DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR KOSOVO

As approved by the Board of Directors at its meeting on 1 May 2013

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EXECUTIVE SUMMARY

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

Kosovo proclaimed independence in 2008. The functioning of democratic institutions has been strengthened over the last several years, although challenges remain. The key areas for improvement, which are common to the Western Balkans, include strengthening public governance and the fight against corruption, the rule of law, capacity of the public administration, and the business environment. Efforts towards approximation with the European Union, which has repeatedly stressed that Kosovo shares the European perspective of the rest of the Western Balkans, remain the main external anchor for comprehensive reforms.

Kosovo's economy has been largely shielded from the adverse external developments in the past few years due to the relatively weak direct trade and financial linkages with the global economy. As a result, growth has been higher in Kosovo than in other South-eastern European (SEE) countries, with typical annual GDP growth rates in recent years of between 3 and 4 per cent, albeit from a low base. The unilateral adoption of the euro has contributed to price stability, and the fiscal discipline that is necessary to underpin this exchange rate arrangement has improved in the past year in the context of an IMF Standby Arrangement.

However, sustained fiscal discipline, structural reforms to boost competitiveness and good financial sector health are needed to fully benefit from the exchange rate anchor. At an estimated €2800 in 2012, Kosovo still has the lowest GDP per capita in south-eastern Europe, placing it in the group of low middle income countries; the official unemployment rate exceeds 40 per cent and poverty levels are relatively high, particularly in the European context. The growth outlook over the strategy period remains positive but is subject to considerable uncertainty as a result of both domestic factors and concerns over the prospects for regional and global recovery.

Structural reforms in Kosovo have been held back over the years by a combination of factors: the legacy of the conflicts in the 1990s, weak institutional and administrative capacity, and uncertainty over the country's status which has deterred investors and distracted policy-makers from pursuing a comprehensive structural reform programme.

Kosovo now faces an opportunity to accelerate the reform process, with the full support of the Bank. As a new country of operations of EBRD, this is Kosovo's first full Country Strategy. Building on the Bank's experience in Kosovo for more than a decade, the Strategy is broadly designed to continue and deepen EBRD's support to private companies to enable them to strengthen their business and governance model, expand their markets and enhance their competitiveness. The Bank will also prioritise support to key infrastructure projects that sustain structural reform, which is vital for private sector operations and market expansion and to facilitate cross-border linkages. Finally, the Bank aims to support the development of a business friendly environment and associated institutional framework.

The key transition challenges and strategic directions for the Bank in the coming three year Strategy period are:

- **Supporting privatisation and private sector development.** Kosovo’s private sector is still small by the region’s standards. Development has been hindered by a difficult business environment and lack of investment. Shortcomings in management expertise and corporate governance, limited access to finance, weak rule of law and bottlenecks in the judicial system and low levels of capital stock have resulted in reduced competitiveness and below-potential growth. While there has been some progress on privatisation, the process needs to be accelerated. The Bank’s financial and technical support will aim to accelerate development of the country’s private sector, enhance its competitiveness and introduce best practices with a particular focus on innovation, value added processing, agribusiness, industries with export potential or ability to compete with imported product alternatives, and attraction of investment capital to the country.
- **Enhancing commercialisation, competition and private sector involvement in infrastructure.** The quality of infrastructure is mostly sub-standard, which constitutes a significant barrier to business and market development and regional linkages. To date, there has been little involvement of the private sector in key areas such as water and wastewater, and roads and railways services. Some key municipal services are still managed centrally and the decentralisation process is proceeding only slowly. Private finance on a commercial basis of municipal and transport infrastructure does not exist presently in Kosovo. The Bank will assist the national and local authorities in Kosovo in strengthening the commercial elements in the management of the water and waste water and solid waste utilities, as well as within the urban transport sector. In parallel, the Bank will support the private sector’s involvement in the transport and municipal sectors to enhance the quality of services, starting with the commercialisation of these utilities.
- **Promoting and supporting sustainable development of the energy and mining sectors.** Privatisation has occurred in the distribution and supply components of the energy sector, but the ability to operate commercially remains to be proven. The legal and institutional framework to support energy efficiency measures and small renewable energy projects is relatively advanced but its implementation remains a bottleneck for the development of the sector. The implementation of the planned large power projects and the upgrade of the network infrastructure will be critical to address the transition challenges in the energy sector. EBRD will co-operate with the authorities in Kosovo to promote private involvement in the country’s power sector and support the required investment to ensure security of supply, development of renewable energy, and improved energy efficiency. The Bank’s assistance will be also required to advance the needed structural reform in Kosovo’s presently inactive mining sector, where the EBRD will selectively assist with technical advice and financing to support transition and best practice for environmentally and socially sustainable production.

In all these activities the Bank will seek to align its operations with the priorities of the Government of Kosovo, promote regional integration and will work closely with other international financial institutions, multilateral and bilateral donors, including the European Union. Kosovo will be a beneficiary of the Joint IFI Action Plan for Growth of the EIB, the World Bank and the EBRD, where the focus is on Southern-

Eastern Europe. The Bank will engage in active policy dialogue and continue to provide technical assistance to maximise transition impact in Kosovo.

1 THE BANK'S PORTFOLIO

1.1 Overview of Bank activities to date

Kosovo became a member of the Bank on 17 December 2012. However, private sector projects in Kosovo were eligible for EBRD support since 1999, via dedicated externally managed regional funds and projects and via the Bank's regional facilities for the Western Balkans. Within this scope, since 1999 the Bank had signed a total of 29 projects in Kosovo with a cumulative EBRD investment value of €66 million. The current portfolio stock is allocated 34 per cent to financial institutions and micro-finance companies, 60 per cent to industry, commerce and agribusiness and 6 per cent to energy and natural resources. All projects to date are in the private sector. The sector distribution broadly represents the investment requirements of the private economy in Kosovo over the past few years.

The launch of the EBRD-Italy Local Enterprise Facility (LEF) in 2006 allowed the Bank to increase its financing activities in Kosovo significantly, in part due to the growth of the private sector that followed the 2008 declaration of independence, but also due to the lack of alternative project-tailored sources of funding to serve the growing demand. The number of the financed operations in Kosovo has grown steadily, although with modest business volume achievable under the delegated facilities. On average, the Bank signed 4-6 new operations every year during the period 2008-2012. In 2012, the Bank signed 5 new transactions with a total volume of €5.3 million, all in the private sector.

