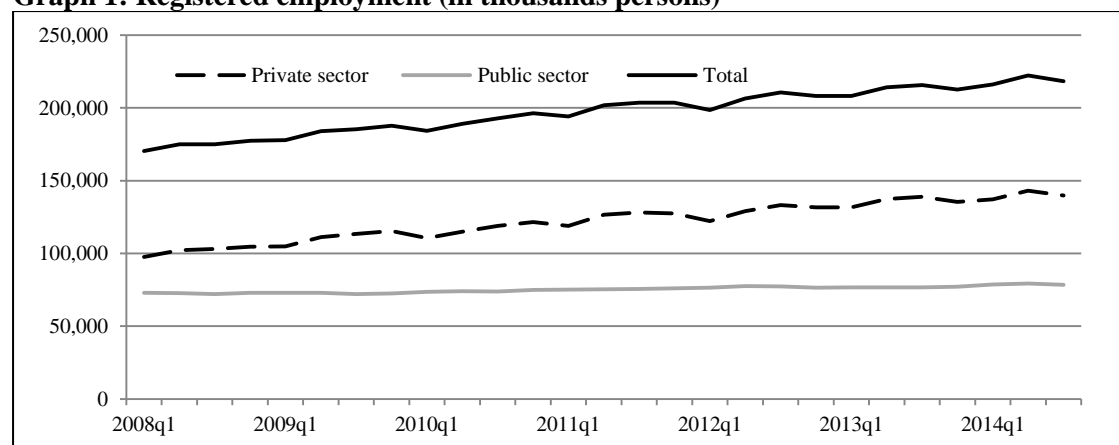
<sup>2</sup> Depending on the downward stickiness of wages

In 2014 (until September 2014) **export** of goods improved at a rate of around 9%. More importantly, as developments in the structure of exports are concerned, further diversification of exports is necessary to achieve stability. Kosovo's main exports are metals and metal-based products (they amount to around 50% of total exports), with metals largely following world metal prices. Kosovo's production capacities remain under-utilized and there is little to no competitiveness in the industrial sector in regional and European markets, which keeps Kosovo's exports at a low value. During the first half of 2014 the export of services has improved by 12.6%, the largest contributor to which is the 'travel services' category.

Considering the current structure and level of **imports** (around 10% of total imports are food and beverages- it is usually among the top three import categories) Kosovo continues to be rather dependant on imports. This dependency, combined with the low level of export, keeps the trade balance at negative levels and thus contributes negatively to growth. The year 2014 has seen a rise in consumption which has increased the demand for imported goods. Until August 2014, imports have increased by about 2%.

**Labour market and productivity** -The unemployment rate in Kosovo remains high, at 30% in 2013, in spite of a low labour force participation rate (40.5%) in the presence of many persons discouraged from labour market participation (SAK, 2012, 2013). Though starting from a low base, according to administrative data by the KPST, the number of employed persons has been increasing steadily in recent years at annual growth rates of 2.5-5%<sup>3</sup> (see Graph 1 below). In 2013, registered employment grew by 3.2% and the same rate of growth is estimated for 2014<sup>4</sup>, however, as opposed to 2013 when the growth came solely from the private sector<sup>5</sup>, the public sector's contribution to employment growth in 2014 was 30%. Based on previous trends, a slowdown of employment growth to around 2% annually is forecasted for the period 2015-2017.

**Graph 1: Registered employment (in thousands persons)**



Source: Administrative data by KPST

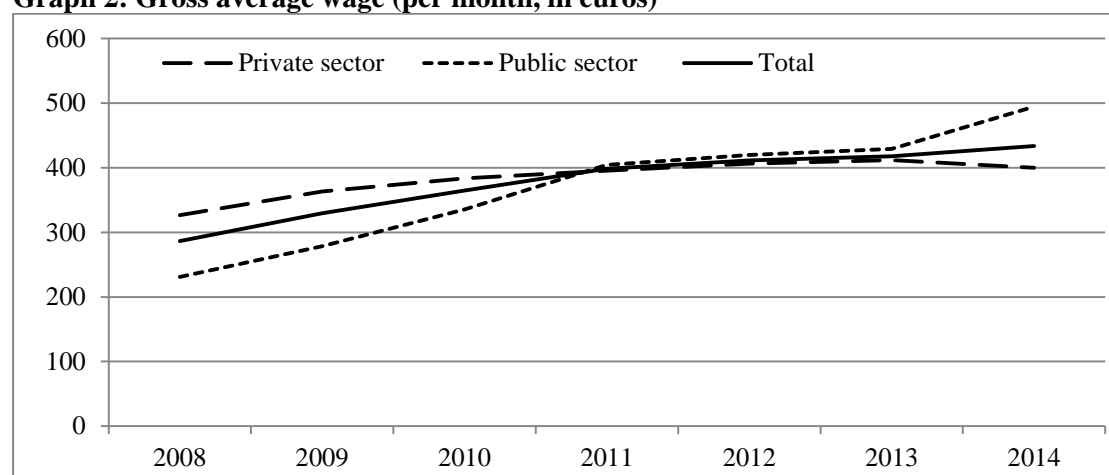
<sup>3</sup> Note that administrative data presented here do not cover informal employment or self-employment. An alternative source of data is the Labour Force Survey (LFS). Based on the employment rate and population projections, LFS reports the number of employed persons to be 302,844 in 2012 and 338,364 in 2013, i.e. 47% and 59% higher than the figures presented above.

<sup>4</sup> The estimates of employment growth rates presented here and in Table 1c in the appendix are based on an auto-regressive model of quarterly data (up to Q3 2014) compiled by the KPST. However, as the number of employed persons is significantly under-estimated in KPST data compared to LFS, the number of employed persons has been calculated by applying the growth rates based on this forecast to the latest LFS figure (2013), thus assuming that informal employment and self-employment increase at the same rate as registered employment.

<sup>5</sup> For the purpose of labour market data on employment and wages presented in this section, the public sector covers budget organisations, the wages of which are affected by government decisions, whereas the private sector covers also public companies, socially-owned companies and non-profit organisations.

Public policy has also exhibited a significant effect on wages. After a period of relatively stable wages (averaging at 412 euros) in the period Q3 2010 to Q1 2014, the average wage has increased to 440 euros in the second quarter of 2014 as a result of a 25% increase of public wages (see Graph 2 below)<sup>6</sup>. The public wage increase has put the gross average wage in the public sector at 512 euros in Q3 2014, i.e. 29% higher than that in the private sector (at 399 euros), further increasing the gap between public and private wages which averaged at 5% since the previous public wage increase in 2011. Given the trend of wages in the private sector in recent years, and the recent increase in public wages, at this point it is forecasted that wages will remain stable in the near future. However, the public wage increase may also exert pressure on private sector wages and competitiveness, therefore the trends will be carefully monitored and more rigorously analysed in the following period.

**Graph 2: Gross average wage (per month, in euros)**



Source: Administrative data by KPST

Labour productivity, as measured by real GDP per employed person, was 15,465 euros in 2013<sup>7</sup>, and it is estimated to have increased by 0.1% in 2014, and is forecasted to increase at an average rate of 2.3% annually in the period 2015-2017.

**Monetary sector and inflation** - In 2002, Kosovo had unilaterally adopted the euro as its legal tender and since then euro became Kosovo's de facto currency. Consequently, Kosovo does not have monetary policy tools and instruments to adjust to any potential shocks facing the economy and the only policy mechanism in hand is the fiscal policy.

The use of euro as a currency limits the Central Bank's use of its function as a lender of last resort (LLR) to provide short term loans to the bank potentially facing liquidity shortages. For this reason, the GoK and the CBK established an Emergency Liquidity Assistance (ELA) fund to act in case of any liquidity shortage in the banking sector. In addition, the GoK also

<sup>6</sup> The gross average was calculated based on reported employment and gross wage figures, as reported to the KPST. Note that data on private sector wages may be distorted for two reasons: they do not include the informal sector, and may be biased downwards to the extent that informal jobs are lower paid; and on the other hand they may be biased downwards to the extent that private firms under-report the wages of their registered employees.

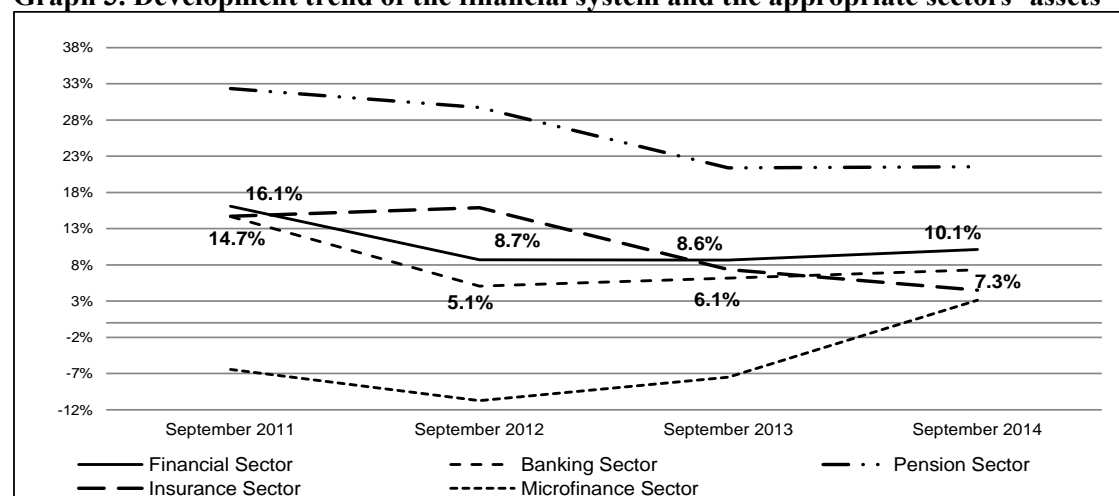
<sup>7</sup> Compared to the figure for 2012, this represents a 5.4% decrease, however, this is solely due to a large increase of the number of employed persons reported by the LFS (13%), which is much larger than the increase in registered employment.

keeps an appropriate level of bank balances as a buffer to respond to any potential shocks faced by the economy.

The euro has contributed largely to the price stability in Kosovo with annual inflation stabilizing at 2% since 2002. The **consumer price inflation** in 2014 is expected to stabilise at a rate of about 0.4% (y-o-y). Price levels in Kosovo are highly dependent on world prices, particularly world food and oil prices. The food price level has fallen by about 0.7% until September 2014 which, considering the share of these goods in the consumer's basket influenced the overall price level.

**Financial sector.** Kosovo's financial system continued its positive growth trend during the first nine months of 2014. Total assets<sup>8</sup> of the financial system marked an annual growth of 10.1%, standing at 4.4 billion (79.5% of GDP in 2014)<sup>9</sup> as of September 2014. Banks represent 70.8% of the total financial system assets, followed by Pension Funds (23.5%), Insurance Companies (3.1%) and Microfinance Institutions (2.6%). Foreign-owned banks assets represented 90.5% of total banking sector assets as of November 2014. The degree of market concentration, measured by the market share of the three largest banks (assets), decreased slightly. In November 2014, the three-largest banks ratio stood at 67.5% compared to 67.7% in November 2013. However, the degree of market concentration measured by Herfindahl-Hirschman Index (HHI) dropped to 1,846 points in November 2014, compared to 1,868 points in November 2013.

**Graph 3. Development trend of the financial system and the appropriate sectors' assets**



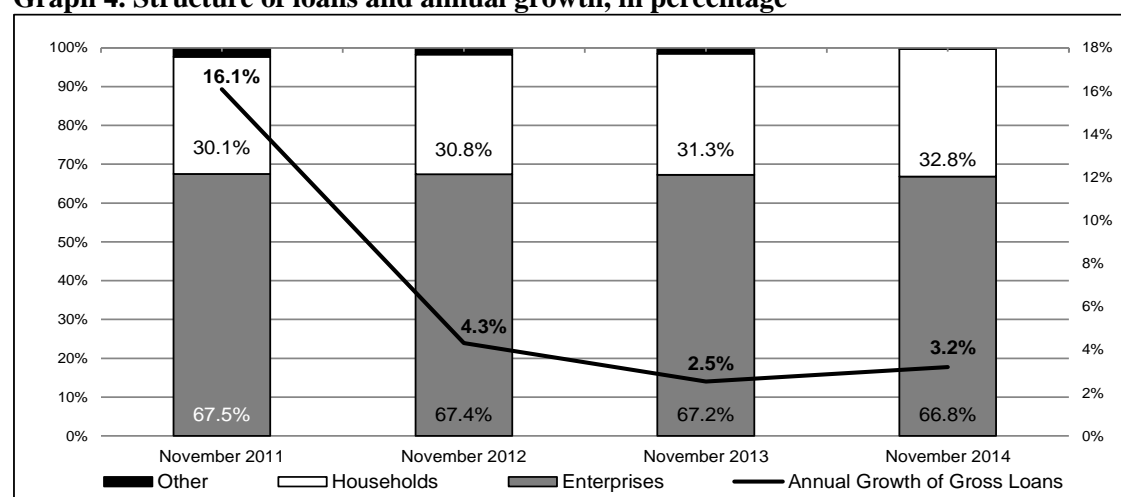
Source: Central Bank of Kosovo (2015)

After two years of decelerating credit growth, lending activity accelerated during 2014. In November 2014, total loans reached 1.9 billion euros, marking an annual increase of 3.2% (2.5% in November 2013). The accelerated growth of total gross loans, among other things, reflects the considerable growth of new loans during 2014 which reached the amount of 889.8 million euros until November 2014, an annual increase of 31.6% (0.7% increase during the previous period). Loans to enterprises grew annually by 2.6% and continued to dominate the loan portfolio with a share of 66.8% in November 2014 (67.2% in November 2013), whereas household loans marked an annual growth of 8.2% and represented 32.8% of total loans (31.3% in November 2013).

<sup>8</sup> Excluding assets of Financial Auxiliaries and of the Central Bank of the Republic of Kosovo

<sup>9</sup> Forecasted GDP for 2014: Central Bank of the Republic of Kosovo.

**Graph 4. Structure of loans and annual growth, in percentage**

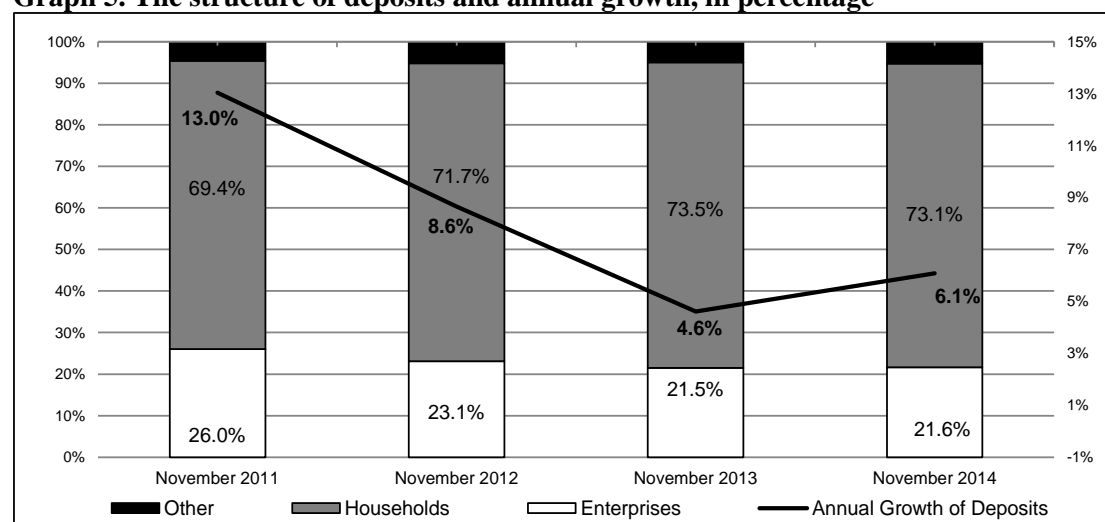


Source: CBK (2015)

The expansion of the lending activity in the first half of 2014 was mainly driven by the supply side, while the demand for loans has generally been lower. In the bank lending survey, conducted by the Central Bank, commercial banks have declared that they have eased 'somewhat' the credit standards for enterprises and households. Until June 2014, banks have mostly eased the credit standards for small and medium enterprises (SMEs) and short-term loans, whereas the banks have reported tighter lending standards to large enterprises. Regarding the demand for loans, in general, banks have noticed a reduction in the demand for loans in this period, with particular emphasis on long-term loans.

The banking activity in Kosovo continues to be financed mainly by domestically collected deposits, which have shown to be a sustainable source of financing. In November 2014, deposits reached the value of 2.5 billion euros, representing an annual increase of 6.1%. The increase of total deposits is mainly attributed to household deposits, which represent 73.1% of overall deposits in the banking sector.

**Graph 5. The structure of deposits and annual growth, in percentage**



Source: CBK (2015)

The financial intermediation activity in Kosovo until November 2014 has been characterised by declining interest rates both in loans and deposits. The interest rate on loans decreased to 9.9% in November 2014 from 12.2% in November 2013, whereas the interest rate on deposits in November 2014 decreased to 0.6% from 3.2% in November 2013. However, because of the more pronounced decrease of interest rates on deposits, the interest rate spread between loans and deposits increased to 9.3 percentage points (p.p.), compared to 9.0 p.p. in November 2013.

**Table 1: Financial Soundness Indicators**

Banking system	Core set	November 2011	November 2012	November 2013	November 2014
Capital adequacy (%)	Regulatory capital to risk-weighted assets	17.3	17.9	16.6	18.0
	Regulatory Tier I capital to risk-weighted assets	14.5	15.0	12.7	14.7
Asset quality (%)	Nonperforming loans to total gross loans	5.9	7.3	8.7	8.5
Profitability (%)	Return on assets (ROAA)*	1.6	1.0	1.0	1.8
	Return on equity (ROAE)*	16.6	10.4	10.6	18.5
	Interest margin to gross income	75.7	74.4	66.9	76.0
	Noninterest expenses to gross income	77.8	85.3	84.7	67.2
Liquidity (%)	Liquid assets (broad) to total assets	30.9	30.6	33.4	33.4
	Liquid assets (broad) to short-term liabilities	38.8	38.4	42.7	42.0

\* Net income before tax is considered. \*\* ROAA and ROAE are annualized.

Guide: Financial Soundness Indicators, Compilation Guide, IMF (2006)

The profitability position of the banking sector increased significantly during 2014, reaching its historical record high levels. Until November 2014, the profit more than doubled in annual terms, reaching 54.0 million euros compared to 23.6 million euros recorded until November 2013. The increase of profit during this period primarily reflects the decrease of banking sector expenditures on loan-loss provisions and interest payments.

The risks to the Kosovo banking sector remain low. The liquidity position of the banking sector in 2014 is in satisfactory levels. The liquid assets to total assets ratio stood at 33.4% in November 2014 while liquid assets to short-term liabilities stood at 42.0%. As of November 2014, the loan to deposit ratio decreased to 74.3% compared to 76.4% in November 2013. Liquidity stress-testing results for year 2014 show that Kosovo banking sector is resilient to adverse simulated liquidity shocks.

Credit risk exposure of the Kosovo banking sector declined in 2014. Non-performing loans in November 2014 stood at 8.5%, which represents a decreasing trend of NPLs in 2014 (8.7% in January) compared to accelerated growth of NPLs during 2013 (from 7.8% in January to 8.7% in December). In addition, the non-performing loans remain well covered by loan-loss provisions. Furthermore, the banking sector remains well capitalized with a capital adequacy ratio of 18.0% that is well above the minimum regulatory requirement of 12%. Credit risk stress testing results for 2014 suggest that the sector is capable to withstand severe shocks to its credit portfolio, along with simulated interest rate and exchange rate shocks.

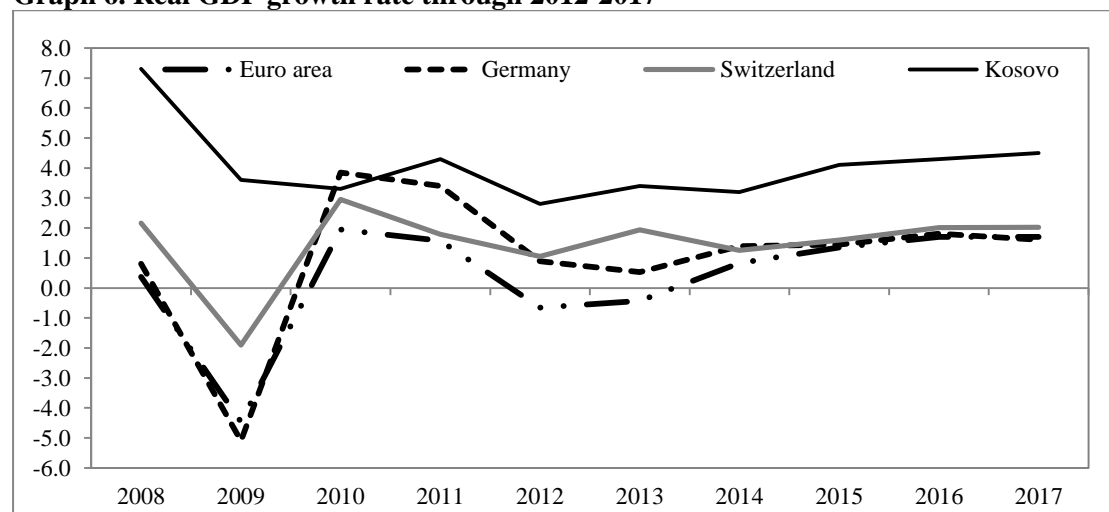


## 2.2. Medium-term macroeconomic scenario

The medium-term outlook for 2015-2017 is expected to reflect structural reforms and policy actions undertaken during 2014 and for reasons laid out in section 1 it does not fully reflect the Government Programme. The **real GDP growth** is expected to recover from the estimated 3.3% to around 4.3% on average during the period 2015-2017. Consumption is expected to be the main driver of economic growth followed by investments. Private consumption will be driven by increased disposable income from the public sector wage and pension increase of March 2014 and supported by the increasing inflow of remittances as well as the expansion of consumer credit. Private investments are expected to have a positive contribution to GDP growth following projected credit growth and expected reforms and support by the Government in the areas such as sustainable energy, sustainable agriculture and infrastructure. Net exports are expected to have a negative impact on GDP growth although there are signs of positive trends in the structure of exports of goods as well as substitution of imports, mainly by agricultural products.

Kosovo's economy is small and with limited potentials which makes it vulnerable to external developments. Therefore, throughout 2015-2017, Kosovo's economy is expected to follow the same trend of economic cycle as that of the Euro-area economies. In particular the trends in Germany and Switzerland have a strong impact on the Kosovo economy through the flow of remittances and possibly FDI. However, while Euro-area slipped into recession during 2008-09 due to financial crises, Kosovo managed to keep positive growth mainly fuelled by consumption as well as public investments (Graph 6).

**Graph 6. Real GDP growth rate through 2012-2017**



Source: SAK, calculations of DEPP/Macroeconomics Unit and IMF WEO October 2014

In 2014, **real GDP** is estimated to grow by 3.3% mainly driven by private consumption, private investments and net exports (see Table 2). **Consumption** is expected to be the major driver of economic growth during 2015-2017 and is expected to grow by 3.6%, on average. This increase is expected to be driven mostly from the public sector wage and pension increase following the decision of March 2014 which will have a full effect on the real disposable income in 2015 and onwards. Private consumption is projected to be supported by the increasing inflow of remittances resulting from the recovery of the euro-area economy as

well as the expected expansion of consumer credit activity by the commercial banking sector in Kosovo. Real wage growth, due to expected fall in consumption goods' prices, is expected to support the projected growth of consumption in the medium term period.

The share of **total investment** to GDP is projected to be 27.9%, on average, over the forecast horizon. Complementing the projected 4.8% growth of public investment inclusive mainly of infrastructure projects, the growth of private investment is projected to be 8.7% on average over the forecast horizon. Continuing reforms in improving business environment, falling of construction costs as a result of the fall of metal and fuel prices and expected expansion of the credit activity associated with the expected fall of interest rates on loans are expected to contribute further to the private investment growth during this period.

**Table 2. Main macroeconomic indicators, baseline scenario**

Description	2011	2012	2013	2014 Est.	2015 Proj.	2016 Proj.	2017 Proj.
<i>Real growth rates (in %)</i>							
GDP	4.4	2.8	3.4	3.3	4.1	4.3	4.6
GDP per capita	2.8	1.2	1.9	1.7	2.5	2.7	3.0
Consumption	3.0	2.6	2.2	3.9	3.4	3.7	3.6
Investment	7.9	-12.9	-0.3	-0.2	7.4	7.1	8.5
Exports	3.3	0.5	2.5	6.8	5.5	4.7	5.1
Imports	3.5	-7.7	-1.5	3.9	4.9	4.6	5.0
CPI	7.4	2.4	1.8	0.4	0.4	0.6	0.4

Source: SAK and DEPP/Macroeconomics Unit calculations

**Exports of goods and services** are projected to grow by 5.1%, on average, which will mainly be driven by the exports of goods, a category expected to grow by 4.9%, on average during 2015-2017. Historically, exports of base metal have been the main driver of the growth trend of exports and to a large extent followed the developments in international metal prices. Considering that international metal prices, in particular those of nickel, are forecast to increase during the observed period, exports of metals is also expected to follow this trend. During the last two years, however, the structure of exports of goods was characterised by a certain degree of diversification, with agricultural and construction material goods increasing considerably their share in total exports. Thus, the expected recovery of the EU economies<sup>10</sup> is expected to contribute further to the growth of non-metal exports and consequently to the sustainability of export growth. On the other hand, exports of services are also expected to grow but with the slowing pace as compared to exports of goods, with travel (mainly diaspora) and IT services expected to be the main drivers as they hold largest share in services.

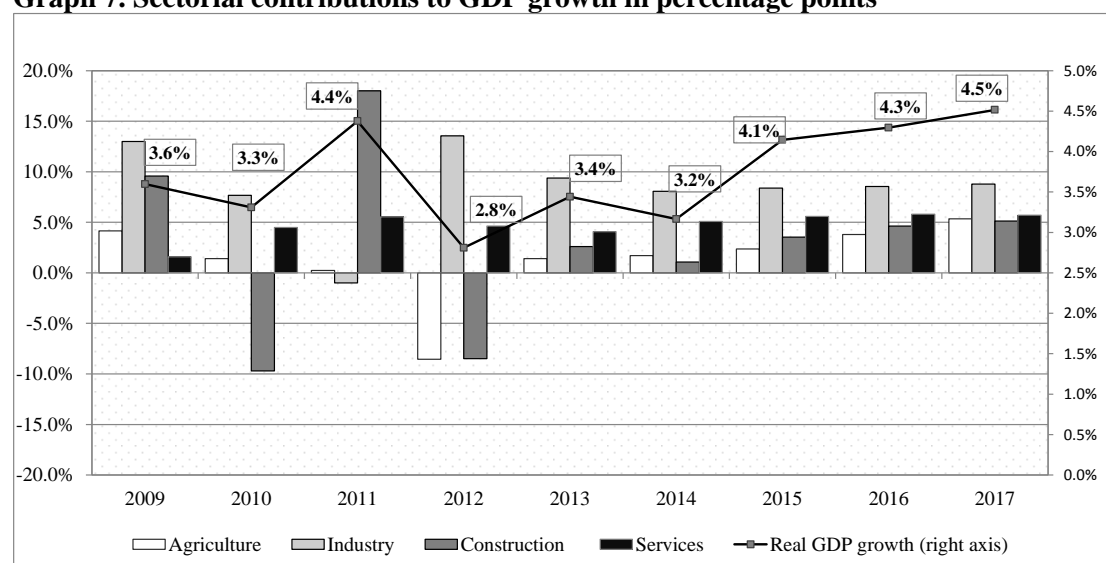
Over the observed period, **imports of goods and services** that continue to constitute 50% of GDP are expected to grow by 4.9%, on average in real terms. Imports of goods are forecast to grow by 5%, on average, being mainly driven by the expected increase of total demand. On the other hand, following the developments in imports of goods, imports of services, which are mainly represented by the 'transport services', are expected to grow by 3.7% on average, although a certain degree of substitution of this category by domestic services is expected.

<sup>10</sup> Around 68% of Kosovo exports are directed towards EU countries.

On the **production side**, services sector which constitutes around 55% of GDP, has grown in real terms by 4.7% on average during the 2011-2013 period, and is forecast to grow by 5.7%, on average during the forecast period. Trade, transportation and IT services are expected to be the main drivers to the services sector growth (see Graph 7). The second largest sector, the industry sector, has marked an average real growth of 7.3% during 2011-2013, and in the next three years is expected to grow in real terms by 8.6%, on average.

The agricultural sector, that constitutes around 14% of GDP, is expected to grow on average by 3.8% in real terms, during 2015-2017. This growth is mainly attributed to the increased productivity supported by the increasing subsidies granted by the Government. On the other hand, construction sector in the next three years is expected to grow by 4.4%, on average partly fuelled by construction of the highway R6 (Pristina to Skopje).

**Graph 7. Sectorial contributions to GDP growth in percentage points**



Source: SAK and DEPP/Macroeconomics Unit calculations

### *Monetary and exchange rate policy and inflation*

Given the use of euro as a legal currency, Kosovo lacks the monetary policy instruments needed to control inflation. Therefore, as a small and largely open economy, it is a price taker and is subject to movements on international food and commodity prices as well as domestic costs. During 2015-2017, the **inflation rate** is expected to fall to 0.5%, on average mainly due to the fall in world commodity, oil and food prices.

### *External sector and its medium-term sustainability*

The needs for infrastructure upgrade and the lack of external competitiveness have had an impact on the current account deficit since the end of the war. The current account balance started deteriorating more since the start of major capital projects such as the highway 'Route 7'. Imports continued to increase faster than exports which had negative impact on the trade balance and therefore on current account.

The **current account deficit** is expected to remain at current levels during the forecast period, averaging at 6.5% of GDP. The **trade balance** is expected to improve as a share to GDP, but it will still record a high deficit of 36% of GDP by the end of the period. **Imports** are expected to grow by 5% on average, reflecting the overall growth of domestic demand. **Exports** are expected to be largely based on metals, although a certain degree of diversification is expected, with exports of agricultural products, construction materials and possibly textile contributing further to the exports growth. In the next three years, exports of goods are expected to grow by 5.6%, on average.

The share of base metals in total exports has been slowly declining (from 63% in 2009 to 49% in 2013) and the performance of other sectors has improved markedly, although from a small base. In 2013, base metal and mineral products accounted for around two-thirds of Kosovo's exports, whilst other sectors with significant shares in export include prepared foodstuffs and beverages, vegetable products, and plastics (see Table 3). Apart from base metals, the exports of all of these sectors have been increasing faster than imports in 2013, likely reflecting increasing competitiveness and some import-substitution. Assuming that the evolution of exports in recent years (2010-2013) continues, the same sectors, and perhaps the small but fast-growing textile sector, are likely to gain ground over the medium-term.

**Table 3: Top exporting sectors, 2013**

HS Section	Share in exports	Export growth (base 2010)	Import growth (base 2010)
Base metal and articles of base metal	49.0%	-23%	30%
Mineral products	16.5%	24%	17%
Prepared foodstuffs, beverages and tobacco	6.6%	68%	23%
Plastics, rubber and articles thereof	6.2%	123%	37%
Vegetable products	5.2%	26%	14%

*Source: Calculations based on SAK, External Trade Statistics*

The **income account** is expected to grow by 5.9%, on average, with compensation of employees which have the largest share being forecast to grow by 6.7%, on average. On the other hand, net transfers account is expected to grow by 3.2%, on average, mainly driven by the private transfers constituting almost 80% of total transfers. Amongst the private transfers, workers' remittances which comprise the major share in total private transfers are expected to grow on average by 4.8%.

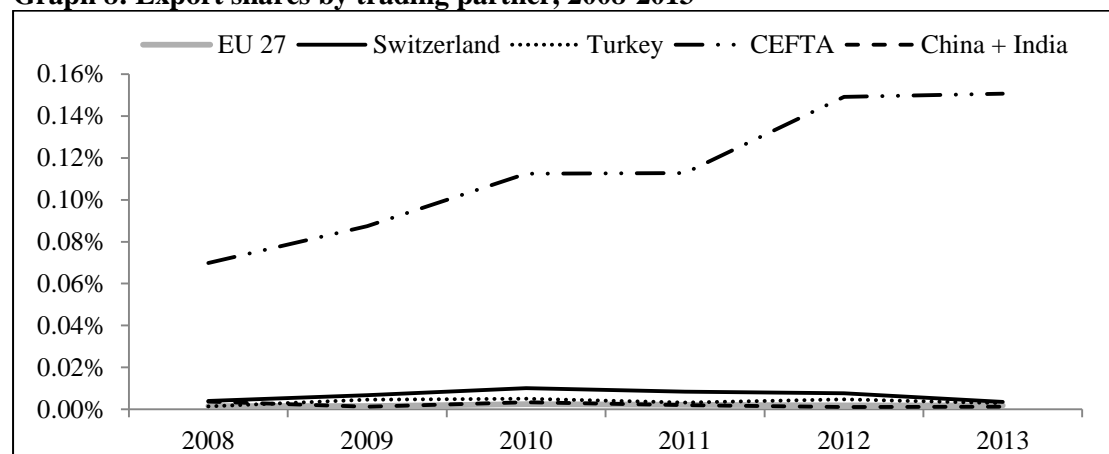
Concerning **competitiveness**, labour costs have increased faster than labour productivity in 2014, leading to an increase of unit labour costs (ULC) by 2.1% compared to 2013 (the earliest year for which a comparable ULC figure could be obtained)<sup>11</sup>. After an appreciation of 4% (y-o-y) in 2011, the real effective exchange rate (REER) has remained relatively stable in the 2012-14 period<sup>12</sup>.

<sup>11</sup> The calculation of ULC is constrained by availability, consistency and quality of data. The numerator, i.e. average cost of labour, was calculated using employee compensation and number of employees as reported to the KPST (which does not include the self-employed and informally employed), whereas the denominator, labour productivity, was calculated using real GDP and the total number of employed persons as reported by the LFS (which includes the self-employed and informally employed). Hence, this calculation implicitly assumes that the average labour cost in the informal sector is the same as that in the formal sector.

<sup>12</sup> REER is provided by the CBK

Kosovo's export share over the period 2005-2013 has been increasing, though highly volatile in the latter years, reflecting partly the volatility of metal exports. Since 2008, export competitiveness in the CEFTA market has been increasing steadily, however there is no clear trend in the export shares to other trading partners (see Graph 8).

**Graph 8: Export shares by trading partner, 2008-2013**

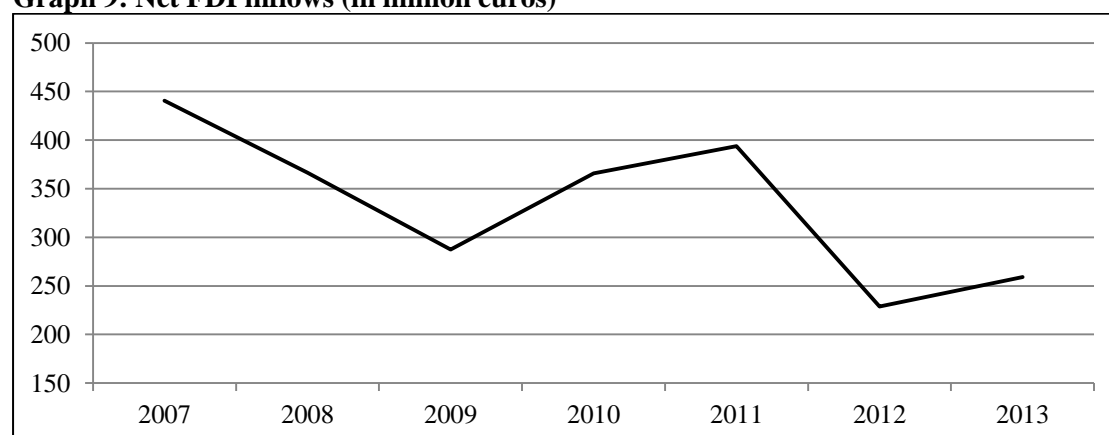


Source: Calculations based on SAK and UNCTAD trade data

**FDI** are expected to grow by 8.7%, on average throughout 2015-2017 supported by the measures to be undertaken by the GoK to improve the business environment and the coming into effect of the SAA. In addition, although to a lesser extent, the privatisation process is expected to continue to positively contribute to the FDI flow.

Since 2007, net FDI inflows have been volatile and with an overall negative trend, reflecting partly a slowdown of the privatization process and the effects of the global financial crisis (see Graph 9)<sup>13</sup>. Whereas the financial services and transport and telecommunications sectors were the major recipients in the earlier years (accounting for around 50% of inflows in 2007 and 2008), the sectorial composition of FDI has shifted towards real estate and construction between 2009 and 2013<sup>14</sup>.

**Graph 9: Net FDI inflows (in million euros)**



Source: CBK

<sup>13</sup> Nevertheless, in terms of the average size of FDI inflows as a share of GDP, Kosovo stood in the middle of Croatia, Bosnia and Herzegovina and Serbia (at 2-3%) and Albania and Montenegro (at 9 and 19%, respectively) in the period 2009-2013.

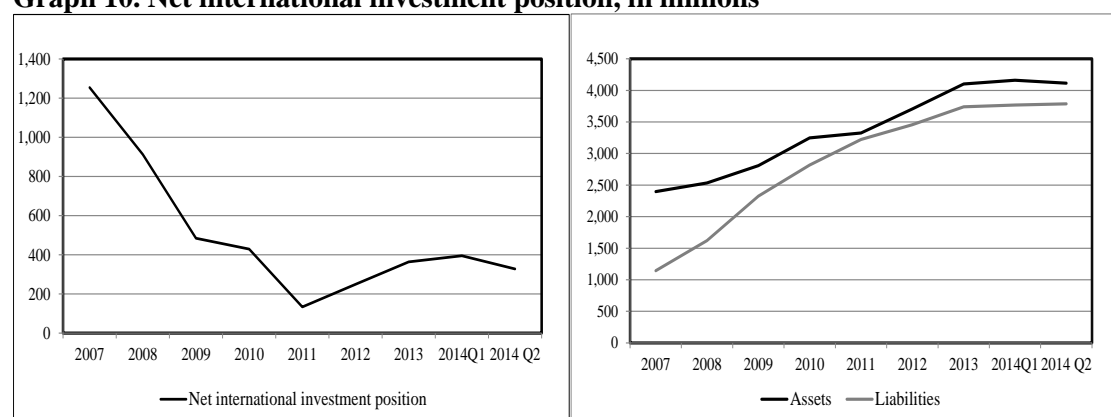
<sup>14</sup> FDI in real estate is significantly driven by the Diaspora investment

**Trade openness and obstacles to trade:** Kosovo has a liberal trade regime with a flat customs rate of 10% for imports. Further gradual liberalization of trade is expected from 2016 as the SAA with the EU and a free trade agreement with Turkey will be implemented. Although a member of CEFTA and enjoying duty-free access to the EU under the Autonomous Trade Preferences and to the US under the Generalised System of Preferences, Kosovar firms have not been able to take (full) advantage of the opportunities provided by these export markets. Apart from the generic obstacles to doing business, discussed in part 4.2.1., and the lack of competitive supply capacity, export-specific obstacles include difficulties to meet international quality standards (or obtain certification), high transportation costs, costly bank guarantees, lack of skills required by exporting companies, limited networking opportunities, and, in some cases, political relations with the destination countries<sup>15</sup>. In short, the benefits of trade liberalization depend on addressing these pervasive supply-side constraints.