Table 1: Portfolio Development in Kosovo as of 31 December 2012

Sector Group	Sector Team	NCBV number of operations	Net Cumulative Business Volume (NCBV)	Portfolio number of operations	Portfolio	% Portfolio	Operating Assets	% Operating Assets
Energy	Natural Resources	1	1	1	1	2%	1	3%
	Power and Energy	1	1	1	1	4%	1	4%
		2	**2**	**2**	**2**	**6%**	**2**	**7%**
Financial Institutions	Bank Lending	3	9	0	0	0%	0	0%
	Insurance & Financial Services	1	3	1	3	7%	0	0%
	Small Business Finance	12	25	8	10	27%	10	31%
		16	**36**	**9**	**13**	**34%**	**10**	**31%**
Industry, Commerce & Agribusiness	Agribusiness	5	16	5	15	39%	13	42%
	Equity Funds	2	3	2	1	3%	1	3%
	Information & Communication Technologies	2	3	2	3	7%	1	3%
	Manufacturing and Services	2	5	2	4	11%	4	13%
		11	**27**	**11**	**23**	**60%**	**20**	**62%**
Summary		**29**	**66**	**22**	**38**	**100%**	**32**	**100%**

1.2 Implementation of the previous strategy

Until now, the Bank did not have a dedicated Strategy for Kosovo but identified in 2007 several key priorities for its activities since 1999. These priorities were:

- **In the enterprise sector**, to target support towards smaller-scale local export-oriented companies demonstrating good corporate governance, by providing loans, guarantees or making equity investments, including through LEF; to support strategic investors, who have privatized enterprises in Kosovo. In close co-ordination with the LEF Team, for the Small Business Support (SBS) team to continue to work directly with individual enterprises, providing assistance in restructuring of the business, improving products, technical and environmental upgrades, quality certification, advising on market positioning and helping to develop business planning skills at management level.

- **In the financial sector**, to focus on (i) providing banks with funding and institutional support to assist in developing new products and improving corporate governance; (ii) channelling more funding to MSMEs through commercial banks and microfinance institutions, including through the implementation of LEF, the Western Balkans SME Finance Facility, and the MSME Finance Framework for Western Balkans and Croatia; (iii) exploring potential equity investment in local banks, including through the implementation of the EBRD-Italy Western Balkans Local Enterprise Facility; and (iv) seeking ways to support sustainable commercialisation of profitable non-bank microfinance institutions.

- **In the infrastructure sector**, to continue to identify possible ways to support corporatised publicly-owned enterprises – the Pristina International Airport (PIA) and the telecoms company. To explore potential projects in support to the railways, district heating and the energy utility (KEK), which were incorporated in 2006.

Prior to and since Kosovo declared its independence in 2008, the Bank has worked primarily with privately owned companies and banks. This focused the Bank's efforts on addressing the transition objectives for the enterprise and the financial sectors. Since 2007 and under the framework provided by the regional facilities for the Western Balkans, such as LEF, the Western Balkans Sustainable Energy Direct Finance Facility, the SME Finance Facility and the MSME Finance Framework for Western Balkans and Croatia and within other regional projects the Bank committed €58 million for 20 projects. In accordance with the Bank's rules for delegated facilities EBRD finance was limited to up to €10 million per project.

The Bank supported investment projects of some important companies in Kosovo's still emerging private economy, covering sectors like manufacturing (production of construction materials), agribusiness (production of food and dairy products), banking and microfinance (MSME finance). Technical assistance was provided to private enterprises within the respective facilities for the initial assessment of the Bank's investment as well as for post-investment support to enhance financial and operational management and ultimately to increase competitiveness.

1.3 Transition impact of the Bank's operations

Since the start of operations, eight transactions signed in Kosovo were individually assessed from the transition impact perspective. These projects are mostly in the financial sector. All of these operations were rated as having either Good or Excellent transition impact potential, well above the institutional target of at least 80 per cent

Good or better. One project was rated Excellent – an MSE loan to a large non-bank financial institution. Apart from these eight operations, 18 projects in Kosovo were not individually rated for transition. These are mostly sub-operations signed under the frameworks which are rated and monitored on facility-level only (i.e. LEF). The TI potential rating of the LEF framework is rated Good. Finally, three regional investments signed by the Bank are partially realised in Kosovo. Two of these projects were signed with the multinational IT holding and the remaining one involved participation in an equity fund active in south-eastern Europe. All three were also assessed with Good transition impact potential.

The Bank's portfolio analysis shows that the projects signed in Kosovo have performed well from the transition impact perspective. Two out of eight individually rated operations are on track to achieving their envisaged transition objectives, and another five projects have already fully achieved them. One project involving equity participation in ProCredit Bank Kosovo had its transition rating upgraded from Good to Excellent to reflect the fact that transition impact achieved by this operation well exceeded original expectations, in terms of financial intermediation, institution building and sustainability. These achievements have ensured that ProCredit Bank Kosovo had a much faster graduation into independence from donor funding compared with other countries in the region. The remaining rated operation, an SME lending support loan to another commercial bank, has only partially achieved its transition objectives, since the impact was limited by delays and the initially low level of utilisation of the credit line. The performance of the LEF framework is on track from the transition impact perspective.

2 OPERATIONAL ENVIRONMENT

2.1 Political Context

Kosovo proclaimed independence in 2008 and adopted its new Constitution the same year. The current coalition government was formed in the beginning of 2011, following general elections held in December 2010. This is the second mandate for the government led by the Democratic Party of Kosovo (PDK) of Prime Minister Hashim Thaci. The governing coalition includes a majority of the parties representing ethnic minorities. Its priorities include economic development, including completion of privatisation, strengthening the rule of law, the fight against corruption, and promoting Euro-Atlantic integration as the key foreign policy priority.

Efforts towards EU approximation remain the main external anchor for comprehensive reforms. The EU has repeatedly stressed that Kosovo shares the European perspective of the rest of the Western Balkans. In a feasibility study published on 10 October 2012 as part of the EU Enlargement Package, the European Commission (EC) concluded that, subject to implementing some concrete measures in the areas of the rule of law, public administration, and the protection of minorities, Kosovo is largely ready to open negotiations on a Stabilisation and Association Agreement (SAA). At the end of 2012, the Council of the EU authorised the EC to open negotiations for a Framework Agreement with Kosovo concerning its inclusion in EU programmes, which, once signed, will enable Kosovo to participate in all EU programmes that are open to candidates and potential candidates.

Kosovo and Serbia have been engaged in an EU-facilitated dialogue aimed at normalising their relations, which remains crucial for both to move forward on their respective European paths. Following an important agreement between Kosovo and Serbia reached in the framework of this dialogue on 19 April 2013, the EC and High Representative of the EU for Foreign Affairs and Security Policy issued a joint report that positively assessed progress in meeting the short-term priorities identified in the Feasibility Study and significant steps towards improvement of relations with Serbia. On this basis, the EC recommended to the Council to authorise the opening of negotiations on a Stabilisation and Association Agreement between the EU and Kosovo.

Kosovo authorities support various cross-border and regional projects. In the beginning of 2012 Belgrade and Pristina reached an EU-facilitated agreement enabling the direct participation of Kosovo in regional cooperation.

See Annex 1 for a more detailed political assessment.

2.2 Macroeconomic context

Nearly five years after the declaration of independence, Kosovo remains one of the poorest countries in Europe with a GDP per capita (at market rates) of approximately €2800 in 2012. However, the economy has been largely shielded from adverse external developments in the past few years due to the relatively weak direct trade and financial linkages with the global economy. The Kosovo economy grew at 3 per cent in 2009, when most countries in the region were in recession, and it has recorded the highest economic growth in the SEE region each year since then. However, the limited high-frequency indicators that are available for Kosovo suggest that the growth of both domestic and external demand is slowing down. Credit growth has been decelerating throughout this year, down to 4 per cent y-o-y in October 2012 from 14 per cent y-o-y at the end of 2011. Remittances – primarily from Germany and Switzerland – are a substantial and stable source of foreign currency inflows and typically exceed 10 per cent of GDP, but they are growing at a slower pace compared to previous years. Weakening domestic demand is also reflected in declining imports through most of 2012 (down by an average of 6 per cent y-o-y between March and December). At the same time, exports have been contracting year-on-year since the beginning of 2012.

The scope for any kind of independent monetary policy is limited by the fact that Kosovo has (like Montenegro) adopted the euro as the sole legal tender. However, headline inflation has fluctuated considerably in the past couple of years, much more so than in the Eurozone. A significant rise in food and energy prices led to double digit inflation in early 2011. Inflation peaked at 10.8 per cent y/y in March before beginning to decline as a result of declining food prices and moderating aggregate demand. It bottomed out in March 2012 at 0.6 per cent but rose again to 3.7 per cent as of December 2012.

The conduct of fiscal policy has improved in recent years. In light of the country's unilateral adoption of the euro and the limited access to debt markets, the maintenance of prudent fiscal policy has been critical for macroeconomic stability. Fiscal adjustment has been supported by the IMF since 2011. Following the successful completion of a staff-monitored programme between June and December 2011, the IMF approved a 20-month €106.6 million Stand-By Arrangement (SBA) for Kosovo in April 2012. Under the SBA, the Kosovar authorities have agreed to introduce a fiscal rule from 2014 that would keep the general government deficit each year below 2 per cent of GDP. The aim is to stabilise the ratio of public debt to GDP, currently just 15 per cent of GDP, at less than 30 per cent in the long term. Implementation was satisfactory and in October 2012 an IMF mission and the Kosovo authorities reached agreement at staff level on the second review of the SBA.

External imbalances are very large in Kosovo. The export base is weak and the current account deficit, excluding official transfers, was 26.2 per cent of GDP in 2011 (20.3 per cent if official transfers are included). Annual net FDI inflows have averaged around €335 million in the past few years (about 7 per cent of annual GDP), while other important capital inflows come from a mixture of trading companies, insurance companies and pension funds. There are also significant positive “errors and omissions” on the balance of payments, associated with unidentified remittances and other inflows. Gross international reserves at the central bank stood at €626 million as of end-2011, equivalent to about 3 months of imports.

The banking sector remains reasonably well-capitalized, liquid and profitable. The capital adequacy ratio stood at 18 per cent as of the end of April 2012 and NPLs are the lowest in the SEE region at 7 per cent, although there has been some increase in this figure in 2012. The sector is largely foreign owned, with parent banks coming mainly from eurozone countries, Turkey and Albania. However, lending is mainly financed from deposits, so risks of crisis spill-over through cross-border financing are limited. Credit growth has moderated this year as has the growth in deposits. The country also has strict financial sector regulation that would prevent large withdrawal of funds from the Kosovo subsidiaries to their parent banks.

Looking ahead, growth in 2013 is likely to be around 3 per cent, slightly above the 2012 figure. Given the low starting point and potential in the economy, growth rates of 4-5 per cent are feasible over the medium term. Increasing the country’s growth potential is crucial to bring down high levels of unemployment. However, the downside risks are substantial, in light of the stagnant regional economy and the on-going crisis in the Eurozone. While Kosovo’s trade and financial linkages with the Eurozone are limited, it is highly dependent on remittance and capital flows from these countries.

See Annex 7 for a table with selected economic indicators.

2.3 Structural reform context

Structural reforms in Kosovo have been held back over the years by a combination of factors: the legacy of the conflicts in the 1990s, weak institutional and administrative capacity, and uncertainty over status which has deterred investors and distracted policy-makers from pursuing a comprehensive structural reform programme. Nevertheless, the Kosovo economy is in some respects quite open and liberalised. Kosovo participates in the regional free trade agreement, CEFTA. Prices are also broadly liberalised, with the exception of some utilities and other key goods.

The Bank has not yet carried out a detailed Assessment of Transition Challenges at the sectoral level in Kosovo. However, it is clear that significant transition gaps exist across all sectors, in terms of both market structure and market institutions and policies. The gaps are particularly large in the energy and infrastructure sectors, where major investment needs exist and where there has been very little progress in institutional reform over the years. Although the banking sector is relatively competitive and modern, other parts of the financial sector are underdeveloped, especially in areas such as capital markets and private equity. Progress in transition in the corporate sector has also been held back by the difficult business environment.

2.4 Business environment

Doing business is difficult in Kosovo, although the authorities are making efforts to improve the situation. In the World Bank's Doing Business 2013 report, Kosovo's overall ranking on ease of doing business improved from 126th in 2012 to 98th in 2013 (out of 185 economies), one of the biggest advances this year. The most difficult problems appear to lie in the areas of construction permits and enforcing contracts. Kosovo also performs poorly in starting a business and trading across borders. In the 2008 Business Environment and Enterprise Performance Survey (BEEPS), businesses owners and managers in Kosovo pointed to corruption, access to electricity, and crime, theft and disorder as the main obstacles to doing business. The 2012 Corruption Perceptions Index published by Transparency International ranks Kosovo 105th out of 176 countries, second from the bottom amongst SEE countries. On the positive side, labour regulations are seen as very flexible, and tax administration and business permits are perceived to be less of a problem than in the rest of the region.

See Annex 2 for a more detailed assessment of remaining transition challenges.

2.5 Social context

Kosovo faces a number of difficult social problems. According to World Bank estimates, 34.5 per cent of the population live below the poverty line of €1.55 per day. While poverty appears to be evenly spread between urban and rural areas, there are major regional and ethnic differences. Young people account for about 60 per cent of those below the poverty line. In addition, there is a significant link between poverty and education, with those who have failed to complete secondary education far more likely to be poor than those who have. As in many other countries, there is a significant link between poverty and unemployment. Kosovo's unemployment rate is around 44 per cent of the labour force, although precise figures are uncertain because of the large informal economy. Labour market participation rates are low by regional standards, especially for women, for whom the rate in 2009 was just 29 per cent, compared with 67 per cent for men. Youth unemployment rates are exceptionally high – 82 per cent for women and 69 per cent for men.

The education and health sectors are facing fundamental challenges. The quality of school infrastructure is well below standards prevailing elsewhere in the region, and there are particular problems with regard to enrolments rates of females and those living in poor households. The health sector is facing growing demands and decreasing public funding (as a share of GDP) and the system needs a thorough overhaul to improve standards and accountability. The authorities have developed an action plan to address the challenges in the health sector, covering the period 2010-14.

2.6 Legal context

The legislation of Kosovo is made of (i) legislation adopted by the new institutions of Kosovo, (ii) legislation adopted by the United Nations Interim Administration Mission in Kosovo after Kosovo was placed under the administration of the United Nations in 1999 and (iii) in respect of subject matters not covered by the foregoing, pre-1999 Serbian legislation that is not discriminatory. As a result, the legislation of Kosovo shows an unusual level of complexity.

To a large extent, legislation relevant to the operations of the Bank has been adopted in the last few years by the new institutions of Kosovo, often with technical assistance from the European Union or the United Nations. Recent laws have in particular set up comprehensive legal frameworks governing business organisations (2007), property (including security) (2009), competition (2010), financial reporting (2011), public procurement (2011), public-private partnerships (2011) and the registration of movable pledges (2012). Generally speaking, such legislation complies with international best practices, aims at ensuring consistency with EU legislation and aims at facilitating investments.