Developments in Kosovo's **net international investment position (IIP)** have been characterised by a positive balance, accounting for around 5% of GDP in 2014 (see Graph 10). Holding the largest share on the assets side, portfolio and other investments predominantly defined Kosovo's net international position. On the other hand, 70% of the liability side is composed of foreign direct investments. Consequently, from 2011 to 2013 the value of IIP balance increased by 13.3% being mainly driven by net portfolio investments and other investments which, throughout the same period, marked an annual growth of 17.1% and 1.4%, respectively. In 2014, the growth rate of these two accounts slowed somewhat, leading to the fall in the IIP balance by 9.9%.

On the other hand, the **balance of direct investments** remained negative and marked an increase of 0.8% in 2014. Throughout 2015-2017, portfolio and other investment balance is expected to decline slightly, as a result of the projected increase in the domestic credit activity as well as higher investments oriented towards government treasury bills. Thus, considering the projected increase in FDI and government external debt, the structure of IIP is expected to change slightly in favour of the liability side.

**Graph 10. Net international investment position, in millions**

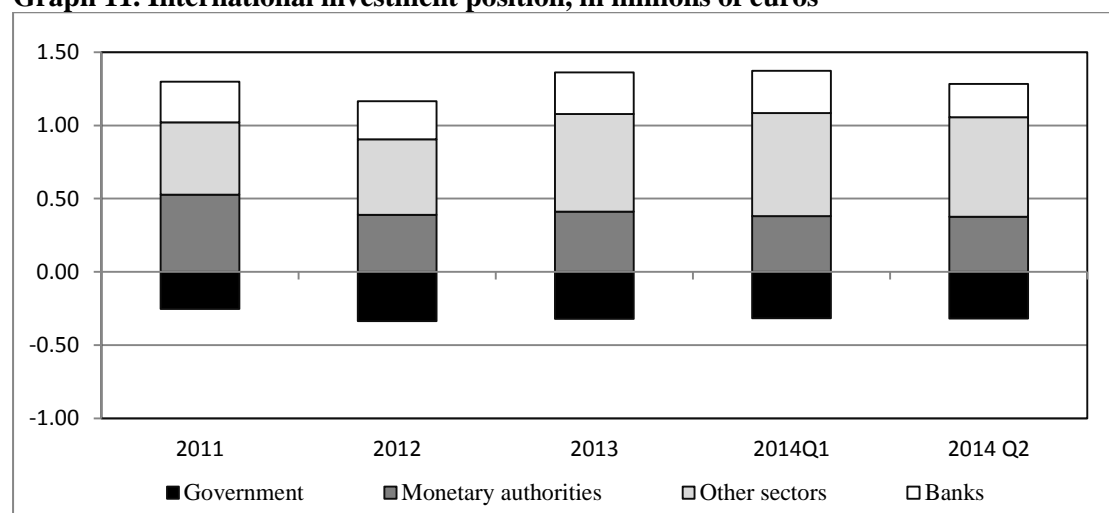


Source: CBK

<sup>15</sup> The discussion on obstacles to exports draws from surveys with firms of selected sectors, provided by MTI/UNDP sector profiles, available at: <http://www.mti-ks.org/en-us/Publications>, and on analysis by Mr. Petrit Gashi.

As regards the institutional sectors, the IIP balance is largely defined by the **CBK and commercial banks' investments** abroad on the asset side and the government external debt and other sectors' debt on the liability side. Again, this structure of IIP is expected to change slightly (see Graph 11), under the expectation that commercial banks will direct their investments towards extending the lending activity domestically at the same time as the government external debt and other sector's debt will increase.

**Graph 11. International investment position, in millions of euros**



Source: CBK

**Financial sector** - the expectations for **credit growth** in 2015 suggest slightly higher growth rate compared to 2014. The credit growth pick-up of 2014 is likely to follow in 2015 with an accelerated rate as a result of better macroeconomic conditions on the one hand, and the sound banking capital, liquidity and loan portfolio quality conditions on the other hand. The positive growth prospects for Eurozone and the domestic economy are expected to be reflected in an increased demand for loans from both enterprise and households sectors. On the supply side, the sound capitalization of the banking sector with capital levels in excess of minimum regulatory requirements, record high profitability, as well as the excess liquidity levels suggests that banks are well positioned to support extended credit.

Bank's lending survey data for the second half of year 2014 support the above expectations. Banks' expectations for the lending activity for the second half of year 2014 were that the demand for enterprise and household loans will increase, along with the eased lending conditions expected to follow due to perceptions for overall risk decline and competition pressures.

### 2.3. Alternative scenarios and risks

Same as with the baseline scenario, the alternative scenario does not reflect the Government Program 2015-2018 and as such is built upon the same policies that underlie the baseline scenario. The **alternative scenario** is constructed on the basis of the assumption that the recovery of the euro-area economy will be delayed, hence, negatively affecting the consumption and exports in Kosovo. The economy of Kosovo was shielded from the global financial crises and turbulences in the euro area, although its growth slowed down. This

resilience to external crises was mainly due to the robust remittances and FDI inflows from diaspora almost half of which reside in Germany and Switzerland, accompanied by limited financial integration with crisis countries. The VECM conducted by IMF staff<sup>16</sup> in 2013 revealed that domestic demand in Kosovo is dependent on and hence, vulnerable to developments in the German economy. Slow recovery of the euro-zone economies will therefore affect the rate of remittance and FDI inflow in Kosovo leading to lower consumption and therefore lower GDP growth. In addition, slowdown in remittance growth is expected to affect economic agents' behaviour as they might be more inclined to save and postpone their spending to later years.

This scenario is based on the assumption that **remittances** will be 5.1% lower, on average for the forecast horizon compared to the baseline projection. As a result of this lower growth of remittance inflow, real private consumption grows by only 1.3%, on average, compared to 4.1% in the baseline scenario.

**Private investments**, part of which is financed by remittances and FDI, are expected to grow slower than projected in the baseline scenario whereas public investments are kept at the same level as in the baseline. In addition, the lending activity of banks' is also assumed to remain low given that banks will continue with the restricted lending policies, further affecting the growth of private investment. Consequently, total investment is projected to grow by 6.7% in real terms or 0.9 percentage points lower compared with the baseline scenario.

Slower euro-zone recovery will also affect the **export** performance given that euro-area countries are Kosovo's main trading partners. Because global metal prices, and in particular nickel prices are expected to increase, exports of metals, production of which was under-utilized for several years due to low metal prices, will increase by a higher rate in 2015 and stabilize in the subsequent years. Due to low external demand, non-metal exports will grow slower, hence contributing only marginally to the export growth. Consequently, exports of goods are forecast to grow by 5%, on average, which is 0.6 percentage points lower compared with exports growth forecast in the baseline scenario.

The economy of Kosovo has such a structure where around 30% of the domestic demand is met with imported goods. Consequently, the resulting developments in the domestic demand, as presented in this scenario, are expected to influence **imports of goods**, leading to a slowdown in its growth to about 2 percentage points compared with the baseline.

Accordingly, the **current account deficit** is projected to deepen slightly compared to the baseline. As expected, the largest contribution to this increase comes from the trade balance and private transfers. In addition, net income is expected to be affected by the lower than projected repatriation of profits by the foreign investors which is expected to be counterbalanced by the lower income from Kosovo's investments abroad due to low interest rates in the euro-area countries.

As a result of these assumptions, **real GDP** is forecast to grow by 2.5%, on average, during 2015-2017 (see Table 4), compared to 4.3% in the baseline scenario. Slower growth would also negatively affect the **budget revenues**. The fiscal implications of the alternative scenario are discussed in Chapter 3.6.

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<sup>16</sup> IMF, 2013 ARTICLE IV CONSULTATION, selected issues paper, July 2013



**Table 4: Main macroeconomic indicators – alternative scenario**

Description	2011	2012	2013	2014 Est.	2015 Proj.	2016 Proj.	2017 Proj.
Real growth rates (in %)							
GDP	4.4	2.8	3.4	3.3	3.3	2.1	2.1
GDP per capita	2.8	1.2	1.9	1.7	1.7	0.5	0.5
Consumption	3.0	2.6	2.2	4.1	2.0	0.7	0.8
Investment	7.9	-12.9	-0.3	-0.2	6.3	6.7	7.1
Exports	3.3	0.5	2.5	6.8	8.2	3.1	2.0
Imports	3.5	-7.7	-1.5	4.2	4.1	2.1	2.3
CPI	7.4	2.4	1.8	0.8	0.4	0.6	0.4

Source: SAK and DEPP/Macroeconomics Unit calculations

### 3. Fiscal framework

#### 3.1. Policy strategy and medium-term objectives

A primary objective of our fiscal policy for 2015-2017 is to guarantee stable public finances, respecting a legally binding fiscal rule which limits government deficit at 2% of GDP. The GoK also decided to reduce the level of expenditures on goods and services by 15% in 2014<sup>17</sup> and maintain this level in the medium term. In this context the Government will continue with the implementation of a fiscal policy that is based on the principles of strict and responsible fiscal planning through ensuring a sustainable level of government debt in line with the long-run ceiling of 40% set in the Law on Public Debt.

The GoK has been successful in building a relatively simple tax system, with a tax revenue-to-GDP ratio reaching at 20%. The tax system in Kosovo is characterized by broad-based taxes with low rates and few exemptions. The fiscal framework presented in this document does not take into account any changes to the tax rates whereas the Government is committed to further broaden the tax base by undertaking measures to prevent and reduce the informal economy and increase the efficiency of tax collecting agencies. Labour market barriers are few and there is a well-established public financial management system in place.

During 2014, the Government approved two decisions<sup>18</sup> aimed at improving tax policy and promoting private sector development. The objective for the 2015 is to adopt necessary legislative changes and to fully functionalize activities foreseen under both Government decisions. In addition, in line with the objective of increasing the production base and import substitution, the Government increased subsidies to the agriculture sector by 41 million euros.

The Government will continue with activities foreseen within the action plan for implementing the ‘National Strategy for the prevention of and fight against informal economy 2014-2018’. A particular focus is given on combating informal economy and increasing further the efficiency of revenue collection. This will be achieved through better coordinating activities and efforts of all involved stakeholders towards increasing anti-corruption

<sup>17</sup> The Government Decision that approves the reduction of expenditures on goods and services by 15%.

<sup>18</sup> 1. Government Decision no. 02 and 03/178 dated d18/03/2014 “On the establishment of Free Economic Zones in three municipalities ( Gjakova, Mitrovica and Prizren); 2. Government Decision no.04/186 dated 29/04/2014 “On providing tax incentives for new investments”

measures, expanding further the tax base and formalization of businesses. Therefore, a significant increase on tax revenue collection (in particular of those domestically collected) is expected to be generated in the medium term from the fight against informal economy through broadening further the tax base and increasing the tax compliance.

On the other side, in line with the Government decision no. 01/176 on the increase of the basic salaries of all public sector employees and pensions to all pensioners by 25% (Trepça pensioners by 50%), the Government will continue with the payment of increased wages and salaries and pensions and other benefits within the planned timeframe.

The baseline fiscal framework 2015-2017 does not envisage any additional increase, neither on wages and salaries nor on pensions and other social benefits. The Government has recently announced there will be no further wage increases in 2015, and any future wage and other benefit increases will be made in accordance with the country's economic development and changes in inflation. A restrictive spending policy on goods and services will be maintained over the period 2015-2017, with the aim of increasing spending efficiency.

In line with these restrictions on current spending, the Government is committed to maintain a high level of capital spending, on average at about 7% of GDP throughout 2015-2017. The construction of new roads and further improvement on existing road and railroad infrastructure will constitute major share of capital investments in the upcoming period.

### **3.2. Budget implementation in 2014**

The General Government Budget of the Republic of Kosovo consists of the central level budget and municipal level budget and it includes all budget organizations. It is being consolidated in accordance with the international accounting standards and is prepared on a cash basis. The municipal budget consists of the general grant determined in accordance with the formula specified by the Law on local finances, education grant and health grant. In addition, the municipal budget comprises expenditures financed by the own source revenues collected at the local level. The central level budget comprises all budget organization (excluding municipalities).

For the first time, the GoK implemented the legally binding fiscal rule according to which the 2014 budget was approved. Nevertheless, the year 2014 was characterized by a number of developments which affected the implementation of the overall operations of the general Government as well as its expenditure structure compared with the approved 2014 budget. Namely, decisions taken by the Government early in 2014 and the uncertainties associated with the period after the elections played a particular role on the implementation of the 2014 budget. Table 5 presents the approved budget and the execution of the 2014 budget according to the preliminary financial report.

**Table 5: General Government revenues and expenditures, 2014**

Description	2013	2014 Budget	2014 Execution	2015 Budget
In millions of euros				
1. Total Revenues	1,316	1,458	1,333	1,576
2. Total Expenditures	1,469	1,589	1,463	1,682
Current	945.5	1,050	1,051	1,220
Capital Expenditures	529.2	530.5	411.4	457.0
3. Primary balance	-152.5	-131.2	-129.8	-106.1
Interest payments	-11.5	-16.5	-12.8	-17.4
4. Overall balance (as per fiscal rule)		-110.7	-121.9	-113.3
5. Overall Balance	-163.9	-147.7	-142.6	-123.5
GDP	5,327	5,581	5,581	5,879
Overall deficit as % of GDP	-3.1%	-2.0%	-2.2%	-1.9%

Source: Treasury, Budget 2015 and DEPP/Macroeconomics Unit calculations

The 2014 budget execution presented in this section is based on preliminary financial report of the 2014 budget execution and might be subject to small changes.

### **Revenues**

During 2014, total budget revenues amounted to 1,333 million euros which corresponds to an execution of 91.4% of the forecasted revenues. According to the report, during 2014, the total budget revenues were about 125 million euros (about 8.6%) lower than the budgeted level for 2014.

Total tax revenues, during 2014, amounted to 1.14 billion euros which is about 123 million euros (9.7%) lower than the forecast for 2014. Among these, border tax revenues totalled to 871 million euros or about 63 million euros (about 6.9%) less than forecasted for 2014. Compared to 2013, border tax revenues were around 33.7 million euros higher (or about 4%). The main reason behind this shortfall, compared with the forecast, is the low level of execution of public capital spending which consequently affected the domestic demand and hence, imports. However, despite the large fall in import quantities and the associated fall in international commodity prices, the measures undertaken by the Kosovo Customs to improve the valuation of imports led to a higher collection of revenues compared with the previous year.

Domestic tax revenues collected by the TAK during this period amounted to 303.7 million euros, or 64 million euros (about 17.3%) lower compared with the forecast for 2014. Compared to 2013, revenues from TAK are about 1.7 million euros (about 0.6%) lower. The main reason behind this shortfall is the inability to collect the planned one-off revenues from PAK and KPST<sup>19</sup> as well as the low level of execution of budgeted capital expenditures.

Non-tax revenues during 2014 totalled to 46.8 million euros or about 1.0 million euros lower compared with the forecast for this category. Own source revenues amounted to 98.2 million euros or about 19 million euros lower than the forecast included in the budget and are about

<sup>19</sup> Due to the lack of the PAK board. The shortfall of domestic budget revenues at the amount of 37 million euros, of which 30 million euros are related to one-off revenues from Privatization Agency of Kosovo (PAK) on behalf of debt of socially owned enterprises to TAK, and additional 7 million euros on behalf of payments, over payments, penalties and interests which are expecting recovery, expected to be collected by KPST

3.2 million euros higher than in 2013. Among this category of revenues, the largest shortfall compared with the forecasted level was recorded in municipal own source revenue collection. Revenues in this category reached 53.2 million euros or about 14 million euros less than the forecast for this year and are 2.7 million euros lower compared with 2013.

Revenue performance indicates a shortfall in revenue collection in almost all revenue categories. This poor performance is related to the following main factors:

- The general political situation related to the delay of establishment of new institutions has been reflected by the slowdown of a number of planned capital investments and also on the non-execution of new budget capital expenditures. This is primarily related to delays on the construction of the Route 6 as well as projects planned to be financed by loans which could not be approved by the parliament. Such situation has had an impact on the performance of other local businesses and as such on the level of revenues collected, mainly on VAT and corporate income tax.
- Lower than expected economic growth – The projected economic growth for 2014 has been revised with the 2015 Budget Law down to 3.3% from the initial projection of 4.1%. The political developments followed with high level of uncertainties have been reflected in the confidence of businesses and their decisions to invest. Despite observed increase in exports and consumption (mainly due to wage increase and higher inflow of remittances), investments and FDI declined significantly during 2014.

### ***Expenditures***

Overall expenditures during 2014 amounted to 1,463 million euros or about 126.3 million euros less than the budget for 2014. Executed expenditures in 2014 are 5.9 million euros lower compared with the executed expenditures for 2013. The delay in the constitution of the main state governing bodies and the uncertainties that arose during this period are considered as the main factors contributing to the non-execution of expenditures, in particular capital expenditures.

Expenditures on wages and salaries during this period were 485 million euros, or about 68.1 million euros higher than in the same period 2013. This increase of expenditures reflects the costs of the increase of salaries for civil servants by 25% based on the Government decision, which began to be implemented in April 2014. As a result, the wage bill increased from a monthly average of about 34.5 million euros to 41.5 million euros, or about 7 million per month.

Expenditures for goods and services during 2014 amounted to 205 million euros, or about 47 million lower than planned for this period. This reflects the Government decision on reducing the expenditures on this category by 15%.

Capital expenditures by the end of the 2014 amounted to 411.9 million euros or about 118.7 million euros less than the amount budgeted for this category, whereas compared with 2013 they were around 123.1 million euros lower. The largest amount of capital expenditures was executed during December.

Expenditures for subsidies and transfers by the end of 2014 reached at 361.2 million euros, or 47.1 million euros higher compared with the budget for this category, and were about 48.3

million euros higher compared with last year. This amount includes the cost of the implementation of the government decision for raising the pensions and other benefits by 25%, taken on April 2014.

Considering the fact that revenues turned out to be lower than projected and despite the low execution of expenditures the overall deficit amounted to 121.9 million euros or 2.2% of GDP<sup>20</sup> in 2014. The fact that the overall deficit exceeded the 2% ceiling by less than 0.5% of GDP is not considered as a breach according to the LPFMA. Specifically, according to the LPFMA the excessive deficit means a deviation from the deficit in excess of 0.5% of the projected GDP in a single fiscal year or cumulative over two subsequent fiscal years. However, the GoK is committed to adjust the deficit within two years so that the overall deficit to GDP for three fiscal years will average at 2%.

### 3.3. Medium-term budgetary outlook

Assessment and forecast of budget revenues for 2015-2017 presented in the NERP and the corresponding expenditure framework are identical to those included in the draft budget approved by the Parliament in 2014 and hence do not fully reflect the measures laid out in the recently approved Government Program 2015-2018. The revenue estimates in the draft budget are based on the macro fiscal framework presented in MTEF 2015-2017, which is based on forecasts of key economic indicators presented in that document and does not fully take into account the recent changes in the economic environment as reflected in the medium-term macroeconomic scenario presented in Chapter 2. These recent developments will be addressed in the next MTEF and, as needed, in budget revision during 2015. Table 6 presents the 2015-2017 fiscal framework as approved in 2014.

**Table 6. General Government Revenues and Expenditures, 2015-2017**

Description	2014 Budget	2015 Budget	2016	2017
<i>In millions of euros</i>				
1. Total revenues	1,458	1,576	1,573	1,599
Tax Revenues	1,264	1,350	1,342	1,366
2. Total expenditures	1,589	1,682	1,664	1,691
Of which: PAK related spending	7.0	10.2	5.4	4.4
Recurrent	1,050	1,220	1,208	1,216
Capital Expenditures	530.5	457.0	450.4	470.3
3. Primary balance	-131.2	-106.1	-90.2	-92.4
Interest payments	-16.5	-17.4	-21.6	-23.1
4. Overall balance (as per fiscal rule)	-110.7	-113.3	-106.4	-111.1
5. Overall Balance	-147.7	-123.5	-111.8	-115.5
GDP	5,581	5,837	5,978	6,117
Overall deficit as % of GDP	-2%	-2%	-2%	-2%

Source: Treasury, Budget 2015 and DEPP/Macroeconomics Unit calculations

#### **Budget revenue forecast 2015-2017**

Budget revenue forecast is based on historical trends of the revenue categories in relation to economic factors that determine them. The indirect effect of the capital project execution on budget revenues is also reflected. Further, assumptions relating to improvements in the efficiency of collecting agencies as well as measures that the Government is undertaking to

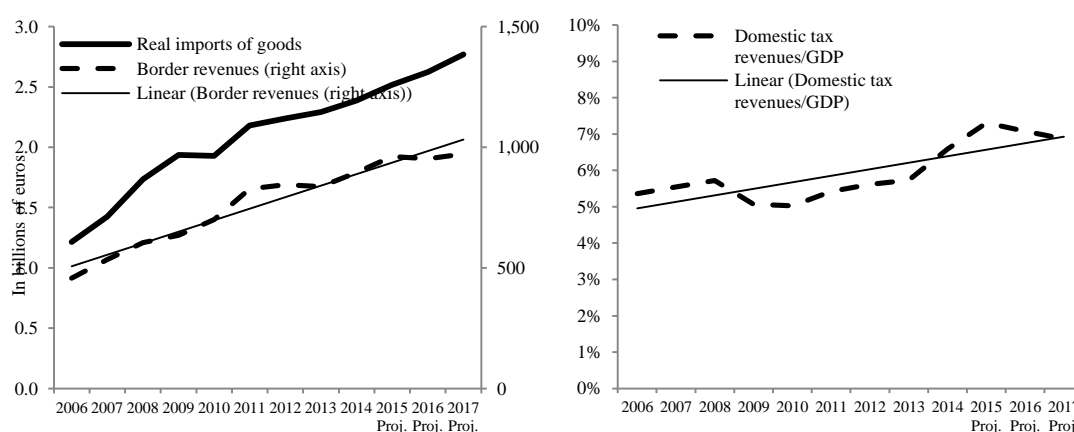
<sup>20</sup> The GDP as estimated in the Budget 2014.

prevent and reduce the informal economy are also taken into consideration while forecasting budget revenues. Budget revenues for 2015-2017 incorporate key fiscal policies as of end 2014, both on revenues, and also expenditures and financing side.

During 2015, overall revenues are expected to amount to 1.576 billion euros, a value which corresponds to an increase of 8.1% compared to budgeted revenues for 2014. The largest contribution to the growth of budget revenues is expected to be provided by tax revenues (which are expected to contribute by 5.9 percentage points) and dividends (2.1 percentage points, since during 2014 a declaration of dividends by publicly owned enterprises was not forecasted). Within the tax revenues, the revenues collected at the border are expected to amount to 962.2 million euros or 3% more compared to forecast included in the 2014 budget. Domestic tax revenues are forecast to amount to 429.6 million euros or 17% more compared to the level planned for 2014. Non-tax revenues are forecast at 195 million euros within which the own source revenues and non-tax revenues are expected to reach 114.2 million euros and 48.8 million euros, respectively. In addition, during 2015 dividends declared by publicly owned enterprises in the amount of 30 million euros is planned.

Similar to previous years, the total revenues are dominated by regular tax revenues representing about 86% of revenues. It is worth mentioning that the increasing trend of revenues does not foresee any change in the tax rates, and despite numerous exemptions from the customs duty and the implementation of the SAA and the free trade agreement with Turkey, this increase of revenues, along with other economic factors, is based on the increase of efficiency of the collecting agencies and on measures to be undertaken against informal economy.

**Graph 12: Trend of tax revenues 2006-2017**



Source: Treasury, Budget 2015 and DEPP/Macroeconomics Unit calculations

As presented in Graph 12, historically border revenues followed the trend as the one of real imports. In the medium-term period, border revenues are expected to follow a slower trend, particularly starting from 2016 which reflects the beginning of implementation of the SAA with the EU countries. Furthermore, despite the expectations of decreasing prices of imports (mainly food products and fuel) over the 2015-2017 periods, there are two basic assumptions supporting the increase of border revenues:

1. Increase in the demand for imports, reflecting the negative demand elasticity relative to prices accompanied by the increase in real wages, will compensate eventual decline in import prices

2. As a result of SAA, a higher volume of imports from EU countries is expected<sup>21</sup>, which will be reflected in higher revenue collection (mainly from VAT and excise duties).

Revenues collected domestically have gradually increased their share to GDP (see Table 7), mainly as a result of measures undertaken by TAK for the increase of compliance, which led to the increase of the total tax collection. Therefore, for the 2015-2017 period, this share is expected to increase, partially as a result of additional measures expected to be undertaken in order to narrow the tax gap, while the increase in 2015 comes as a result of the previously planned and not collected one-off revenues from PAK on behalf of debt of socially owned enterprises to TAK and from KPST on behalf of payments, over payments, penalties and interest which are to be reconciled. The increase of domestic tax revenues, which includes revenues from direct taxes (on personal income, corporate income and property) as well as part of indirect taxes (VAT), will also be supported by the projected growth of consumption and investment for the period under observation.

Non-tax revenues and own-source revenues are forecast to keep the same share to GDP with marginal changes deriving from changes in the plan for the collection of concession tax and changes in central own-source revenues as a result of the decrease in own-source revenues of public universities.

**Table 7. Budget revenues as % to GDP**

Description	2014 Budget	2015 Budget	2016	2017
Total revenues	26.1	26.8	25.6	24.8
Tax revenues	22.7	23.0	21.8	21.2
Non tax and own source revenues	3.4	3.3	3.3	3.1
Dividend	-	0.5	0.5	0.5

*Source: Budget 2015 and DEPP/Macroeconomics Unit calculations*

### ***Budget expenditures 2015-2017***

Assessment and breakdown of budget expenditures for 2015-2017 is based on the budget approved by the Parliament in 2014, which was prepared on the basis of the macro-fiscal framework presented in MTEF 2015-2017 and on the principle of implementation of fiscal rule, limiting the overall budget deficit at 2% of GDP. In this context, total expenditures for 2015 (including also the expenditures for PAK) are planned to be at the value of 1,682 million euros, which is about 6% higher than planned expenditures for 2014. Total spending is planned to increase by 9 million euros in 2017 amounting to 1,691 million euros.

The 2015-2017 budgetary framework incorporates the implementation of new policies and reforms for which the decisions have already been taken. To this end, current spending is planned to increase by around 170 million euros in the 2015-2017 framework. The additional current spending includes the following policies:

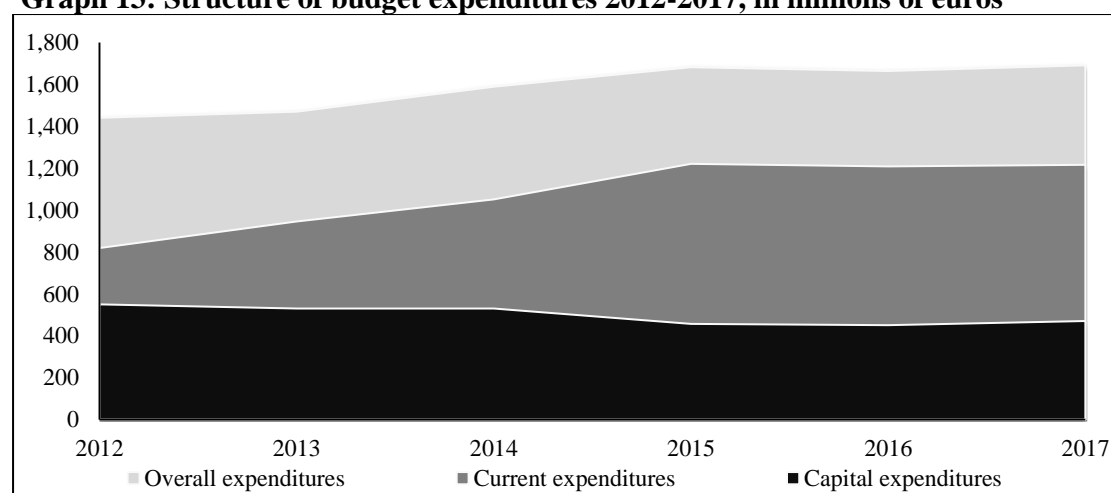
<sup>21</sup> Through higher investment due to the lower cost of inputs which previously were imported from the EU countries.

- (i) The full cost of the implementation of the Government decision no. 01/176 on the raise of the basic salary of all public sectors employees by 25% taken on March 2014 (the total cost of implementing the decision on wage increase amounted to around 90 million euros),
- (ii) Full cost of the implementation of the Government decision no. 01/176 on raising of pensions to all pensioners by 25% taken on March 2014 (Trepça pensioners in the value by 50%) (The total cost of this decision amounts to around 50 million euros),
- (iii) Implementation of the health reform, namely beginning of implementation of Law on Health and Law on Health Insurances including introduction of Health Fund contribution on wages (the cost to the budget includes the contribution that the Government as an employer will pay on behalf of its employees. The amount included in the budget for this reform is 10 million euros)
- (iv) Implementation of the sectorial review of the reform in the defence sector
- (v) Implementation of Law on War Veterans and the resulting compensation for them and the compensation for wartime rape victims (24 million euros for both)

On the other hand, this forecasted budget also includes the implementation of the Government decision no. 07/172 on the reduction of Expenditure on Goods and Services by 15%, compared to the planned budget for 2014 (around 35 million).

The total budget expenditures also include the beginning of implementation of the construction of the highway Road 6 (Prishtinë – Shkup), a project which is expected to be finalised within the upcoming medium-term period (90 million euros in 2015, and 288 million euros in total over the 2015-2017 period). In addition, the 2015-2017 budgetary framework also plans to finance the rehabilitation of railway the cost of which within this period amounts to 30 million euros. Part of the total budget expenditure framework is also the expenditure of about 10 million euros which will be financed out of PAK dedicated revenues (The Law on Privatisation agency of Kosovo specifies that 0.5% of liquidation proceeds will be used to finance PAK administrative and operational cost).

**Graph 13: Structure of budget expenditures 2012-2017, in millions of euros**



Source: Treasury and Budget 2015, MoF

In Graph 13, we can see the development of Kosovo budget expenditures since 2012, continuing with projections up to 2017. As it can be seen in the chart, along with the total



increase of budget expenditures from 2013 and onwards, the current expenditures have increased more rapidly than capital expenditures which also reflects a displacement of the general structure of expenditures in favour of current spending.

### *Expenditures by economic categories*

Table 8 presents expenditures classified by economic categories for the period 2014-2017.

**Table 8: The medium-term budget expenditure framework**

Description	2014 Budget	2015 Budget	2016 Proj.	2017 Proj.
<i>In millions of euros</i>				
Total Expenditures	1,589	1,682	1,664	1,691
<i>Of which: PAK related spending</i>	7.0	10.2	5.4	4.4
Current	1,050	1,220	1,208	1,216
Wages and Salaries	483.4	560.1	551.9	553.9
<i>of which: payments for health insurance</i>	0.0	10.0	10.0	10.0
Goods and Services	252.0	221.6	215.6	215.4
Subsidies and Transfers	314.1	438.7	440.6	446.6
Social transfers	292.7	417.0	419.6	436.4
Subsidies for PEO <sup>22</sup>	21.4	21.7	21.0	21.0
Reserve	2.2	5.0	5.0	5.0
Capital Expenditures	530.5	457.0	450.4	470.3

Source: Budget 2015, MoF

The structure of budget expenditure during 2015-2017 is dominated by the current expenditures, the participation of which in the total budget expenditures averages at 72%, while as a share of GDP they are expected to remain at about 20%, thus marking an increase of about 1.7 percentage points compared to budgeted expenditures in 2014. A similar share of about 19% in GDP is expected to remain also during the three upcoming years as a result of the need for maintenance and for the implementation of the new policies and reforms listed above, which are associated with the increase of current expenditures.

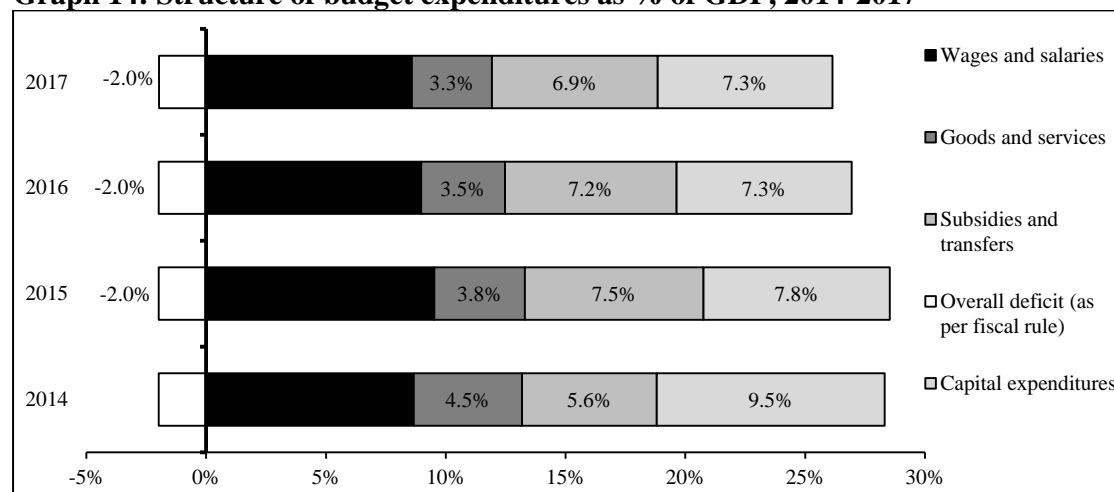
The share of capital expenditures in the total budget expenditures still remains to be high, about 28%, while as a percentage to GDP, they are expected to fall from 9.5% as budgeted in 2014 to about 7%, on average during the observed period.

**Expenditures for Wages and Salaries:** Expenditures on wages and salaries are estimated to amount to 560 million euros for 2015, an amount which presents an increase by about 15.9% compared to its budgeted level in 2014. As a share to GDP, this category of expenditures increased from 8.7% as budgeted in 2014 to 9.5% in 2015 (Graph 14). This increase of expenditures reflects the costs of the salary increase of civil servants by 25% based on the Government decision, implemented in April 2014. In addition, around 11 million euros out of the total amount allocated for this category reflects the cost budgeted as a contingency for payment to be made with regard to the years of the experience for public workers which relates to the implementation of the collective agreement signed early in 2014. Moreover, the increase of this category of expenditures also reflects the cost of filling the existing vacant positions from 2014 for numerous budget organizations. This relates to the opening and

<sup>22</sup> Publicly-Owned Enterprises

functionalization of new public universities, staffing the new working positions both in the existing structures and also in the new institutions established as a result of the new responsibilities transferred from international institutions to the domestic ones, and the implementation of the reform in the security sector. In addition, expenditures for wages and salaries includes the cost to the Government resulting from the implementation of health care reform related to the health insurance contributions that the GoK will pay for all civil servants on the central level, expected to start being implemented during 2015. This portion of funds was allocated as a contingency within the budget of the MoF.

**Graph 14: Structure of budget expenditures as % of GDP, 2014-2017**



Source: Budget 2015, MoF

**Subsidies and transfers:** expenditures on subsidies and transfers include spending on social transfers and subsidies for publicly owned enterprises. In 2015, expenditures for this category are planned to amount to 438.7 million euros, thus marking an increase of about 39.7% compared to the budgeted value for 2014. These expenditures are planned to increase slightly over the planning horizon reflecting the increase in the number of beneficiaries (mainly pensioners) as well as a considerable increase in agriculture subsidies. As a share to GDP, this category is expected to reach the level of about 7.5% in 2015, compared to 5.6% planned for 2014 (Graph 14).

Within this category of expenditures, the category of social transfers is budgeted to increase by about 40% in 2015 from 292.7 million euros as budgeted for 2014 to 417 million euros. This sharp increase in this category is a result of the implementation of the following policies:

- 1) Reflection of the full cost of implementation of the Government decision of March 2014 on the raise of pensions by 25% for the following categories: persons with disabilities, war invalids, KPC<sup>23</sup> early pensioners, basic pension for all pensioners and KSF<sup>24</sup> members, compensation for the blind; and an increase by 50% for Trepça early pensioners.
- 2) Beginning of the implementation of the Law on War Veterans
- 3) The cost also reflects the natural increase in the pensioners and other beneficiaries

<sup>23</sup> Kosovo Protection Corps

<sup>24</sup> Kosovo Security Forces

**Goods and Services:** expenditures in this category reflect the policy for the reduction of expenditures for goods and services by 15% in accordance with the Government decision for undertaking measures to limit the spending on luxury goods at the general level of the Government. Expenditures for goods and services in 2015 are forecasted to be at the level of 221.6 million euros, thus marking a decrease by 12.3% compared to the previous year. It is worth mentioning that this category of expenditures also reflects the increased budget for the supply with essential pharmaceuticals reflecting the beginning of the implementation of the Government Programme 2015-2018. A similar level of expenditures for this category is also planned for the years 2016 and 2017.

**Capital expenditures:** there are 457 million euros forecasted for 2015, a category which represents about 29% of the total budget, or nearly about 8% of GDP (Graph 14). Following the finalization of the Highway Route 7, a project which during the previous period represented the main capital project, the medium term budgetary framework includes the budget for the implementation of the construction of the Highway Road 6 (Prishtinë – Skopje) project. Within the category of capital expenditures there are also a large number of other infrastructure projects including construction of Road M2 to Mitrovicë and M9 to Pejë, improvement of local roads, sports and education infrastructure.

### ***Budget deficit and financing***

Despite the increase of budget for current spending, as well as of maintaining the high share of capital expenditures, the total budget deficit over the medium term period is maintained at 2% of GDP thus respecting the fiscal rule. Based on this rule, the overall fiscal position during the forecasted period is assessed to remain stable and sustainable.

The medium term overall deficit, as forecasted in the fiscal framework, is planned to be **financed** by domestic and foreign borrowing. The foreign debt is planned to be drawn for the purpose of financing projects that are already included in the existing budget framework as well as on-lending projects for non-government organizations for which the government acts as a guarantor (which amounts to 86 million euros cumulative for the 2015-2017 period).

As shown in the table below, foreign borrowing, as presented in the budget 2015 fiscal framework, is planned to amount to 200 million euros cumulative for the three year period while the debt principal repayment is forecast to reach 143 million euros, cumulative. The high amount of principal repayment relates mainly to the repayment of previously drawn IMF debt. The foreign debt presented in this table includes only the borrowing for the purpose of financing the budgetary projects and does not foresee additional financial assistance from IMF.

Domestic borrowing is expected to total 320 million euros (cumulative) for the three year period whereas, by the end of the planning period the bank balance is estimated to fall to 130 million euros or 2% of GDP.