Challenges mostly result from implementation and enforcement issues. In certain cases, secondary legislation required to implement new legislation remains to be adopted. In other cases (e.g., registration of immovable property and security, financial reporting), implementation is lagging behind or inconsistent. In addition, the quality and predictability of court judgements is generally poor and the pool of knowledgeable and well-trained counsel is very limited, although the situation is improving.

Accordingly, the legal context is generally compatible with the standard operations of the Bank, but an increased level of legal due diligence is typically required, especially with respect to property and security matters.

See Annex 3 for a more detailed assessment of the legal environment.

2.7 Energy efficiency and climate change context

There is a substantial potential for sustainable energy investments in Kosovo. It is driven by unsustainable and inconsistent energy supplies, increasing energy prices and out-dated and inefficient equipment and infrastructure. Kosovo has also a good potential for utilization of renewable energy sources (RES), which, if employed, will make Kosovo less dependent on energy imports. At this stage, however there are still significant and numerous barriers preventing implementation of potentially feasible projects in this area. While the regulatory framework is being improved (with assistance from multilateral and bilateral donors), some barriers still remain, especially low confidence of local commercial banks in financing sustainable energy projects.

In the recent years, the level of sustainable energy project activity in Kosovo has been low. The development of stand-alone SE projects for local small and medium-sized enterprises and other energy end-users (e.g. residential and non-residential building sector) has proven difficult with the existing instruments for a number of reasons, including: lack of funds for realisation of local firms' investment programmes; insufficient access to long-term financing; poor project development capacity/expertise and limited awareness of energy efficiency and renewable energy measures in the building sector.

In response to unsustainable and inconsistent energy supplies, scarce natural resources and geographic connectivity, and in a bid for compliance with EU directives, the Government of Kosovo has undertaken legal and institutional steps towards improving energy efficiency. Based on these strategic aims, the Kosovo Mid-Term Energy Efficiency Action plan (2010-2012) evaluates current challenges to energy efficiency, and details targeted institutional (policy, regulatory) measures to help achieve this ambitious agenda.

3 STRATEGIC ORIENTATIONS

Kosovo's progress in transition has been limited in the past decade, but the country now faces an opportunity to accelerate the process, with full support of the Bank. In the coming three-year Strategy period the Bank will focus on sustainable development of Kosovo's private sector, including through support of the privatisation process, specifically in the areas of energy supply, energy efficiency, financial services, processing industry, services, trade and agribusiness. The Bank will also aim to support infrastructure projects that aim to remove main bottlenecks in the process of the country's development.

The key transition challenges and strategic directions for the Strategy period are:

- **Supporting privatisation and private sector development.** Kosovo's private sector is still small by the region's standards. Development has been hindered by a difficult business environment and lack of investment. Shortcomings in management expertise and corporate governance, limited access to finance and low levels of capital stock have resulted in reduced competitiveness and below-potential growth. While there has been some progress on privatisation, the process needs to be accelerated. The Bank's financial and technical support will aim to accelerate development of the country's private sector, enhance its competitiveness and introduce best practices with a particular focus on innovation, value added processing, agribusiness, industries with export potential or ability to compete with imported product alternatives, and attraction of investment capital to the country.
- **Enhancing commercialisation, competition and private sector involvement in infrastructure.** The quality of infrastructure is mostly sub-standard, which constitutes a significant barrier to business development. To date, there has been little involvement of the private sector in key areas such as water and wastewater, and roads and railways services. Some key municipal services are still managed centrally and the decentralisation process is proceeding only slowly. Private finance on a commercial basis of municipal and transport infrastructure does not

exist presently in Kosovo. The Bank will assist the national and local authorities in Kosovo in strengthening the commercial elements in the management of the water and waste water and solid waste utilities, as well as within the urban transport sector. In parallel, the Bank will support the private sector's involvement in the transport and municipal sectors to enhance the quality of services, starting with the commercialisation of these utilities.

- **Promoting and supporting sustainable development of the energy and mining sectors.** Privatisation has occurred in the distribution and supply components of the energy sector, but the ability to operate commercially remains to be proven. The legal and institutional framework to support energy efficiency measures and small renewable energy projects is relatively advanced but its implementation remains a bottleneck for the development of the sector. The implementation of the planned large power projects and the upgrade of the network infrastructure will be critical to address the transition challenges in the energy sector. EBRD will co-operate with the authorities in Kosovo to promote private involvement in the country's power sector and support the required investment to ensure security of supply, development of renewable energy, and improved energy efficiency. The Bank's assistance will be also required to advance the needed structural reform in Kosovo's presently inactive mining sector, where the EBRD will selectively assist with technical advice and financing to support transition and best practice for environmentally and socially sustainable production.

The Bank has been working in many of these areas for the past several years and now has an opportunity to accelerate the pace and broaden the direction of its activities since Kosovo became a member and recipient country on 17 December 2012. The Bank has shown a capacity to deliver results in Kosovo and will work closely with the authorities and with the business community to build on this track record. Further institutional and regulatory reforms and improvements in the business environment will provide the important enabling conditions for investment. The Bank will engage in active policy dialogue in these areas, and will sequence operations over the course of the three-year Strategy period, taking into account the longer lead times and administrative capacity needed to ensure the success of larger, strategic projects.

In its activities in Kosovo, the Bank will seek to promote inclusive growth, specifically promoting women's entrepreneurship, working equally with all communities in Kosovo and seeking to expand operations outside the capital and in deprived areas. Kosovo has a very high rate of youth unemployment and low female participation in the labour market. In line with its Strategic Gender Initiative, the Bank will encourage its clients to promote equal opportunities in the work place and will provide support for this objective where necessary. In the municipal and environmental infrastructure sector and in transport the Bank will seek to ensure that services are responsive to the needs of both men and women, in terms of physical access to the services or maximising the safety and use by women of the facilities the Bank finances. The Bank will seek to support women entrepreneurs by facilitating their access to finance and supporting their business activities

See Annex 9 for a more detailed analysis of gender equality.

3.1 Key Sectoral Challenges and Bank Operational Response

3.1.1 Supporting privatisation and promoting private sector development

Sectoral challenges

- Kosovo's privatisation agenda remains unfinished, with some key state-owned companies still not privatised and many of the post-privatisation investment obligations still unfulfilled.
- There are persistent gaps in governance on a wider scale in Kosovo. Substandard market practices are prevalent, including in the areas of accounting and reporting, and the judicial system is not efficient enough to support a well-functioning market-based system.
- Large parts of Kosovo's private sector are characterised by inadequate, substandard or a fully amortized asset base. Lack of foreign investment and low levels of domestic capital stock have resulted in below-potential growth and slow development in many areas of Kosovo's private economy.
- Kosovo has significant potential to boost its agricultural production and exports, but the sector is facing sizeable challenges. The majority of farms in Kosovo operate at subsistence or semi-subsistence level, while the commercial producers face critical obstacles to business expansion, including access to finance, land, quality inputs and high-value markets.
- Private sector companies, especially SMEs, have restricted access to finance and banks impose exceptionally high risk premiums given poor governance standards at most firms. Particularly in the rural areas outside the main cities access to finance remains severely restricted.
- Kosovo has a vibrant micro-lending market, with almost a dozen companies operating. However, a significant majority of those are NGOs, which increases the risk of poor corporate governance.

Bank's operational response

To promote expansion of the private sector, the Bank will significantly increase its support for the privatisation of the remaining state-owned enterprises such as the Post and Telecommunications Company of Kosovo (PTK), encouraging a fair and competitive process. The Bank will also expand the scale of its support to existing private companies, previously limited to under €10 million for individual projects. The Bank will aim to work with large privatised companies providing financing to assist with fulfilling post-privatisation commitments, achieving compliance with regulations and industry standards, and increasing competitiveness. In parallel to working with the relatively few large enterprises, the Bank will continue to assist smaller and mid-sized companies through financing existing businesses, green-field developments and acquisition projects.

To facilitate increased access to finance for dynamic private companies, the Bank will continue to work with Kosovo's SMEs through growth-oriented initiatives like LEF and ENEF and step up its co-financing with domestic banks, including through co-financing frameworks, such as the Medium-sized Co-Financing Facility (MCFF). In line with the Bank's Sustainable Energy Initiative and the Joint IFI Action Plan for Central and South-Eastern Europe, projects in the areas of energy efficiency, economic restructuring, consolidation, exports, diversification of products and services range will have priority and benefit from EBRD equity, debt or hybrid finance coupled with technical assistance for upgrades in the operational management and industrial expertise. The Bank will continue to co-operate actively with the local banks by pursuing selected equity investments and providing credit lines or risk-sharing frameworks to extend the reach of the financial market, including to rural areas outside the main cities. The Bank's SBS programmes will play a significant role in supporting the enterprise sector in Kosovo across the country with knowledge from external expert resources.

To encourage domestic production and private-sector led growth, primarily through equity and mezzanine investments, the Bank will look to tap Kosovo's potential for domestic production of value added goods and services, particularly those with potential for export. . The Bank will support foreign and domestic private investment that aims to establish local manufacturing and services on a sustainable, competitive basis.

The Bank will use a wide range of instruments to help expand Kosovo's high-potential **agribusiness sector**. The Bank will continue to support established domestic food and beverages processing and retail companies, and such engaged in trade with local products and services, while providing also financing to smaller companies still in the growth stage. In line with its regional and sector initiatives for sustainable energy investments, projects that target higher energy efficiency and utilisation of renewable energy in the agribusiness will be prioritised. Such projects will be able to benefit from tailored finance and technical assistance under dedicated EBRD frameworks like the Agribusiness Sustainable Investment Facility (ASIF).

To promote Kosovo's the non-banking financial sector, the Bank will support leasing and microfinance companies through equity and debt finance and technical assistance for institutional capacity building. The Bank will continue to play a leading role in the commercialisation of the Kosovo micro-lending market by providing technical assistance, finance and equity support to selected viable institutions.

Policy Dialogue

The Bank will continue to be involved in the local and regional policy dialogue via sector and regional forums with the aim to further improve the business environment and encourage private investment in Kosovo.

In addition, the Bank will promote further improvement of the business climate and explore opportunities to contribute to the enhancement of property rights, particularly for women, tax administration and the judicial system. To this end, the Bank will continue to engage in a dialogue with investee companies and business partners to identify issues that hamper the development of the private sector and will raise them with local authorities in cooperation with other IFIs and the EU via the National Council for Economic Development, forums of commercial and industrial chambers, respective donor conferences and the WBIF. The Bank will also aim to support initiatives that aim to enhance business conduct in Kosovo, including operational and financial management, industrial expertise and equal opportunities for men and women in the work place.

In the financial sector, the Bank will promote best industry practices and good governance, including initiatives to support women entrepreneurs in terms of facilitating their access to finance and supporting their business activities. Technical assistance will be provided to the Central Bank of Kosovo aimed at further capacity building and support to legal transition in the sector.

3.1.2 Enhancing commercialisation, competition and private sector involvement in infrastructure

Sectoral challenges

- The transport sector is underdeveloped in all respects, and administrative and technical capacity constraints are significant.
- Municipal services lack the necessary infrastructure and management capacity to provide better access and quality.
- Waste-water treatment is virtually non-existent across the entire country and the water supply is at risk. The Kosovo Water and Waste Water Regulator adopted in 2011 a Tariff Policy for Water and Waste Water Services, but its implementation has just started and the commercialisation of the regional water companies remains a longer term goal.
- District heating is widely absent. Only 5 per cent of households in Kosovo benefit from centralised heating. Households in the rest of the country are heated with electricity.
- Municipal decentralisation is generally being pursued but it is progressing slowly due to the still largely centralised management of some key municipal services and still relatively limited local taxation competencies.
- Private sector participation in the urban and intercity (autobus) transport sector exists but it is relatively chaotic and of substandard quality. The market is fragmented and contractual arrangements with the regulator are weak.

Bank’s operational response

To address transition gaps in transport infrastructure, the Bank will work with the authorities in supporting with loan financing the implementation of key transport infrastructure projects in Kosovo, such as the expansion and upgrade of the roads and motorways and railways network. The Bank will provide support in particular to regional and pan-European transport corridor sections in Kosovo with strong potential for enhancing the regional and pan-European trade and cooperation. The Bank will also promote and support private engagement in other infrastructure projects, such as transport terminals, and co-operate with private companies investing in logistic, shipping and storage facilities.

To address transition gaps in the water supply and waste water treatment and solid and industrial waste management, the Bank will work with municipalities and Government agencies, municipal and public utilities and provide technical assistance to gradually develop project implementation capacity and increase absorption potential for external commercial finance. At the next stage, the significant investment requirements in infrastructure will be addressed by providing both direct loan finance for larger investments and through deployment of regional funds like the

Western Balkans Municipal Infrastructure Development Fund (MIDF), to support smaller, including rural, municipalities and utilities. The Bank will further assist the municipalities in Kosovo, especially the Municipality of Pristina, with expert advice and finance for projects emphasising integrated urban transport policy and potential for commercialisation, of selected services, such as parking.

It is important to bear in mind that the likelihood of attracting private sector participation in key infrastructure projects is probably limited. The sovereign borrowing capability of Kosovo will most likely be restrained within the confines imposed by the agreements with the IMF. In general, the capacity of the central and local administration to absorb finance from IFIs like EBRD has still to be tested. There are indications that a substantial long-term engagement to build administrative capacity is a pre-requisite for effective delivery of sovereign and sub-sovereign transactions.

<u>Policy dialogue</u>

EBRD's engagement in public infrastructure projects in Kosovo will be critical to address the administrative limitations in absorbing the needed infrastructure finance. The Bank will provide significant technical assistance for capacity building alongside the infrastructure projects in preparation, possibly resulting in a gradual process of Bank's engagement in direct finance to infrastructure projects over the medium to long term. In this context, the Bank will play an active role to help Kosovo authorities in raising the needed grant resources via the WBIF and EU-IPA.

The Bank will promote the use of concessions and well-designed PPP structures in pre-selected areas in infrastructure. The Bank will also work with other IFIs, the EU and the central and local authorities on developing and promoting a decentralisation agenda that includes mechanisms for sustainable financing of regional public and municipal utilities, as appropriate. The Bank will also work with Kosovo public and municipal sector regulators to develop and promote tariff systems on a full cost recovery basis that will support sustainable development and the commercialisation of the sector.