**Table 9: The financing of the budget deficit and the Government bank balance**

Description	2014 Budget	2015 Budget	2016 Proj.	2017 Proj.
<i>In millions of euros</i>				
Financing	-147.7	-123.5	-111.8	-115.5
Foreign financing	33.6	57.3	13.3	-13.0
Drawings	55.7	84.6	74.0	42.3
of which: IMF	0.0	0.0	0.0	0.0
Amortization	-22.1	-27.2	-60.6	-55.3
Domestic Financing	114.1	66.2	98.4	128.4
Domestic borrowing	120.0	100.0	100.0	120.0
One-off Financing	20.0	0.0	0.0	0.0
Change in other financial assets	-19.5	-40.3	-36.2	-10.0
Change in stock of OSR <sup>25</sup>	4.0	10.2	5.4	4.4
Change in Bank Balances	-10.4	-3.8	29.3	14.0
Balance of KCF <sup>26</sup>	170.2	173.9	144.6	130.6
of which: ELA	46.0	46.0	46.0	46.0
Overall deficit as % of GDP	-2%	-2%	-2%	-2%
Debt stock as % GDP	11.0%	12.4%	13.4%	14.5%
Of which: guarantees as % to GDP	0.2%	0.2%	0.2%	0.2%

Source: Treasury and Budget 2015, MoF

### 3.4. Structural balance (cyclical component of the deficit, one-off and temporary measures, fiscal stance)

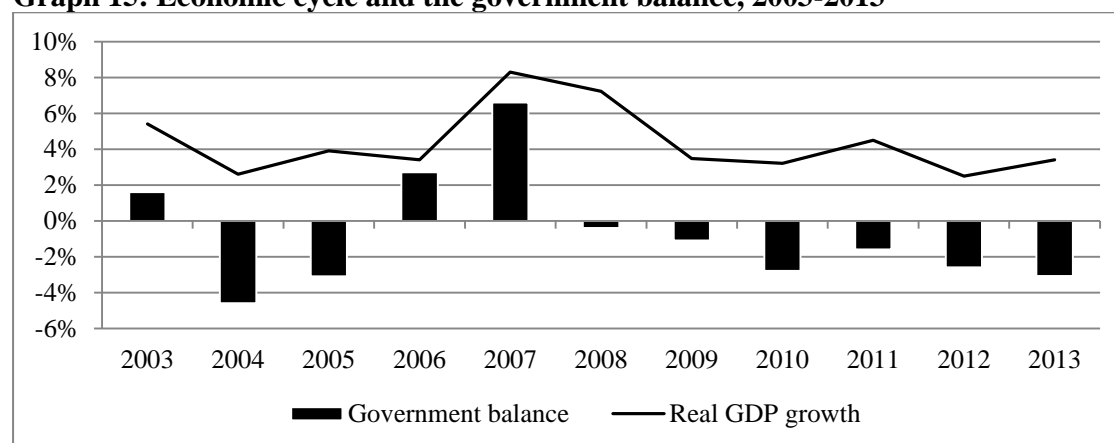
Graph 15 presents cyclical movements of the real GDP growth rate over the past ten years and the corresponding government balance. The government managed to create surpluses in high growth years (2006 and 2007) and used the balance to partly finance deficits in the following years when international financial crises negatively affected Kosovo's growth rate. The share of public investments in GDP also doubled from around 5% before 2008 to around 10% afterwards.

The chart suggests that fiscal policy has been largely counter-cyclical and has partly offset the impact of the economic crisis. Such evaluation is shared by the recent World Bank Public Finance Review of Kosovo.<sup>27</sup> Short time series, due to the lack of quarterly national accounts data, do not allow a valid econometric estimation of potential GDP and cyclical and structural components of the budget balance.

<sup>25</sup> Own Source Revenue

<sup>26</sup> Kosovo Consolidated Fund

<sup>27</sup> In the World Bank's assessment, "Headline fiscal policy has been counter-cyclical and implemented with the intention of supporting economic growth". World Bank: Kosovo Public Finance Review, June 2014, p. i.

**Graph 15: Economic cycle and the government balance, 2003-2013**

Source: IMF, SAK

### 3.5. Debt levels and developments, analysis of below-the-line operations and stock-flow adjustments

All public and publicly guaranteed debt is managed and serviced by the DMU which functions jointly with the cash management unit within one division in the State Treasury. In addition, the CBK serves as a fiscal agent for the Government, and facilitates the technical side of domestic debt issuance including the management of the electronic auction platform for primary and secondary markets, as well as providing a securities depository and clearing system. At the end of 2013, the DMU has introduced a State Debt Program which includes the medium-term objectives and an annual borrowing plan. The objectives are set to facilitate the domestic market development as well as to limit the exposure of the total debt to financial risks.

**Table 10. Stock and structure of debt**

Stock of Debt	2013	2014 (est.)
External + Domestic Debt	475	571.4
<i>External Debt</i>	323	314.5
<i>Domestic Debt</i>	153	256.5
Possible debt 1/	2	20
Public Debt	477	591
Debt to GDP (%)	9.0	10.6

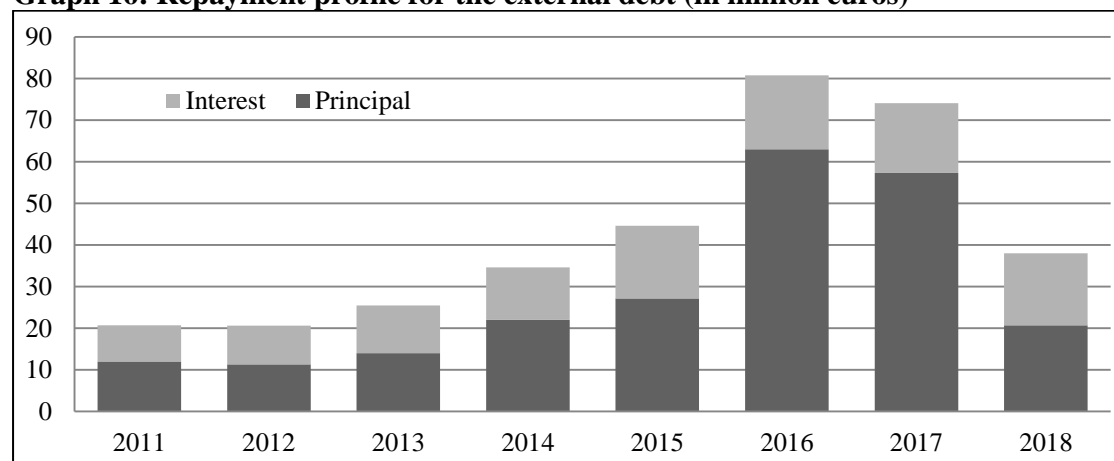
1/Net lending and guarantees

As of the end of October 2014, the total debt of Kosovo stood at 553 million euros. This amount consisted of 231 million domestic and 322 million external debt (figures on Table 10 are estimations for the year 2014). The determining factor of the debt evolution is the budget deficit. Currently the weighted average interest rate of our portfolio is 2.58%, and we do not expect it to significantly change in the mid-term due to the fact that the majority of our contracted debt is with a fixed rate and long maturity. A slightly higher weighted average rate is expected for the domestic debt, considering that we will extend the maturities in the following years. Furthermore, about 103 million euros of the external debt is debt owed to the IMF. Considering that our net exposure to foreign exchange denominated debt stands at only 13.8% of our total debt portfolio, we don't foresee any significant currency risk arising in the

medium term. Similarly, only 18.7% of our debt portfolio is exposed to variable interest rates, the majority of which is due to the IMF loan.

From Graph 16 below we see that in the years 2016 and 2017 there is a considerable increase in the repayment profile; this is due to the debt service amount to be paid on the IMF loan. This will be monitored closely by the DMU in order to find ways to control this increase.

**Graph 16: Repayment profile for the external debt (in million euros)**



Source: 'Public Debt Programme Dec 2014', Treasury, MoF

Among the main features of the public debt for the period 2015-2018 is the introduction of government bonds in longer maturities (of 2, 5, 7, and 10 years), as the government is committed to further developing the internal market of securities, whereas it plans to use foreign borrowing as the main source of budget financing.

**Contingent liabilities** - To date, the MoF has issued only one guarantee for a credit line facility. Such guarantee was issued to the EBRD to cover a credit line facility amounting to 10 million euros which was extended to the Deposit Insurance Fund of Kosovo.

### 3.6. Sensitivity analysis and comparison with the previous programme<sup>28</sup>

As stated in section 2.3, the main risk that might emerge from the alternative scenario is the fall in tax revenues compared with previous years. Based on the estimated decline of imports, given that budget revenues are predominantly composed of revenues collected at the border, this scenario produces lower budget revenues than those projected in the baseline scenario at around 120 million euros in total for three years, out of which around 95 million euros relates to revenues collected at the border (Table 11). Detailed estimations of revenues sensitivity to imports are presented in Annex 2).

<sup>28</sup> This being the first NERP of Kosovo, no comparison to previous programmes is provided.

**Table 11: General Government revenues and expenditures under the alternative scenario**

Description	2014 Budget	2015 Budget	2016	2017
<i>In millions of euros</i>				
1. Total revenues 1/	1,458	1,559	1,529	1,535
Tax Revenues	1,264	1,338 2/	1,298 3/	1,302 3/
2. Total expenditures	1,589	1,682	1,664	1,691
Of which: PAK related spending	7.0	10.2	5.4	4.4
Recurrent	1,050	1,221	1,208	1,216
Capital Expenditures	530.5	457.0	450.4	470.3
3. Primary balance	-131.2	-123.0	-134.6	-156.1
Interest payments	-16.5	-17.4	-21.6	-23.1
4. Overall balance (as per fiscal rule)	-110.7	-130.2	-150.8	-174.7
5. Overall Balance	-147.7	-140.5	-156.2	-179.1
GDP	5,581	5,837	5,978	6,117
Overall deficit as % of GDP	-2.0%	-2.2%	-2.5%	-2.9%

1/ The revenue projection in this scenario is based on the same tax effective rates used in the baseline scenario

2/This includes the 37 million euros one-off revenues from PAK and KPST which will not be accounted for as per the LPFMA escape clause.

3/The estimated revenue loss of around 25 million euros from the SAA and free trade agreement with Turkey is accounted for in the tax revenue projections. Therefore, this measure will not be accounted for when calculating revenues as per the escape clause.

Under this scenario, the combination of lower revenues and the fiscal rule would require adjustments to be made on the expenditure side to the extent that revenues fall, hence, generating lower GDP growth. Given that current spending limits the ability of the Government to find savings, capital spending would have to be reduced.

The exception clause in the LPFMA states that the Government, with the approval of Parliament, can increase the deficit level if for any period of six months within a fiscal year, collection of tax revenues is equal to or lower than tax revenues collected in the same period of the previous year (excluding any fiscal measures). In such a case, given that there is little room for current expenditures to be reduced and some capital expenditures are contract based and many are on-going projects, there is a limited room to reduce expenditures to compensate for the fall in revenues. Although, initiatives are already being taken by the Government to find additional savings, the maintenance of the fiscal deficit within the limits set by law remains a challenge in this scenario. Another possibility, in the case of lower revenue execution compared with the previous year, is for the deficit level to increase temporarily<sup>29</sup>, increasing the need for additional borrowing which in turn, may introduce additional risk, that of the increase of interest rates on Government treasury bills. However, projections in Table 11 show that in any year the tax revenues do not seem to be lower than the previous year, although the annual change is low.

### 3.7. Sustainability of public finances

The main policy strategy to assure sustainability of public finances was to legislate fiscal rules that limit the government deficit and the debt to GDP ratio, and set in place monitoring and corrective mechanisms.<sup>30</sup> The Debt Sustainability Analysis presented in **Annex 3** assesses the long-run sensitivity of debt to changes in the underlying macroeconomic conditions and

<sup>29</sup> The LPFMA does not put limit on the allowed level of deficit increase.

<sup>30</sup> Fiscal rules are explained in Section 3.8.

government deficit. It shows that fiscal policy has only a small room for error, and that keeping the public debt below the 40% threshold will require a gradual reduction of deficits below the maximum level allowed by the fiscal rule (graphs are presented in the debt sustainability part of this section).

DSA projections do not include potential fiscal effects of demographic change. Kosovo has a young population; the median age was 28.2 years in 2011 and the share of population over 65 years was only 6.9%. Based on SAK demographic projections, the old-age dependency ratio in Kosovo will not reach the current average level of the EU-28 countries before 2040.<sup>31</sup> This indicates that ageing does not present a major risk for public finance sustainability in the foreseeable future.

Basic pensions are paid directly from the budget and they are estimated at 119 millions of euros (about 2.2% of GDP) in 2015 including supplements for special categories of beneficiaries. A fully funded mandatory pillar 2 pensions system is also in place. Contribution rate is 5% for both the employer and the employee. The funds are held in individual accounts managed by the Kosovo Pensions Savings Trust (KPST). Since this second pillar is fully funded (with funds managed by a professional body and largely invested abroad), it does not require budgetary financing and is considered sustainable.<sup>32</sup>

The recent Law on Health introduced a mandatory contribution of 3.5% for both employers and employees that will finance the newly established Health Fund and is expected to start being collected in 2015. This will increase the scope of services provided by the public health system and improve its financial sustainability. Financing improvements in the health system by a newly introduced and ear-marked contribution will not put additional pressure on the budget.<sup>33</sup>

### **3.8. Institutional features**

#### ***Fiscal rules***

The Law on Public Financial Management and Accountability was amended in 2013 to include a fiscal rule with the following key features:

- maintaining the overall deficit at 2% of the projected GDP in the current budget year. This deficit level includes central and municipal level budgets,
- the unspent appropriations from the previous year, in the category of capital expenditure, can be used as a source of financing new budget appropriations, and are not considered for purposes of compliance with the deficit ceiling,
- revenue receipts on top of budgeted revenues may be transferred in the following year for new budget appropriations in the category of capital expenditure, and are not considered for purposes of compliance with the deficit ceiling,
- privatization proceeds and their spending are be considered for purposes of compliance with the deficit ceiling and can be used only for projects in the category

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<sup>31</sup> Kosovo Population Projection 2011-2016, SAK, December 2013.

<sup>32</sup> World Bank: Kosovo Public Finance Review, June 2014, p. 98.

<sup>33</sup> The health reform is explained in more detail in Chapter 4



of capital expenditure, provided that the level of usable Government bank balance amounts to at least 4.5% of projected GDP,

- any excess of the projected budget deficit of more than 0.5% of GDP must be compensated within the next three fiscal years.

The Rule also specifies the situations when there might be exemptions or temporary suspension in respect of the rule:

- cases of economic recession defined as a situation where during either period of six months within a fiscal year nominal collection of tax revenue is equal to or lower than the tax revenues collected during the same period of the prior fiscal year, excluding the impact of policy changes and one-off tax revenues,
- a case of emergency, including a natural disaster,
- a crisis in the banking system identified by both the Minister and the Governor of the KCB, on the proposal of the KCB,
- a state guarantee within the meaning of the Law on Public debt that will have to be paid by the Government and that has an impact on overall expenditures over 1.5 percent of projected GDP.

In addition, the Law on Public Debt sets a limit to the public debt level at 40% of GDP. The government is obliged to propose corrective measures if reports on budget execution or debt projections show that the fiscal rules might be breached.

### ***The annual budget process***

The budget cycle starts with a Medium Term Expenditure Framework (MTEF) to be approved by the Government in April and presented to the Parliament for discussion. This framework consists of:

- Macro-economic and fiscal framework for the three-year period;
- Statement of Priorities for Mid-Term Government Policies, which aims to orient the appropriation of budget funds during the next budget process;
- Base Scenario for budget appropriations by sectors and budgetary organizations;
- Intergovernmental reports relating to the amount of grant transfers at the municipal level (the Municipal MTEF).

After the budget hearings with the budgetary organizations, taking into consideration their comments within the reach of budget and the updated macro-fiscal framework, the draft budget is submitted to Government for approval no later than end October.

### ***Public finance management***

Regarding the improvement in the management of public finances, since 2012 a World Bank funded project is underway. Its primary objective is enhancement of the capacities for the management of public finances in pilot budgetary organizations.

To improve the public finance management, the following activities were undertaken by MF during 2014:

- Implementation of article 7 of the 2014 Budget Law regarding fulfilment of financial obligations remaining from the previous year for capital projects.

- Instruction issued on 31.03.2014 to secure better management of the economic category of wages and salaries and to discourage new employment.
- Instruction issued on 02.07.2014 that allowed budgetary organizations to make budgetary adjustments for the purpose of efficient budget execution during the remaining period of the budget year.

The MoF has tasked the GoK PEFA Secretariat to compile a two-year, government-wide, Action Plan for the Improvement of Public Financial Management (PFM) practices. The design of this improvement plan is focused on each sub-indicator area identified with the PEFA methodology, and its ultimate performance will be evaluated through a PEFA self-assessment in 2017. Moreover, the plan has annual measurement indicators for each activity, enabling the PEFA Secretariat to measure activity performance throughout the implementation phase.

The current draft of the Action Plan contains more than 50 actions aimed at: enhancing budget planning and transparency; improving the linkage between policies priorities and budgeting; and improving expenditure execution and reporting. Final consultations with stakeholders on the draft-plan are expected to be finalized in early 2015, and the plan will be presented to the Government for approval during 2015.

In addition to the Action Plan on Improving Public Financial Management, the MoF is also drafting, as part of an IMF technical assistance mission, a two year data improvement plan. A technical group has already been created between the Treasury at the MoF, the CBK, and the SAK, to work on the standardization of public institutional units. As part of this plan, which is expected to be approved by end of January, the MoF in cooperation with other local stakeholders will compile and disseminate revenue and expenditure data for the General Government in full compliance with the IMF's Government Financial Statistics Manual 2014.

#### **4. Reforms underpinning the macro/fiscal strategy**

This chapter provides information about major structural obstacles to economic growth in Kosovo and articulates those policy measures and reforms that underpin the macro-fiscal framework elaborated in the previous two chapters.

Taking into account that NERP is composed of two parts with Part II dedicated specifically to policy measures and structural reforms which are sectorial in nature, this chapter focuses on a selected number of those structural reforms and policy measures that are of horizontal, national macro-economic character and have significant direct effect on public finances of the country.

##### **4.1. Obstacles to growth and the macroeconomic structural reform agenda**

Within the context of the preparation of this document and as background for articulation of policy measures and structural reforms, a detailed diagnostics of the principle constraints to economic growth in Kosovo was made. The analysis takes into account the economic and

institutional context and identifies country specific growth constraints, as well as the most critical bottlenecks, with a view to prioritizing interventions<sup>34</sup>.

There is no generally accepted methodology for analysing constraints to economic growth. Following the European Commission's outline for the 2015 NERP preparation, one can classify these constraints into the following two groups.

- The first one consists of constraints that are of a horizontal, national character and have a direct impact on implementation of the macro-fiscal strategy presented in chapters 2 and 3 of NERP Part I.
- The second group of constraints is concentrated on those that are of more sectorial character. Their reduction and / or elimination would contribute towards improving the country's competitiveness and thus achieving high and sustainable growth. This group of constraints is discussed in the NERP's part II.

The two groups of constraints are strongly interrelated and cannot be clearly distinguished. For example, in the area of business environment, there are segments that are of a strongly horizontal character as well as those with a strong sectorial component. In this chapter, key constraints of the first group, i.e. of those ones with a horizontal, national character, are outlined. The group includes problems and challenges to economic growth in the areas of macroeconomic policies, financial sector, and microeconomic areas, including business environment, rule of law and labour market.

**Macroeconomic conditions** are not a binding constraint to growth, as Kosovo's real GDP growth and inflation as well as key public finance indicators, especially budget deficit and public debt, are sound. However, significant imbalances in the current and trade accounts are a cause for concern, as is the relatively small share of the industry as a percentage of GDP. Average real GDP growth rate in Kosovo for the period 2005-2013 stands at 4.3%, compared to 4.1% in Albania, 3.1% in Macedonia, 3.5% in Montenegro, and 2% in Serbia (World Economic Outlook -WEO- database). The average inflation rate for the same period was also low at 2.9%. General government gross debt, as a percentage of GDP, stands at an average of 7.2% for the period 2009-2013, compared to 29.2% in Macedonia, 40.6% in Bosnia, and 52.4% in Serbia (WEO database). The current account (CA) balance, as a percentage of GDP, is worrisome, but it is similar across the region. The export of goods and services, as a percentage of GDP, stands at an average (for the period 2009-2012) of 18.8% in Kosovo, compared to 48.8% in Macedonia, 38.5% in Montenegro, 32.3% in Albania, and 26.5% in Serbia (World Bank, WDI indicators). The share of net FDI inflows as a percentage of GDP (measured in current USD) stands at an average of 7% for the period 2009-2013, whereas it is 2% in Bosnia, 3% in Macedonia and Serbia, 9% in Albania, and 19% in Montenegro (WDI).

Though Kosovo's fiscal position is stable, there are significant challenges the country will be facing in this area over the forthcoming years. The key challenge will be how to preserve this fiscal stability – the 2014 fiscal rule should be instrumental in this respect – while addressing growing expenditure pressures. Though beneficial from the growth point of view, it is realistically to expect that the share of capital investments will be under pressure to start declining towards the level similar in other countries of the region. On the budget revenue side, the challenge remains in reducing dependence on taxes and duties collected at the border

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<sup>34</sup> Due to the volume of the document, the analysis was not included but is available upon request

and to move towards a structure that will be more in line with the economy's shift towards stronger domestic production and revenues collected internally.

**Financial sector** has been very resilient to the deterioration of the external environment. Due to very conservative conduct of banks with respect to their lending activity, the banking sector has remained well capitalised, liquid and profitable. One of the key weaknesses of the Kosovo's banking sector are very high intermediation spreads which reflect high credit risk and weak contract enforcement by the judiciary. The **access to finance** is, indeed, a binding constraint to growth, considering the very low loans-to-GDP ratio, high interest rates, a high level of contract enforcement risk, uncompetitive behaviour in the banking sector, and a rudimentary business structure lacking solid business standards to improve its access to finance. Based on WDI, Kosovo's level of domestic credit provided by the financial sector, as a percentage of GDP, stands at a mere average of 18% for the period 2009-2012, compared to 46% in Macedonia, 56% in Serbia, 66% in Bosnia and Montenegro. Based on the 2013 World Bank BEEPS survey, over 40% of firms in Kosovo identify the cost of finance as a serious obstacle to enterprise survey, compared to 6.5% in Albania, 7.5% in Montenegro, 14.7% in Serbia. Another indicator of constrained access to finance, based on a Riinvest<sup>35</sup> enterprise-level survey in 2011, is that only 20% of the firms surveyed suggested they used the banking sector for capital, whereas 60% reported using their 'own capital'.

**Microeconomic areas, including business environment, rule of law and labour market**, present a mixed picture. While labour regulations are flexible and taxes low, there are segments of business environment which are considered a significant obstacle to economic growth. For example, in the area of construction licensing, Kosovo lags significantly behind the peers in the region; more than 140 days are required to obtain a construction-related permit in Kosovo, compared to an average of around 80 days in Eastern Europe and Central Asia (BEEPS, 2013). Kosovo firms rank "**practices of competitors in the informal sector**" as the single biggest constraint to their business growth: 57.8 % of the Kosovo firms, compared to 11% in Montenegro, 16.1% in Serbia, 19.9% in Albania and 34.8% in Macedonia.

Another area that is assessed as a binding constraint to growth is the rule of law with respect to **contract enforcement**, mainly because the commercial court resolution process is highly cumbersome. "Enforcing a contract" is an area which is consistently being touted as a serious impediment to business growth in Kosovo. Based on the World Bank Doing Business indicators, Kosovo has made no progress over the past few years. It still takes a staggering 420 days from filing a claim to having it taken up by a court, until final resolution. The cost of legal contest remained at a 33% of the total claim value (in Croatia at 13.8%, Bulgaria at 23.8%, Bosnia at 34%, and Albania at 35.7%). The number of procedures required for making and resolving a claim remained unchanged at 53. Similarly, "resolving an insolvency" continues to take 2 years on average, costing 15% of the estate, and the recovery rate hovers at 35 cents/dollar (WB, DB, 2014).

Note that further obstacles to growth of a more sectorial nature are discussed in Part II. In the area of physical capital, insufficient and unstable **power supply** is identified as the most important obstacle from the point of view of the business sector. Regarding human capital, the main obstacle to growth and employment is the **skills gap**, particularly the lack of

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<sup>35</sup> Local research institute/ think tank

workforce with graduate and vocational secondary education. Measures to address these obstacles are explained and costed in Part II.

## 4.2. Key areas of macroeconomic structural reforms

This chapter presents key areas of reforms relevant for the overall macro-fiscal framework and policy strategy. Among these reforms, those that are part of wider sectorial policy agendas are presented in more detail in Part II and in this chapter only short summaries are included for comprehensiveness and ease of reference. Reforms that are not explained within the context of sectorial reforms in Part II, are presented in more detail here. These are the reforms related to:

- tax system reform
- creating an Investment and Employment Fund
- privatisation and involvement of the private sector (as part of product market and business environment reforms)
- reforms aimed at improving financial stability
- information on labour market flexibility, tax and benefit systems, and wage bargaining (as part of labour market reforms)
- information on the pension system
- health reform
- increasing efficiency of public expenditure
- information on wages and employment policies in the public sector

### 4.2.1. Product markets and business environment

Kosovo implements wide ranging policies for improving business environment and external competitiveness, including support to developing domestic export-oriented industrial base. Insufficient **access to finance** reflecting **imperfect contract enforcement** was identified as a binding constraint for investment and stronger economic growth. As part of efforts to mitigate this problem, a fully digitalised pledge register was introduced in 2012 and is now used by the banks. Actions planned to improve access to finance are presented in detail in Part II (Initiative 3.3) and include:

- improving access to finance through contract enforcement and legal and regulatory framework
- drafting and approving the first comprehensive law on bankruptcy procedures in 2015
- improving efficiency of the judiciary system in commercial dispute resolution by implementing the national backlog reduction strategy, introducing specialised courts and private bailiffs, making better use of ICT
- development of the cadastral system
- implementing a credit guarantee scheme for SME (see Flagship Measure 3.8.1)

To further improve access to finance, the new Government programme plans to further liberalize the market and increase the competition in the commercial banking sector aiming at reducing the interest rates.

Another major constraint to private sector development often cited by businesses is the large extent of **informal economy**. This problem is addressed by a horizontal National Strategy for the prevention of and fight against informal economy 2014-2018. Some of the actions planned in the strategy are presented in detail in Part II and include:

- joint units and investigations of informal economy and tax evasion by tax and customs administrations (see Measure 3.7.6)
- implementation of anti-corruption measures within the customs administration (see Measure 3.7.7)
- targeted information campaigns promoting benefits of formalising employment contracts and development of an action plan for the labour inspectorate in 2015 (see Measure 2.3.4)

Further actions aimed at improving the business environment and functioning of the product markets explained in Part II include: implementation of the Better Regulation Strategy (Initiative 3.1), industrial policy (Initiative 3.6), SME and export development (Initiative 3.8), investment promotion (Initiative 3.7), integration of Kosovo into the global economy (Initiative 3.2), improvement of research and innovation capacity (Initiative 2.4), improvement of the public procurement system (Initiative 3.4), and quality infrastructure development (Initiative 3.5).

To address the binding constraint of insufficient and unstable power supply, key actions include energy infrastructure development (Initiative 1.1), creating a well-functioning SEE energy market (Initiative 1.2) and improving energy efficiency (Initiative 1.3). Measures on improving the road, railway and air transport (Initiative 1.4 and 1.5) will also contribute to sustained economic growth.

#### *Tax system reform*

**Current status:** The tax system in Kosovo is characterized by broad-based taxes with low rates and few exemptions. There is a significant tax gap especially for income tax collection, reflecting the extent of informal economy. The key structural challenge remains in reducing dependence on taxes and duties collected at the border and to move towards a structure that will be more in line with the economy's shift towards stronger domestic production and revenues collected internally.

**Policy measures/reforms:** The Government of Kosovo is committed to maintain the simple and inclusive tax system and is planning to further simplify the declaration procedures by upgrading the electronic reporting and control system. The underlying reforms laid out in the Government Program are the following:

- VAT differentiation by applying lower rates for the basic commodities and applying 0% rate for the primary agricultural products with the aim to increase domestic production and hence reduce imports of agricultural products,
- Decreasing the VAT threshold aiming at creating fair and more competitive environment for doing business for small and medium size businesses,
- Introducing tax holidays for a certain amount of investments and a specified number of employees employed with the aim at increasing investments and employment,
- Merging the revenue collecting agencies, namely TAK and Customs into one agency and shifting the collection of VAT from the border towards domestic collection, in other words after the goods are sold,
- Exemption from customs duty of the IT equipment aiming at promoting the services sector growth and hence increasing youth employment,
- Simplifying procedures for fiscalisation with the aim at encouraging higher number of business to use fiscal cashiers.

The key principle of the tax system reform is therefore to create fair and competitive market by having more comprehensive, sustainable, predictable, transparent and fair tax system.

#### *Creating an Investment and Employment fund*

**Current status:** Resources available to support business development and private sector employment are scarce and distributed among several government programs and donor supported projects. This reduces their effectiveness and invites coordination failures. There is a need to concentrate and enhance the funds available for business support and employment creation.

**Policy measures/reforms:** The Government Program 2015-2018 envisages the mobilisation of the privatisation fund towards the economic activities that generate employment and sustainable economic growth. The aim of this measure is to support sectors that help employment and growth by enabling easier access to finance at a lower cost. The fund will mainly be intended for start-ups, small and medium sized producers, corporations which are mainly focused on innovation and exports, and for public and private partnerships.

The fund will be managed by applying the best international practices of professionalism and transparency. The regulatory framework and the operational plan will precede the implementation of this measure.

#### *Private sector involvement and privatisation*

**Current status:** Reducing the direct state involvement in economic activities is an important vehicle for private sector development and investment promotion. The policy objective of private sector involvement within the sectors with prevailing public ownership was introduced into the Kosovo legislation in October 2008. The first implementation of this objective was granting the 20 year concession for the Pristina International Airport ‘Adem

Jashari' to a private operator. Further on, unbundling of infrastructure and operations at the Kosovo Railway as well as at the Post of Kosovo and PTK (Vala & Telekom) has been accomplished. The GoK, during 2013 finalized the privatisation of distribution and supply part of KEK.

***Policy measures/reforms:*** In the coming years, the process of restructuring of publicly owned enterprises and the inclusion of the private sector into water and waste sectors will be implemented (for water supply services, see also Initiative 1.7 in Part II). Private sector involvement is also foreseen for the operations part of telecommunication and railway services. The private sector involvement may take different forms ranging from private-public partnership in investments and provision of services to partial or full privatisation of government ownership.

As the dynamics of this process depends on a complex set of political and economic developments, there is at the time no approved detailed strategy for privatisation. There is also a need to transpose the legal infrastructure for the process of privatization, making clear the authorizations for disposal of the public assets by law.

Publicly owned enterprises operate mainly in the infrastructure and network industries sectors. There are also some remaining former socially owned enterprises which are managed by the PAK. As these are mainly nonviable undertakings, the main objective of PAK is sale of their remaining assets and consolidation of outstanding claims.

#### **4.2.2. Financial stability**

***Current status:*** Kosovo's financial sector was not affected by the international financial crises to the extent evidenced in most of the EU member states. Still, supervision of the sector needs to be improved and these measures will also contribute to improving access to finance over the medium term.

***Policy measures/reforms:*** In the forthcoming period, the authorities aim to improve the legal framework for functioning of financial intermediates. More specifically, the following adjustments in the legal system are planned:

- *Amendment and development of regulatory framework for supervision of financial institutions as regards prevention of money laundering and financing of terrorism;* In the process of development and advancement of legislation for prevention of money laundering and financing of terrorism, in order to adapt with the new requirements of latest amendments of the law on prevention of money laundering, CBK regulation has been amended which introduces requirements towards financial institutions on this issue. Also in order to adapt the new legal and regulatory requirements the manual for examination of financial institutions on prevention of money laundering and financing of terrorism has been reviewed.
- *Amendment and advancement of legislative and regulatory framework on supervision of insurance companies;* A law on general insurance has been drafted and will be proceeded further for approval. The adoption of this piece of legislation will require amendment of secondary legislation to complement with the requirements of new law.



- *Amendment and development of regulatory framework for supervision of pension funds;* with the aim of implementation of requirements of the new law on pensions, secondary legislation for supervision of pension funds will be complemented. This process is on-going, whereas working groups for drafting the secondary legislation are established.

As far as supervision is concerned, a number of activities is planned for implementation in the banking and insurance segments of the financial sector. In the banking sector, these activities include complete application of the risk based supervision approach for banks, preparation and development of a manual for liquidation of banks is to be completed as well as an update of manuals on supervision of financial institutions in compliance with new legislation and regulatory requirements. Further advancements are to be implemented in the insurance area as well. Within this context, manuals on the risk based approach for supervision of insurance companies will be prepared, and scholarship programme for actuaries will be introduced.

And finally, several projects are underway with the common objective to contribute towards further strengthening of various segment of the Kosovo financial system. Some of these projects are the following:

- *Project on development and advancement of legislative and regulatory framework on financial services consumer protection;* The project supported by the World Bank is aimed at putting in place a regulation on internal process of treatment of consumer complaints by financial institutions and such a regulation has been issued. This includes also preparation of internal CBK procedures for treatment of complaints. In addition, in the course of next two years two other regulations will be issued for setting out methods for introduction/disclosure of financial services as well as methods for advertisement of these financial services by financial institutions. In line with this, the web page of CBK will be upgraded, to include a separate link which will contain all necessary information for financial services consumers.
- *Project on development and advancement of framework for regulation of mortgage loan and assessment/evaluation of mortgages by banks;* the project that started in 2013 with the aim of setting out rules and standards for mortgage loans is being finalised. Two regulations were prepared during this period: regulation on residential mortgage loans and regulation on evaluation of immovable property which will be adopted during this year. During the next year, follow up standard documents will be prepared, related to mortgage loans as well as preparation of detailed instructions on implementation of these regulations.
- *Project on assessment of regulatory framework for supervision of banks based on Basel II standards and basic principles for bank's supervision in order to identify areas of intervention with the aim of meeting these standards;* The purpose of this project (supported by GIZ) is to assess the legislative and regulatory framework for supervision of banks, as well as identifying areas which need to be amended/complemented in order to harmonise CBK rules for bank supervision with basic principles of Basel for supervision of banks and Basel III standards, which are also adapted with the new EU directives. Following the identification of differences/gaps, respective regulations may be issued in order to harmonise our legislation with the above mentioned principled and standards.

### 4.2.3. Labour market

Kosovo's labour market is characterised by high structural unemployment and low employment rates, reflecting the large skills gap (particularly for graduate and vocational secondary education) and the lack of effective active labour market policy.

Actions to address the skill gap are explained in more detail in Part II and include:

- increasing enrolment in the secondary education, improving its quality with better management and teacher training, and linking it with the labour market demand through introducing better career guidance (see Initiative 2.1)
- improving vocational education by advancing industrial clusters based approach to skills demand and supply matching, developing mechanism for continuous interaction between education and training institutions and the business sector, promotion of competence centres, preparation of sectorial skills demand forecasts (see Initiative 2.2.)
- increasing competitiveness of higher education (Initiative 2.3)

#### *Labour market flexibility*

**Current status:** Regulation of labour market contracts in Kosovo is low compared to EU member states. Most of employment in private sector is based on fixed-term contracts and there are little restrictions on hiring and firing decisions by employers. Since December 2011, employment and labour relations have been regulated through a new Law on Labour. The most notable changes introduced through this labour law were: (i) an extension of maternity leave to up to 12 months, out of which 9 are paid leave (the first 6 months covered by the employer at 70% of the base salary and the other 3 months by the government at 50% of the average national salary); (ii) an extension of paid annual leave to 4 weeks; (iii) a formalization of the 40-hours working week; and (iv) a requirement for firms to hire at least one disabled person per every 50 employees.

Another change in the labour market was the introduction of a minimum wage for both private and public sectors at 170 euros (130 euros for individuals under 35) in August 2011. According to a World Bank study<sup>36</sup> the 170 euros minimum wage is equivalent to that of the 10th percentile of the wage distribution of medium and large firms. The minimum wage of 170 euros puts Kosovo in the middle of the minimum wage distribution among neighbouring countries, whilst the ratio of the minimum wage to the average wage and GDP per capita put Kosovo at the upper end of the distribution among these countries<sup>37</sup>.

**Policy measures/reforms:** Given the high flexibility of existing labour market regulation, no reforms are currently planned that would be aimed at further reducing the regulation. There are also no planned or legally demanded increases to the minimum wage level. The Economic and Social Council may propose an increase of the minimum wage, but the final decision is in the discretion of the Government.

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<sup>36</sup> Winkler, H., 2013. "Kosovo: A Note on Recent Labor Market Developments." Mimeo. World Bank, Washington, D.C.

<sup>37</sup> IMF, 2013. "Republic of Kosovo: Third Review Under the Stand-by Arrangement: Request for Waiver of nonobservance of performance criterion". IMF Country Report No. 13/133.

Ajwad, M.I., 2012. Kosovo: Minimum Wage Discussion. Mimeo. World Bank, Washington, D.C.

In the current situation, reforms addressing the skills gap and improving the active labour market policy and employment service, detailed in Part II, are considered as more important for reducing unemployment and increasing employment than regulatory changes regarding flexibility of labour market. However, the effectiveness of labour inspectorate in assuring compliance and reducing informal economy (see section 4.2.1) will be improved.

#### *Reforms in tax and benefit systems (labour taxes, redundancy-related costs)*

**Current status:** Kosovo has a low tax wedge with only a 10% pension contribution, in addition to a progressive income tax that ranges from 0 to 10%, as well as flexible labor regulations, all of which are considered important advantages of the Kosovar economy for doing business. The scope of passive labour market policies, i.e. policies that provide income-replacement in case of unemployment, is limited. There is no unemployment insurance scheme per se, although elements of means-tested, non-contributory assistance are included in the minimum income guarantee scheme. Steps have been taken recently to promote activation by limiting access to social assistance for work-able beneficiaries and by introducing requirements for jobseekers to visit Public Employment Service units once every three months, report on their job-search activities, and devise an action plan for the following period. The Law on Social Assistance was amended to include stricter eligibility criteria so that only families or households with not more than one work-able member can receive social assistance.

**Policy measures/reforms:** A new contribution for obligatory health insurance of 7% (divided equally among the employer and the employed) will be introduced as part of the health reform (see section 4.4.2). Other than this, no changes are planned to the current income tax and benefit systems, regarding the general evaluation that they do not impose major constraints on competitiveness, activation and employment.

#### *Wage bargaining*

**Current status:** The collective bargaining between employers' and employees' representatives takes place within the tripartite Social and Economic Council. The scope of bargaining is limited and the practice and implementation of collective agreements is still in the early development stage. No formal collective agreements exist on the level of wages or pay scales. A collective agreement was signed before 2014 elections regulating some of the work conditions, such as reimbursement for meals and transport and reward for experience. However, the implementation of the contract is currently on hold as it was found to not be fully compliant with the Labour Law.

**Policy measures /reforms:** No reforms are currently planned for the legal framework related to wage bargaining.

#### *Active labour market policy*

Actions to improve the active labour market policies are explained in more detail in Part II (Initiative 2.3) and are focused on developing the operations of the recently established Kosovo Employment Agency which will replace the existing Public Employment Service units. The measures include, among others:

- analysis of labour market demand and effectiveness of active policy measures, information campaigns, reviewing and updating the activities of Vocational Training Centres, contracting private providers of vocational training
- personalisation of services by registering and profiling the unemployed, providing counselling, training and other services
- licencing and cooperation with private providers of employment services

#### **4.2.4. Public finance reforms**

This chapter presents actions planned in reform areas that are most important from the point of view of sustaining fiscal stability.