3.1.3 Promoting and supporting sustainable development of the energy and mining sectors

<u>Sectoral challenges</u>

- The electricity sector is being unbundled and commercialised. As of today, however, the private sector is not participating in power generation, transmission or trade.
- The distribution and supply have been recently privatised but their successful commercialisation remains to be proven, as fixing the high technical losses and historically low collection rates could become a source of possible future social conflict.
- One key factor that constrains the development of the sector is that infrastructure – particularly electricity generation and distribution – is in a dire state, characterized by severe supply limitations, technical losses and frequent load shedding.

- High and inefficient subsidies in the electricity sector distort incentives and lead to misallocation of resources.
- The legal and institutional framework to support energy efficiency measures and small renewable energy projects is relatively advanced but its implementation remains a bottleneck for the development of the sector.
- Mining and extractive companies in the natural resources sector are still largely state-controlled, although some privatisations are under way, and in significant need for restructuring and modernisation.

Bank's operational response

To promote energy security and expand capacity, the Bank, in cooperation with other IFIs and donors, will look to support projects that help ensure security of energy supply, including projects to meet the country's expected demand for electricity. In this regard, and aligned with its policies, the Bank will consider engagement in the implementation of the greenfield thermal power plant and coal mine rehabilitation project 'Kosovo C' that is planned to start construction in the second half of the strategy period, provided the project complies with EBRD environmental and social standards, its policy on financing energy projects and delivers high transition impact. The Bank will also work closely with the authorities on exploring alternative sources of energy and demand side management. The Bank will consider assistance to Kosovo's transmission company, KOSTT, with finance and technical assistance to support the implementation of its multi-year investment plan and ultimately strengthen the country's transmission grid and improve regional interconnections. The Bank will also seek to support private investment in the country's power distribution and supply segment, in order to help reduce technical losses and improve collection rates. In addition, the Bank will deploy a Sustainable Energy framework via credit lines to Kosovo's financial sector and coupled with technical assistance and incentives to smaller private investors that will target significant reduction of the country's presently relatively high energy intensity.

To promote energy efficiency and the use of renewables, the Bank will assist renewable energy projects with loan finance through its dedicated regional facilities like the WeBSEDFF that address specific transition gaps in the segment with tailored incentives and technical assistance to investors.

To promote sustainable and responsible development of the mining sector, the Bank will consider support to private investments in projects that adopt high standards of governance and business conduct (including the Extractive Industry Transparency Initiative – EITI), transfer of skills and best practices for environmentally and socially sustainable production.

Policy dialogue

In the energy sector, the Bank will actively engage in policy dialogue and provide technical assistance to the authorities to enhance the regulatory framework to promote investment in the energy sector in general, including in the field of renewable energy and in the rationalisation of energy tariffs. To that end, the Bank, together with Kosovo's authorities, will aim to develop a joint Sustainable Energy Action Plan that will define the scope of cooperation in the areas of energy efficiency and energy security. Additionally, the Bank will actively participate in sector working groups with relevant stakeholders that develop and promote strategies and policies both with domestic and regional focus. The Bank will also provide technical assistance with focus on the application of cost-reflective tariffs to encourage and support private investment in the energy sector.

In the mining sector, the Bank will dedicate resources to support the Government of Kosovo in deploying its strategy for the restructuring of the mining sector. The scope of actions will include technical assistance for the development of the country-wide strategy for the sector and assistance to the Privatization Agency for the transformation and subsequent privatization of the enterprises operating in the sector, including the Trepca company.

3.2 Environmental and Social Implications of Bank Proposed Activities

Kosovo is taking part in the SAA process of the European Union (EU) and is in the process of adopting environmental legislation that is harmonised with EU *acquis*. The transposition of EU environmental laws is among Kosovo’s key environmental priorities for the next five years together with gradually meeting EU standards and efficiently carrying out and incorporating environmental legislation and methodologies in all sectors and setting up and expanding institutions for the implementation of environmental policies. These priorities set out a sound framework for structuring the Bank’s operations to comply with its Environmental and Social Policy (“ESP”) and Performance Requirements (“PRs”). These include social requirements where projects could have adverse impact on ethnic minorities, displaced or otherwise vulnerable people. Affordability constraints related to any increase of utility tariffs will need to be taken into account, given that a significant number of people are estimated to live below the national poverty line and that a substantial part of the population, approximately 17 per cent, are extremely poor.

The Bank’s activities relating to privatisation and private sector development will be an effective way to promote sustainable development in Kosovo. Due attention will need to be paid to ensuring environmental liabilities resulting from past and historic activities are investigated and managed so as to avoid the private sector operators becoming liable for pollution containment and clean-up costs.

In the municipal environmental infrastructure sector, the investment needs in constructing, rehabilitating and modernising drinking water supply and wastewater treatment systems as well as solid waste management facilities are substantial. Financing projects in this sector will offer the Bank significant opportunities to achieve tangible environmental and social benefits and public health improvements. However, affordability constraints and limited financial resources will pose challenges in this area.

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

In the energy sector, the Bank is likely to consider financing the restructuring and modernising of Kosovo's state owned power generation assets, with a focus on the construction of a new local lignite coal fuelled Thermal Power Plant that is planned to replace some of the existing old and inefficient capacity. The project is expected to result in substantial reduction of air emissions from Kosovo's power plants and energy sector. However, due to the use of local lignite coal as fuel, the project is likely to receive attention from local and international Civil Society Organisations and other stakeholders. The Bank will need to ensure that due process is followed in undertaking an Environmental and Social Impact Assessment ("ESIA") of the project, including a participatory public disclosure and consultation, as well as that the new power plant will meet EBRD's PRs and EU environmental requirements. The ESIA is expected to include a carbon capture and storage assessment. On power transmission and distribution projects the Bank will ensure its requirements relating to public health and safety and involuntary resettlement are complied with. Sustainable energy projects financed either directly by EBRD or via financial programmes with local banks focusing on small energy efficiency and renewable energy projects present significant opportunities to reduce air emissions and associated public health impacts.
On projects in natural resources and mining sectors, the Bank will ensure that ESIAs are carried out and mitigation measures designed in accordance with the Bank's PRs and good international practice. Significant investments may be needed for modernising the existing mines and bringing them into compliance with applicable EU requirements, including Best Available Techniques as well as acceptable worker health and safety standards that meet EBRD PRs.

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

See Annex 8 for a more detailed assessment of the physical environment.

4 ACCESS TO CAPITAL: PRIVATE AND PUBLIC SOURCES OF FINANCE

4.1 Access to capital

At the sovereign level, Kosovo has relied almost exclusively on IFI and bilaterals for funding, partly on concessional terms. Public external debt is low at 15 per cent of GDP and debt service as a per cent of exports was just 2.2 per cent in 2011, projected (by the IMF) to rise to 5.1 per cent in 2016. Kosovo has had no access to international capital markets, and is not rated by any of the main ratings agencies.