##### *Improving public expenditure efficiency*

**Current status:** As explained in Chapter 3.3., current spending has been increasing in recent years at the expense of capital expenditures. To preserve the growth-enhancing expenditure, further increases in current expenditures need to be curtailed and efficiency of spending improved.

**Policy measures /reforms:** The aim of the Government of Kosovo during the medium term period is to reduce the size of the public sector and increase the efficiency of the institutions in providing public services. More specifically, in accordance with the Government Program 2015-2018, the government is planning to maintain the high level of capital expenditures which will mainly be oriented towards growth generating projects.

Many budgetary organisations that have similar functions will be extinguished or integrated within the relevant organisation or Ministry. In addition, the GoK is planning to apply the electronic procurement for expenditures that go through tendering process and to further expand the e-governance. These measures will be corroborated by further efforts to improve the overall public finance management, as explained in chapter 3.8.

The Government Programme also plans to introduce country credit rating and publish the results.

##### *Pension reform*

**Current status:** Basic pensions are paid directly from the budget and they are estimated at 2.2% of GDP in 2015 including supplements for special categories of beneficiaries. A fully funded mandatory pillar 2 pensions system is also in place. Contribution rate is 5% for both the employer and the employee. The funds are held in individual accounts managed by the Kosovo Pensions Savings Trust (KPST). Since this second pillar is fully funded (with funds managed by a professional body and largely invested abroad), it does not require budgetary financing and is considered sustainable.

**Policy measures / reforms:** Kosovo has a young population; the median age was 28.2 years in 2011 and the share of population over 65 years was only 6.9%. Based on SAK demographic projections, the old-age dependency ratio in Kosovo will not reach the current average level of the EU-28 countries before 2040. This indicates that ageing does not present a major risk for pension system sustainability in the foreseeable future. Accordingly, apart from some

operational improvements, no comprehensive pension reform is planned nor needed in current circumstances.

### *Health reform*

**Current status:** Kosovo is currently unable to provide meaningful universal access to health services, while the quality of such services is low.

Kosovo has an under-financed public health system, in which total public spending from the national budget, and as a percentage of GDP, are low based on the regional and EU average. This relates both to total health expenditure and to the health share of the government budget. Spending on health in 2012 stood at 2.6% of GDP, while health accounted for 9% of total government spending in that same year. The EU average in 2011 stood at around 13% of the general government spending and 5% of GDP.

In part because of limited public health spending, out of pocket (OOP) spending is high and is a key factor in impoverishment. Based on the estimations by the World Bank using the Kosovo Budget Household Survey data from 2011, the high level of OOP spending is estimated to have contributed to a 7% increase in the poverty headcount associated with OOP payments. The high OOP spending comprises of especially large spending on drugs; increasing their affordability is critical to improve health outcomes and the quality of care. Public spending on pharmaceuticals is very low: 12.5 euro per capita per year in 2012.

The management capacities of the institutional architecture that governs health services are low, and are compounded by institutional fragmentation between the central and local levels. Responsibilities for the primary and secondary care are fragmented between central and municipal levels. Hospital care is under the responsibility of the Ministry of Health, while primary care service delivery is under the responsibility of the municipalities. Such a fragmentation complicates the effective oversight of primary care services by the Ministry of Health and appropriate incentive structures and coordination mechanisms are required.

As a developing country, Kosovo struggles with its lagging health outcomes. The life expectancy at birth is 70.2 years, but this is 10 years lower than the EU average. Based on the most updated data, the Infant Mortality Rate stands at between 9 and 11 per 1,000 live births, which are double the EU average. The epidemiological patterns imply that health care services at the primary level are critical to improve these health outcomes. An expanded coverage of health education, counselling and testing services at the primary level are critical to improve health results. Strengthening the system of health care is also important in the context of health insurance.

**Policy measures/ reforms:** Kosovo has recently adopted a new law on mandatory health insurance which will be implemented during 2015 and 2016. This is expected to improve financial protection and raise more revenues for increased public health spending. A new Health Insurance Fund (HIF) will be tasked with implementing the mandatory health insurance system, which includes collection of insurance revenues, the purchase of services and monitoring and oversight of service delivery. Currently, the Health Financing Agency (HFA), a unit within the Ministry of Health is responsible for purchasing health services. The HFA will initially be responsible for implementing the provisions of the new health insurance law, while gradually such functions will be transitioned toward the new Health Insurance

Fund. This is also. It is being developed in parallel with changes in the management of health institutions and their accountability.

The new health insurance law creates a mandatory health insurance scheme, which covers Basic Package of Health Services at primary care facilities and hospitals. Insurance premiums will be a payroll tax at 7% (divided equally between employer and employee) for public sector employees and formal private sector employees. All other non-exempt individuals will be required to pay a flat monthly premium amount of 2 euros. The new health insurance provides protections for the poor and other vulnerable individuals, who will be exempt from premiums and cost-sharing. The basic health package will include a package of services, such as emergency care, services for uninsured children and essential public health services, which will be guaranteed for all. The estimated additional revenue to be raised in the first full year of operation is around 80 million euros.

The health sector reform, based on the Sectoral Health Strategy 2014-2020, which aims at enabling equal access to qualitative health services for the whole population, and is reflected the Government Program 2015-2018, also includes other measures to improve the organisation of the health sector and access to health services:

- clear and complete division of labour between buyers and providers of health services will enable the beginning of the reform of provider payment method by rewarding performance, increase efficiency and improve the quality of health services in hospitals. The new law empowers the Health Insurance Fund to enter into performance contracts for primary care as a tool to increase the incentives for improving the quality of care and coverage.
- strengthening the funding of the health sector will include higher budget for the public health care providing institutions including UCCK, regional hospitals and other secondary and tertiary health care providing institutions; higher health grants for municipalities; ensuring the adequate supply with essential drugs and other medical expendable supplies for public medical institutions; strengthening of the diagnostic capacities with a particular emphasis on the radiology and lab through higher investments in new medical equipment in public health providing institutions.
- as part of the mandatory health insurance scheme, the Ministry of Health also plans to reduce out of pocket spending through an outpatient drug benefit. The OP benefit is expected to considerably expand access to drugs among the insured, and specifically among the poor.
- organisational improvements will include improving the management of health care providing public institutions and introduction of the performance based incentives; cooperation with Professional Health Chambers; implementation of an integrated health information system; and reforming/restructuring the Ministry of Health

#### *Public sector wages and employment policy*

**Current status:** Wages and salaries of public sector employees were increased by 25% in 2014 by a government decision. Public administration reform, aimed at improving organisational structure and making provisions for performance based payment and promotion, following SIGMA and other established principles of public governance, was prepared for the 2010-13 period with annual action plans extending its implementation into

2014 and 2015. There are no formal limits on public sector employment, but it is limited by the budget appropriations available for wages to budget organisations. These are based on current employment, implying that new employment mainly takes places in newly established agencies and other public bodies, and by replacing employees who leave the public sector.

**Current status:** The government announced that no new across the board wage increase will take place in the following years, and that it is expected that the trend of public wages will follow the developments in the general labour productivity and economic conditions of the country. The existing public administration reform will be gradually implemented by introducing new job classifications during 2015 and 2016, and the reform itself will be upgraded during the same period. Implementing of new job classification in budget organisations is subject to approval by an inter-ministerial commission and availability of funds.

### **4.3 Budgetary implication of major macroeconomic structural reforms**

As explained in section 4.2., this chapter presents key areas of reforms relevant for the overall macro-fiscal framework and policy strategy. Among these reforms, those that are part of wider sectorial policy agendas are presented in more detail in Part II and in this chapter only short summaries are included for comprehensiveness and ease of reference. The timelines and budgetary costs of these reforms are presented in the annex tables to Part II. During preparation of the NERP, care was taken that only those sectorial reforms were included that have been budgeted in either the draft budget for 2015 or in the latest MTEF.

Reforms that are not explained within the context of sectorial reforms in Part II, were presented in more detail here. We provide information on their budgetary effects below.<sup>38</sup>

**Privatisation** - As explained in section 4.2.1., there is no detailed plan for future privatisation and private sector involvement actions. The government will address the opportunities on a case by case basis, given the economic circumstances and the interest of potential private sector investors and partners. Accordingly, no annual plan for privatisation receipts accruing to the budget can be provided.

The budgeted amount of 10 million euros in the draft budget for 2015 is mainly intended for financing of the operations of PAK as per the Law on PAK. As sale of assets is not considered to be a major structural reform, these receipts are not included in annex Table 9.

**Financial stability** - Reforms aimed at improving financial stability mainly include changes to regulation and improvement of supervisory practices of the CBK. As such, they are funded by the CBK and do not demand additional expenditures from the budget.

**Labour market reforms** - As explained in section 4.2.3, no reforms in areas of labour market flexibility, taxation and benefit systems, or wage bargaining are planned or considered necessary under the current circumstances. Measures to improve the active labour market policies, the operations of the Public Employment Agency, and vocational training, are explained and costed in Part II.

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<sup>38</sup> The Government Programme, as previously mentioned, was received while the NERP was being drafted, so the costing of the changes that this Programme entails. The costing of these reforms/measures (e.g. tax system reforms or the investment incentives) is currently under way and will be provided in future planning documents

***Pension reform*** - The budgetary effects of the 2014 increase of pension benefits are fully included in the draft budget for 2015 and amount to about 50 million euros. As this measure does not represent a major structural reform of the pension system, these costs were not included in the annex Table 9. As explained in section 4.3.1, no structural reforms to the existing pension system are planned or considered necessary under the current circumstances and with respect to the expected demographic developments for the foreseeable future.

***Health reform*** - The contributions for the newly introduced obligatory health insurance, estimated at around 80 million euros annually, will be paid directly to the Health Insurance Fund and as such do not represent additional revenues for the budget. As these contributions will also finance the operational activities of the fund, and the fund is not planned to receive additional resources from the budget, the major budgetary cost of the health reform will be paying the employers' contribution of 3.5% on wages and salaries of public sector employees. It is currently expected that the contribution will start being collected during 2015 and a reserve of 10 million euros is budgeted for that purpose in the budget. In future years, the annual budgetary cost of contributions is estimated at 18 million euros. This information is also included in the annex Table 9.

***Public sector wages and employment policies in the public sector*** - The budgetary effects of the 2014 increase of public wages and salaries are fully included in the draft budget for 2015 and amount to about 90 million euros. No further increases of public wages and salaries are currently planned or budgeted. The budgetary effects of the public administration reform implementation are estimated at 18 million euros and will be included in wage appropriations of budgetary organisation as the reform is being implemented over 2015 and 2016. This information on costs of public administration reform is also included in the annex Table 9.



## ANNEX 1: Summary data

**Table 1a: Macroeconomic prospects**

Percentages unless otherwise indicated	ESA Code	Year 2013	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
		Level (millions of euros)	Rate of change				
1. Real GDP at market prices	B1*g	5,233	3.4	3.3	4.1	4.3	4.6
2. Current GDP at market prices	B1*g	5,327	5.3	4.8	5.4	4.7	4.8
<b>Components of real GDP</b>							
3. Private consumption expenditure	P3	4,568	2.0	4.4	3.5	4.5	4.3
4. Government consumption expenditure	P3	870	3.3	1.2	2.9	-0.4	0.1
5. Gross fixed capital formation	P51	1,314	-0.2	-0.1	7.9	7.8	9.3
6. Changes in inventories and net acquisition of valuables (% of GDP)	P52+P53	146.1	-1.5	-1.0	2.2	0.1	0.8
7. Exports of goods and services	P6	944.7	2.5	6.8	5.5	4.7	5.1
8. Imports of goods and services	P7	2,610	-1.5	3.9	4.9	4.6	5.0
<b>Contribution to real GDP growth</b>							
9. Final domestic demand		6,752	2.3	4.0	5.5	5.7	6.1
10. Change in inventories and net acquisition of valuables	P52+P53	146.1	0.0	0.0	0.1	0.0	0.0
11. External balance of goods/services	B11	-1,665	1.2	-0.7	-1.4	-1.4	-1.5

**Table 1b: Price developments**

Percentage changes, annual averages	ESA Code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
1. GDP deflator		1.8	1.5	1.2	0.3	0.2
2. Private consumption deflator		2.3	0.8	0.4	0.6	0.4
3. HICP		:	:	:	:	:
4. National CPI change		1.8	0.4	0.4	0.6	0.4
5. Public consumption deflator		-0.7	3.2	2.4	-0.1	-0.8
6. Investment deflator		0.7	0.8	0.3	-0.4	-0.3
7. Export price deflator (goods & services)		-1.9	1.1	1.8	1.2	1.0
8. Import price deflator (goods & services)		0.0	0.4	-0.1	0.6	0.4

**Table 1c: Labour markets developments**

	ESA Code	Year 2013 Level	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
			Level/Rate of change				
1. Population (thousands)		1,805.9	1,805.9	1,816.9	1,827.2	1,837.0	1,847.6
2. Population (growth rate in %)			0.7	0.6	0.6	0.5	0.6
3. Working-age population (thousand persons)[1]		1,196.6	1,196.6	1,213.8	1,230.5	1,247.3	1,260.8
4. Participation rate			40.5	40.5	40.5	40.5	40.5
5. Employment, thousand persons [2]		338.4	338.4	349.2	355.3	363.3	370.5
6. Employment, hours worked[3]			:	:	:	:	:
7. Employment (growth rate in %)			11.7	3.2	1.8	2.2	2.0
8. Public sector employment (thousand persons)			76.8	78.8	79.3	79.8	80.3
9. Public sector employment (growth in %)			-0.2	2.6	0.6	0.6	0.6
10. Unemployment rate [4]			30.2	29.0	28.7	28.1	27.4
11. Labour productivity, persons[5]		15,465	-7.4	0.1	2.3	2.0	2.5
12. Labour productivity, hours worked[6]			:	:	:	:	:
13. Compensation of employees[7]	D1	1.1	4.9	7.3	3.9	2.1	1.9

[1] Age group of 15-64 years; [2] Occupied population, domestic concept national accounts definition; [3] National accounts definition; [4] Harmonised definition, Eurostat; levels; [5] Real GDP per person employed; [6] Real GDP per hour worked [7] Data on compensation of employees refers to the total wage bill as reported to the KPST. The total wage bill is likely to be significantly underreported for two reasons: a) a tendency of some private firms to underreport their employees' wages and b) the exclusion of the wages of the informally employed persons altogether.

**Table 1d: Sectoral balances**

Percentages of GDP	ESA code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-7.5	-6.3	-6.0	-6.0	-6.2
<i>of which:</i>						
- Balance of goods and services		-41.0	-37.3	-36.7	-36.4	-36.0
- Balance of primary incomes and transfers		33.2	30.3	30.5	30.2	29.6
- Capital account		0.3	0.7	0.2	0.2	0.2
2. Net lending/borrowing of the private sector	B.9/ EDP B.9	-4.4	-3.8	-3.9	-4.1	-4.4
3. Net lending/borrowing of general government		-3.1	-2.6	-2.1	-1.8	-1.8
4. Statistical discrepancy		0.0	0.0	0.0	0.0	0.0

**Table 1e: GDP, investment and gross value added**

	ESA Code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
<b>GDP and investment</b>						
GDP level at <i>current</i> market prices (in millions of euros)	B1g	5,327	5,581	5,879	6,155	6,450
Investment ratio (% of GDP)		24.8	23.8	24.5	25.1	26.1
<b>Growth of Gross Value Added, percentage changes at constant prices</b>						
1. Agriculture		1.4	1.7	2.4	3.8	5.3
2. Industry (excluding construction)		9.4	8.1	8.4	8.6	8.8
3. Construction		2.6	1.1	3.5	4.6	5.1
4. Services		4.1	5.1	5.6	5.8	5.7

**Table 1f: External sector developments**

Millions of euros unless otherwise indicated		Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
1. Current account balance (% of GDP)	% of GDP	-6.4	-6.3	-6.1	-6.6	-6.8
2. Export of goods	Mil. EUR	305.0	343.2	378.6	407.2	441.0
3. Import of goods	Mil. EUR	2,297.1	2,392.6	2,505.1	2,634.9	2,774.4
4. Trade balance	Mil. EUR	-1,992.1	-2,049.4	-2,126.5	-2,227.6	-2,333.4
5. Export of services	Mil. EUR	622.0	622.0	657.9	696.3	731.4
6. Import of services	Mil. EUR	313.7	313.7	332.4	352.1	371.0
7. Service balance	Mil. EUR	308.3	308.3	325.5	344.2	360.4
8. Net interest payments from abroad	Mil. EUR	-97.1	-75.7	-80.6	-87.7	-95.7
9. Other net factor income from abroad	Mil. EUR	218.9	208.9	233.2	243.1	253.0
10. Current transfers	Mil. EUR	1,222.3	1,253.5	1,290.6	1,319.9	1,379.3
11. <i>Of which</i> from EU	Mil. EUR	:	:	:	:	:
12. Current account balance	Mil. EUR	-339.7	-354.3	-357.8	-408.1	-436.4
13. Capital and financial account	Mil. EUR	168.8	167.3	184.7	215.6	251.7
14. Foreign direct investment	Mil. EUR	241.0	240.0	264.8	284.8	308.4
15. Foreign reserves	Mil. EUR	21.0	-124.3	-153.9	-162.6	-166.6
16. Foreign debt	Mil. EUR	323.8	326.4	423.4	359.1	288.1
17. <i>Of which</i> : public	Mil. EUR	323.8	326.4	423.4	359.1	288.1
18. <i>O/w</i> : foreign currency denominated	Mil. EUR	118.1	122.5	118.4	73.7	37.5
19. <i>O/w</i> : repayments due	Mil. EUR	14.0	22.1	28.2	63.5	57.7
20. Exchange rate vis-à-vis EUR (end-year)	EUR/EUR	1.0	1.0	1.0	1.0	1.0
21. Exchange rate vis-à-vis EUR (annual average)	EUR/EUR	1.0	1.0	1.0	1.0	1.0
22. Net foreign saving	% of GDP	:	:	:	:	:
23. Domestic private saving <sup>1/</sup>	% of GDP	-6.6	-5.6	-6.4	-5.8	-5.2
24. Domestic private investment	% of GDP	17.7	19.1	19.3	20.3	21.2
25. Domestic public saving <sup>2/</sup>	% of GDP	6.1	4.8	5.5	5.4	5.5
26. Domestic public investment	% of GDP	9.9	7.4	7.8	7.3	7.3

*1/ Calculated using the following formula: GDP minus total revenues plus subsidies and transfers minus private consumption; 2/ Calculated using the formula: Total revenues minus current expenditures minus dividends*

**Table 1g: Sustainability indicators**

	Dimension	Year 2010	Year 2011	Year 2012	Year 2013	Year 1/ 2014
1. Current Account Balance	% of GDP	-6.4	-6.3	-6.1	-6.6	-6.8
2. Net International Investment Position	% of GDP	9.7	2.8	4.9	6.8	5.9
3. Export market shares	%, yoy	45.8	-12.2	-13.2	3.3	:
4. Real Effective Exchange Rate	%, yoy	100.0	104.1	103.8	104.2	104.4
5. Nominal Unit Labour Costs	%, yoy	:	:	:	:	2.1
6. Private sector credit flow	% of GDP	3.2	4.3	1.1	0.7	0.9
7. Private sector debt	% of GDP	:	:	:	:	:
8. General Government Debt	% of GDP	:	:	8.1	9.0	10.6

1/ Estimation

**Table 2a: General government budgetary prospects**

	ESA code	Year 2013 Level (mil. of euros)	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
<b>Net lending (B9) by sub-sectors</b>							
1. General government 1/	S13	-164.0	-3.1	-2.6	-2.1	-1.8	-1.8
2. Central government	S1311	:	:	:	:	:	:
3. State government	S1312	:	:	:	:	:	:
4. Local government	S1313	:	:	:	:	:	:
5. Social security funds	S1314	:	:	:	:	:	:
<b>General government (S13)</b>							
6. Total revenue	TR	1,316.2	24.7	23.9	26.8	25.6	24.8
7. Total expenditure	TE	1,480.2	27.8	26.4	28.9	27.4	26.6
8. Net borrowing/lending	EDP.B9	-164.0	-3.1	-2.6	-2.1	-1.8	-1.8
9. Interest expenditure	EDP.D41 incl. FISIM	11.5	0.2	0.2	0.3	0.4	0.4
10. Primary balance		-152.5	-2.9	-2.3	-1.8	-1.5	-1.4
11. One-off and other temporary measures		:	:	:	:	:	:
<b>Components of revenues</b>							
12. Total taxes (12 = 12a+12b+12c)		1,155.6	21.7	21.4	23.3	22.7	22.0
12a. Taxes on production and imports	D2	1,141.2	18.5	18.1	19.4	18.7	18.1
12b. Current taxes on income and wealth	D5	172.9	3.2	3.4	3.9	4.0	3.9
12c. Capital taxes	D91	0.0	:	:	:	:	:
13. Social contributions	D61	0.0	:	:	:	:	:
14. Property income	D4	43.6	0.8	0.3	0.5	0.5	0.5
15. Other (15 = 16-(12+13+14))		117.0	2.2	2.2	3.0	2.4	2.3
16 = 6. Total revenue	TR	1,316.2	24.7	23.9	26.8	25.6	24.8
p.m.: Tax burden (D2+D5+D61+D91-D995)		1,155.6	21.7	21.4	23.3	22.7	22.0
<b>Selected components of expenditures</b>							
17. Collective consumption	P32	632.6	11.9	12.4	13.3	12.5	11.9
18. Total social transfers	D62 + D63	288.3	5.4	6.2	7.1	6.8	6.6
18a. Social transfers in kind	P31 = D63	:	:	:	:	:	:
18b. Social transfers other than in kind	D62	288.3	5.4	6.2	7.1	6.8	6.6
19 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	11.5	0.2	0.2	0.3	0.4	0.4
20. Subsidies	D3	24.6	0.5	0.2	0.4	0.3	0.3
21. Gross fixed capital formation	P51	529.2	9.9	7.4	7.8	7.3	7.3
22. Other (22 = 23-(17+18+19+20+21) [6])		:	:	:	0.1	0.1	0.1
23. Total expenditures	TE [1]	1,480.2	27.8	26.4	28.9	27.4	26.6
p.m. compensation of employees	D1	417.1	7.8	8.7	9.5	9.0	8.6

1/ the deficit presented here is not calculated in accordance with the fiscal rule definition as per LPFMA

**Table 2b: General government budgetary prospects**

	ESA code	Year	Year	Year	Year	Year
		2013	2014	2015	2016	2017
Mil. euros						
Net lending (B9) by sub-sectors						
1. General government 1/	S13	-164.0	-142.6	-123.5	-111.8	-115.5
2. Central government	S1311	:	:	:	:	:
3. State government	S1312	:	:	:	:	:
4. Local government	S1313	:	:	:	:	:
5. Social security funds	S1314	:	:	:	:	:
General government (S13)						
6. Total revenue	TR	1,316	1,333	1,576	1,573	1,599
7. Total expenditure[1]	TE	1,480	1,476	1,700	1,685	1,714
8. Net borrowing/lending	EDP.B9	-164	-143	-124	-112	-116
9. Interest expenditure	EDP.D41 incl. FISIM	12	13	17	22	23
10. Primary balance[2]		-153	-130	-106	-90	-92
11. One-off and other temporary measures [3]		:	:	:	:	:
Components of revenues						
12. Total taxes (12 = 12a+12b+12c)		1,156	1,196	1,369	1,397	1,421
12a. Taxes on production and imports	D2	983	1,009	1,141	1,149	1,169
12b. Current taxes on income and wealth	D5	173	188	227	248	251
12c. Capital taxes	D91	-	-	-	-	-
13. Social contributions	D61	-	-	-	-	-
14. Property income	D4	44	15	30	30	30
15. Other (15 = 16-(12+13+14)) [4]		117	122	178	146	148
16 = 6. Total revenue	TR	1,316	1,333	1,576	1,573	1,599
p.m.: Tax burden (D2+D5+D61+D91-D995) [5]		1,156	1,196	1,369	1,397	1,421
Selected components of expenditures						
17. Collective consumption	P32	633	690	782	768	769
18. Total social transfers	D62 + D63	288	348	417	420	426
18a. Social transfers in kind	P31 = D63	:	:	:	:	:
18b. Social transfers other than in kind	D62	288	348	417	420	426
19 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	12	13	17	22	23
20. Subsidies	D3	25	13	22	21	21
21. Gross fixed capital formation	P51	529	411	457	450	470
22. Other (22 = 23-(17+18+19+20+21) [6]		:	0	5	5	5
23. Total expenditures	TE [1]	1,480	1,476	1,700	1,685	1,714
p.m. compensation of employees	D1	417	485	560	552	554

1/ the deficit presented here is not calculated in accordance with the fiscal rule definition as per LPFMA

**Table 3: General government expenditure by function 1/**

% of GDP	COFOG Code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
1. General public services	1	6.0	5.7	6.9	6.3	5.9
2. Defence	2	0.6	0.7	0.7	0.6	0.6
3. Public order and safety	3	2.2	2.2	1.5	1.4	1.3
4. Economic affairs	4	7.3	4.8	5.9	5.7	5.6
5. Environmental protection	5	0.1	0.1	0.3	0.3	0.3
6. Housing and community amenities	6	0.7	0.7	0.4	0.4	0.4
7. Health	7	2.6	2.8	2.8	2.8	2.7
8. Recreation, culture and religion	8	0.6	0.6	0.7	0.6	0.6
9. Education	9	3.8	4.1	4.6	4.4	4.3
10. Social protection	10	4.1	4.8	5.1	4.9	4.9
11. Total expenditure (item 7 = 23 in Table 2)	TE	27.8	26.4	28.9	27.4	26.6

1/ The classification of expenditures by function presented in this table should be taken as indicative as the budget is not compiled using functional classification codes

**Table 4: General government debt developments**

% of GDP	ESA code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
<b>1. Gross debt</b>		9.0	10.6	12.4	13.4	14.5
<b>2. Change in gross debt ratio</b>		0.9	1.6	1.8	1.0	1.0
<b>Contributions to change in gross debt</b>						
<b>3. Primary balance</b>		2.9	2.3	1.8	1.5	1.4
<b>4. Interest expenditure</b>	EDP D.41	0.2	0.2	0.3	0.4	0.4
<b>5. Stock-flow adjustment</b>		-2.2	-0.9	-0.3	-0.8	-0.7
<i>of which:</i>						
- Differences between cash and accruals		:	:	:	:	:
- Net accumulation of financial assets		:	:	:	:	:
<i>of which:</i>						
- Privatisation proceeds		:	:	:	:	:
- Valuation effects and other		:	:	:	:	:
<b>p.m. implicit interest rate on debt</b>		:	2.7	2.9	3.0	2.8
<b>Other relevant variables</b>						
6. Liquid financial assets		:	:	:	:	:
7. Net financial debt (7 = 1 - 6)		:	:	:	:	:

**Table 4a: General government guarantees**

% of GDP	Year 2014	Year 2015
Public guarantees	0.2	0.2
Of which: linked to the financial sector	0.2	0.2

**Table 5: Cyclical developments**

% of GDP	ESA Code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
1. Real GDP growth (% , yoy)	B1g	3.4	3.3	4.1	4.3	4.6
2. Net lending of general government	EDP.B.9	-3.1	-2.6	-2.1	-1.8	-1.8
3. Interest expenditure	EDP.D.41	0.2	0.2	0.3	0.4	0.4
4. One-off and other temporary measures [1]		:	:	:	:	:
5. Potential GDP growth (% , yoy)		:	:	:	:	:
Contributions:						
- labour		:	:	:	:	:
- capital		:	:	:	:	:
- total factor productivity		:	:	:	:	:
6. Output gap		:	:	:	:	:
7. Cyclical budgetary component		:	:	:	:	:
8. Cyclically-adjusted balance (2-7)		:	:	:	:	:
9. Cyclically-adjusted primary balance (8+3)		:	:	:	:	:
10. Structural balance (8-4)		:	:	:	:	:

**Table 6: Divergence from previous programme**

N/A

**Table 7. Long-term sustainability of public finances**

N/A

**Table 8. Basic assumptions on the external economic environment underlying the EFP framework**

	Dimension	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
Short-term interest rate	Annual average	1.2	1.3	1.4	1.8	1.9
Long-term interest rate 3/	Annual average	1.3	1.3	1.3	1.3	1.3
USD/EUR exchange rate	Annual average	1.3	1.4	1.3	1.3	1.3
Nominal effective exchange rate 2/	Annual average	101.6	102.4	-	-	-
Exchange rate vis-à-vis the EUR	Annual average	1.0	1.0	1.0	1.0	1.0
Global GDP growth, excluding EU 1/	Annual average	4.5	4.7	5.7	5.9	6.0
EU GDP growth	Annual average	0.2	1.6	1.8	1.9	1.9
Growth of relevant foreign markets-Germany/5	Annual average	0.5	1.7	1.6	1.4	1.4
Growth of relevant foreign markets-Switzerland/5	Annual average	2.0	2.1	2.2	2.0	2.0
World import volumes, excluding EU	Annual average	3.8	5.1	6.2	6.2	5.7
Oil prices (Brent, USD/barrel)	Annual average	108.8	108.0	103.0	98.2	94.9

Source: 1/WEO, April 2014, and own calculations; 2/CBK; 3/ ECB Macroeconomic projections for euro area June 2014; 4/ UNCTAD statistics up to 2013, WEO world import volume growth rate applied afterwards; 5/ WEO, April 2014; 6/treasury department, MF

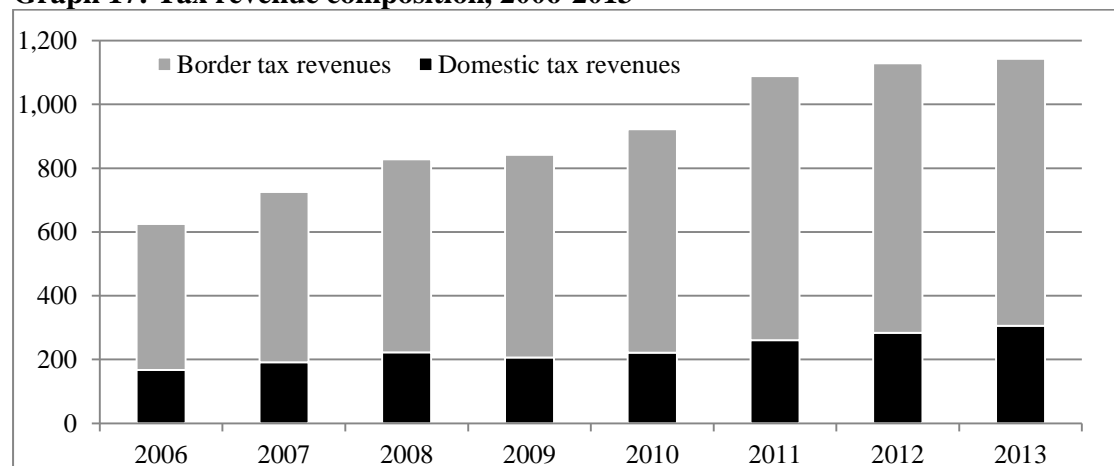
**Table 9: Matrix of Policy Commitments**

Description of policy	Year 2014	Year 2015	Year 2016	Year 2017
<b>1. Policy measure- Health reform</b>				
A. Implementation profile		x	x	x
B. Net direct budgetary impact		x	x	x
B.1 Direct impact on budgetary revenue				
B.2 Direct impact on budgetary expenditure		x	x	x
<b>2. Policy measure- Public administration reform</b>				
A. Implementation profile		x	x	x
B. Net direct budgetary impact			x	x
B.1 Direct impact on budgetary revenue				
B.2 Direct impact on budgetary expenditure			x	x
<b>Total net budgetary impact</b>				
Total impact on budgetary revenue				
Total impact on budgetary expenditure		18	36	36

## ANNEX 2: Sensitivity analysis of tax revenues to imports

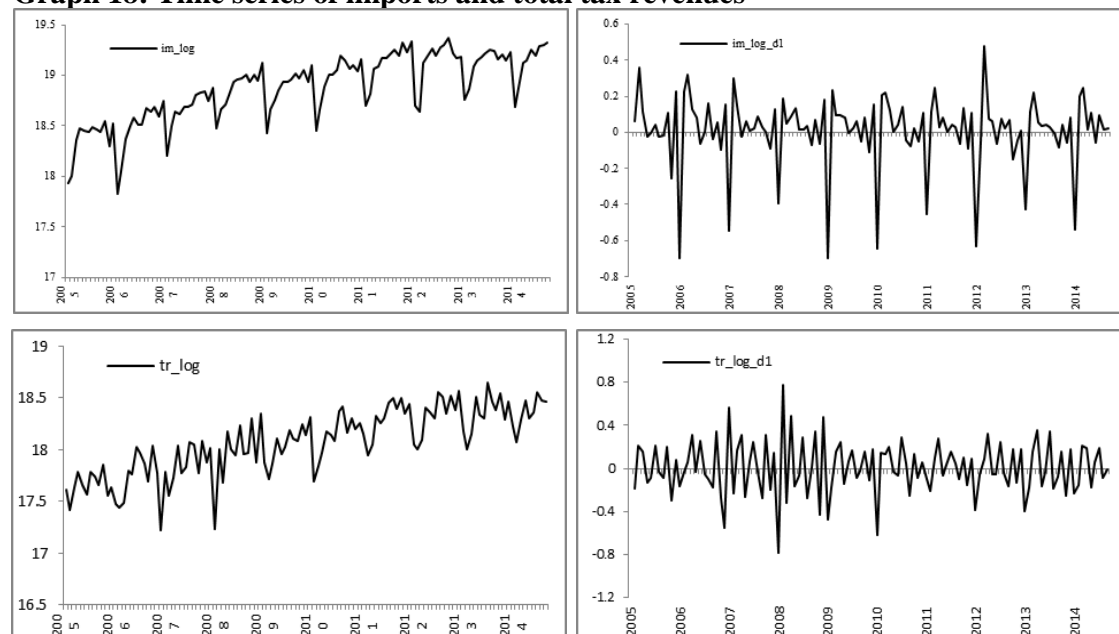
The main feature of the economy of Kosovo is that it absorbs more than it produces, hence it is highly dependent on imports. This structure of the economy has been reflected in the structure of budget revenues with revenues collected at the border composing around 70% of total tax revenues (see Graph 17). Imports have followed an increasing trend since the after war period following the trend of the aggregate demand. This, in turn, has generated opportunities for collecting agencies to collect more revenues at the border and hence, to maintain a high share of border to total tax revenues.

**Graph 17: Tax revenue composition, 2006-2013**



Given this underlying feature of the economy, an analysis was conducted to assess the effect of changes in imports to total tax revenues. The analysis was conducted using a simple bivariate VECM and its purpose is essentially to show the relationship between these two variables and the effect of a shock of imports on budget revenues.

**Graph 18: Time series of imports and total tax revenues**



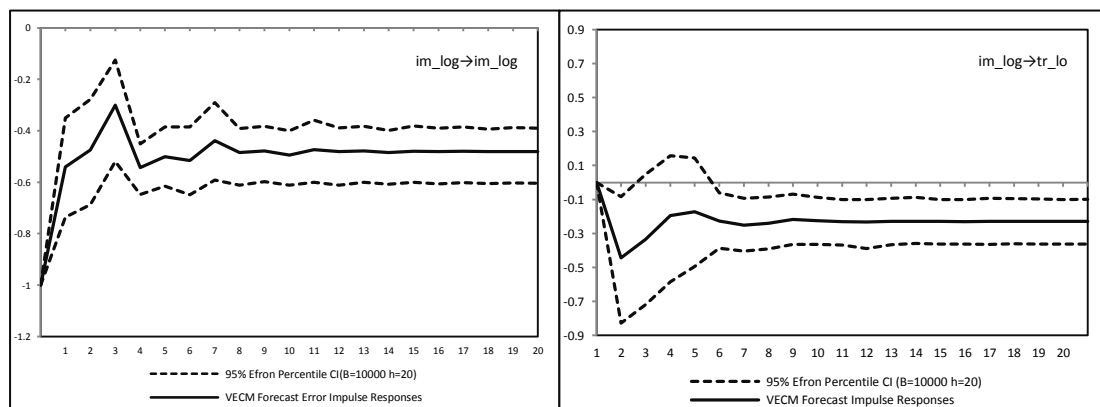


The model was conducted using monthly data of log of imports (Im\_log) and log of tax revenues (tr\_log) which appear to follow a positive deterministic trend and have a seasonal component. The first differences of variables fluctuate around a constant mean and there is no time variability. Therefore, Graph 18 shows that the series in first differences are generated by a stationary process.

Hence, the cointegration analysis of the long-run equilibrium relationship among variables was tested, including the deterministic trend, seasonal dummies and non-constant mean. As expected, the results reveal that there is a long-run positive relationship between tax revenues and imports.

To estimate the effect of the shock in imports to tax revenues, the impulse response analysis was conducted. The impulse responses are reported with 95% confidence intervals, empirically computed by 10,000 bootstrap replications. The impact of a shock is presented in Graph 19 below, which shows that a 1% decrease in imports will affect tax revenues by around 0.2% in the medium term.

**Graph 19: Impulse response function of a shock on imports to tax revenues**



### ANNEX 3. Debt Sustainability Analysis (DSA)

The risk of debt distress in Kosovo is still moderate given its low debt to GDP ratio and recently adopted legally-binding fiscal rule which limits the deficit at a debt-stabilizing level in the long-run. Risks may arise, however, from the possible budgetary spending pressures associated with continued low export level.

The DSA estimates the debt on the basis of sustainability of fiscal rule by comparing the indicators of debt and debt burden thresholds under the both, baseline and alternative scenarios for the period 2012-2060.

Kosovo DSA was conducted using the DSA Model developed by the MoF. The analysis uses risk indicators compiled by the World Bank-IMF for medium performer countries<sup>39</sup>. Starting from 2014, the GoK adopted a fiscal rule which limits the overall deficit to GDP ratio at 2%. This limits the ability of the Government to provide for additional spending, either by expanding the social policies or infrastructure projects into the existing budgetary framework.

The debt indicators and debt burden thresholds compiled by the WB-IMF and the debt ratio limited by law are as follows:

- Net Present Value (NPV) of Debt to GDP – 40%
- NPV of debt to exports of goods and services – 150%
- NPV of debt to budget revenues – 250%
- NPV of debt servicing to exports of goods and services – 20%
- NPV of debt servicing to budget revenues – 30%

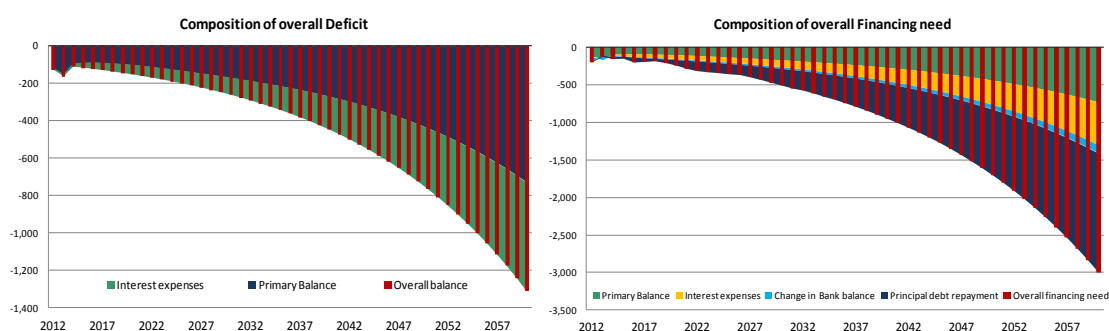
The main assumptions underlying the baseline scenario are based on the growth of nominal GDP of 5.5% on average for the projected horizon, an increase of 0.5 percentage points in exports of goods and services ratio to GDP reaching 27% at the end of the projection period, government bank balance of 2% of GDP and overall deficit to GDP ratio at 2%. In addition, since Kosovo is still in its development stage it still can raise concessional or soft loans. But, when later it reaches the higher income threshold, the ratio of concessional loans will decline in favour of more commercial loans. As a result, the DSA assumes that starting from 2016 concessional loans will compose 60% of the overall public debt and there will be limited grant element of the new borrowing.

Graph 20 shows the changes in the composition of deficit and the financing need over the forecast horizon. Given that the actual debt level is low, the interest expenditures compose only a small part of the overall deficit and in the outer years, as the debt levels increase, interest payments will form a major part of the deficit. The overall deficit composes only a small portion of the financing need, while the principal repayment gets the largest portion over the projection horizon.

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<sup>39</sup> World Bank's Country Policy and Institutional Assessment (CPIA)

**Graph 20: Composition of overall deficit and financing need**



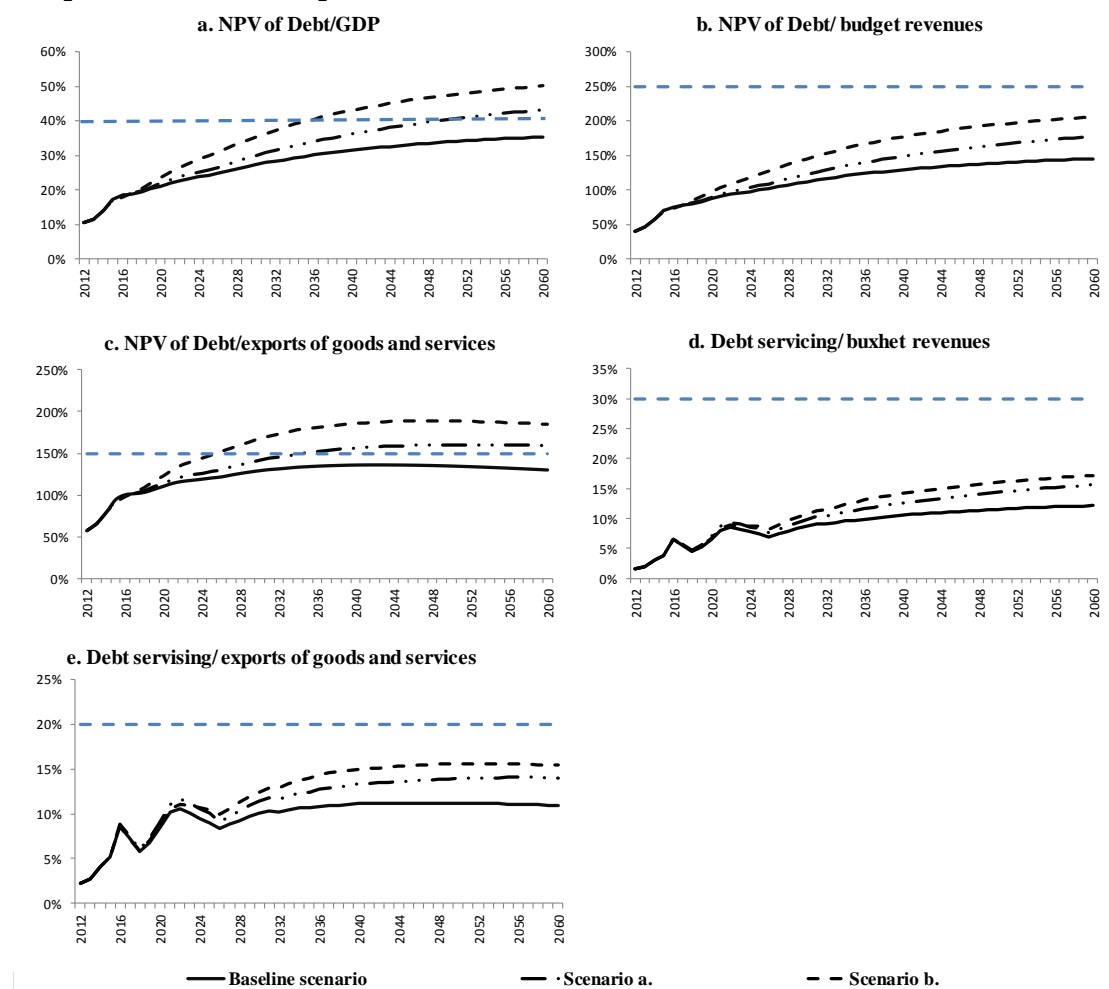
Under the baseline scenario, both groups of indicators, namely solvency and liquidity indicators, are below the threshold levels (see Graph 21). In the baseline scenario, the debt-to-GDP ratio stabilizes at just below the 40% threshold while the debt to exports of goods and services reaches the threshold reflecting the narrow and volatile base of exports.

**Scenario a.** This scenario is built upon the assumption that the nominal GDP growth will be lower by 1.5 percentage points compared to the baseline scenario. In this scenario, the PV of debt to GDP is continuously rising and breaches the threshold at 2040. Similarly, because of the still low base of exports, the PV of debt to exports breaches the threshold in 2028 and the debt servicing to exports stabilizes just below the threshold. The policy implication of this exercise is that the nominal GDP growth and export levels should be continuously monitored to adjust policies towards private sector development and export growth and diversification.

**Scenario b.** This scenario simulates a situation where the legally binding fiscal rule is amended to increase the limitation of deficit to 3% of GDP starting from 2017. As a result, the solvency and liquidity indicators relative to exports breach the threshold permanently. This change will increase the debt ratio to GDP beyond the threshold by a large margin suggesting that any increase in the deficit to GDP ratio should be accompanied by higher GDP growth and higher and sustainable export growth (see Graph 21).

In all scenarios however, the ratios relative to revenues remain below the threshold, again suggesting that budget revenues should either increase as a share to GDP or remain constant should these changes take place.

**Graph 21: Indicators of public debt under baseline and alternative scenarios**



Source: MF, Economic and public policy department, macroeconomics unit calculations



**Republika e Kosovës**  
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*Qeveria –Vlada–Government*

## **2015 ECONOMIC REFORM PROGRAMME (NERP)**

### **PART II**

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## 1. Introduction

This section provides a brief overview of overall economic reform strategy at national level, including a short diagnostic of the main constraints to achieving growth and improving competitiveness. This diagnostic summarizes the main sectorial structural reform priorities to support competitiveness and growth identified.

A key **objective** of the policy strategy for 2015-2017 presented in the NERP is to strengthen economic growth through accelerating economic reforms and improving further the business environment conducive to private sector growth. A particular priority will be granted to industries with employment potential and export capacities. To achieve this, Government is committed to implement a number of structural reforms aimed at improving overall Kosovo's economy competitiveness, in particular through strengthening the rule of law and reducing further business barriers.

Strong resilience of Kosovo to external shocks over the recent years was a consequence of limited trade and financial linkages Kosovo had with the crisis countries, and of the country's rather specific development model. It is based on two pillars. The first one consists of large remittances and FDI inflows from diaspora that boost domestic demand through household consumption and investments while the core of the second pillar is a strong pro-growth oriented budget structure with the share of capital investments significantly higher than in any country of the region.

The existing development is associated with significant risks. On the short run, the main risk factor would be a sudden fall of large capital inflows with its negative consequences for growth, public finances and financial sector stability. On the medium and long run, however, the main challenge for Kosovo is how to establish conditions conducive to promoting self-sustained growth based on increased domestic productivity and export competitiveness, and aimed at reducing high unemployment and poverty, improving human capital and physical infrastructure.

There are numerous obstacles the country is and will be facing on its way towards sustainable economic growth. A detailed diagnostics of the **principle constraints to economic growth** in Kosovo was made in the context of the NERP preparation to facilitate identification and prioritization of key structural reforms. Following the European Commission's outline for the 2015 NERP preparation, the constraints were classified into two groups. The first one, it consists of constraints that are of a horizontal, national character, was addressed in the sub-chapter 4.1 of the NERP's part I. The binding constraints to economic growth identified and explained in that chapter are limited access to and high cost of finance, the large extent of the informal sector and weak contract enforcement.

The second group of obstacles, they are addressed within this chapter, concentrates on those ones that are of a more sectorial character. Reduction or eventual elimination of these obstacles would contribute towards improving the country's competitiveness and thus achieving high and sustainable growth. The group includes problems and challenges to economic growth in the following sectors / areas: (i) physical capital, such as transport and energy networks, (ii) human capital, such as various forms of education, R&D, (iii) better industrial structures, such as financial and non-financial support to SMEs, (iv) business

environment, and (v) trade integration, such as export and FDI promotion. For institutional and operational reasons, the areas iii-v have been joined-up under one heading of Business Environment, Industrial Structures and Trade Integration.

Kosovo has enormous needs in the area of **physical infrastructure**. The country is landlocked which means its economy is strongly dependent on adequate transport links with neighboring countries. At present, the cost of transporting goods from and to Kosovo is among the highest in the region. It is within this context that the country embarked on major highway investments. This includes the construction of the motorway to Albania (giving Kosovo access to international ports), and plans to start constructing the route towards Macedonia, Kosovo's largest trading partner.

**Power supply** continues to be a binding constraint to Kosovo's economic growth, mainly because of mounting enterprise losses given a high frequency of interruptions. In a mid-term perspective, an upcoming energy crunch in the absence of new energy production capacities will also become binding. Around 50% of Kosovo firms surveyed identify access to electricity as a major obstacle, compared to a mere 5.8% in Montenegro, 8.1% in Serbia, 10.2% in Bosnia. Without new power generation capacities, the estimated combined cost of energy production and imports, the World Bank estimates, will increase from around 6 eurocents per kilowatt/hour to more than 8 eurocents per kilowatt/hour in 2024 (PFR, World Bank, 2014). The frequency and duration of power interruptions is significant. In 2012, the average annual number of interruptions per customer was 59.5, of which only 2.6 were planned, and the average interruption duration was 114.5 hours, of which only 4.9 hours were planned (World Bank, PFR, 2014). Based on the World Bank BEEPS survey (2013), the number of outages in a typical month stood at 11.4 in Kosovo, compared to 0.2 in Slovenia, 0.9 in Serbia, 1.2 in Macedonia, and 2.5 in Montenegro. Furthermore, the losses from power interruptions as a percentage of annual sales amounted to 7.3% in Kosovo, compared to 0.5% in Serbia, 0.8% in Montenegro, and 2.6% in Albania. Also, around 64% of surveyed Kosovo firms reported owning or sharing a power generator, compared to 9% in Macedonia, 10.7% in Serbia, 20% in Bosnia, and 47.2% in Albania (WB BEEPS, 2013).

As identified in the most recent Progress Report, **high-skilled labor** (graduate and vocational education) is another binding constraint to growth, mainly because of evidence of excess demand for high-skilled occupations and evidence of a high-skill premium. Based on the analysis of the LFS by the World Bank (Public Financial Review, 2014), there is excess demand for individuals with graduate and postgraduate education, and vocational secondary education, including for such occupations as machine operators, technicians and other professionals. On the other hand, there is excess supply for individuals with only primary and general secondary education, and those occupations such as clerks, sales services, craft, managers and agricultural workers. Evidence of a high-skill wage premium – as evidence of supply scarcity of the high-skilled – is not firmly established. However, a survey by Riinvest in 2011 using an enterprise-level survey found that the average salary of individuals holding a postgraduate degree was twice as large as those holding a bachelor's level diploma. The importance of an adequately educated labor force is also shown in the latest World Bank Business Enabling and Enterprise Performance (BEEPS) survey in 2013. Compared to the previous BEEPS survey of 2009, there is a 13 percentage point increase in the number of local firms that say that Kosovo's inadequately educated labor force is a constraint.



As to industrial structures, business environment, and trade integration, there is no single constraint to growth but interplay of multiple factors applies. For example, insufficient **access to finance** reflecting **imperfect contract enforcement** was identified as a binding constraint for investment and stronger economic growth. **Overall regulatory environment** including licencing and permits procedures, inspection regime and assessing impact of regulations on business also impedes growth. For example, in the area of construction licensing, Kosovo lags significantly behind the peers in the region; more than 140 days are required to obtain a construction-related permit in Kosovo, compared to an average of around 80 days in Eastern Europe. Similarly, access to electricity by companies is too slow compared to regional benchmarks, according to Doing Business Survey. Another major constraint to private sector development often cited by businesses is the large extent of **informal economy**. **Quality infrastructure** is insufficient for Kosovo companies to trade across borders and compete internationally, and **competitiveness of SMEs**, **access to investment** is limited among other factors.

The above analysis of the key obstacles to growth is broadly consistent with the latest EU Progress Report which also points out labour market and education weaknesses (unemployment, skills gap, VET and tertiary education), deficient energy infrastructure, discouraging business environment and lack of export competitiveness, large extent of the informal economy and weak rule of law (reflected in limited access to finance). The NERP measures addressing these obstacles therefore also address recommendations in the Progress Report. Linkages between Progress Report and flagship measures are further specified in Annex tables.

Considering the above outlined constraints as well as taking into account the proposed reform measures within the Part II, the NERP process is complementary to that of **the National Development Strategy (NDS)**. While being prepared in parallel to the NERP, it will be consulted with various stakeholders and adopted in 2015. However, the main focus of the NDS will be to set medium term (e.g. 2020) priorities for unlocking Kosovo's economic growth potential. Thus, on the one hand, the NERP process was contributing to the NDS elaboration, while, on the other hand, it can be expected that the NDS will become the basis for updating the NERP in the next planning cycle.

## 2. Macroeconomic context and scenario

**Developments in 2014** – The estimated real growth of the Kosovo economy in 2014 was 3.3%. The developments during the year have been characterized by an unwanted political situation in Kosovo (government formation was delayed after the elections in June 2014) which has affected investor confidence. Investments thus recorded a slight decrease in real terms, in particular private investments. Consumption continued to be the main factor of domestic demand, reflecting an increase in real disposable income from the 25% increase of public sector wages and pensions in April and the declining food prices. The increased consumption contributed to demand for imported goods and, until August 2014, imports have increased by about 2%. Export of goods improved at a rate of around 9% and that of services by 12.6% (data until September). Nevertheless, due to a low share of export in GDP, the trade balance remained at negative levels and thus contributed negatively to growth. The consumer price inflation in 2014 is estimated to have stabilised at a rate of about 0.4% (y-o-y).

**Labour market and productivity** – The unemployment rate in Kosovo remains high, at 30% in 2013, in spite of a low labour force participation rate (40.5%) and with many persons discouraged from labour market participation (SAK, 2012, 2013). Though starting from a low base, according to administrative data by the KPST, the number of employed persons has been increasing steadily in recent years at annual growth rates of 2.5-5%. Based on previous trends, a slowdown of employment growth to around 2% annually is forecasted for the period 2015-2017. Labour productivity, as measured by real GDP per employed person, was 15,465 euros in 2013, and it is estimated to have increased by 0.1% in 2014, and is forecasted to increase at an average rate of 2.3% annually in the period 2015-2017.

After a period of relatively stable wages (averaging at 412 euros) in the period Q3 2010 to Q1 2014, the average wage has increased to 440 euros in the second quarter of 2014 as a result of a 25% increase of public wages. The public wage increase has put the gross average wage in the sector at 512 euros in Q3 2014, i.e. 29% higher than that in the private sector (at 399 euros). Given the trend of wages in the private sector in recent years, and the recent increase in public wages, at this point it is forecasted that wages will remain stable in the near future.

**Competitiveness** – Kosovo's production capacities remain under-utilized and competitiveness in regional and European markets is weak. The share of base metals in total exports has been slowly declining (from 63% in 2009 to 49% in 2013) and the performance of other sectors has improved markedly, although from a small base. In 2013, base metal and mineral products accounted for around two-thirds of Kosovo's exports, whilst other sectors with significant shares in export include prepared foodstuffs and beverages, vegetable products, and plastics. Apart from base metals, the exports of all of these sectors have been increasing faster than imports in 2013, likely reflecting increasing competitiveness and some import-substitution.

Kosovo's export market share in the CEFTA market has been increasing steadily since 2008, while shares in other markets have been highly volatile and smaller.

After an appreciation of 4% (y-o-y) in 2011, the real effective exchange rate (REER) has remained relatively stable in the 2012-14 period. Labour costs have increased faster than labour productivity in 2014, leading to an increase of unit labour costs (ULC) by 2.1% compared to 2013.

**Macroeconomic outlook for 2015-17** – The medium-term outlook reflects policy actions undertaken during 2014, but, to avoid an optimistic bias, it does not take into account the effects of structural reforms planned in NERP and in the recently approved Government Programme. The real GDP growth is expected to recover from the estimated 3.3% in 2014 to around 4.3% on average during the period 2015-2017.

Consumption is expected to be the major driver of economic growth and is expected to grow by 3.6%, on average. This increase will be driven mostly from the public sector wage and pension increase, having a full effect on the disposable income in 2015 and onwards. Private consumption is expected to be supported by the increasing inflow of remittances resulting from the recovery of the euro-area economy as well as the expected expansion of consumer credit activity by the commercial banking sector in Kosovo. Real wage growth, due to expected fall in consumption goods' prices, is expected to support the projected growth of consumption in the medium term period.

The share of total investment to GDP is projected to be 27.9%, on average, over the forecast horizon. Alongside the projected 4.8% growth of public investment inclusive mainly of infrastructure projects, the growth of private investment is projected to be 8.7% on average. Continuing reforms in improving business environment, falling of construction costs as a result of the fall of metal and fuel prices and expected expansion of the credit activity associated with the expected fall of interest rates on loans are expected to contribute to the private investment growth.

The current account deficit is expected to remain at current levels during the forecast period, averaging at 6.5% of GDP. The trade balance is expected to improve, but it will still record a high deficit of 36% of GDP by the end of the period. Imports of goods and services are expected to grow by 4.9% on average, reflecting the overall growth of domestic demand. Exports of goods and services are expected grow by 5.1%, on average, being largely based on metals and driven by developments in world prices.

The inflation rate is expected to fall to 0.5%, on average, mainly due to the fall in world commodity, oil and food prices.

**Table 1. Main macroeconomic indicators, baseline scenario**

Description	2011	2012	2013	2014 Est.	2015 Proj.	2016 Proj.	2017 Proj.
<i>Real growth rates (in %)</i>							
GDP	4.4	2.8	3.4	3.3	4.1	4.3	4.6
GDP per capita	2.8	1.2	1.9	1.7	2.5	2.7	3.0
Consumption	3.0	2.6	2.2	3.9	3.4	3.7	3.6
Investment	7.9	-12.9	-0.3	-0.2	7.4	7.1	8.5
Exports	3.3	0.5	2.5	6.8	5.5	4.7	5.1
Imports	3.5	-7.7	-1.5	3.9	4.9	4.6	5.0
CPI	7.4	2.4	1.8	0.4	0.4	0.6	0.4

Source: SAK and DEPP/Macroeconomics Unit calculations

**Fiscal framework** – A primary objective of the fiscal policy is to guarantee stable public finances, respecting a legally binding fiscal rule which limits government deficit at 2% of GDP. The baseline fiscal framework 2015-2017 does not envisage any additional increase of public wages or benefits. A restrictive spending policy on goods and services will be maintained. In line with these restrictions on current spending, the Government is committed to maintain a high level of capital spending, on average at about 7% of GDP throughout 2015-2017. The construction of new roads and further improvement on existing road and railroad infrastructure will constitute a major share of capital investments in the upcoming period.

### **3. Sectorial reform measures being implemented and planned to achieve economic policy objectives 2015-17**

This section presents the key priority sectorial reform initiatives and measures within them. Some of the measures under each initiative are regarded as the most critical. Those are called “flagship” measures, which are detailed in the table 1 presented in the Annex 1. The initiatives are presented under three main themes:

- **Physical Capital** containing initiatives on energy infrastructure development; creating well-functioning SEE energy market; increasing energy efficiency; development of Kosovo’s land and transport infrastructure; supporting air transport; and addressing environmental concerns of development;
- **Human Capital** containing initiatives on pre-university education; linking VET and labor market; implementing active labor market policies; improving R&D capacities;
- **Business Environment, Industrial Structures and Trade Integration** containing initiatives on better regulation; integrating into global economy; improving contract enforcement as a measure to facilitate access to finance; development of public procurement system; advancing quality infrastructure; implementing industrial policy measures; investment promotion; and SME support.

For each initiative, there is a table with target indicators for the medium-term. To the extent possible, these indicators are aligned with those in the SEE2020 Action Plan for Kosovo and with the ongoing work on the National Development Strategy.

### 3. A: Initiatives and measures related to Physical Capital

This sub-section summarizes initiatives and measures planned in the Physical Capital pillar of the NERP. Each initiative is presented by highlighting the rationale and overall direction of the Government policy followed by summarizing the main measures planned. Most important or priority measures have been highlighted as “Flagship Measures”. Those are also presented in the table format in the Annex 1.

Initiatives and the Measures, particularly the Flagship Measures, proposed under this pillar address some of the critical gaps identified in the EU Progress Report from 2014:

- *“Overall, there was very little progress in alignment and Kosovo is still at a preliminary stage of harmonization with the acquis in this area. Kosovo needs to start implementing the acquis on security of supply. Kosovo needs to continue its alignment with and implementation of the electricity, oil and nuclear safety and radiation protection acquis. It needs to step up efforts to implement its own energy efficiency and renewable energy plans and targets”, EU Progress Report 2014, page 44;*
- *“Overall, there has been very limited progress in the improvement of physical capital besides road infrastructure. Higher priority should be given to sectors such as education, energy efficiency and water distribution. FDI inflows, by large degree, seem to be financing consumption rather than investment which could spell balance of payments problems in the future”, EU Progress Report 2014, page 29.*

The selection of the Flagship Measures within this pillar are undertaken on the basis of this criteria:

- They directly address constraints identified in the growth constraints diagnostic study conducted as part of preparing the NERP;
- They contain ongoing actions and commitments to continue those;
- They are likely to be included in the National Development Strategy, which will form the basis for updating the NERP for 2016;

#### **Initiative 1.1: Stimulate energy infrastructure development**

The Government of Kosovo is committed to further stimulate energy infrastructure development in order to ensure stable energy supply, which has been identified as one of the major growth constraints for Kosovo. Ensuring sustainable energy supply and addressing environmental concerns would largely contribute to competitiveness, investments and job creation.

Kosovo committed to decommissioning of TPP Kosovo A based on the Energy Community Treaty, regarding the fulfilment of European Directive for environment. The Government of Kosovo has established three working groups dealing with the process of decommissioning of TPP A and decided that the process of decommissioning and dismantling will start with gasification facilities, fertilizer, heat plant and some other objects whose decommissioning

and dismantling does not present a problem for the functioning of the active units of TPP Kosovo A. KEK established a department for managing of the process of decommissioning of the non-functional facilities in TPP Kosovo A.

In addition to this, Kosovo will continue with its commitment for construction of new power generation capacities, respectively construction of new TPP Kosova e Re. The Steering Committee established by the Government of Kosovo has recently received offers from prequalified investors for the construction of TPP 'Kosova e Re'.

The main indicators for this initiative are:

Indicators	Measure	Baseline 2014	Target 2020
Installed capacity of electricity production from TPP	MW	1 478	1 678
CO <sub>2</sub> emissions	tons/year	7.1m	6.1m
Other pollutants	tons/year	38ths	27ths
Total energy consumption	toe	-	1451 toe

In line with the current achievements, during the period 2015-17 reforms on energy infrastructure will be focused on the following measures:

- **Flagship measure 1.1.1:** Decommissioning of TPP Kosova A: The implementation of this measure time-wise to comply with the dynamic plan depends mainly on availability of funds from EC, since the process of decommissioning is expected to be fully supported by EU funds, part of IPA II. Process of the decommissioning of TPP Kosovo A will consist of decommissioning and dismantling of gasification objects, fertilizer, heat plant and other associated objects that do not impede the normal operation of active units of TPP Kosovo A. The total cost of implementing the project in accordance with the decision of the government, is not yet defined. 2 million Euro are assigned only for consulting engagements (IPA 2014) but the cost for full implementation of the decommissioning and dismantling is expected to involve additional financial implications. More precisely the cost of decommissioning will be determined by the study. Further process of the decommissioning of units of the TC Kosovo A should be in line with TC Kosova e Re development, according to the draft Kosovo energy strategy.
- **Flagship measure 1.1.2:** Investment of new power generation capacities TPP 'Kosova e Re': Kosovo is committed for optimal use of its energy resources, by addressing also environmental concerns in order to ensure stable energy and quality energy supply. As the offers of prequalified investors were opened recently, the Government aims to close tendering procedures during 2015. The target is to build new power plant 'Kosova e Re' with generation capacity of 600 MW by 2020 with best available technology;

- Measure 1.1.3:** Feasibility study for revitalisation of the old power plant Kosovo B. The Government of Kosovo will also complete the revitalization of the old power plant Kosovo B based on the recommendation of foreseen relevant studies in order to meet the EU environmental requirements. This will require a feasibility study to: determine the level of environmental pollution from emissions and discharges of industrial wastewater, determine the processes and technology required to reduce all emissions and to recycle the industrial waters and other waste coming out from the plant, as well as necessary measures and based on the models related for financing of these recommended measures. Through IPA 2014 MED together with KEK applied for a study and the estimated cost is 1 mil Euro. As a follow up to this feasibility study, additional investment will be needed for TPP Kosovo B to comply with European emission standards, especially with the Directive on industrial emissions 2010/75/EU. The current level of dust emissions according to KEK own measurements is approx. 665mg/Nm<sup>3</sup> while it should be under 20 mg/Nm<sup>3</sup>. Average quantity of SO<sub>2</sub> emissions is 678 mg/Nm<sup>3</sup>, and it shouldn't be higher than 200 mg/Nm<sup>3</sup>. Average quantity of NO<sub>x</sub> emissions is 835 mg/Nm<sup>3</sup> and it shouldn't be higher than 200 mg/Nm<sup>3</sup>.

**Initiative 1.2: Create a well-functioning SEE energy market that would provide affordable but cost reflective and reliable supply of energy**

Contribution of Kosovo to creation of a functioning SEE energy market will consist of regulatory and administrative measures, as well as significant investment in strengthening the transmission network infrastructure.

Kosovo will build a high voltage interconnectivity line between Kosovo and Albania by the end of 2016. Based on this interconnection Kosovo can start developing a joint energy market with Albania. The electricity production patterns in the two countries are complimenting each other, since electricity in Albania is mainly produced by hydropower plants while in Kosovo by coal power plants. A joint market would significantly increase security and reliability of electro energetic systems of both countries as well as contribute to energy security of the region. Also, the joint electricity market may provide good economic signals to the investors for increasing generation capacities in order to ensure proper generation adequacy to meet power demands of both countries.

The construction of interconnection line of high tension 400 kV Kosovo – Albania will have a direct impact on the transmission capacities between the two countries and the region, increasing the security and reliability of the electro energetic systems. Moreover, the construction of this line would create a common energy market and facilitate more efficient market operation in accordance with the EU requests. The current capacity of 200 MW for the interconnection transfer with Albania will be upgraded to 900 MW with the implementation of the 400 kV line.

The main indicators for this initiative are:

Indicators	Measure	Baseline 2014	Target 2017
Transmission line capacity between Kosovo and Albania	kV	220	400
Capacity for the interconnection transfer	MW	200	900
Laws adopted to assure energy market liberalization	No	-	5
Kosovo membership in ENTSO-E	Yes/No	No	Yes

During the 2015-17 the following measures will be undertaken:

- **Flagship Measure 1.2.1:** The project for building the interconnection line 400 kV, Kosovo-Albania, is a common project of the Kosovo Transmission System Operator (KOSTT) and the Albanian Transmission System Operator (OSTSH) based on the agreement signed on December 20, 2013.

The funding for the Kosovo part of the project will be secured by the German Government based on the Financial Agreement signed by KfW, Ministry of Economy and Finance (Kosovo Government) and KOSTT, for a total amount of €33.5 mil (out of which €16.5 mil. grant + €17 mil. loan). In addition, KOSTT and OST will contribute with funding from their respective budgets. The Project is expected to be finalised by 2016 (the construction phase is planned to be within 24 months from the date of the contracting);

- **Measure 1.2.2:** Further legislative measures will be needed to complete the market liberalization for all energy activities in order to create a competitive, open, and non-discriminative market. It is expected that the 3<sup>rd</sup> energy package will be fully transposed over the coming short term period. The legislative package of 5 laws is expected to be adopted during 2015. These laws include: Law on Energy, Law on Electricity, Law on the Energy Regulator, Law on Natural Gas, as well as based on the new directive for energy efficiency, together law on energy efficiency and law on thermal energy.

In addition to this, the Energy Strategy (10 years period) along with the Programme for Implementation of Energy Strategy (3 years period) has been included for revision in the Annual Plan for Strategic Documents to be adopted by the first or second quarter of 2015;

- **Measure 1.2.3:** Administrative measures aimed at strengthening the capacity of the energy regulator to complete its mandate as an independent regulator, as requested by the EU 3<sup>rd</sup> legislative package will be implemented.
- **Measure 1.2.4:** Further KOSTT strengthening will help with the synchronization of the KOSTT transmission system to the ENTSO-E transmission network as it is foreseen in the Inter TSO Operation Agreement signed between KOSTT and Serbian TSO EMS based on requirement of Energy Agreement signed between Kosovo and Serbia. Final goal of those agreements is Kosovo membership in ENTSO-E.



**Initiative 1.3: Increase efficient use of energy by achieving a minimum 9% energy saving target by 2018, in line with its commitments to the Energy Community**

Kosovo is suffering high losses in electricity distribution caused by technical (old infrastructure) and commercial (consumers not paying for electricity) factors. The Government of Kosovo is addressing this issue in cooperation with the electricity distribution company KEDS. KEDS has adopted a commitment to decrease the distribution losses and invest into infrastructure over the period of 5 years as part of its privatization agreement. As a matter of affordability and in order to avoid energy poverty, the Government of Kosovo is preparing a social assistance scheme to support vulnerable groups of population. Already now the budget is spending 4.5m EUR in support for families in social need who get up to 400 kW of free electricity.

Kosovo has signed the Energy Community Treaty and committed to transpose the 3<sup>rd</sup> energy package and acquis on energy efficiency and renewable energy. The targets are set for Kosovo in line with the targets adopted through the Renewable Energy Directive No. 2009/28/KE (according to Directive No. 2006/32 EC on energy end-use efficiency and energy services) at 9% increase of energy efficiency in the final consumption by 2018 and 25% for the share of renewable energy sources in the final energy consumption by 2020.

The main indicators for this initiative are:

Indicators	Measure	Baseline 2013	Target 2020
Losses in electricity distribution	%	35.54	29
Total energy consumption	ktoe	1238.8	1 451.09
Energy saving from GDEC	%	3	9
Production of energy from renewable sources	%	n/a	22.28

In line with the current achievements, during the period 2015-17 the following measures will be implemented within the scope of this initiative:

- **Flagship measure 1.3.1:** In order to achieve the target share of renewable energy in gross final energy consumption the government and Energy Regulatory Office will adopt the following measures:
  - Implement second mid-term energy efficiency plan 2013–2015 with the aim of 3% energy saving from GDEC;
  - By 2016 establish municipal energy offices with aim to support energy efficiency measures at the local level and develop municipal plans for energy efficiency;
  - In 2015 finalize the co-generation project, connecting Prishtina District Heating with power plant Kosovo B by completing installation of steam extraction from unit B2 (WBIF project supported by EC and KfW). Connection with unit B1 is completed and already in testing phase (WB project).

- **Measure 1.3.2:** In order to achieve the target share of renewable energy in gross final energy consumption the government will adopt the following measures:
  - In 2015 the Energy Regulatory Office will set the feed-in tariffs for all renewable energy sources (RES), such as electricity generated by small hydro power plants up to 10 MW (already set at 63.3 €/MWh), wind energy (already set at 85 €/MWh), energy produced from biomass (already set at 71.3 €/MWh) and solar/photovoltaic energy (already set at 136 €/MWh);
  - Introduce mandatory buy-out of the entire quantity of electricity produced from RES by power distribution operator, even when this energy exceeds the energy requirements;
  - Introduce fiscal measures (tax/customs exemptions for all the technologies using renewable sources of energy and efficient energy) in order to provide stimulus for the production and import of products and technologies aimed at increasing energy efficiency.

#### **Initiative 1.4: Further develop Kosovo transport infrastructure**

In the transport sector the main challenges are of infrastructural nature, Kosovo needs to develop its road and railroad infrastructure in order to facilitate regional trade and attract FDI. While in the road infrastructure there have been major advances in quality through building an extensive network of highways, in the railway sector further investment is necessary to bring the Kosovo railroads to EU quality standards. The support for construction of multi-modal terminals should contribute to fulfilment of EU environmental standards. Specifically the government will continue to implement its projects on construction and modernisation of road transport, in addition to specific projects outlined below on railway network.

Currently the government is not planning any specific structural reform in the road sector, but rather finishing the phase 1 of road construction. Road safety is addressed partially through improvement of the road network, which besides construction of new roads also includes annual increase of allocation of financial resources for road maintenance.

As regards the railway sector institutional and regulatory framework is in place, however during the coming medium and long term period there is a need to focus on key railway network lines. In general the state of play on railway sector could be summed up on these elements:

- Feasibility study for rehabilitation of the Railway Route 10 (financed by IPF and WBIF), which connects Serbia, Kosovo and Macedonia has been completed;
- In 2012 a feasibility study for rehabilitation of the East West Railway Lines Podujevë – Fushë Kosovë – Pejë, and Klina – Prizren has been completed;
- In 2013, Kosov government has secured the needed investment for Detailed Technical Project Design for general rehabilitation of the southern part of Railway Route 10 (Fushë Kosovë – Hani i Elezit – border with Macedonia).

Therefore main priority projects depending on the funding for upgrading Kosovo Railways Infrastructure priority projects are: General rehabilitation of the Railway Route 10 southern line (200m EUR), eastern line from the Border of Serbia to Fushe Kosove (66m EUR);

rehabilitation of western line Fushe Kosova Peja (123,6m EUR), General rehabilitation of the southwestern line from Klina up to Prizren (89m EUR). In addition to this, in order to connect the railway network with neighbouring countries (Albania and Montenegro), two other priority projects are planned, respectively: Feasibility study, project design and TD, and construction for new railway line Prizren in Kosovo – Durres in Albania (55m EUR): Feasibility study, project design and TD, and construction for new railway line Pejë in Kosovo – Mateshevo in Montenegro (costs are not known yet). Currently, Kosovo Government has started negotiations with EBRD and EIB for loan for general rehabilitation of then Railway Route 10, which connects Serbia, Kosovo and Macedonia. The southern part of Rail Route 10 is considered as a priority compared to the northern part of the route.

Key measures in relation to transport infrastructure for the period 2015-17 are:

- **Flagship measure 1.4.1** Road infrastructure construction and maintenance. Kosovo will continue on construction and modernisation of road transport through domestic funding and funding from development partners. In line with this the main projects on the road network involve:
  - 1) Complete construction of R7 – Highway Merdare - Pristina - Vermnice, interconnecting Kosovo with Albania and Serbia. In respect to the remaining part of the road to the border a feasibility study will be undertaken during 2015 to seek external financing opportunities;
  - 2) Complete construction of R6 – Highway Pristina – Hani i Elezit, Macedonia (project has been contracted for 5 year implementation, for the next three years a total of €288.6 is budgeted). The total estimated cost is € 600, milion, whereas 2015 budget breaks down expenditures for this project in this way: 2014 €55, 9 million, 2015 €90.00 million, 2016 €90.00 million, and 2017 €108.6 million).
  - 3) Complete construction of N9 – Road construction Pristina – Peje – Montenegro. To complete construction of this road during 2015-2017 the following numbers have been budgeted: 2015 - €4,500,000, 2016 - €19,688,172, and 2017 - €9,200,000.
  - 4) Complete construction of N2 – Road construction Pristina – Mitrovica – Serbia. The total cost for construction of this road is €83,754,745, whereas 2015 budget breaks down expenditures for this project in this way: 2015 - €24,000,000 (20.1 million through loan, whereas 3.9 through Kosovo budget); 2016 - €14,700,000 (external financing - loan); 2017 - €9,200,000 (external financing – loan).
- **Flagship measure 1.4.2:** Upgrade railway infrastructure. The Government of Kosovo will implement following the actions in the railway sector the period of 2015-2017:
  - Gradually implement recommendations drawn on the basis of the feasibility study of Rail Route 10, to have this route in good condition for operation;
  - In 2015-2017 prepare the detailed design for Rail Route 10 with financial support of EBRD (10m annually for 3 years);
  - In 2017 carry out a feasibility study on the rehabilitation / modernization of the East-West lines, which connect the airport to the branches of the southern part of the line;
  - In 2017 carry out a feasibility study for construction of a railway line linking Kosovo with Albania, the main centres and ports.

- **Measure 1.4.3:** Besides capital projects, Kosovo is planning to address the road safety through adoption of a new Road safety strategy and amendment of the Law on Road Traffic Safety, in order to comply with acquis in the transport area. This includes also respective secondary legislation for its implementation. Both have been submitted to OPM for legislative procedure and their adoption is expected in 2015. Besides infrastructure quality issues the activities in this field will focus on adjustment of compliance of drivers with general traffic rules, including:
  - strengthening the information technology regarding the mutual exchange of information on criminal and traffic offenses between Kosovo Police, State Prosecution and Courts (for tracking and recording data for offenses, safety measures, protective measures, negative points, written warning measures, accidents and their consequences);
  - streamlining of court procedures linked to traffic rules violation punishment.
 In addition to this, during 2015 the GoK will finalise and adopt the Sectoral and Multi-modal Transport Strategy and Action Plan.
- **Measure 1.4.4:** The targets of renewable energy utilization include also the target on the energy consumption in the transport sector, according to which 10% of energy consumption in transport will be derived from renewable resources by 2020. Ministry of Trade and Industry is in the stage of completion of the legal framework, which will address the issue of biofuels, in order to meet the goal of predicting energy consumption in transport.

### Initiative 1.5: Developing the air transportation

Kosovo has made significant progress towards implementation of EU standards in the area of civil aviation. The government liberalized access to air transportation for the air carriers as well as for the ground service providers (in 2011 regulation No. 4/2011 on the access in the ground handling market was approved). As to the overall developments recently there is an initiative to fully normalize the airspace and this initiative is going through a period of consultation between the stakeholders. Opening of the low air space (tentatively in 2015) would become the drive for the development of general aviation in Kosovo.