At the enterprise level, there are a number of formal sources of finance, and Kosovo scores well on "getting credit" in the World Bank's *Doing Business* report, ranking 23rd in the world on this measure. However, access to finance remains problematic for many businesses in Kosovo, according to surveys such as the BEEPS. The banking sector is the main source of finance, and there are nine commercial banks operating in Kosovo. Two of them are domestically owned, with foreign-owned banks holding a market share of more than 90 per cent. Despite the entrance of two new commercial banks and increased activity of smaller banks in 2008, the sector remains highly concentrated and around 80 per cent of total banking assets are managed by the three largest (foreign-owned) banks. The share of assets in GDP rose from 47 per cent in 2008 to 54 per cent in June 2012. Most funding comes from deposits, many of which are funded by remittances from abroad.

Other parts of the financial sector remain underdeveloped. There are 13 insurance companies currently operating in Kosovo, but they account for just 3.2 per cent of total financial sector assets in Kosovo. However, their assets are growing at a fairly rapid rate – 16.3 per cent in the first half of 2012. Pension fund assets are also growing rapidly, from a small base. Total assets in the pension system amount to more than 13 per cent of GDP.

4.2 MDB finance and collaboration with other IFIs and multilateral donors

The Bank will expand its WBIF-based activities to Kosovo, participate in relevant Donor Co-ordination Meetings and take part in other initiatives that promote sustainable economic development alongside bilateral and multilateral donors in Kosovo. The Bank will consider parallel financing with the World Bank and the IFC in the energy sector, joint support for some large upcoming or processing privatisations and other potential major investments in important public and private enterprises and infrastructure. The Bank will seek co-financing with the EU agencies, the EIB and other donors particularly in transport infrastructure and municipal projects. The Bank will co-ordinate its activities in these sectors through established platforms such as the WBIF, dedicated facilities for Kosovo such as the Aid Management Platform and project or sector specific steering committees and forums for Kosovo and the Western Balkans region. EBRD will co-operate closely with the EU Office in Kosovo in areas such as energy efficiency and SME finance and support to the small business. The Bank will also work with other engaged development institutions in Kosovo, particularly the German KfW, on projects in the sectors of municipal infrastructure and energy.

The World Bank Group has released in May 2012 its Country Partnership Strategy for Kosovo for the period 2012-2015. The World Bank expects to focus its efforts in the following priority areas, organised in two pillars, aiming to (i) accelerate broad-based economic growth and employment generation; and (ii) improve environmental management:

- Support for infrastructure, particularly energy;
- Improving the business climate, supporting the private sector, and increasing access to finance;
- Agriculture development;
- Education and skills;

- Strengthening the regulatory and institutional frameworks for labour and social protection;
- Reinforcing public financial management and anti-corruption efforts;
- Support to the Government to increase energy efficiency and the use of renewables, reduce environmental hazards, enhance water supply, and move towards harmonization with EU environmental standards.

The World Bank's focus on infrastructure, energy and access to finance for the private sector is addressing critical bottlenecks towards the sustainable development of the country's economy. Given the significant need for investment in these areas, the combined efforts of the Bank with the World Bank Group would represent a strategic approach to the development of these sectors, rather than implementing single measures. In this sense, the World Bank's strategy would be complementary also in other areas to the Bank's operational objectives by catalyzing economic growth and social development via investments in the private, energy and infrastructure sectors.

The German development bank **KfW** supports actively Kosovo's economy, with particular focus in the areas of financial intermediation, municipal services and energy supply, mobilising for this purposes also grants from the German government. The EBRD will cooperate closely with KfW within the identified priority areas for this strategy period. The Bank will work with KfW particularly in supporting the Kosovo Deposit Insurance Fund for the banking sector, in addressing the transition gaps in the municipal infrastructure and in ensuring a sustainable development of the energy sector, particularly in the areas of the energy supply and transmission.

Kosovo became a member of the **IMF** in June 2009. Following the successful completion of a Staff Monitored Programme in 2011, the IMF board approved in April 2012 a €107 million, 20-month Standby Arrangement for Kosovo. The programme is aimed at addressing Kosovo's macroeconomic challenges and preserving financial stability. Two reviews of the programme have been completed to date. The Bank will continue to liaise closely with IMF counterparts and will share information and views on macroeconomic and structural reform issues.

The EU is actively engaged in the upgrading of the country's transport and municipal infrastructure, improvement of critical factors in the country's business environment like the judiciary system, administration, education and access to finance, as well as advancing social inclusion. Kosovo is a potential candidate for the stabilisation and association process and the EU offers assistance to the country through the Instrument for Pre-Accession Assistance (IPA). The recent programme covered multiple areas from three major categories: political, economic criteria, and European standards. Funds from the program were partly used to support EBRD's SBS programmes.

The Bank will work closely with the EU Commission, with the EU Office in Kosovo and with EIB, including through co-financing projects originated via the Western Balkans Investment Framework. Close cooperation is anticipated in the areas of energy efficiency, transport and municipal infrastructure and support for the small business. The latter will also include cooperation with the EBRD SBS programmes.

Bilateral donors are very active in Kosovo and play crucial role in supporting the country's recovery from the damages of earlier conflicts and addressing the social and economic challenges. In addition to direct grant funds or soft loan financing to sector specific programs like the agriculture, these donors also provide support to measures and frameworks in Kosovo to increase the competitiveness of social enterprises, elevate the management skills within the smallest companies and promote social inclusion and gender equality. The Bank and such bilateral donors will continue to work together, for instance within EBRD's SBS programmes, to provide a joint support to these important groups and sectors and to widen the impact of the measures for a tangible and sustainable improvement of the overall business climate.

ANNEX 1 – POLITICAL ASSESSMENT

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

Kosovo proclaimed independence in 2008. The question of legality of this act was considered by the International Court of Justice (ICJ), to which it had been referred by the United Nations General Assembly (UNGA). The ICJ issued its decision on 22 July 2010, ruling that "the Declaration of Independence did not violate any applicable rule of international law". Although this decision constituted an Advisory Opinion, which, as such, is not binding on any country, it was reinforced in September 2010 by the Resolution of the UNGA, which "acknowledged the contents of the decision of the ICJ". While many countries do not recognise Kosovo, and this will remain a political matter for each member of the international community to decide upon, the number of bilateral recognitions has been gradually growing and is currently approaching 100. Kosovo became a member of the IMF and the World Bank in 2009. In the beginning of 2012 Belgrade and Pristina reached an EU-facilitated agreement enabling the direct participation of Kosovo in regional cooperation. Continuing political controversy stemming from different positions in the wider international community regarding Kosovo's status affects assessments of the situation in Kosovo produced by different international actors.

Kosovo's key weaknesses, which are common to the Western Balkans, include the rule of law, the relatively low capacity of public administration, especially at the local level, and a difficult business environment. There has been overall progress in these areas, as assessed by the UN and the EU. Nevertheless, as the latest Resolution of the Parliamentary Assembly of the Council of Europe (PACE) on the situation in Kosovo of January 2013 notes, this progress has been slow.

The constitutional and legislative framework for a pluralistic parliamentary democracy, the separation of powers and checks and balances in the political system, the guarantees for fundamental rights and protection of minorities, and for the meaningful role of civil society are in place in Kosovo and are largely in line with international and European standards. The functioning of democratic institutions has been consolidated over the last few years. Since the proclamation of independence in 2008 Kosovo adopted its new Constitution and various new laws. At the same time, part of the legislation has been inherited from UNMIK, which administered Kosovo throughout the previous decade. In general, owing both to its being a young state and to the fact that it was governed in the past by the UN and the EU, whose experts assisted in drafting laws for Kosovo, Kosovo's legislation is by and large modern and compatible with European and international standards. However, certain gaps still need to be filled with new laws and secondary legislation. More importantly, the gap needs to be bridged between the relatively advanced legislation and the level of its implementation.