The main indicators for this initiative are:

Indicators	Measure	Baseline 2013	Target 2017
Number of passengers	ths	1 628.7	2 000.0
Number of flights	No	7 305	10 000
Number of air operators	No	28	35

In the period from 2015-17, the focus of the Government will be on the following measures:

- **Flagship measure 1.5.1:** Increasing technical and human capacities of Air Navigation service provider. An agreement between NATO and Hungary, air navigation services for

aircraft to bypass the ethereal space of Kosovo is being provided by Hungaro-Control. This agreement ends in 2019. Meanwhile, the Service Provider Air Navigation of Kosovo needs to build its technical capacity and human resources in order to be capable to offer all these services individually after the year 2019. The provision of these services by Service Provider Air Navigation of Kosovo would greatly increase work activity and income and would make it competitive with similar agencies in the region;

- **Measure 1.5.2:** Preparation for opening of Gjakova airport to civil aviation. The Government on March 2014 adopted the decision on establishing the Public Enterprise "Gjakova Airport". In the 2015-2017 period plans will be elaborated to make it operational for civil aviation purposes – freight and passenger transport. The airport has raised the interest of private investors, so the option of private sector involvement will be considered;
- **Measure 1.5.3:** Upgrading the air traffic through incentives provided to airlines. A strategic objective for the Government of Kosovo is increasing the competition of airlines and flight routes. CAA legislation and the Prishtina International Airport concession contract foresee the possibility of providing financial incentives for airlines as a method to increase air transport market. The Civil Aviation Authority approved an incentive program for the airlines to the International Airport of Pristina through Decision No. 02/ZDP/VE/2014 valid up to March 29, 2015. Incentives cover tax exemptions from aeronautic tariffs, financial support for covering marketing costs etc. The Government of Kosovo will continue with the incentive program with the aim to reach 2 million passengers at the International Airport of Pristina by 2017. It is expected that with the increase in number of passengers also the number of operators and destinations will also increase. To achieve this objective, the government will provide, upon request of the Prishtina International Airport further operational incentives in conformity with EU legislative framework to simulate affordable flights from and to Pristina as well as to increase the number of flights and destinations;

#### **Initiative 1.6: Mitigate environmental impacts related to business activity**

The Government of Kosovo has developed an updated version of the Environmental Strategy and National Environmental Action Plan 2011-2015. Its target is strengthening environmental protection standards and capacity for climate change adaptation. In the legislative and administrative field, amendments to legislation on Environment Strategic Assessment (ESA), Environment Impact Assessment (EIA), and Integrated Pollution and Prevention Control (IPCC) were already adopted.

It should be noted that Kosovo is not a member of UNFCCC, and as such it does not have national reference targets yet. For now, only preliminary inventory for greenhouse gases for 2008, 2009, 2012 exists, so Kosovo needs to establish an environmental database, before starting to focus on fulfilling the targets in reduction of environmental pollution.

In the period from 2015-17, the focus of the Government will be on the following flagship measures:

- **Flagship measure 1.6.1:** Improving capacity and effectiveness of institutions responsible for the implementation and monitoring of environment policies. In this regard, MESP

will develop capacities for issuing of permits and consents for businesses in the area of environment and spatial planning. Specific activities for the implementation of legislative framework will be focused on: capacity building for MESP employees, central and local level institutions, and external experts responsible for implementation of law and issuing permits and consents to better inform businesses about environmental requirements; provision of information to businesses on procedures as defined by the legislation; drafting information manual and guidelines on procedures for issuance of permits for official dealing with these permits/consents (MESP).

**In addition to this**, further strengthening of institutional framework will be carried out in order to address the challenges in terms environmental concerns. Main focus will be on establishing the National committee on climate change (SEE 2020) in order to strengthen cooperation with other ministries that have responsibilities in the field of environment (MoI, MED, MoA). In order to improve institutional coordination Kosovo will work on integration of environmental protection into all horizontal sectors so that it will be part of their overall policies/programs. In specific, GoK in 2015 will operationalize the Kosovo Framework Strategy on Climate Change through adoption of an action plan on implementation of this strategy. Trainings will be provided through ECRAN in order to develop capacities to meet the international obligations on climate change as per UNFCCC and EU requirements. Implementation timeline is 2015-2017;

- **Measure 1.6.2:** Adoption of the Water Strategy. In 2015, it is planned to be finalized and adopted the Kosovo Water Strategy 2014-2033 – guarantying access to health-safe drinking water for all and maximize the economic benefits from water usage. Further, the strategy will aim at eliminating water scarcity, respecting international treaties on water usage, and respecting the principles of sustainable water management;
- **Measure 1.6.3:** Permits and consents for the water, construction and waste management operators. Business operators should be equipped with environmental permits and consents (including also permits and consents for water, construction, waste management and other activities) before starting the business in order to assess the impact of their activities on the environment. MESP will further strengthen the oversight over environmentally harmful business activities and implement following measures:
  - Issuing IPPC permits for big operators (is in the process, e.g. Feronikel, KEK) with the aim of reducing pollution to levels which meet the EU acquis and international standards;
  - Terminating activities and remove all operators from riverbeds causing harm to rivers in order to minimize discharge of wastewater and oil from commercial operators.
- **Measure 1.6.4:** The Government of Kosovo will also strengthen the regional and international cooperation in the field of environmental protection:
  - Enhance regional cooperation with Macedonia and Albania through RCC in the field of trans-boundary water resources management (TWRM);
  - Finalize agreements on cross-border national parks (currently signed MOUs) with Macedonia, Albania and Montenegro;
  - Develop and put in place measures necessary for commencement of the Regional

### Initiative 1.7: Improvements in water supply

Up to this point, Water and Wastewater Regulatory Office has licensed seven regional water companies that provide retail water and one company that provides wholesale water without treatment. Licenses for these companies are valid until October 31, 2015. The most common problems that companies encounter during licensing are getting water permits from MESP and the signing of service agreements with respective municipalities in the regional area. Unlicensed service providers of which the Authority had knowledge were fined and court proceedings were initiated against them (Kaçanik, Shtërpce, Northern part of Mitrovica).

Water and Wastewater Regulatory Office reviews the tariff rates on regular basis. Currently, it is reviewing the public water service tariffs for the period 2015-2017. The tariffs for the coming three years period will be set for seven regional water companies that provide retail water services, one company providing wholesale water supply services and another company providing wholesale water without treatment. The tariffs for the wholesale water supply without treatment have already been set for the coming period 2015-2017. The application of the 2015 tariff regime will start from 1 January until 31 December 2015, while those of 2016 and 2017 are reviewed for adjustment of inflationary movements and assessment of the degree of fulfilment of targets set by the tariff regulatory process in the prior year.

The main indicators for this initiative are:

Indicators	Measure	Baseline 2014	Target 2017
Licenses issued	No	7	7
Water companies corporatized and consolidated	No	-	7

In the field of licensing and tariff setting the government will implement the following measures:

- **Flagship measure 1.7.1: Finalise the project for construction of Prishtina drinking water supply system** with capacities of 700 l per second to improve the water supply in Prishtina and the region. The contract for this project has been signed and works on construction started on December 2014. This project is one of the largest investments in drinking water supply since the establishment of RWC “Prishtina” – j.s.c.. This will be an investment in the new Water Treatment Plant in Shkabaj, in the amount of 35 million Euros. The first phase will be 700 l/s and the second phase 500 l/s, to be implemented for the Water Treatment Plant in Shkabaj. This project is funded by: the Municipality of Prishtina with 5 million Euros, the European Commission 5 million, the Government of the Republic of Kosovo with 5 million Euros, 20 million loans taken by the Water Company Prishtina from the German Development Bank, and the guarantor for loan repayment is the Government of Kosovo for RWC “Prishtina” – j.s.c. The project is expected to be finalised by 2016;

- **Measure 1.7.2: Integrated River Basin Management Planning.** Pursuant to the Law on Waters these plans will be available in 2015. They will cover the period until 2020. They will be based on: River Basin Characterisations as prepared by MESP with the assistance of the EU Funded KWS WAIP Project. This is in line with the overall planning for approximation of Kosovo legislation with EU, therefore there is a need to prepare a long-term strategy (a “road map”) for the implementation of EU legislation and this shall relate in particular to the preparation of river basin management plans (RBMPs) and implementation of the EU Water Framework Directives requirements. This process shall be conducted in conjunction with the timing of the Kosovo Water Strategy (KWS) and River Basin Management (RBM) planning requirements as specified in the Kosovo Water Law under articles 31 and 32.
- **Measure 1.7.3:** Corporatisation and consolidation of regional companies. In 2015 ensure corporatization and consolidation of all regional companies in order to fully implement the Government Decision No. 06/18. Corporatization and consolidation of regional water companies was approved based on Government Decision No. 06/18 dated 08.06.2011. The implementation of this decision has implication to all parties in raising service standards and in billing at a realistic cost for the services provided.



### **3. B: Initiatives and measures related to Human Capital**

This sub-section summarizes initiatives and measures planned in the Human Capital pillar of the NERP. Each initiative is presented by highlighting the rationale and overall direction of the Government policy followed by summarizing the main measures planned. Most important or priority measures have been highlighted as “Flagship Measures”. Those are also presented in the table format in the Annex 1.

Initiatives and the Measures, particularly the Flagship Measures, proposed under this pillar address some of the critical gaps identified in the EU Progress Report from 2014:

- “Very limited progress has been made in improving the quality of the education sector. Total public spending on education decreased slightly, by 0.1 percentage points, to 3.8 % of GDP in 2013, still less than the average for low and middle income countries (4.3%)... Overall, insufficient funding, the low level of cooperation between vocational schools and enterprises to conduct practical learning and delays in the implementation of policies to provide the skills required by the labour market remain as the major problems”. EU Progress Report 2014”, page 28-29;
- “Overall, there have been limited efforts to improve labour market conditions. More efforts and funding should be made to support active labour market policies, which remained insufficient, and to produce adequate data on employment”, EU Progress Report 2014, page 26;
- “Kosovo needs to step up efforts to activate jobseekers through active labour market measures to reduce structural unemployment. The budget for expanding active labour market measures remains low and is insufficient to address needs effectively”, page 36.
- “More efforts are needed to strengthen Kosovo’s research and innovation capacity through boosting investment in the sector and by taking action to facilitate the integration of Kosovo into the European Research Area and its contribution to the Innovation Union”, EU Progress report 2014, page 39.

The selection of the Flagship Measures within this pillar is conducted on the basis of these criteria:

- They directly address constraints identified in the growth constraints diagnostic study conducted as part of preparing the NERP;
- They contain ongoing actions and commitments to continue those;
- They are likely to be included in the National Development Strategy, which will form the basis for updating the NERP for 2016.

#### **Initiative 2.1: Quality Pre-University Education as basis for capitalizing on the “demographic dividend”**

The Government of Kosovo will continue to improve the **quality of pre-university**

**education** with a view to capitalize on the “demographic dividend”. During 2015-17 implementation of this measure will primarily **focus on further roll-out of the new Kosovo Curriculum Framework and related teacher training and licensing** along with actions to **improve school management and addressing of the problem of dropouts**. Further **development of sector financing**, particularly as regards linking teacher qualifications and performance to salaries will be considered. Special attention will be paid to **addressing the current level of low enrolment in pre-primary and pre-school education**.

In Kosovo, enrolment rates are nearly universal in primary education but upper secondary enrolment is still not (around 90 per cent), especially among girls and students from low-income families. However, as to enrolment in pre-school (0-5 years) and pre—primary (5-6 years) education in 2014, Kosovo lags behind its neighbours – the combined GER is 26.1% (3.7 of children are attending public pre-school education while the enrolment rate in compulsory pre-primary education is 71.5%). Efforts to expand pre-school and pre-primary education would lead to societal-wide benefits in the medium to long term in terms of higher employment and worker productivity and contribute to a positive fiscal dynamic.

Due to recent salary increases, teacher remuneration is now competitive for attracting young and qualified graduates from profession. However, this has reduced the „fiscal” space for accommodating other education reform priorities especially as concerns infrastructure, ICT etc. Also, the link between pay and qualifications / performance still needs to be developed. 14% of teachers have a so called temporary license (beginners or unqualified). Qualifications of licensed teachers also need to be improved. The curricula and teaching quality are inadequate, school management is still weak, and there are significant variations between municipalities. The system of measuring education attainment is not fully developed, but the existing Matura exam results are alarming, and there is a lack of systematic and comparable data on inputs and outputs of the education system. Career guidance is not functional.

Already (since 2011) the revised Kosovo Curriculum Framework (KCF) promotes a competency-based approach, developed through practically oriented learning. It envisages an enormous shift from a content-based to a competency-based curriculum, aimed at mobilizing the potential of Kosovo youth to compete successfully in the labour market locally and abroad. The new KCF already has been tested in 92 schools. Teacher training has been ongoing to support application of the new curricula. In total 259 teachers have been trained. To improve school management, 350 head teachers have received training during 2011-13.

In line with the current achievements, during 2015-17 the reform strategy will be focused on the following measures:

- **Flagship Measure 2.1.1:** Improving access to pre-primary education. The Law on Pre-University Education was passed in 2011. It provides for compulsory pre-primary (grade 0 for children aged 5 to 6) education. It also mandates the creation of a new curriculum and learning standards for both pre-school and pre-primary pupils. In the next period focus will be on implementation of this Law. The KESP 2013-16 already includes provisions for curricula development and teacher training in this regard. Particular emphasis will be on elaborating options for financing closure of the gap in access to pre-primary education;

- **Measure 2.1.2:** At the primary and secondary education level, expanding application of the new KCF to additional schools will be continued. In total it is planned that 3300 teachers will be trained based on the core curricula. Training on ICT skills will be provided to 700 teachers as part of that programme. The process of advancement of teacher qualification will continue aiming at some 1100 members of profession. Teacher licensing efforts will be continued with priority focus on the schools applying the new KCF. This will be paralleled with consideration of actions to enhance incentives for professional development among teachers including through teacher licensing and pay;
- **Measure 2.1.3:** Modernization of the Education Management Information System (EMIS) with a view to ensure availability of high quality data for effective resource management in the sector will be launched in 2016 while certain improvements to take place already in 2015. Implementation of per-capita financing of education in municipalities will be further applied following improvements in availability of reliable data;
- **Measure 2.1.4:** In parallel to professional development and licencing of teachers, furthering improvements in school management through additional training of school directors (at least 120) and some 400 members of school management boards, and preparing school development plans will also continue;
- **Measure 2.1.5:** Implement the Programme for International Student Assessment (PISA), a triennial international survey which aims to evaluate the education system worldwide, by testing the skills and knowledge of 15 year old students.
- **Measure 2.1.6:** Implement the Strategy for effective implementation of ICT in Education and Science

## **Initiative 2.2: Vocational Education and Training System Linked with the Needs of the Labour Market**

The Government of Kosovo will implement actions aimed at increasing match between skills needed by the labour market and the output of the VET system. The particular **focus will be on building capacities, establishing mechanism and setting incentives for continuous interaction between the education and training sectors**, on the one hand, **and labour market**, on the other hand. Special emphasis will be on **advancing industrial cluster based approach to skills supply and demand matching**. Further adaptation to the European Qualifications Framework (EQF) is also planned.

The main indicators for this initiative are:

<b>Indicators</b>	<b>Measure</b>	<b>Baseline 2014</b>	<b>Target 2020</b>
Number of students in VET's accredited programmes as percentage of total enrolment in Upper Secondary education	%	56.8	60
Unemployment rate among graduates of the VET system	%	65	35

VET students undergoing practice based learning in schools with equipped workshops	%	65	100
VET students undertaking placements in enterprises as part of the study programme	%	63	100
Industrial cluster based mechanisms established and functional for dialogue between the education and training system / providers and the cluster firms	No	0	6
Modern Occupational Standards / Qualifications developed and validated	No, %	43	10
Accreditation of training providers			
• Formal	No,%	2	4
• Informal & Non-formal	No,%	18	10

The demand for labour in Kosovo is small when compared to its supply, but requires specific skills, some of which are not available on the market or are of poor quality. Unemployment rate among those with VET education is 28% (2013). Not only slow job creation is to be blamed for this. The VET system is still to develop to be able to sufficiently meet the labour market needs in terms of relevance of qualifications.

In Kosovo there are 61 VET schools. These are subordinated to municipalities but funded mostly through the grant from Kosovo budget on per capita basis. Allocations per student in VET, amounting to 23 Euro per year, are not sufficient to cover even the basic needs. This, among other aspects, restrains investment in schools' infrastructure, equipment and workshops for specific skills. Many programmes do not sufficiently reflect the needs in terms of relevance, and the quality of teaching needs to be improved. Besides, there is the need to tackle reluctance of companies to cooperate with schools in terms of professional practice. Only 63% of VET schools offer practice opportunities in enterprises while less than 20% do not provide practice opportunities neither within the school nor outside.

As to the current policies to tackle the above-described problems, the National Qualifications Authority (NQA) has set up procedures for validation of occupational standards and accreditation of VET institutions. It has made progress approximating the National Qualifications Framework with the European Qualifications Framework. The Agency for Vocational Education and Training and Adult Education (AVETAE) became operational during the spring of 2014. It manages VET institutions in terms of financial and human resources, construction and infrastructure.<sup>4</sup> Centres of Competence under the MEST (construction, tourism, economy, health) have been made operational, and 2 more are planned (auto mechanics and metalworking). They provide short and longer-term training courses, and are generally better equipped than the VET schools.

In line with the current achievements, during 2015-17 the reform strategy will be focused on measures:

- **Flagship Measure 2.2.1: Continue improving quality of the VET education.** This measure will contain the following main activities: Support National Qualification Authority (NQA) in further increasing its capacities – especially through training and

development of staff; Increase awareness and develop information materials about National Qualifications Framework (NQF); Adopting secondary legislation and guidelines for harmonization of NQF with European Qualifications Framework (EQF); Establishing two new centers of competence in metal-working and automechanics; and Supporting and promoting the establishment of Quality Assurance Offices (QAO) in VET schools;

- **Flagship Measure 2.2.2: Enhance the capacity for coordinated development of the VET system.** This measure will include the following activities: Functionalizing (through adopting its mandate and operating procedures) the Council for Vocational Education and Training (CVET) and strengthening inter-ministerial coordination through this new forum with particular emphasis on linking education and labor market; Increase capacities of AVTAE Staff through training. Review of the funding mechanisms of VET with a view to improve system's efficiency, effectiveness and sustainability; Gradual introduction of performance assessment framework for the VET schools; Implement the Torino Process Methodology. These actions will be carried out taking into account provisions for VET development included also in the "Kosovo Vision for Skills 2020" document;
- **Measure 2.2.3:** Further develop the system for forward-looking analysis of the skills demand in Kosovo labour market. This measure will include the following activities: Elaborating functional mechanism and undertaking necessary legislative changes to establish procedures for sectorial skills forecasts based on employer and employee surveys for future skills demand; Building capacity at the AVATE to enable staff to coordinate carrying out of the sectorial skill forecasts followed up by testing of the approaches to skills matching; Improve practical coordination between VET schools and businesses by establishing industry councils;
- **Measure 2.2.4:** Implement the system for formal recognition and validation of informal and non-formal learning. The measure will contain the following main activities: Drafting of the secondary legislation for implementing the validation of informal and non-formal learning; Drafting the external evaluation procedure criteria for recognition of informal and non-formal learning; and Implementing the system for external evaluation of informal and non-formal learning;
- **Measure 2.2.5:** Implementing the training programme for VET teachers. This measure will contain the following main activities: Developing the timetable for VET teacher training to ensure that all teachers have pedagogical skills to teach in their subjects; Training of at least 20% of teachers in VET system within 3 years;
- **Measure 2.2.6:** Promotion of professional practice. This measure will include activities such as: Operationalizing CVET and formal consultation mechanisms between VET Schools, businesses and labor market institutions (similar to measure 2.2.1); Reviewing the curricula to ensure that all programmes and schools implement professional practice; Promote awareness and support to strengthening the local level cooperation between schools and businesses; and Increasing the number of businesses and other organizations that provide professional practice;

- **Measure 2.2.7:** Improve the career guidance in schools. This measure will contain activities on implementing an integrated model for career guidance in schools through preparing programs and standards for career guidance; supporting cross-sectorial cooperation in career guidance; Increasing the number of schools that offer career guidance from the existing 7 to 40; and Increasing the number of staff involved in career guidance from 6% to 8%. It is also planned to adopt the strategy for improved career guidance, lack of which is considered to be one of the main obstacles to better link the labour market and the education system.

### **Initiative 2.3 Active Labour Market Actions**

Under this initiative the Government of Kosovo will **focus on building a modern employment services in Kosovo able to register, profile and support through training and other active labour market measures the unemployed** while at the same time continue **addressing informality** in employment.

Kosovo continues to face an unemployment rate of around 30%, very low labor market participation and employment rates, especially among women (around 20% and 13% respectively). Nearly 70% of the unemployed are long-term unemployed. The unemployment rate among young people aged 15-24 was about 56%. The number of registered unemployed was at around 270,000 in 2014. The Public Employment Service (PES) has helped to find 4,729 jobs for jobseekers. The number of people trained by the PES was 2,093. Public expenditure for PES in Kosovo amounts to around 0.16% of the GDP, but there is an extensive donor support for the active labor market measures, which is estimated at up to of 0.30% of GDP in 2014. Besides the PES, there are 8 Vocational Training Centres and 6 Mobile Centres (under the MLSP) providing short-term modular trainings to unemployed. There are also numerous private sector providers of training services; however, the licensing is not fully developed. Informality in employment remains high.

The focus of the next period (2015-17) will be on completing administrative restructuring of the public employment services with a view to establish a modern PES with full capability to implement ALMPs. In particular, the focus will be on the following measures:

- **Flagship Measure 2.3.1:** Establishing the Agency for Employment (AE). It will be responsible for policy implementation in the field of employment including implementation of the ALMP; analysis of labour market; information campaigns; contracting accredited private providers of vocational training; registering and profiling the unemployed; providing information, counselling, training and other services to unemployed. The Agency is to be created on the basis of merging the current institutional units, such as MLSW's Division for Monitoring and Coordination of the Employment Offices; Division for Vocational Training; Employment offices; and the Regional Vocational Training Centres and their mobile units. In the following year additional financing will be considered. Special emphasis will be paid to improving personalisation of PES provision. The profiling (i.e. assessment performed by PES counsellors and the use of IT and statistical tools for profiling) will play an important role in activation and matching. This function will be strengthened within the new Agency;
- **Measure 2.3.2:** Review of training programs of the VTC. As part of institutional

reorganization, an analytical review of the suitability of programs offered by Vocational Training Centres (VTCs), now part of the new Agency, relative to market needs, along with a change in the mix of programs in accordance with this review, will be undertaken in 2015-17. In addition, the introduction of new training programs that focus on “soft skills” such as job search techniques, CV and cover letter preparation, and communication skills will be considered subject to financing;

- **Measure 2.3.3:** Introduction of the e-registration of employment opportunities. The main challenge to PES currently is lacking sufficient level of cooperation with private sector. As part of the modernisation of PES, the actions have been planned to develop the infrastructure for e-registration by employers and identification of jobseekers with required skills. In relation to this, provisions are to be put in place to operationalize exchange of information regarding vacancy announcements made by licensed private employment portals. Cooperation agreements (MoUs) with employers and training of employment office staff in intermediation measures will be pursued. All the above will be supported by activities of awareness rising among employers and unemployed;
- **Measure 2.3.4:** Addressing the problem of informal employment. In terms of tackling informal employment, several specific activities are planned. First, the Labour Inspectorate will elaborate its Strategic Development Plan and the Action Plan 2015. These documents are expected to become the basis for further activities vis-à-vis the informal employment through means of inspection. At the same time the Agency for Employment will organize several targeted information campaigns with a view to increase awareness of persons and employers engaged in informal employment about benefits of formalizing the employment status;
- **Measure 2.3.5:** Licensing of non-public providers of employment services. To improve employment services it is planned to elaborate and adopt the necessary secondary legislation for licensing of non-public providers of employment services. Currently, such providers are not licenced, and information about their activities is not fully available. Once the new legislation is in place, it is planned to proceed with implementation of the new licencing system for providers of employment services;
- **Measure 2.3.6:** Advancing the concept of “social enterprise”. This will include actions to develop the Concept Document on social enterprises followed up by elaboration and adoption of the Law on Social Enterprises.

#### **Initiative 2.4: Development of sustainable policy framework for research and innovation**

Research and innovation is still a marginal undertaking in Kosovo. Basic statistics on science and technology are still lacking. The Government has attempted to establish a functional system of research and innovation through the National Research Programme (2010-2014). The Law on Scientific Research Activity (2004) has enabled the establishment of the National Research Council - the body responsible for setting national research priorities and administration. The law states that up to 0.7% of Kosovo GDP should be spent on research and innovation. However, the overall absorptive knowledge and capacity for research and innovation is still limited in size, scope and quality.

The adoption of the National Research Programme has marked the first comprehensive approach to identify the research priorities and also to establish the system and infrastructure for research. The programme has identified five research priorities: national resources, energy and environment; agricultural production and food safety; medical research; social and economic studies; and cultural and historic studies. The key objectives of the research programme are the development of human capacities for research, development of research infrastructure, internationalisation of research activity, strengthening the links between research and economy and promoting excellence in research activity.

Under this measure the Government of Kosovo will focus **on creating the policy framework for accelerating creation of research and innovation capacity** with a focus on priority sectors of industrial policy and based on improved partnerships between public research institutions, such as universities, the private sector firms, and the Government. As to the later, a joined-up approach between various institutions will be sought. It is expected the measure will establish the basis for increased public and private spending on research and development, which requires a clear policy framework, coordination and appropriate incentives.

The main indicators for this initiative are:

Indicators	Measure	Baseline 2014	Target 2020
Expenditure on R&D as % of GDP	%	0.1	0.7
Kosovo research citation index	%	0.42	1.0
EU innovation Scorecard	%	0	0.200

The Government recognizes importance of applied research; innovation and technology transfer are critically important elements for Kosovo industrial sector to progress in the value chain and contributing to increase of exports. Significant problem is the lack of even basic research and technology statistics. However, survey data, such as one by the OECD from 2013, suggest that very few firms are actually engaged in R&D activities. About 80% of surveyed firms did not actually conduct formal R&D activities, while 77% among others invested less than 1000 euros in R&D during 2009-2011. 62% of the surveyed companies that perceived themselves to be innovative did not devote any financial resources to R&D during 2009–2011. The sector with the highest share of R&D performers was manufacturing, at 47%. Innovations are mostly adaptive (acquisition of equipment, software etc.), not research driven. Slightly less than two-thirds of Kosovo's total exports are primary products such as raw materials or goods with a low level of processing and relatively low value added such as base metals.

The universities primarily engage in teaching, and their research capacity is limited, the number of graduates in science and technology (S&T) is weak, and there are very few researchers working in key priority areas of industrial development. There is an inadequate and outdated infrastructure at research centres and universities. Limited funding has been among the main constraints to implementation of the NRP. In 2014 the Government of Kosovo due to fiscal constraints could allocate only 0.1% of GDP to this field while the Law



on Scientific Research Activity requires the spending level to be at 0.7% of the GDP level. Other reasons for slow development of research capacities are to be found in the existing incentive frameworks for higher education institutions.

Collaborations between research institutions and the private sector are few, and are commonly limited to training and consultancy services, as well as the use of technical facilities. The reasons for a lack of co-operation with the private sector are primarily the absence of interest from private companies and an absence of incentives. Equally, there are insufficiently developed linkages with global networks of research and innovation, including linkages with the scientific diaspora, although, advances have been made recently, as noted by the EU PR 2014.

In the period from 2015-17, the focus of the Government will be on the following measures:

- **Flagship Measure 2.4.1:** Improving the governance of R&D. This measure will include such activities as finalization and adaption of the National Innovation Strategy (NIS). The document will build on the stock-take and evaluation of the past and current R&D initiatives; Reviewing the institutional structure and establishing the “research and technology function (potentially Agency) in Kosovo; Developing the R&D Information System; Adopting new Laws on Research and on the Academy of Science and Arts; Identifying mechanisms of quality assurance of research activities; Strengthen the capacities of the Industrial Property Agency. During 2015 the MEST will operationalize the proposed measure as well as cost it with a view to feed it into the next MTEF cycle.
- **Flagship Measure 2.4.2:** Support to internationalization of research. This measure will include activities on Promoting links, participation and memberships in European Industrial Research and Management Association (EIRMA), European Association of Research and Technology Organization (EARTO), BusinessEurope, and European University Association (EUA) and European Roundtable; Supporting and advance the Bologna Process and further integration into European Research Area; Supporting and promoting cross-border and European cooperation on research in the framework of Horizon 2020 programme; Participating and actively contributing to Western Balkans Research and Innovation Exercise (WISE); Supporting local institutions in participating and producing proposals for FP6-7 programmes; and Implementing the EU Innovation Scoreboard Methodology in Kosovo.
- **Measure 2.4.3:** Improving research productivity and excellence. This measure will contain activities on Establishing a new competitive National Research Fund; Reviewing of the existing National Research Programme scheme (Brain Gain Grant), mobility grants and other existing mechanisms to support research; Undertaking the review the level of public funding for research and identifying options for gradual increase of grant allocations; Promoting the concept of a national network of centers of excellence; Increasing the support to doctoral and post-doctoral students scheme; Promoting and increasing awareness on the profession in line with European Charter for Researchers and the Code of Conduct. Conduct. During 2015 the MEST will operationalize the proposed measure as well as cost it with a view to feed it into the next MYTEF cycle.

- **Measure 2.4.4:** Fostering research-based innovation and knowledge transfers. This measure will include activities on increasing the capacities of the Center for Innovation and Technology Transfer (CITT); Support 'triple-helix' initiative for cooperation between research, industry and HEI (industrial cluster promotion, development of technology incubators, technology and innovation based programme development where HEI cooperate actively with industry, supporting and promote incubators and greater linkages with HEI's, supporting the establishment of Knowledge Transfer centres at 4 HEI's);

## **Initiative 2.5: Increasing competitiveness of higher education**

The organization of higher education is based on the *Law on Higher Education in the Republic of Kosovo* adopted in August 2011. Although Kosovo has not officially joined the Bologna Process, since the introduction of Bologna Reforms by the University of Prishtina in 2001/2002 all national legislation has served to better implement and make operational the Bologna reform objectives and principles in Kosovo. As a result of the implementation of these reforms in higher education in Kosovo today all institutions of higher education implement the ECTS credit system, curriculum reform, three-cycle degree system, student and staff mobility, diploma supplement and quality assurance system. The sole exception is an American-styled institution founded after the recent war.

In the effort to follow the trends in European Higher Education Area (EHEA), policy makers in Kosovo have been most challenged in respecting the autonomy of higher education institutions and increasing the responsibility of HEIs for their quality. The development and reform of higher education at National level is supported by a few strategic documents, including the *Strategy for Development of Higher Education in Kosovo 2005-2015*. One of the main goals of these documents regarding Kosovo higher education is to formally become part of the Bologna Process, the European Higher Education Area and the European Research Area. The Government has also adopted the *National Qualifications Law* and the National Qualifications Framework, which were developed to fully integrate the European Qualifications Framework.

The main indicators for this initiative are:

Indicators	Measure	Baseline 2014	Target 2020
Number and share of Highly qualified people (Second stage of Tertiary education, bachelors, masters or doctors' degree) in the working age population (active + inactive), 15+	Nb.,%	120,000	-
Share of persons aged 30-34 with tertiary education	%	n/a	40%

During 2010-15, the emphasis was on increasing the access to higher education, improving the quality and internationalization of higher education. In 2011, only 8% of the population had a university degree, which was significantly lower than other Western Balkan countries (23% in Croatia and 17 percent in Macedonia) and below the average of EU-27 countries (34%). Over the period of last 4 years, the Government has tackled this problem by

expanding the network of public universities by establishing the University of Prizren, University of Mitrovica, University of Gjilan and University of Gjakova and the licensing and accreditation of 30 private bearers of higher education. The total number of students enrolled in higher education improved considerably to 120,000 (Kosovo Accreditation Agency, 2014).

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Last but not least, MEST focused on the internationalization of higher education. In line with this priority, it has established NARIC Kosovo (National Academic Recognition Information Centre) for academic recognition of diplomas and study period undertaken abroad. In order to facilitate student mobility and diploma recognition it fully implements the ECTS (European Credit Transfer System) and has adopted the *National Qualifications Law* and the National Qualifications Framework to fully integrate the European Qualifications Framework.

In the period from 2015-17, the focus of the Government will be on the following measures:

- **Flagship Measure 2.5.1:** Modernization of the higher education system. The sector of higher education needs to be modernized in terms of curricula, governance and funding. To do so, the Government has planned to review the Law on Higher Education and draft secondary legislation. A Working group has been established to review and propose further recommendations to amend the Law on Higher Education as per suggestions of the Assembly Committee; MEST will also elaborate options and policy frameworks for improving financial autonomy and accounting systems in higher education. The aim will be to fully implement the EHEA good practices on higher education autonomy and commitment to public education in line with EHAE Bucharest Communiqué (2012). Further to that, the MEST will undertake the review of primary and secondary legislation on higher education in order to fully implement the best EHAE practices on Financing and Governance of Higher Education, and promote and support the establishment of Kosovo Rectors' Conference;
- **Flagship Measure 2.5.2:** Enhancing quality assurance in higher education. Maintaining a high quality in higher education is crucial for the attractiveness of higher education. The quality assurance system in higher education needs to be fully implemented by the Kosovo Accreditation Agency in line with the European Standard Guidelines (ESG) and ENQA Criteria. The main action within this reform initiative will be: Enhancing the capacities of MEST Higher Education Department; Support higher education institutions to fully implement internal quality assurance measures; Promoting and fully supporting MESTs KAA to implement E4 Group (ENQA, EUA, ESU, EURASHE) European Standard Guidelines on quality assurance; Support MEST KAA continued membership in ENQA and EQAR; Promoting and supporting the HEI to develop internal quality assurance systems; and Developing a University ranking system methodology;

- **Measure 2.5.3:** Continue improving access to higher education. Higher education is a major driver of economic competitiveness in the knowledge driven economy and essential for socio-economic progress. More Kosovo young people need to enter and complete higher education in order to reach the Europe 2020 target of 40% attainment of higher education or equivalent. This measure will contain the following main activities: Promoting and increasing awareness on the importance of higher education among age groups over 25 years of age; Reviewing legal, financial and social obstacles to equal opportunities in accessing higher education; Gradually investing in improving and extending infrastructure to accommodate increased numbers of students entering higher education at universities of Prizren, Peja, Gjakova, Gjilan and Mitrovica; Promoting and initiating the establishment of Kosovo Student Union as a mechanism to promote student participation and influence in HEI's; Establishing the National Student Register (NSR); Developing secondary legislation and conduct awareness campaigns to promote alternative routes into higher education; and Developing secondary legislation and regulatory framework for alternative ways of completing higher education including recognition of prior learning, blended learning, distance learning and peer-to-peer learning;
- **Measure 2.5.4:** facilitating student employability. This measure will include the following activities: Establishing the Kosovo Forum of University-Business Cooperation and initiate a new project for updating the curricula and aligning future curricula with the labor market; Drafting a proposal for improvement of the legal framework with focus on the improvement of mechanisms of monitoring, coordination and consultations between the administrative structures and stakeholders (businesses, HEI, research organizations); Carrying out an analysis of future specialties that will be completed and presented to MEST and KAA as part of a Forecasting Study. Besides, the Career Orientation Centers will be supported in the newly established public universities. About 5,000 students will have completed internships in industry annually;
- **Measure 2.5.5:** Internationalization of Kosovo's higher education. The higher education has become increasingly internationalized. The Government will promote more mobility and international openness for students, academic staff and researchers. The initiative will be bolstered through increasing awareness on EU Tempus, EU Erasmus, EU Erasmus + student exchange programmes and exploring further exchange mechanisms and funding within the region and wider in Europe. The main actions are to include: Becoming a full member of the Bologna Follow-up Group and actively participating in European Higher Education Area (EHEA); Fully implementing the Lisbon Convention on Recognition of Degrees and actively following the developments in the ENIC-NARIC Network; Developing and Action Plan for Recognition and promoting bilateral recognition agreements with areas and countries outside of the Europe; Supporting Kosovo's Accreditation Agency to fulfill all the criteria for continued membership in ENQA and EQAR; Promoting Kosovo HEI membership and partnerships within the European Research Area and in European University Association (EUA) and European Association of Higher Education Institutions (EURASHE); Producing a Stocktaking Report on the Implementation of Bologna Process in Kosovo.

### **3. C: Initiatives and measures related to Business Environment, Industrial Structures and Trade Integration**

This sub-section summarizes initiatives and measures planned in the Business Environment, Industrial Structures and Trade Integration pillar of the NERP. Each initiative is presented by highlighting the rationale and overall direction of the Government policy followed by summarizing the main measures planned. Most important or priority measures have been highlighted as “Flagship Measures”. Those are also presented in the table format in the Annex 1.

Initiatives and the Measures, particularly the Flagship Measures, proposed under this pillar address some of the critical gaps identified in the EU Progress Report from 2014:

- “Overall, Kosovo’s private sector remains underdeveloped. The large informal economy, low access to finance and its high cost continue to pose major challenges. Reducing the share of the informal economy remains a challenge” EU Progress Report, page 29;
- “To improve the business environment, Kosovo needs to improve conditions for enforcing contracts, reduce unnecessary administrative barriers, promote the fight against the informal economy and corruption, and develop a financial market. The government needs to introduce a regulatory impact assessment. The SME development strategy and action plan need to be based on clear timelines whose implementation needs to be ensured and monitored”, EU Progress Report, page 39;

The selection of the Flagship Measures within this pillar have been done on the basis of the criteria:

- They directly address constraints identified in the growth constraints diagnostic study conducted as part of preparing the NERP;
- They contain ongoing actions and commitments to continue those;
- They are likely to be included in the National Development Strategy, which will form the basis for updating the NERP for 2016.

#### **Initiative 3.1: Implementation of Better Regulation Strategy**

On 23 May 2014, the Government adopted the “Better Regulation Strategy 2014 – 2020”. The Strategy aims to institutionalize the Regulatory Impact Assessment (RIA) and to develop a public-private dialogue procedures and capacities with a view to advance smarter regulation. The Office of the Prime Minister (OPM) is to lead on coordinating implementation of this Strategy, which among other reforms aims to establish the RIA Unit in the OPM; review and amending legislation to make RIA mandatory; and providing training and other support to the bodies of Kosovo public administration and the main social partners in terms of capacity building. In 2015, it is expected to institutionalize the RIA unit and adopt the necessary legislation.

The initiative on the implementation of the better regulation strategy aims to implement the following three measures: to establish a web-based portal for central publication of all draft

normative acts and supporting documents; to streamline administrative procedures for businesses, and to implement the Law on Permits and Licenses.

The main indicators for this initiative are:

Indicators	Measure	Baseline 2014	Target 2020
The indicators for the implementation of the better regulation strategy:			
• RIA Unit in the OPM established	Yes/No	No	Yes
• Approve the parallel law on Normative Acts	Yes/No	No	Yes
• Implementation of the Law on Permits and Licences	Yes/No	No	Yes
• Increase inspections activities for new 25 new principles	Yes/No	No	Yes
• The bodies are fully staffed and operational	Yes/No	No	Yes
• Number of procedures streamlined	Nr.	-	-
• Number of procedures abolished	Nr.	-	-

The following are the detailed measures for the implementation of better regulation strategy 2015-2017:

- **Flagship Measure 3.1.1:** Establish a web-based portal for central publication of all draft normative acts and supporting documents, as mandated by the Law on Normative Acts to be approved by the Parliament during 2015. This mechanism will significantly enhance opportunities for a public-private dialogue, particularly as it concerns the impact of draft normative acts on business community. The implementation of the Strategy is expected to be part of the National Development Strategy (NDS) and its subsequent implementation plans;
- **Flagship Measure 3.1.2:** Improve of practice of inspections. Another objective of the Better Regulation Strategy is streamlining of administrative procedures with a view of reducing administrative burden on business. Implementation of the Law on Permits and Licences, adopted in 2014, is the key tool for doing this, as it establishes new and business-friendly principles of regulating business activity through permits and licences. The implementation measures include establishing the institutional mechanism to oversee this reform, provisionally led by the OPM; creating a central register for all permits and licences and recognizing as valid only those permissive acts that are in the register; undertaking review of legislation to identify obsolete permits and licences; and putting in place safeguards for restricting issuance of unnecessary regulation;
- **Flagship Measure 3.1.3:** Implement the Law on Permits and Licenses. The implementation of the Law on Permits and Licences is to be paralleled with finalization and adoption of the Law on Inspections, which is to set out new principles for activities of various inspections, of which there are above 25. It is also to introduce the risk-based approach to inspecting activities. It is expected that adoption and subsequent implementation of the law will further improve the business climate by diminishing the number of unnecessary inspecting activities, which are burdensome for the business, especially SMEs. Additionally, it is planned to finalize and adopt the Law on Administrative Procedures, which will provide all business regulatory bodies with clear procedures for handling appeals and complaints in accordance with the EU best practices in public administration. Also these measures are also to be included in the National Development Strategy.

### Initiative 3.2: Integration of Kosovo into Global Economy

The Government of Kosovo will increase Kosovo's economic integration with the regional and global economy through trade agreement and double taxation treaty development. Trade agreements are foundational to Kosovo's integration with the global economy and economic development through ensuring stable, smooth, and free trade flows. Kosovo is a member of the Central European Free Trade Agreement (CEFTA) and has a free trade agreement with Turkey as of January 2015. These goals are included in the Strategy for Private Sector Development 2013-2017 and the Trade Facilitation Action Plan.

One of the main objectives of this measure is to increase the SEE Intra-regional trade in goods by more than 140% by reducing export and import barriers. This measure contribution toward integration of Kosovo into global economy is also to ensure that up to 20 double taxation treaties with other countries are negotiated by the end of 2017. The objective is that Kosovo gains preferential access to export markets through the single diagonal cumulation zone under the Pan-Euro-Mediterranean Convention (PEM). In addition, a harmonization of MFN duties towards EU CET is required as well as the full transposition of the EU Directive on services by end 2017.

The main indicators for this initiative are:

Indicators	Measure	Baseline 2014	Target 2017	Target 2020
Number of double taxation treaties signed by the end of 2017 with a goal of at least 20	Nb., yes/no	-	20	-
SEE intra-regional trade value in goods with a goal of a 140% increase from 2014	%, yes/no	-	-	140% ↑
Value of exports in goods and services	Value in mill. EUR	950.7 <sup>40</sup>	-	-

The measures for the period 2015 – 2017 to increase global economy integration are as follows:

- **Flagship Measure 3.2.1:** Modernization of Kosovo Custom's process services. In relation to the decrease of the administrative compliance cost for goods crossing Kosovo, Kosovo Customs will continually work towards the creation of a modern and efficient system for revenue collection and contribute to trade facilitation, further improvement of IT infrastructure to facilitate the businesses approach to Customs services, Custom's modernization according to Customs EU Blueprint Guide, and the improvement of Customs Ethics and prevention of corruption and any conflict of interest;
- **Measure 3.2.2:** Accession to WTO. Implementation of this will be undertaken through the following activities: Memorandum regarding the current state of trade-related policy prepared and sent to WTO (Q4-2015) (€20,000.00); Structures for the WTO negotiations, enlisted clearly (Q4-2015) (€5,000.00); The team responsible for WTO trained (Q1-Q4-2015) (€20,000.00);

<sup>40</sup> Note: Value of goods and services data baseline year is 2012.

- **Measure 3.2.3:** Negotiation of double taxation treaties. Specifically, 20 double taxation treaties will be signed by the end of 2017;
- **Measure 3.2.4:** Promote Trade in Services. This will be done through: the Law on Trade in Services being approved (Q4-2015) (€15,000.00 for drafting the Law); Negotiations on Services with CEFTA finished (Q3-2016) (€20,000.00); and Starting the transposition of the EU Services Directive (start in Q2 2016) (€80,000);

### **Initiative 3.3: Improve Access to Finance**

Access to finance, due to the high cost of it, has been identified as the major problem in development of the private sector and boosting employment and economic growth in Kosovo. According to the 2013 World Bank BEEPS survey, over 40% of firms in Kosovo identified the cost of capital as a significant constraint, compared to 19.9% in Slovenia, 14.7% in Serbia, 7.5% in Montenegro, and 6.5% in Albania. The interest rate spread remains high as compared to peer countries signalling imperfect competition in the banking sector. Thus, because of the more pronounced decrease of deposit interest rates, the interest rate spread between loans and deposits increased to 9.9 percentage points (pp), compared to 8.6pp in August 2013.

The focus of this measure is on addressing the problems of **contract enforcement**, insufficiently functional **registers of immovable and movable property** and unclear **bankruptcy procedures** – factors that are the main contributors to the high-risk premium in lending.

The pledge register was updated in 2012 to be fully digitized and all financial institutions currently use it. Since it is a recently updated, efficient, and well-used system there are no plans to improve it. On the other hand, the Law on Liquidation and Reorganization of Legal Persons in Bankruptcy governs the context of liquidation and reorganization of corporate creditor rights. Passing a law on bankruptcy is a priority because one does not currently exist. The first draft will be submitted to the government for approval in January 2015. Depending on the government approval process, the law will be passed by the end of 2015 at the most..

Limited lending to enterprise sector is also driven by insufficient number of credible debtors, since there are only few businesses that exceed a certain size of turnover and are oriented on production and export. Of the registered enterprises in Kosovo in 2013, 98.4% were micro with 1-9 employees and only 1.3% with 10-49 employees. Over 50% of SMEs were in retail and less than 10% engaged in production activities. There were 159 manufacturing companies of which 154 were micro, 4 were small (4-9 employees) and 1 about medium (20-49 employees).

While the stimulation of the SME growth is foreseen under the measures 3.1, 3.3, 3.5, 3.6, 3.7, and 3.8, this measure addresses other obstacles for low access to finance. One of the key factors is related ability to recover NPLs (frozen assets). **Effective dispute resolution** is paramount for banks to be able to re-cover assets, and speedy trials are also essential for small enterprises, which may lack the resources to stay in business while awaiting the outcome of a long court dispute. Therefore, improving the performance of the judicial system in terms of increase of the clearance rates, reduction of disposition time and elimination of backlogged cases is the top priority.



Compared to peer countries, Kosovo performs well in terms of the clearance rate (122%) for the civil cases<sup>41</sup>. However, due to a huge backlog that has accumulated throughout its history, the number of days needed to dispose of a civil case is a record high (831 overall, 414 first instance). For comparison, it is 173 in Albania, 259 in Macedonia, and 316 in Serbia. However, it must be noted that the prevailing number of the incoming cases (82% of the total) are minor offences (mostly police fines). Their share of the total backlog is 50% and, with an extra effort, the courts can be unclogged. The latter is particularly relevant given that since 2009 the number of cases of minor offence pending at the end of the year has tripled.

Indicators	Measure	Baseline 2013	Target 2020
Disposition time for civil cases, total	Nb.,%	831	50%
Clearance rate for civil cases	%	122	>100
Backlog	Nb.	446,000	-
ADR cases	Nb.	699	>

To address the access to finance problem, the following measures are planned in this initiative:

- **Flagship Measure 3.3.1:** Improving access to finance through contract enforcement and legal and regulatory framework. This measure will involve the following activities:
  - Implementation of the National Backlog Reduction Strategy. The specific actions under this strategy include improving the caseload statistics procedures, adoption of operational action plans by the individual courts, development of partnerships with other organizations, training and staffing of courts (including potential deployment of task force of judge assistants to clear the historical backlog, measure proposed in the draft NDS), and providing equipment to the courts and establishment of performance standards including for the disposition of civil cases;
  - Implementation of the ICT Strategy for 2012-2017. An ICT Strategy for 2012-2017 was adopted by the KJC in March 2012, and its implementation will continue in 2015-17. Among its measures this strategy aims to improve the availability of information on court cases and court performances through full introduction of ICT and increasing the possibilities for KJC, court presidents, judges and support staff to perform their tasks effectively and efficiently, thus contributing to overall increase of efficiency and transparency of the judicial system. The ICT Strategy relies on the implementation of automated Case Management and Information System (CMIS);
  - Co-funded by the EU and the Government of Kosovo is the construction of the Palace of Justice in Pristina. It will accommodate the Constitutional Court, Supreme Court, Basic Court of Pristina, Appellate Court, State Prosecution, Special Prosecution, Appellate Prosecution, and the Basic Prosecution of Pristina. It is expected to be fully

<sup>41</sup> A common indicator of efficiency is the clearance rate given by the number of disposed cases throughout a year to the number of incoming (received) cases by a court in the same period. A clearance rate below 100% will indicate that the courts do not manage all the incoming cases and, as a result, a backlog of cases accumulates from one year to another.

completed and made operational in 2015-17. Also, the USAID supported Kosovo in the transition to the new court system first by creating the so-called “model courts” and then by replicating this concept nationwide. Implementation of the “model courts” principles will continue in 2015-17;

- Ongoing is the USAID technical assistance in the field of ADR and introduction of **private** bailiffs<sup>42</sup>. Use of mediation, reconciliation and arbitration may reduce caseloads per judge. Similarly, the private bailiffs will help reducing the execution caseload saving time and money for their clients.

- **Measure 3.3.2:** Development of cadastral system. It is critical for efficient functioning of the credit market. Cadastral information is a critical part of loan transactions as well as important tool for efficient contract enforcement. Kosovo has continuously supported development of the cadastral system. The progress is evidenced in the Doing Business Report from the World Bank where Kosovo ranks 3<sup>rd</sup> in 2014 as to registration of real property rights.

Some of the recent achievements include Implementation of textual (legal database) module of Kosovo Cadastre Land Information System (KCLIS) in 35 MCO; reengineering of offices is finalized in 23 NCO and KCA. It is implemented a front/back office system model; finalization of the registration of multi-flat buildings, apartments and business premises in Cadastre in 29 cities (urban areas); reconstruction of Cadastral Information according to the Law on Cadastre No. 04/-L-013 is finalized in 43 cadastral zones; orthophotos of territory of Kosovo were completed; the Global Navigation Satellite System (GNSS) network - Kosovo Positioning System (KOPOS) is functional, since June of 2013, KCA has implemented its National Geoportal as a service for dissemination of geospatial data; a unified Address Register Information System (ARIS), which possesses information for each address including geographic position (geographic co-ordinate reference point) of addressable entrances to buildings and an electronic road map with road names, has been made operational.

The following indicators are to be used to monitor overall progress:

Indicators	Measure	Baseline 2014	Target 2020
Increased coverage of Land administration services for all comparing numbers of registered properties to the numbers visible in 2009 ortophoto maps (OPM)	%	70	100%
Average number of days to register a standard purchase/sale of a typical residential property in the land administration system	Nb.	15	1

<sup>42</sup> The legal professions in Kosovo are slowly emerging. The number of attorneys per 100 thousands of population is less than in any other of the peer countries (32), but generally in line with the respective number in the neighbouring Bosnia and Herzegovina (34). The number of notaries per 100 thousands of population (4.2), introduced by law in 2012, is aligning towards the level of the peer countries, but still is the smallest of all seven peers. The situation is worse with regard to the enforcement agents: with 27 basic courts acting as public enforcement agents and 13 private bailiffs, the number of enforcement agents is only 2.3 per 100 thousands of population, considerably less than in any other peer country

In the next planning period (2015), the following are the key activities under the measure on development of cadastral system:

- Legislation required to implement the agreement on cadastre between Kosovo and Serbia will be adopted. Following from this, actions will be taken to ensure transfer of certified copies of cadastral records from Serbia to Kosovo. This will significantly improve the completeness and quality of cadastral information available in Kosovo;
- Adoption and implementation of the Law on the National Spatial Data Infrastructure (NSDI) through elaborating the NSDI Strategy during 2015. This will be followed by implementing this document in 2016-18;
- Continuation of development of efficient institutional structure of the KCA with a focus on strengthening vertical integration and functionality of cadastral services. In particular, two reports analysing the legal aspects of establishing the “vertical structure” and ensuring KCA’s financial sustainability will be prepared and discussed. Based on the agreed recommendations, the action plan will be prepared;
- Continuation of improving systems of cadastral data and ensuring availability of information by: systemic registration of data (cadastre reconstruction); improving quality management of data; completing the mapping (GIS) module of KCLIS in 13 MCOs and related capacity development; continuing to implement front/back office model in remaining municipalities (currently it is functional in 23); continuing to carry out registration of multi-flat buildings, apartments and business premises in Cadastre; continuing the reconstruction of cadastral information in 50 Cadastral Zones across 10 municipalities; completion of the topographic map of Kosovo with scale 1:25000; implementing the IMPULSS project, which makes harmonized and high quality spatial information readily available for the citizens and business.

### **Initiative 3.4: Further improve public procurement system**

The objective behind procurement reform is creating a competitive public procurement market striving to support industry development and developing the industrial base. The National Public Procurement Strategy 2015-2020 recommends strategic reforms on overall improvements of the public procurement system with the implementing stakeholders: Public Procurement Regulatory Commission (PPRC), Central Procurement Agency (CPA) and Procurement Review Body (PRB).

Improved legal framework, development of e-procurement, improvement of administrative capacity and procurement skills, and monitoring of procurement procedures are the planned reforms to be undertaken in line with the current achievements in the public procurement. During 2015-17 the reform strategy will be focused on assessing the national public procurement system and practices, developing the strategy and action plan, improving the legal framework to simplify administrative procurement procedures, and reducing usage of negotiated procedures without publication of a contract notice. The legal framework will be improved: first the Law on Public Procurement will be modified so as not to give preference to domestic bidders, and second the Law on Prevention of the Conflict of Interest in the exercise of public office will be aligned with the Criminal Code. Therefore, the corresponding policy framework could be improved through: adoption by Ministry of Finance of a list of

common items to be procured in order to enable the Central Procurement Agency (CPA) to fulfil its core mandate and the Public Procurement Regulatory Commission (PPCK) should create rules to make mandatory the reporting of situations of conflict of interest by members of procurement panels.

The following indicators are to be used to monitor overall progress:

Indicators	Measure	Baseline 2014	Target 2020
Contracts awarded in open procedures (% of total)		-	-
Average number of bidders per tender		-	-
Complaints by economic operators that were reviewed by the Procurement Review Body on time		-	-

In the next planning period (2015), the following measures planned:

- Flagship Measure 3.4.1:** Further improve the Public procurement system. Main focus under this measure will be on improving administrative capacities which will include:: boosting staffing and funding of implementing institutions (PPRC, CPA and PRB), and streamlining procedures between the numerous entities involved in the public procurement system. The main objective of the National Strategy for Public Procurement is to improve the public procurement system through continuous monitoring and implementations of the regulatory amendments, enforcing the access to public finance, increasing the transparency and efficiency, following the actual trends (green procurement, social responsible procurement, e-procurement, SME support), and further developing the public procurement human capital. Implementation timeline 2015/2016, World Bank and European Commission supported. Achieving a functional public procurement system is subject to availability of financing by the donors, e.g. WB and EC projects.
- Measure 3.4.2:** Developing the e-procurement platform – the aim is to increase efficiency and transparency of the public procurement system in Kosovo. The purpose of the reform is to increase the efficiency in the public procurement procedures, to ensure a better usage of public funds and to reduce the procedural costs, and to encourage economic operators to participate in the public procurement procedures. It also strives to promote a fair competition between the economic operators, while guaranteeing an equal treatment and non-discriminatory principle for all economic operators participating in the public procurement procedures, guarantees integrity, public trust and transparency in public procurement procedures. (Implementation timeline 2015/2016, WB supported);
- Measure 3.4.3:** Boost procurement skills. In terms of capacity building a National Strategy of Training for Public Procurement in Kosovo for 2014-2018 has been drafted. The general objective of this strategy is to increase the quality and quantity of trainings in the public procurement in Kosovo, while contributing in developing the competencies and knowledge of the staff. (Project implemented by the end of 2015, supported by EC);

- **Measure 3.4.4:** Monitoring of procedures, detection and reporting of irregularities - since May 2014, PPRC started to do the monitoring of reports of contracting authorities that are sent to PPRC for publication. The aim of monitoring is to prevent mistakes made such as on criteria, deadlines or other points not conforming to the rules for completion of the notification. This deficiency was pointed out in the progress report on Kosovo for 2014 and it is being addressed for the period 2015-2017.<sup>43</sup> The objective of this activity is to monitor the compliance and performance measurement of the contracting authorities and procurement staff, as well as to measure the public procurement performance activities in Kosovo, according to the indicators set in the manual in order to identify weaknesses in the functioning of public procurement system in Kosovo. All in all, the purpose of this reform is to support the PPRC and in accordance with the findings to make recommendations to improve the system (implementation by Q4-2015).

### **Initiative 3.5: Develop Quality Infrastructure**

Quality Infrastructure is a necessary and essential basis for technology development, production, services and trade. Kosovo, particularly the Ministry of Trade and Industry (MTI) will continue efforts in modernizing its Quality Infrastructure (standardization, conformity assessment, metrology and accreditation) to reduce barriers to trade and enable better access to the EU and international markets for Kosovo based firms. Additionally, MTI will emphasize increasing business awareness about the importance of standardization.

Even though Kosovo's ISO and CEN membership are blocked until the UN recognition, in the past period Kosovo has established the institutional backbone of the Quality Infrastructure. The MTI's Division of Quality Infrastructure is the main policy body in this sphere. The Kosovo Standardization Agency (AKS), Kosovo Accreditation Directorate (KAD), and Kosovo Metrology Agency (AMK) implement Quality Infrastructure policy. The Standardization Law is in line with the EU acquis. Kosovo has already adopted over 7,000 standards. The system of metrology laboratories is being developed. Over 27 Conformity Assessment Bodies (CABs) have been accredited including testing and calibration laboratories.

In the period from 2015-17, with support available under the IPA, the measures to improve Quality Infrastructure are as follows:

- **Flagship Measure 3.5.1:** Strengthen the legal framework with particular focus on bringing the conformity assessment procedures in accordance with the requirements of the EU directives. This includes assessing current legislation (765/2008/EC and 768/2008/EC), approving technical regulations for CAB authorization, foreign conformity documents recognition, and CE mark as well as approving the EU directives on low voltage and gas appliances;
- **Measure 3.5.2:** Raise awareness among Kosovo-based firms about quality infrastructure and quality management through informational meetings, television ads, and a quality award;

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<sup>43</sup> Since May 2014 there were 289 monitoring controls of contract notifications.

- **Measure 3.5.3:** Develop new metrology LABs and continue to accredit more conformity assessment bodies (CABs). Continue to develop metrology laboratories, particularly those focused on length, time and frequency, as well as pressure and force, by modernizing equipment, training staff, and increasing the staff number. Continue to accredit more CABs in testing and calibration laboratories, inspection bodies, and certification bodies. Adopt 1,600 new standards with priority on construction products by the end of 2015;
- **Measure 3.5.4:** Gradually increase staffing levels and skills of MTI and its agencies in the area of Quality Infrastructure;
- **Measure 3.5.5:** Develop information and notification mechanisms in the area of quality infrastructure: i) through the establishment of a quality infrastructure “notification centre”, and ii) by effective implementation of the notifications process for technical regulations (TR), conformity assessment procedures (CAP) and draft National standards.

### Initiative 3.6: Industrial Policy Development

A coordinated strategic industrial policy will increase the level of economic development in Kosovo. An Industrial Statistics Database has been created. Six priority sector profiles have been identified for the following industries: wood processing, metal processing, food processing, textile, information and communication technology (ICT), and tourism. These resources inform the industrial policy strategy.

These goals are included in the Strategy for Private Sector Development 2013-2017 and the Industrial Policy Concept Paper. Measures within this Initiative will also be supported by changes in the tax system explained in NERP Part 1, Chapter 4 (tax holidays for a certain amount of investments and a specified number of employees, introducing a 0% VAT rate for primary agricultural products, exemption of customs duty for IT equipment). Another measure which is included in the new Government Programme 2015-18 and is explained in NERP Part 1, Chapter 4 is the mobilisation of the privatisation fund towards the economic activities that generate employment and sustainable economic growth, supporting sectors that help employment and growth, mainly start-ups, small and medium sized producers, corporations which are mainly concerned with innovation and exports, and public and private partnerships.

The main indicators for this initiative are:

Indicators	Measure	Baseline 2013	Target 2020
Value added and share of high tech of GDP	EUR (mill.); %	1,173.8	1,824.9
		25.10	23.2
Value and share of exports of GDP	EUR (mill.); %	927	1,535.1
		17.40	20.37
Value and share of exports of goods of GDP	EUR (mill.); %	305	604.2
		5.7	7.9
Value and share of exports of services of GDP	EUR (mill.); %	886.5	930.82

		11.8	12.39
Value and share of manufacturing of GDP	EUR (mill.); %	581.98 <sup>44</sup>	-
		14.0%	
Labour participation	%	40.50	63.03
Monthly average pre-tax salary in the private sector	EUR	412	464

In the period from 2015-17, the measures to develop Industrial Policy are as follows:

- **Flagship Measure 3.6.1:** Industry clusters are strategic geographic concentrations of related businesses where economy of scales can be capitalized on. In addition to the initiative on vocational education and training system linked with the needs of the labour market, industry clusters will assist to facilitate the primary groups about needed business skills. The government will facilitate and strengthen Industry clusters through:
  - Gather the businesses from the six priority sectors in the Economic Zones; (functionalize three economic zones by the end of 2017) (€1,000,000.00)
  - Support of industry associations and cluster bodies to engage in industrial dialogue (at least 5 meetings every year) (€30,000.00)
- **Flagship Measure 3.6.2:** Set up technology transfer centres at a few key universities (primarily technical) in collaboration with industry bodies. This complements Measure 2.4. Build two technology transfer centres during 2015-2017. (€200,000.00);
- **Measure 3.6.3:** Engage the diaspora in knowledge transfer and productive investments. (at least 6 promotional events with the diaspora to be organized every year) (€30,000.00)
- **Measure 3.6.4:** Create a tourism development plan (June 2015) (€15,000.00);
- **Measure 3.6.5:** Conduct an assessment of needs in human resources skills in the 6 strategic industries. This complements Measure 2.2. (three sectors each year, the task to be completed end of 2016) (€60,000.00).

### Initiative 3.7: Investment Promotion

The flagship measures under the Investment Promotion initiative include but are not limited to the development of economic zones, advancement of the scope of the joint investigation department of the Kosovo Customs and Tax Administration of Kosovo as well as the harmonization of customs legislation with EU regulations and directives.

The macro issues to be addressed in the investment promotion are rooted in the Strategy for Private Sector Development 2013-2017 and National Economic Zone Plan 2014-2018.

Improving Kosovo's overall Investment Climate through FDI strategy development, strengthened intellectual property rights, online services for businesses and reduced informal economy (Ministry of Finance (MF), Tax Administration of Kosovo (TAK) and Kosovo

<sup>44</sup> Note: GDP by activities under Value and share of manufacturing of GDP data baseline year is 2012.

Customs) contributes to attracting investment, improve the investment climate, and ultimately increase Kosovo's sustainable economic growth.

Tax Administration and Customs will continue working on improvement of services for the taxpayers by using electronic channels of communication. On one side, TAK's will implement reforms on: electronic filing, electronic payments, electronic tax certificate, online taxpayer registration via One-Stop- Shop services point on the Municipalities, digitalized tax payer services environment. On the other hand, Customs will implement reforms on: introduce the modern concept of "intelligence-led operations", implement the Enterprise Content Management system, intensify the information exchange with the TAK, harmonization of customs legislation with EU regulations and directives, etc.

The main indicators for this initiative are:

Indicators	Measure	Baseline 2014	Target 2020
Value and share of FDI of GDP (through especially in 6 priority sectors)	EUR (mill.); %	241 4.5	417.9 5.56
All 7 established economic zones fully functional (infrastructure complete and businesses established in zone)	yes/no	No	Yes
Value and share of exports of goods of GDP	EUR (mill.); %	305 5.7	604.2 7.9
Value and share of exports of services of GDP	EUR (mill.); %	886.5 11.8	930.82 12.39
Number of intellectual property laws passed	Nb.	-	-
MF Reduced Informal Economy	-	-	-
adoption of an investment promotion strategy defining target sectors, and the establishment of investor targeting practices	yes/no	No	Yes

The following measures will be implemented as part of this initiative:

- Flagship Measure 3.7.1:** Free Economic Zone development: Currently, there are three Free Economic Zones having low or no business taxes in addition to infrastructure such as electricity, water, land, and transportation infrastructure. Moreover, **five economic zones** are currently preparing documentation for legalization (Business Park in Vushtri, Economic Zone in Lipjan, Dutch Industrial Park (Zinkunie) Prizren, Industrial Zone Shiroke – Suhareka, and Economic Zone in Gjilan/Novoberde). The goals for all seven economic zones are to fully build the physical infrastructure, develop a strategic niche for each zone, and fill each zone with at least 75% business capacity. Moreover, the objective is for each zone to become legalized by the end of 2017 and at least two to have completed physical infrastructure. The planned implementation date is by Q4-2017;



- **Measure 3.7.2:** Laws on patents, trademarks, industrial designs, geographical indications and designations of origins amended with secondary legislation completed. (Q4-2015). Public awareness activities on Intellectual Property Rights will be implemented. (Q4-2015);
- **Measure 3.7.3:** FDIs through investment promotion. This measure will include: Developing new **FDI** Strategy. (Q4 2015) (€30,000.00); survey development and implementation on Kosovo investment perceptions (Q4 2015) (30,000.00); organizing at least 5 promotional activities for each year 2015, 2016 and 2017. (€75,000); investment protection through signing of agreements with three countries for protection of investments (€30,000.00) ; and increasing activities in **monitoring the foreign investments** with the ultimate goal to improve the business environment and improve investment promotion practices by KIESA. (10 businesses visited and interviewed for each year (€15,000.00). Furthermore, the GoK aims to further promote investments through the following actions: establishing appropriate FDI incentives schemes which can help attract investors without excessive spending; establish an SEM database including the product portfolio of domestic suppliers and establish FDI-SME linkage practices (e.g. communication about database, events for linking with SMEs); establish one-stop-shop for investors which would help streamlining the investment practices and making them more transparent. These activities will aim at targeting high-potential investors from priority sectors.
- **Measure 3.7.4:** Creating the online business registration system will make the business registration process even easier than it currently is (two days to complete with 28 one stop shops throughout the country). The goal of implementing it by the end of 2016 will be challenging because this complex system requires time and significant budget. This will include an initial phase project by TAK for the VAT electronic invoices, the pilot project is planned to be implemented by Q2-2015; and upgrading the Corporate Income Tax - CIT (annual return), including (marginizing) the Financial statements based on the IFRS accounting standards;
- **Measure 3.7.5:** Revision of the Strategy of Tax Administration for period 2015-2020. This will include modernizations of Tax Administration and Modernizing the Information System based on e-tax approach and self-services for taxpayer (the implementation project will take approximately 24 months);
- **Measure 3.7.6:** Advancing the scope of joint investigation department CUSTOMS and TAK administration; and functionalizing of Customs Policing, joint units with TAK officials for fighting informality. (Implementation timeline - 2015 and beyond); also functionalizing of **OCKM** (Operational Centre for Commercial Management). In longer term, the new Government Programme 2015-18 foresees merging the revenue collecting agencies;
- **Measure 3.7.7:** Enhancing the implementation of anti-corruption measures at all levels of management in Customs in terms of impartiality, professional standards and responsibilities that apply to all officers, acceptance of gifts, conflicts of interest,

declaration of wealth, etc. This will include: Setting up of a system of continuous and systematic screening procedures and audits by the respective units to eliminate corrupt practices; (Implementation timeline – 2015/2016/2017); Implementing Kosovo Customs IT strategy, particularly, the Enterprise Content Management system, which will enable the Kosovo Customs to work in a paperless environment. A system is developed whereby Information and documents for internal and external are tracked more efficiently (one central location) and effectively (debt deadlines or bank guarantee expiration dates of importers and exporters; integration of all documents in one central location; security and compliance of documents; workflow of all documents for approval, etc.; the ECM system will be mostly for administration purposes); and Implementing a paperless environment for customs procedures through ASYCUDA World (AW), system which allows all procedures to be done with limitation of papers. (Implementation deadline 2016/2017);

- **Measure 3.7.8:** Harmonization of customs legislation with EU regulations and directives, This will include activities to:
  - Tackle the inconsistencies between the Customs and Excise Code and the Penal Code (quoting from the Progress Report 2014 for Kosovo) (the implementation term – 2015/2016)
  - Draft law on customs enforcement of intellectual property rights. (Deadline for implementation - 2015)
  - Draft Law on procedures for collection of customs duties for cell (mobile) phones. (Deadline for implementation - 2015)
  - Change of the Customs and Excise Code in accordance with the Customs Code of the EU. (Deadline for implementation - 2016/2017)
  - Law on authorized economic operators. (Deadline for implementation - 2016/2017).

### **Initiative 3.8: SME and Export Development**

Over 90% of Kosovar enterprises are SMEs. As such, government SME support and access to resources and export markets are critical for SME development as well as economic development. The main focus on SME development will be on: SME Grant Program, Competitiveness and Export Promotion, Voucher Scheme, and Credit Guarantee Scheme.

The SME and export development policy reform goals are also encompassed in the Strategy for Private Sector Development 2013-2017 and the Strategy for SME development for 2012-2016, which ultimately strive to strengthen the overall performance of this policy area.

The main measures for the period 2015 – 2017 to develop SMEs and export capacities are as follows:

**Flagship Measure 3.8.1:** SME support and export development through Voucher, Credit Guarantee and Grants scheme programs, **including:**

- The Voucher Scheme is a program to offer subsidized consulting to SMEs regarding their business practices. By the end of 2015 the Voucher Scheme will reach 1,300 days of consulting. (Q4-2015) (€250,000.00);
- The Credit Guarantee Scheme is a program to increase SME access to loans through banks by providing a guarantee to the bank for the business loan. The realistic time frame

is that by the end of 2015, the Scheme will be functionalized (€16,000,000 euros will be available in the fund);

- The Grant Scheme is a program to stimulate export-orientated businesses by subsidizing import of products with grants for micro small and medium enterprises (MSMEs). By the end of 2016, 46 businesses will use the €4 million fund.

**Measure 3.8.2:** B2Bs events are opportunities for businesses to exchange and coordinate plans to improve their businesses to the six industrial policy priority sectors. The aim of these B2B is to increase the SME participation and subsequently have direct impact on establishing new business contracts, create new jobs, and increase the number of innovations. There will be **5** B2B's organized in 2015. (€40,000.00);

**Measure 3.8.3:** Trade fairs are opportunities for businesses to showcase their products and services while developing relationships with customers and partners abroad. Likewise, the target sectors are the six industrial policy priority sectors. There will be **3** trade fairs will be organized in 2015. (€60,000.00);

**Measure 3.8.4:** Support and enlarge the Vocational Educational system and provide professional trainings, giving priority to 6 key sectors and their respective relevant location. This complements Measure 2.2. (1,300 days of consulting) (250,000.00); and

**Measure 3.8.5:** Support internship programs for students, youth, women, minorities, and unemployed people. This complements Measure 2.2. (2 month internship for 150 persons per year) (€75,000.00).

#### **4. Institutional issues and stakeholder involvement**

The Ministry of Finance (MoF) and the Office of the Prime Minister (OPM) coordinated the preparation of the Economic Reform Programme jointly. While the former coordinated part I, the Office for Strategic Planning (SPO) of the OPM was responsible for coordination of preparation of the part II. As the subjects that are being addressed in the two parts of the document are strongly interlinked, an effective coordination has been established also between these coordinating institutions.

Stakeholder engagement is regarded as an important part of the process. Engagement at sectorial and ministry level was encouraged by the SPO with regard to the range of specific issues that arise in the context of this NERP. For example, the line ministries and other institutions of Kosovo's central government, as well as Kosovo Central Bank, were involved through the interministerial working group, which met on several occasions including the joint meeting with representatives of the European Commission.

Implementation of the country-specific recommendations and the achievement of the Europe 2020 targets require a commitment not only from Government, but also from the social partners, local Government and non-governmental organizations. Recognizing this, the MoF and the SPO jointly conveyed consultative meeting with non-governmental organizations and think tanks from civil society on January 19, 2015 to present the idea of the NERP and its

first draft, as well as receive feedback from representatives of the civil society on the proposed structural reform measures.

While in some cases observations received went beyond the specific scope of this document, the MoF and SPO, where possible and appropriate, reflected the input of these organizations in the text. A number of the issues raised during the consultation process were of general nature related mostly to the role of the NERP in the national planning system. Others were specific to particular policy. The later will be further considered in the context of any future changes to the operation of those schemes/measures.

The current NERP was prepared during the Government transition in Kosovo. This assumed limited space for political dialogue and consensus building as to new priorities that have not been discussed and agreed upon within the government earlier. With this in mind, most measures included in the NERP, including the flagship measures summarized in the Annex 1, represent already committed policies. As such, they have been subject of previous stakeholder consultations including through:

- Elaboration of sector and cross-sector strategies initiated by ministries;
- Preparation of Concept Documents pertaining impact assessment;
- Development of the Medium Term Expenditure Framework;

Drafting of the NERP coincided with the kick-off of the work on the overall National Development Strategy (NDS), which is to be consulted with various stakeholders and approved by the new government in 2015. The NDS is expected to focus primarily on unlocking Kosovo's economic growth potential and jobs. It is likely to have a multi annual planning cycle aligned to that of the EU, e.g. up to 2020. It will identify 5-year priority measures of Kosovo Government. Early preparation for the NDS, namely elaboration of the National Development Priorities Consultations Documents, also served as a unique opportunity to identify potential flagship measures and present them to multiple stakeholders through the process of informal consultations.

It can be expected that the next cycle of NERP updating will be already based on the approved NDS priorities and paralleled to Government's work on the NDS Implementation Roadmaps. This will allow the NERP Part II to be essentially the report on implementation of the NDS priorities while also allowing reflecting decisions taken within other strategic planning frameworks such as MTEF and sector strategies.

# Annex 1: REPORTING TABLE ON SECTORAL FLAGSHIP MEASURES (FM)

Recommendation / country-specific policy guidance (1)	Number and title of the measure and the sector (2)	Description of main measures of direct relevance to support competitiveness and growth, and to address country-specific policy guidance (if applicable)					Link to SEE2020 targets	Challenges/ Risks	Budgetary implications/ including committed IPA funds	Qualitative elements
		Main policy objectives and relevance for competitiveness and growth (3)	Description of the measure (4)	Legal/ Administrative instruments (5)	Timetable on progress achieved in the last 12 months (6)	Timetable on upcoming steps (up to three years) (7)			Estimated contribution to SEE2020 national action plan (8)	
		Flagship Measures in relation to Physical Capital								
EU PR 2-14: "In October 2013, the government adopted a decision to dismantle three facilities (heating, chemical and gasification plants) at the Kosovo A power plant. Preparations for decommissioning are suffering significant delays", page 44.	FM 1.1.1 "Decommissioning of TPP Kosovo"	Implementation of this measure will allow Kosovo to further implement internal energy market.	Process of the decommissioning of TPP Kosovo A will consist of decommissioning and dismantling of gasification objects, fertilizer, heat plant and other associated objects that do not impede the normal operation of active units of TPP Kosovo A.	Preparation of lists the objects for decom; Prepare the necessary documentation for permits; Finalization of the plan for decom; Realization of the feasibility; Drafting of a detailed plan for the dismantling of facilities and treatment of workers; Preparation of the study for EIA for objects that will decom.	The Plan for Application of Government Decision on Decommissioning has been prepared;	The legal/regulatory framework for decommissioning of nonoperational units of the plant is being adopted and it is expected to finish by 2015, a process that has been supported by IPA 1.	<ul style="list-style-type: none"><li>Fulfillment of IED and other directives related to environment &amp; energy as required by ECT is approached/achieved</li><li>Achieved CO2 and pollutant reduction by 1 million ton and 30%, respectively</li></ul>	The implementation of this measure time-wise to comply with the dynamic plan depends mainly from EC, since the funds for the completion of such activity are expected to be completely from EU. The process of decommissioning the facilities is expected to be fully supported by EU funds, part of IPA II	25,000,000.00 EUR IPA II funds have been programmed for completion of this activity	Implementation of this measure will advance realization of internal energy market in Kosovo as well as significantly improve environmental conditions.

EC PR 2014: "Overall, there was very little progress in alignment and Kosovo is still at a preliminary stage of harmonization with the acquis in this area. Kosovo needs to start implementing the acquis on security of supply. Kosovo needs to continue its alignment with and implementation of the electricity, oil and nuclear safety and radiation protection acquis. It needs to step up efforts to implement its own energy efficiency and renewable energy plans and targets", page 44.	FM 1.1.2: "Investment of new power generation capacities"	The target is to build new power plant 'Kosova e Re' with generation capacity of 600 MW by 2020 with best available technology. This will directly address one of the most critical constraints to economic growth – insufficient energy supply.	Investment of new power generation capacities TPP 'Kosovo e Re': Kosovo is committed for optimal use of its energy resources, by addressing also environmental concerns in order to ensure stable energy and quality energy supply. The target is to build new power plant 'Kosova e Re' with generation capacity of 600 MW by 2020 with best available technology	Mechanism to supervise implementation of the contract with the private investors will have to be established.	Tender process for building the new power plant was launched in 2014.	As the offers of prequalified investors were opened recently, the Government aims to close tendering procedures during 2015. If successful, it is planned to start implementation on 2016.	Installed capacity of electricity production from TPP, 1678 MW by 2017	Implementation of this measure is subject to a successful completion of the tendering procedure and follow up contract negotiations.	Currently implementation of this measure is planned through means of investment by private operator.	It can be expected that by 2020 Kosovo will have sufficient supply of energy to ensure that lack of energy or its instability of supply is not an obstacle for firms to grow.
EC PR 2014: "Overall, there was very little progress in alignment and Kosovo is still at a preliminary stage of harmonization with the acquis in this area. Kosovo needs to start implementing the acquis on security of supply. Kosovo needs to continue its alignment with and implementation of the electricity, oil and nuclear safety and radiation protection acquis. It needs to step up efforts to implement its own energy efficiency and renewable energy plans and targets", page 44.	FM 1.2.1 "Building the interconnection line 400 kV, Kosovo-Albania"	Create a well-functioning SEE energy market that would provide affordable but cost reflective and reliable supply of energy.	The construction of interconnection line of high tension 400 kV Kosovo – Albania will have a direct impact on the transmission capacities between the two countries and the region, increasing the security and reliability of the electro energetic systems. Moreover, the construction of this line would make the two common energy markets and creates the conditions for a more efficient market operation in accordance with the EU requests. It will provide more opportunities for the exchange of energy after the capacities have already been set in place.	No special / additional legal and administrative requirements need to be put in place.	Actions related to preparation of this measure, including on securing necessary financing, have been completed.	The Project is expected to be finalized by 2016 (the construction phase is planned to be within 24 months from the date of the contracting).	The current capacity of 200 MW for the interconnection transfer with Albania will be upgraded to 900 MW with the implementation of the 400 kV line.	No significant risks are foreseen for implementation of this measure.	The funding for the project for building the interconnection line 400 kV Kosovo-Albania for the Kosovo part will be covered by the German Government based on the Financial Agreement signed by KfW, Ministry of Economy and Finance (Kosovo Government) and KOSTT, for a total amount of €33.5 mil. In the form of loan and funding, out of which €16.5 mil. grant + €17 mil. loan. In addition to the German government funding, KOSTT and OST will contribute with funding from their respective budgets.	Implementation of this measure will significantly improve security of energy supply as well as contribute to creating regional energy market

EU PR 2014: "The existing renewable energy policy framework has yet to produce significant results. The regulatory office authorized three 30 MW in hydropower projects and one 0.9 MW wind-powered electricity plant, none of which are producing power. Heavy authorizing and licensing procedures continue to jeopardies Kosovo reaching its Energy Community target of producing 25 % of its energy from renewable sources by 2020. Kosovo still needs to transpose the 2009 renewables directive, and to create a mechanism to monitor progress in reaching its 2020 targets. There are no developments in meeting EU requirements for the use of biofuels in transport. Kosovo has yet to establish a certification scheme and a certification body", page 44	FM 1.3.1: Achieve national share of renewable energy in gross final energy consumption	The objective of Kosovo is to achieve the capacity of the national renewable energy at a 25% share.	KEEA will adopt the following measures: (i) implement second mid-term energy efficiency plan 2013–2015 with the aim of 3% energy saving from GDEC; (ii) establish municipal energy offices (iii) draft municipal plans for energy efficiency and action plans for energy efficiency (iv) Introduce mandatory buy-out of the entire quantity of electricity produced from RES by power distribution operator, even when this energy exceeds the energy requirements;	Kosovo has signed the Energy Community Treaty and committed to transpose the 3rd energy package and acquis on energy efficiency and renewable energy.	The main commitments by Kosovo were to increase efficient use of energy by achieving a 25% share of renewable energy capacity, minimum 9% energy saving target by 2018, in line with its commitments to the Energy Community In the end of 2014 ERO has adopted the Rule on authorisation procedure for construction of new generation capacity, The Rule on support scheme and Feed in tariffs for photovoltaic	(i) In 2015, ERO will set the feed-in tariffs for RES (ii) The mid-term energy efficiency plan 2013-2015 implemented (iii) In 2015 fully finalize the co-generation project (iv) By 2016 establish municipal energy offices	The targets are set for Kosovo in line with the targets adopted through the Renewable Energy Directive No. 2009/28/KE at 9% increase of energy efficiency in the final consumption by 2018 and 25% for the share of renewable energy sources in the final energy consumption by 2020.	Risks associated to the achievements of the targets in renewables remain down to the energy insufficiency and its risks it might pose as one of the main constraints for growth determinant.	Energy presents the major constraint for businesses in Kosovo, with estimated losses caused by instable energy supply at 260m EUR in 2012. When putting these losses in perspective and comparing them to annual sales, in Kosovo they present 7.3%, which is significantly higher when compared with 0.1% in Slovenia, 0.8% in Montenegro, or 2.6% in Albania.	The direct impacts to energy pertain to it being: (i) Reliable – (energy balance, grid, need for new power plant) (ii) Sustainable – needs to take measures to mitigate negative environmental and health impacts (renewables, energy efficiency) (iii) Affordable – so that consumers are able to pay the price for their energy needs cost of renewables, provide ways to switch heating)
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EU PR 2014: "Kosovo is still at an early stage of harmonization with the acquis. Kosovo still cannot join many of the international or European bodies regulating transport or the relevant sector associations. The regulatory institutions need to be more independent and to be further strengthened. Further efforts to improve road safety are required. Efforts to alignment with the transport acquis need to be stepped up, especially in road transport. The decision to revoke a rail license already given was a regression in Kosovo's alignment with EU standards in railways", page 43	FM 1.4.1: Road infrastructure construction and maintenance	There have been major advances in quality through building an extensive network of highways, in the railway sector further investment is necessary to bring the Kosovo railroads to EU quality standards. Therefore, the main objectives for this FM are predominantly based on construction of new roads also includes annual increase of allocation of financial resources for road maintenance. In addition, the focus in the railway sector is to conduct feasibility studies and carry out general rehabilitation in key railway network lines.	Road infrastructure construction and maintenance. Kosovo will continue on construction and modernisation of road transport through domestic funding and funding from development partners. In line with this the main projects on road network involve: (i) Complete construction of R7 – Highway Merdare - Pristina - Vermnice; (ii) Complete construction of R6 – Highway Pristina – Hani i Elezit (project has been contracted 5 year implementation, 350m EUR for next 3 years). (iii) Complete construction of N2 – Road construction Pristina – Peje – Montenegro; 4) Complete construction of N9 – Road construction Pristina – Mitrovica – Serbia;	Kosovo has made significant progress on the road infrastructure. There have been major advances in quality through building an extensive network of highways.	Kosovo Government has invested substantially on road infrastructure with a top priority being the upgrade of the road infrastructure. At this point, Kosovo has 7,000 km of roads. During 2009-2013, most of the primary level roads have been upgraded from 2 track roads into 4 track roads as well as the network of secondary and local roads has been expanded too. The milestone strategic project of the Government of Kosovo was the highway Morinë-Merdare.	Completion of the construction of R6 – Highway Pristina – Hani i Elezit, Macedonia (project has been contracted 5 year implementation)	While there is no directly link to SEE2020 reforms of this FM, the government sees this FM as a strong investment towards the attracting FDI and increasing regional trade through modern road infrastructure network.	The risk in the implementation of the infrastructure construction and maintenance projects remains on the availability of funds.	Completion of the construction of R6 – Highway Pristina – Hani i Elezit, Macedonia (project has been contracted 5 year implementation, 350m EUR for next 3 years)	An effective transportation system has a high importance which would have a direct impact on the economic development, precisely on the on regional trade and attraction of FDI. In this regard, Kosovo Government has invested substantially on road infrastructure and investments trend will continue unless a infrastructure will not change substantially.
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EU PR 2014 "The current transport strategy is heavily skewed towards road transport, favoring a less environmental friendly mode, to the detriment of railways. There are plans to increase investment in railway infrastructure (€10 million a year for 2014-16) but this is still below the level needed. The revised multi-modal transport strategy (2012-21) and action plan have still not been approved", page 42	FM 1.4.3: Upgrade railway infrastructure	Advances in quality through building an extensive network of highways, in the railway sector further investment is necessary to bring the Kosovo railroads to EU quality standards. Subsequently, the focus in the railway sector is to conduct feasibility studies and carry out general rehabilitation in key railway network lines. In addition, the main objectives for this FM are predominantly based on construction of new roads also includes annual increase of allocation of financial resources for road maintenance.	The GoK will implement the following measures in the railway sector the period of 2015-2017: (i) implement recommendations drawn on the basis of the feasibility study of Rail Route 10 (ii) prepare the detailed design for Rail Route 10 (iii) modernize the East-West lines	As regards to railway sector institutional and regulatory framework is in place. However, The support for construction of multi-modal terminals should contribute to fulfilment of EU environmental standards.	Due to the government investment on road infrastructure during 2009-2014, including the last 12 months, there is only a small functioning railway network system.	Upcoming measures: (i) in 2015-2017, prepare the detailed design for Rail Route 10 (ii) in 2017 carry out a feasibility study on the rehabilitation of the East-West lines (iii) In 2017, carry out a feasibility study for construction of a railway line linking Kosovo with Albania, the main centres and ports	While there is no directly link to SEE2020 reforms of this FM, the government sees this FM as a strong investment towards the attracting FDI and increasing regional trade through the railway infrastructure upgrade.	The risks pertaining to the implementation of this FM remain predominantly on the availability of financing. Kosovo Government has started negotiations with EBRD and EIB for loan for general rehabilitation of then Railway Route 10, which connects Serbia, Kosovo and Macedonia. The southern part of Rail Route 10 is considered as a priority compared to the northern part of the route.	Main priority projects depending on the funding for upgrading Kosovo Railways Infrastructure priority projects are: (i) rehabilitation of the Railway Route 10 – southernline (200m EUR), (ii) eastline (66m EUR); (iii) rehabilitation of western line (123,6m EUR), (iv) rehabilitation of the southwest line (89m EUR), (v) feasibility study for railway Prizren-Durres (55m EUR), and (vi) railway Peje-Mateshevo (costs are not known yet)	An effective transportation system, i.e. railway network would have a significant impact on the on the transport of goods and people, regional trade and attraction of FDI. In this regard, Kosovo Government has committed that the investments in the upcoming years will be shifted to railway network.
EU PR 2014: Implementing legislation needs to be adopted to ensure the professionalism of air navigation and safety services. The air navigation service provider still needs to be certified. Kosovo's aviation sector continues to suffer from restrictions imposed by Serbia for flights coming in and out of Pristina." Page 43	FM 1.5.1 Increasing technical and human capacities of Air Navigation service provider.	The aim of this FM is to transfer competences to Kosovo authorities on air navigation as well as to build its technical capacity and human resources in order to be capable to offer all these services.	An agreement between NATO and Hungary, air navigation services for aircraft to bypass the ethereal space of Kosovo is being provided by Hungaro-Control. This agreement ends in 2019. Meanwhile, the Service Provider Air Navigation of Kosovo needs to build its technical capacity and human resources in order to be capable to offer all these services individually after the year 2019.	Agreement between NATO and Hungary; Law on Air Navigation Services Agency	Adoption of the law on Air Navigation Services Agency; Control of the upper airspace of Kosovo was assigned to Hungarocontrol, and in April 2014 this airspace was reopened.	This FM will be implemented throughout the period 2015-17 and beyond.	There is no direct link to SEE 2020 indicators.	No risks associated with this measure are foreseen	The cost for developing air navigation will be included in the MTEF 2016-2019 as the process of handover from HungaroControl will be concluded.	Provision of Air Navigation Services by Service Provider Air Navigation of Kosovo would greatly increase work activity and income and would make it competitive with similar agencies in the region.

EU PR 2014: "Overall, Kosovo has not progressed beyond the very initial stages of harmonisation with the acquis in these areas. There has been little progress on new legislation and implementing existing laws. Environment and climate need to become government priorities. The quality of environmental reporting needs to improve to better inform government policies." Page 42	FM 1.6.1: Improving capacity and effectiveness of institutions responsible for the implementation and monitoring of environment policies.	Capacity development for issuing environmental and spatial planning permits and consents for businesses in order to better align activities of local and central institutions in this regard. Further strengthening of institutional framework will be carried out in order to address the challenges in terms environmental concerns. Main focus will be on Establishing the National committee on climate change (SEE 2020) in order to strengthen cooperation with other ministries that have responsibilities in the field of environment.	The Government will implement these measure through specific capacity building activities, information campaigns, integration of environmental protection into all horizontal sectors so that it will be part of their overall policies/programs; trainings will be provided through ECRAN in order to develop capacities to meet the international obligations on climate change as per UNFCCC and EU requirements	Environmental Strategy and National Environmental Action Plan 2011-2015; legislation on Environment Strategic Assessment (ESA), Environment Impact Assessment (EIA), and Integrated Pollution and Prevention Control (IPCC). Kosovo Framework Strategy on Climate Chang	The Government of Kosovo has developed Environmental Strategy and National Environmental Action Plan 2011-2015. In the legislative and administrative field, amendments to legislation on Environment Strategic Assessment (ESA), Environment Impact Assessment (EIA), and Integrated Pollution and Prevention Control (IPCC) were already adopted.	The timeline for implementation of this FM is 2015-2017	This FM contributes to implementation of Dimension J – Environment, respectively sub-dimension: (4) i) Capacity for Climate Change Adaptation; ii) Environmental Protection; iii) Sustainable Management of Natural Resources; iv) International and Trans-boundary cooperation	Risks associated to implementation of environmental policies in Kosovo are subject to government funding.	There no estimation on the cost for implementation of this measure, although donor funding will be considered.	Capacities of institutions to tackle environmental concerns will contribute to better alignment of country policies with EU standards as well as increase the living standard of the population
EU PR 2014: In the area of water, Kosovo has not established River Basin Authorities or an independent water management authority (as envisaged in last year's law). Investment needs in water security are considerable (leaking pipe losses are estimated at around 75 % of the water carried). Water utilities are hampered by low collection levels. Page 41	FM 1.7.1: Finalise the project for construction of Prishtina water treatment plant	Construction of new water treatment plant in Prishtina will address water supply shortages in the center of Kosovo, respectively Prishtina and its region. Overall this measure will have direct impact to better investment climate, and development of businesses.	This will be an investment in a new Water Treatment Plant in Shkabaj, in the amount of 35 million Euros, project being funded by the German Government through KfW German Development Bank, the European Commission, the Government of the Republic of Kosovo and Prishtina Municipality. The first phase will be 700 l/s and the second phase 500 l/s, to be implemented for the Water Treatment Plant in Shkabaj. Project includes the following components: Construction of the new Water Treatment Plant in Shkabaj and construction of a new network and pumping station to enable connecting the new Water Treatment Plant with Iber channel and the existing network.	Government Programme, MTEF	The contract for this project has been signed and works on construction started on December 2014 and works for construction of the water treatment plant have started	The project is expected to be finalised by 2016	This FM contributes to implementation of Dimension J – Environment, respectively sub-dimension: (4) i) Capacity for Climate Change Adaptation; ii) Environmental Protection; iii) Sustainable Management of Natural Resources; iv) International and Trans-boundary cooperation	No significant risks have been foreseen for implementation of this measure	This project is funded by: the Municipality of Prishtina with 5 million Euros, the European Commission 5 million, the Government of the Republic of Kosovo with 5 million Euros, 20 million loan taken by the Water Company Prishtina from the German Development Bank, and the guarantee for loan repayment is the Government of Kosovo for RWC "Prishtina" – j.s.c.	Improved infrastructure and water supply for Prishtina and its region

## Flagship Measures in relation to Physical Capital

EU PR 2014: "Very limited progress has been made in improving the quality of the education sector. Total public spending on education decreased slightly, by 0.1 percentage points, to 3.8 % of GDP in 2013, still less than the average for low and middle income countries (4.3%)", page 35.	FM 2.1.1: "Improving access to pre-primary education"	This FM aims to ensure universal access to pre-primary education as means of ensuring not only equal opportunities for all children of pre-school age, but also to achieve better preparation of children for school. The measure is relevant for competitiveness and growth, as it is expected to lead to improved quality of primary education, which is one of the main bottlenecks of quality of education system in Kosovo.	The Law on Pre-University Education provides for compulsory pre-primary (grade 0 for children aged 5 to 6) education. It also mandates the creation of a new curriculum and learning standards for both pre-school and pre-primary pupils. In the next period focus will be on implementation of this Law primarily through budgetary needs.	The Law on Pre-University Education (04/L-032) was already passed in 2011. Implementation of this measure is subject to MTEF.	The access to pre-primary education has been improved with the current indicator being 85%.	The MEST will propose this measure for funding for the 2016-18 MTEF	While there is no directly link to SEE2020 AP for Kosovo, the MEST sees this FM as important for improving overall quality of education in Kosovo, which is critical for quality of the labour force.	Achieving the access to pre-primary education target (95%) is subject to availability of financing in the MTEF.	The FM measure will result in increased public expenditure on pre-University Education by 0.4 million Euro and an additional 1 million on capital expenditure. This will be considered in the 2016-18 MTEF process.	Improved access to and better quality of the pre-university education is expected to lead to better outcomes at the level of primary education. It is expected that impact of this activity is to take place 2019-2020.
EU PR 2014: "The labor market relevance and the quality of education need to be greatly improved", page 45.	FM 2.2.1: "Continue improving quality of VET".	This FM aims to improve quality of education in the VET in line with European Qualifications Framework. Implementation of this FM supports competitiveness and growth agenda by improving quality of labor force and relevance of its skills to the labor market needs.	This FM will contain the following main activities: Support National Qualification Authority (NQA) in further increasing its capacities – especially through training and development of staff; Increase awareness and develop information materials about National Qualifications Framework (NQF); Adopting secondary legislation and guidelines for harmonization of NQF with European Qualifications Framework (EQF); Establishing two new centers of competence in metal-working and automechanics; and Supporting and promoting the establishment of Quality	The Law on Vocational Education and Training (04-138). Besides legal instruments, this measure is primarily about institution building and development of administrative capacity, as well as funding.	The MEST has undertaken preparatory activities through preparing initial drafts of normative acts and proposals for development of institutional mechanism.	In 2015 the following actions will be taken: Develop standards and guidelines for occupations. Standards and Guidelines for QA will be produced and disseminated. Teacher training programmes will be activated for QA practices. A new curriculum on VET Education will be developed in cooperation with Faculty of Education in the third quarter of 2015.	Number of highly qualified persons in the workforce (92.000 in 2012)	No major risks are foreseen for implementation of this measure (BUT MEST needs to see if financing is available)	The FM measure will result in increased expenditure on VET by 0.4 million Euro. The financing is to be proposed for 2016-18 MTEF. EU Kos VET project is also providing support to implementation of this measure.	Gradual harmonization with the EQF and establishing systems for quality assurance in VET schools will lead to higher qualified labor force with skills fit for the labor market needs. The impact of this measure is planned for 2020.

EU PR 2014: "Attempts to address the evident skills mismatch in the labor market were made when a legal framework for the establishment of the Agency for Vocational Education and Training and Adult Education was put in place. However the agency itself is not yet operational", page 35.	FM 2.2.2 "Enhance capacity for coordinated development of the VET system".	Similarly to FM 2.2.1, also this FM aims to quality and relevance of the VET in Kosovo. As such, it is directly relevant to the competitiveness and growth agenda.	This FM will include activities on: Functionalizing the Council for Vocational Education and Training (CVET); increase capacities of established AVTAE Staff through training; Review of the funding mechanisms of VET with a view to improve system's efficiency, effectiveness and sustainability; Gradual introduction performance assessment framework for the VET schools; Implement the Torino Process Methodology.	The Law on Vocational Education and Training (04-138) Besides legal instruments, this measure is primarily about institution building and development of administrative capacity, as well as funding.	Both – the CVET and AVTAE have been established formally. MEST has started to work on preparations for revision of Education Sector Strategy – the process to involve revision of financing mechanism for the VET.	During 2015 the following actions were planned: Hold regular meetings of CVET, produce a concept paper on VET Financing Formula. Establish a working group to discuss an integrated VET performance assessment framework.	Number of highly qualified persons in the workforce (92.000 in 2012)	As to operationalization of the CVET, no major risks are foreseen; Availability of funding within the MTEF remains the major risk factor for the. Revision of the funding mechanisms for the VET is expected to take place in 2016.	Increased public expenditure by 0.4 million Euro in 2016-18 MTEF. IPA ETF PRIME also supports this measure.	Strengthening of the institutional mechanism and administrative capacity will improve governance of the VET system. Revised funding mechanisms will increase incentives for schools to provide higher quality and more relevant education.
EU PR 2014: "In December 2013, the law on the Employment Agency was adopted. However, no budget allocation was made for the agency for 2014. Statistics regarding the labor market remained inadequate and outdated, hampering a sound analysis of the situation", page 32.	FM 2.3.1: "Establishing the Agency for Employment (AE)."	The objective of this FM is to strengthen capacity of the institutional set-up for active labor market policies including skills-matching, training and counseling of unemployed and other measures; as well as overall labor market monitoring and analysis.	The main activities will include operationalization of the new AE – staffing, budgeting and capacity development. This is to take place gradually in the period 2015-17.	Law No 04/L-205 on the Employment Agency of the Republic of Kosovo. Besides legal instruments, this measure is primarily about institution building and development of administrative capacity, as well as funding.	The Law on the Employment Agency has been adopted. The institutional design of the new Agency has been prepared along with preparation of the financing plans. Implementation subject to the MTEF.	The MLSW will draft a new regulation on internal organization of the Employment Agency as well as the Rules of Procedure of its Advisory Board.	Overall Employment Rate, % of 15+ population (25.5% in 2012)	Implementation of this FM is subject to gradual increase of financing for the newly established Agency.	Set up of the Agency is being financed from resource allocation from the MLSW to the new Agency. Additional budget needed for completing the set up of the new Agency is about 100.000 euro. This will be gradually requested as part of the MTEF process.	Implementation of this FM is expected to strengthen capacity of Kosovo's institutions to implement active labour market measures, hence reduce unemployment.

EU PR 2014: "Kosovo has taken limited action to strengthen research and innovation capacity. The budget for research remains too limited to create competitiveness and implementation suffers from budgetary constraints and administrative capacity needs to be strengthened", page 38.	FM 2.4.1; "Improving the governance of the R&D sector"	The main policy objective of the measure is to unleash the innovative potential and smart specialization through increased links between research and industry.	This measure will include such activities as finalization and adaption of the National Innovation Strategy (NIS). The document will build on the stock-take and evaluation of the past and current R&D initiatives; Reviewing the institutional structure and establishing the "research and technology function (potentially Agency) in Kosovo; Developing the R&D Information System; Adopting new Laws on Research and on the Academy of Science and Arts; Identifying mechanisms of quality assurance of research activities; Strengthen the capacities of the Industrial Property Agency	The Law of Scientific Researchch Activities (DL-12-2013) has already been adopted. However, it needs to be complemented by additional Administrative Instructions and regulations on Scientific Research Financing and Administrative Instructions for the establishment of Research Promotion Agency and Innovation.	A new draft Law on Research and Developed has been proposed and is under review at the Assembly of Kosovo.	MEST has established a working group to review the new Law on Research and their recommendations will be reviewed in the second quarter of 2015. A new working group will be established to propose a new Law on Innovation and Technology in the second half of 2015	The measure and corresponding initiative and actions contribute to SEE Smart Growth Objective, R&D Dimension	The implementation of the Law is subject to the availability of funds,. Under the existing Law on Scientific Research, 0.7% of total public expenditure should be allocated to R &D.	Increased annual government expenditure by 4 million Euro from 2016-18 MTEF.	The implementation of the FM measure is expected to strengthen the capacity of Kosovo institutions to stimulate research and innovation and enhance SME competitiveness through research-based innovation.
EU PR 2014: "Kosovo's participation in the EU framework programme for research (FP7) has continued to stagnate. ore efforts are needed to strengthen Kosovo's research and innovation capacity through boosting investment in the sector and by taking action to facilitate the integration of Kosovo into the European Research Area and its contribution to the Innovation Union", page 38-39.	FM 2.4.2: "Support to internationalization of research"	The main objective of the measure is to support knowledge transfer and Kosovo SME participation in the regional and European economy through smart specialisation and growth.	Promoting links, participation and memberships in European Industrial Research and Management Association (EIRMA), European Association of Research and Technology Organization (EARTO), BusinessEurope, and European University Association (EUA) and European Roundtable; Supporting and advance the Bologna Process and further integration into European Research Area; Supporting and promoting cross-border and European cooperation on research in the framework of Horizon 2020 programme; Participating and actively contributing to Western	The Law of Scientific Researchch Activities (DL-12-2013) has already been adopted. However, it needs to be complemented by additional Administrative Instructions and regulations on Scientific Research Financing and Administrative Instructions for the establishment of Research Promotion Agency and Innovation.	A working group has been established to review the Law on Scientific Research and discuss a new law on Research Financing. The working group has also discussed the option of proposing a new Law on Technology and Innovation	MEST has established a working group to review the new Law on Research and their recommendations will be reviewed in the second quarter of 2015. A new working group will be established to propose a new Law on Innovation and Technology in the second half of 2015. The MEST Centre for International cooperation has drafted an action plan for the promotion of Horizon 2020.	The measure and corresponding initiative and actions contribute to SEE Smart Growth Objective, R&D Dimension	The implementation of the Law is subject to the availability of funds,. Under the existing Law on Scientific Research, 0.7% of total public expenditure should be allocated to R &D. Besides that, Kosovo is not formally part of Bologna Follow-up Group	Increased annual government expenditure by 4 million Euro from 2016-18 MTEF.	The FM measure would lead to enhanced integration of Kosovo in the European Research Area.

EU PR 2014: "Education and training programmes (for both pre-university and university level education) need to improve support for applied and practical work, to complement theoretical teaching and learning practices Little progress has been made in developing a clear strategic plan for higher education institutions in Kosovo", page 44.	FM 2.5.1: "Modernization of higher education system"	The objective of the measure is enhance accountability and academic freedom in the higher education sector	A Working group has been established to review and propose further recommendations to amend the Law on Higher Education as per the suggestions of the Assembly Committee. MEST will also elaborate options and policy frameworks for improving financial autonomy and accounting systems in higher education. Fully implement the EHEA good practices on higher education autonomy and commitment to public education in line with EHAE Bucharest Communiqué (2012). Review Primary and secondary legislation on higher education in order to fully implement the best EHAE practices on	The Law on Higher Education (2011) has been adopted and 14 Administrative Instructions of the newly established public HEI have been endorsed by MEST Working Group.	MEST has established a working group to review the suggestions and recommendation of the Assembly of Kosovo on HE. A stakeholder discussion has been held during 2014	The Law on Higher Education will be reviewed and adopted in the second quarter of 2015. Policy options paper on financial management and accounting systems in HE will be presented in the third quarter of 2015. A working group will be established to guide and support HE institutions to establish the Rectors Conference.	The measure and corresponding initiative and actions contribute to SEE Smart Growth Objective, R&D Dimension by ensuring an increased number of 30-34 olds is in tertiary education.	No major challenges are foreseen, albeit HE governance is a highly sensitive issue in view of difficulties to ensure the right balance between HE autonomy and public accountability.	Financing of this FM is subject to the policy decisions taken as part of elaboration amendments to the Law on Higher Education, which will include considering several funding options.	The measure will result in enhanced governance, financial management and stakeholder engagement practices in higher education. These criteria are essential for full integration into the European Higher Education Area.
EU PR 2014: "Education and training programmes (for both pre-university and university level education) need to improve support for applied and practical work, to complement theoretical teaching and learning practices Little progress has been made in developing a clear strategic plan for higher education institutions in Kosovo", page 44.	FM 2.5.2: "Enhancing quality assurance in higher education"	The main objective is to enhance the quality of higher education and make HE systems compatible with European Standard Guidelines on Quality Assurance	This FM will focus on <ul style="list-style-type: none"> <li>Enhance the capacities of MEST Higher Education Department,</li> <li>Support higher education institutions to fully implement internal quality assurance measures.</li> <li>Promote and fully support MEST KAA to implement E4 Group (ENQA, EUA, ESU, EURASHE) European Standard Guidelines on quality assurance.</li> <li>Support MEST KAA continued membership in ENQA and EQAR.</li> <li>Promote and support HEI to develop internal quality assurance systems.</li> <li>Develop a University ranking system methodology</li> </ul>	The Law on Higher Education (2011), Administrative Instruction on Kosovo Accreditation Agency and Administrative Instruction on Accreditation of Private Providers were drafted and fully implemented.	KAA has established a working group to review the suggestions and recommendation of the Assembly of Kosovo on HE. ENQA and EQAR have granted full membership to KAA.	The Law on Higher Education will be reviewed and adopted in the second quarter of 2015. Administrative Instructions and regulations will be reviewed to ensure will compatibility with ESG. A concept paper on University ranking system will be initiated in the fourth quarter of 2015 ENQA recommendations on student involvement and appeal procedures will be relieved.	The measure and corresponding initiative and actions contribute to SEE Smart Growth Objective, R&D Dimension by ensuring an increased number of 30-34 olds is in tertiary education.	The implementation of FM is subject to the availability of funds.	Currently no additional cost to the budget is foreseen.	The FM will result in enhanced quality practices in higher education and consolidated implementation of EHEA practices in Kosovo HE.

**Flagship Measures in relation to Business Environment, Industrial Structures and Trade Integration**

EU PR 2014: "The government needs to introduce a regulatory impact assessment."	FM 3.1: Implementation of Better Regulation Strategy	The initiative on the implementation of better regulation strategy aims to implement the three measures: (i) to establish a system, web-based portal, for central publication of all draft normative acts and supporting documents; (ii) to streamline administrative procedures for businesses, and (iii) to implement the Law on Permits and Licenses.	The Office of the Prime Minister (OPM) is to lead on coordinating implementation of this Strategy, which among other reforms aims to establish the RIA Unit in the OPM; review and amending legislation to make RIA mandatory; and providing training and other support to the bodies of Kosovo public administration and the main social partners in terms of capacity building.	The implementation of the Law on Permits and Licenses is to be paralleled with finalization and adoption of the Law on Inspections, which is to set out new principles for activities of various inspections, of which there are above 25. On 23 May 2014, the Government adopted the "Better Regulation Strategy 2014 – 2020".	The implementation of the Better Regulation Strategy 2014 – 2020 is expected to institutionalize its mechanism during 2015. Hence, no milestone activities have been identified in the last 12 months.	In 2015, it is expected to institutionalize the RIA unit and adopt necessary legislation.	While there is no directly link to SEE2020 of the Better Regulation for Kosovo, the OPM sees this FM as a strong view to advance smarter regulation.	The risks pertaining to the implementation of the measures remain on the (i) RIA Unit functionality, (ii) availability of financing in the MTEF.	OPM will propose this FM for funding for the 2016-18 MTEF.	Implementation of Better Regulation Strategy would positively impact the opportunities for a public-private dialogue to business community. In addition, it would establish new and business-friendly principles of regulating business activity through permits and licences and most importantly establishing the institutional mechanism to oversee the Law on inspections.
EU PR 2014: "To improve the business environment, Kosovo needs to improve conditions for enforcing contracts, reduce unnecessary administrative barriers, promote the fight against the informal economy and corruption, and develop a financial market."	FM 3.3.1: Improving access to finance through contract enforcement and legal and regulatory framework	The FM on access to finance aims to better the business environment in Kosovo through: (i) implementation of the National Backlog Reduction Strategy, (ii) Implementation of the ICT Strategy, (iii) the transition to the new court system "model courts", and (iv) ADR and introduction of private bailiffs, use of which is expected to significantly reduce caseloads per judge.	This FM includes a number of theme measures with the ultimate objective to contributing to overall increase of efficiency and transparency of the judicial system, including but not limited to: contract enforcement, the legal and regulatory framework, such as ADR and introduction of private bailiffs and development of cadastral system.	The string of laws and strategies pertaining to this FM: (i) Law on Liquidation and Reorganization of Legal Persons in Bankruptcy governs the context of liquidation and reorganization of corporate creditor rights; (ii), ICT Strategy for 2012-2017, adopted by the KJC in March 2012, and (iii) Law on Cadastre No. 04/-L-013		The implementation of the ICT Strategy for 2012-2017 will continue in 2015-17.	While there is no directly link to SEE2020 headline targets of the access to finance FM, the main challenges remain the weak judiciary, lack of contract enforcement and rule of law.	The risks pertaining to FM on access to finance through contract enforcement come down to a weak judiciary and insufficient capacities to keep up the reduction rate of the backlog.		The following FM impacts are foreseen: (i) Disposition time for civil cases decreased by 50% by 2020. (ii) Clearance rate for civil cases increased by more than 100% by 2020. (iii) Eliminate the backlog by 2020. Increase significantly the ADR cases (iv) Full coverage of land administration services for all comparing numbers of registered properties to the numbers visible in 2009 orthophoto maps (OPM)

EU PR 2014: "The capacities of all the bodies related to the public procurement need to be enforced"	FM 3.4: Further improve the public procurement system	The objective behind procurement reform is creating a competitive public procurement market striving to support industry development and developing the industrial base. The initiative on the public procurement system reform encompasses measures on: (i) administrative capacities improvements, (ii) development of e-procurement, (iii) boosting procurement skills and (iv) the monitoring of procedures, detection and reporting of irregularities.	The administrative capacities can be improved by: boosting staffing and funding of implementing institutions (PPRC, CPA and PRB), and streamlining procedures between the numerous entities involved in the public procurement system. Second, the e-procurement platform aims to increase the efficiency in the public procurement system in Kosovo.	The legal framework can be improved by first the Law on Public Procurement should being modified so as not to give preference to domestic bidders, and second the Law on Prevention of the Conflict of Interest in the exercise of public office should be aligned with the Criminal Code. National Strategy of Training for Public Procurement in Kosovo for 2014-2018 has been drafted	The administrative procedure for the e-procurement project, including the evaluation of offers and the winner proposal for the project have already been achieved in the last 12 months. The implementation will be in 2015/2016	Implementation timeline 2015/2016, World Bank and European Commission supported.	Dimension B under the SEE 2020 addresses issues in facilitating competitive economic environment through fully liberalised public procurement market in the Region.	Achieving a functional public procurement system is subject to availability of financing by the donors, e.g. WB and EC projects.	Implementation timeline 2015/2016, World Bank and European Commission supported	The following direct impacts are foreseen in the FM on public procurement reform: (i) the number of contracts awarded in open procedures is increased by 2020 (ii) the average number of bidders per tender increased by 2020 (iii) give preference to domestic bidders (iv) the public procurement system performance is significantly improved
EU PR 2014: "To improve the advocacy in the private sector for the usage and importance of the standards - Regarding accreditation, there is still no evaluation of the inspection bodies - The LABs in metrology are partially operational - The coordination among the responsible authorities for the monitoring of the Kosovo market need to be improved and the applicable procedures need to further be explained."	FM 3.5: Develop Quality Infrastructure	This initiative comes down to the following flagship policy measures: (i) Strengthen the legal framework (ii) Continue to develop metrology laboratories (iii) Accredited more CABs (iv) Boosting quality of infrastructure staff skills (v) Awareness raising and development of information and notification mechanisms in the area of quality infrastructure	Quality Infrastructure is a necessary and essential basis for technology development, production, services and trade. Kosovo, particularly the Ministry of Trade and Industry (MTI) will continue efforts in modernizing its Quality Infrastructure (standardization, conformity assessment, metrology and accreditation) to reduce barriers to trade and enable better access to the EU and international markets for Kosovo based firms.	Strengthen the legal framework with particular focus on bringing the conformity assessment procedures in accordance with the requirements of the EU directives. This includes assessing current legislation (765/2008/EC and 768/2008/EC), approving technical regulations for CAB authorization, foreign conformity documents recognition, and CE mark as well as approving the EU directives on low voltage and gas appliances.	In the near past, Kosovo has established the institutional backbone of the Quality Infrastructure. The MTI's Division of Quality Infrastructure is the main policy body in this sphere. KSA, KAD and AMK implement Quality Infrastructure policy. The Standardization Law is in line with the EU acquis. Kosovo has already adopted over 7,000 standards.	Adopt 1,600 new standards with priority on construction products by the end of 2015	There is no directly link to SEE2020 for the Quality Infrastructure Development.	The Quality Infrastructure Development legal, technical and notification mechanism reforms are subject to MTEF and donors.	MTI along with donors will propose this FM for funding for the 2016-18 MTEF.	Develop information and notification mechanisms in the area of quality infrastructure: i) through the establishment of a quality infrastructure "notification centre", and ii) by effective implementation of the notifications process for TR, CAP and draft National standards.



EU PR 2014: "Overall, limited progress was made on industrial and SME policy."	FM 3.6.1: Industry clusters and technology transfer centers	The objective of a coordinated strategic industrial policy is to increase the rate of economic development in Kosovo. Six priority sector profiles have been identified for the following industries: wood-processing, metal-processing, food-processing, textile, information and communication technology (ICT), and tourism.	Industry clusters are strategic geographic concentrations of related businesses where economy of scales can be capitalized through mainly gathering the businesses from the six priority sectors in the Economic Zones. In addition, Set up technology transfer centres at a few key universities in collaboration with industry bodies.	These goals are included in the Strategy for Private Sector Development 2013-2017 and the Industrial Policy Concept Paper.	The Industrial Policy Concept Paper identified top six priority sectors with export potential. Their respective profiles have been identified for the following industries: wood-processing, metal-processing, food-processing, textile, information and communication technology (ICT), and tourism. These resources inform the industrial policy strategy.	(i) Gather the businesses from the six priority sectors in the Economic Zones; (functionalize three economic zones by the end of 2017) (ii) Support of industry associations and cluster bodies to engage in industrial dialogue (at least 5 meetings every year) (€30,000) (iii) Build two technology transfer centers during 2015-2017	Value added and share of high tech, exports goods and services, and manufacturing share of GDP are the main measurable indicators contributing to SEE2020.	Picking the winner sectors is an exclusive methodology. One of the main obstacles for growth for the six priority export potential sectors remains access to finance, weak judiciary, and lack of power supply.	(i) Gather the businesses from the six priority sectors in the Economic Zones; (functionalize three economic zones by the end of 2017) (€1,000,000) (ii) Support of industry associations and cluster bodies to engage in industrial dialogue (at least 5 meetings every year) (€30,000) (iii) Build two technology transfer centers during 2015-2017.	Focusing on advantageous export potential sectors, this FM foresees direct impacts to the total exports increase towards the share of GDP from 17.40% in baseline year (2014) to 20.37 (in 2020). In specific, an increase in the share of share of exports of goods of GDP from 5.7% (2014) to 7.9% (2020); and also share of exports of services of GDP from 11.8% (2014) to 12.39% (2020).
EU PR 2014: "The main obstacles to SME development and further growth are access to finance, weak legal enforcement of contracts and business regulation, weak competition and weak judiciary, as well as the large informal economy and corruption."	FM 3.8.1: SME support and export development through Voucher, Credit Guarantee and Grants scheme programs	Over 90% of Kosovar enterprises are SMEs. As such, government SME support and access to resources and export markets are critical for SME development as well as economic development. The main focus on SME development will be on: SME Grant Program, Competitiveness and Export Promotion, Voucher Scheme, and Credit Guarantee Scheme.	(i) The Voucher Scheme is a program to offer subsidized consulting to SMEs regarding their business practices. By the end of 2015 the Voucher Scheme will reach 1,300 days of consulting. (ii) The Credit Guarantee Scheme is a program to increase SME access to loans through banks by providing a guarantee to the bank for the business loan (iii) The Grant Scheme is a program to stimulate export-orientated businesses by subsidizing import of products with grants for MSMEs	The SME and export development policy reform goals are also encompassed in the Strategy for Private Sector Development 2013-2017 and the Strategy for SME development for 2012-2016, which ultimately strive to strengthen the overall performance of this policy area.	In the last 12 months, a grant scheme project was implemented by the MTI for the support of export oriented SMEs. The project donor was EC, the implementer being the IOM.	Timetable list on the upcoming steps: (i) The Voucher Scheme - by the end of 2015 the Voucher Scheme will reach 1,300 days of consulting  (ii) The Credit Guarantee Scheme - The realistic time frame is that by the end of 2015	Dimension K under the SEE 2020 addresses issues in facilitating competitive economic environment through fully liberalised public procurement market in the Region.	The FM on SME support on exports in voucher, credit and grants schemes are subject to donor contributions and the budget of the MTI is insignificant towards the committed budgetary schemes.	Budgetary implications/financial commitments: (i) The Voucher Scheme – the scheme will reach 1,300 days of consulting with a funding of €250,000  (ii) The Credit Guarantee Scheme - €16,000,000 euros will be available in the fund	The following impacts are expected: (i) increased total export generation; net export generation (net of imports) is also captured by the value added indicator  (ii) Increased number of businesses in the value chain supported by the schemes; a proxy for entrepreneurial development and expansion of the formal (tax-paying) economy