Efforts towards EU approximation remain the main external anchor for comprehensive reforms. The EU has repeatedly stressed that Kosovo shares the European perspective of the rest of the Western Balkans. In its feasibility study, designed to assess whether Kosovo fulfils the political, economic, and legal criteria for the Stabilisation and Association Agreement (SAA) with the EU, published on 10 October 2012 as part of the EU Enlargement Package, the European Commission (EC) concluded that, subject to implementing some concrete measures in the areas of the rule of law, public administration, and the protection of minorities, Kosovo is largely ready to open negotiations on the SAA.

Kosovo and Serbia have been engaged in an EU-facilitated dialogue aimed at normalising their relations, which remains crucial for both to move forward on their respective European paths. Following an important agreement between Kosovo and Serbia reached in the framework of this dialogue on 19 April 2013, the EC and High Representative of the EU for Foreign Affairs and Security Policy issued a joint report that positively assessed progress in meeting the short-term priorities identified in the Feasibility Study and significant steps towards improvement of relations with Serbia. On this basis, the EC recommended to the Council to authorise the opening of negotiations on a Stabilisation and Association Agreement between the EU and Kosovo.

Representative and Accountable Government

Free, fair and competitive elections

The existing legal framework enables democratic elections, provided the authorities and political parties exercise sufficient will to implement it. Elections in Kosovo generally allow for competition between different political parties, including parties representing ethnic minorities, and free choice for voters. The candidates are able to campaign freely. The Central Election Commission is an independent permanent body, appointed by the parliament for a four-year mandate, and operates in an efficient and transparent manner. The media provide voters with diverse and extensive coverage of the electoral campaign. The Electoral Code provides for domestic and international election observation at all levels of election administration. The parliament has established an *ad hoc* Committee for electoral reform with a view to launch improvements reflecting best practices in the EU.

Kosovo has held regular democratic and competitive elections at both central and municipal levels. In 2000-2008, elections in Kosovo were effectively organised by the OSCE. The OSCE could not formally observe the elections which it helped to organize, but the elections have been assessed by the UN as being conducted generally in line with international standards for democratic elections. However, the quality of the elections administration and electoral behaviour has been uneven over the years. Among recurring procedural irregularities is the so-called ‘proxy’ (family) voting, as well as allegations of pressure on, or intimidation of, citizens. The participation of ethnic Serbs, which has been over the years inconsistent, remains relatively low, including a near complete boycott in northern Kosovo.

Since 2008, the local electoral institutions have been carrying out executive functions, while the OSCE retained a non-executive advisory role. The latest general elections, which took place in December 2010, were the first conducted under the sole responsibility of the Kosovo authorities, although OSCE continued to provide non-executive advice. The elections were marred by a number of serious shortcomings and technical difficulties, as noted by the European Parliament and PACE, highlighting the need to improve the conduct of elections in order to better reflect best international practices and standards.

Separation of powers and effective checks and balances

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

Overall the functioning of the single-chamber parliament, which is the primary legislative institution directly elected for a four-year mandate, is satisfactory. Agenda items proposed by the opposition are discussed in plenary; and representatives of the opposition head a number of parliamentary committees. The scope of powers of the legislature to hold the government to account and to exercise parliamentary oversight is largely in line with international standards, although the parliament and its committees need to strengthen their monitoring of implementation of policies by the government. MPs use the ‘government question time’ to scrutinize the activities of the government. The adoption of relevant legislation on the status of civil servants of the parliament would make the parliament’s funding and administration more independent from the government.

The government has sufficient capacity to draft legislation and has demonstrated over the last years good inter-ministerial coordination, especially as related to the EU agenda. The government’s meetings are regular and transparent.

The president is elected by the parliament (two-third majority required). In the future, Kosovo may move to the direct elections of the president.

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

Effective power to govern of elected officials

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

The international presence in Kosovo is significant, but its role is limited. After the proclamation of independence by Kosovo in 2008 the authorities invited an international civilian presence, as envisaged by the Comprehensive Proposal for the

Kosovo Status Settlement (Ahtisaari Plan). The International Steering Group (ISG) established the International Civilian Office with the International Civilian Representative (ICR) at the helm, who was charged with the specific task of ensuring implementation by Kosovo of the Ahtisaari Plan. On 10 September 2012, ISG, based on its assessment of the progress achieved by Kosovo, unanimously declared the end of the "supervised independence" of Kosovo and ended the mandate of the ICR with immediate effect.

The UN Security Council Resolution 1244 (UNSCR 1244), which in 1999 established the United Nations Interim Administration Mission in Kosovo (UNMIK), is still formally in force and serves as the basis for the status-neutral international presence both of the UN and the European Union Rule of Law Mission (EULEX).

The European Union Rule of Law Mission in Kosovo (EULEX) is the largest civilian mission ever launched under the European Security and Defence Policy. Its aim is to assist and support the Kosovo authorities in the area of the rule of law area, specifically in the police, judiciary and customs. EULEX mentors, monitors, and advises whilst retaining a number of limited executive powers.

Kosovo has also NATO-led foreign military presence - Kosovo Force (KFOR) - which, in accordance with UNSCR 1244, has been leading a peace support operation in Kosovo since June 1999. Today, significantly reduced KFOR (5,600 troops) continues to contribute towards maintaining a safe and secure environment and freedom of movement for all citizens.

Civil Society, Media and Participation

Scale and independence of civil society

There is a satisfactory legal framework for civil society organisations. A new Strategy for Cooperation between the government and civil society for 2013-2018 and a respective 3-year Action Plan, whose preparation was broadly participatory, is being finalised. The new Strategy envisages establishing a Council for Cooperation with Civil Society. As elsewhere in the Western Balkans, CSOs remain heavily dependent on foreign funding and problems with funding are the greatest obstacle for their functioning.

While there are almost 7,000 registered NGOs in Kosovo, although only about 200 of them are well established and functioning. Many NGOs are project-based, and relatively narrowly specialised. However, in contrast to many other Western Balkan countries, NGOs in general are spread evenly throughout the country, including the rural areas.

Civil Society is involved in legislative activities, including consultations for new draft laws, and NGOs participate in the work of the parliamentary committees. However, some CSOs maintain that the consultation process with civil society is not sufficiently robust. In general public participation in decision-making in Kosovo needs further improvement.

The right to form trade unions is enshrined in the law and respected in practice. However, trade unions in general lack stable finances.

Independent pluralistic media that operates without censorship

Pluralism in the media, which operate broadly freely and without censorship, has increased overall in recent years. The legal framework is largely in place and in line with international standards. The Press Council of Kosovo, which is a self-regulatory body for the print media, helps to promote freedom of speech and respect of journalistic ethics.

At the same time, more needs to be done to ensure that freedom of expression and media, which are guaranteed by the Constitution, are respected in practice, since there is a widespread perception among Kosovo citizens that media are over politicised and are under pressure from political parties and state institutions. The Association of Professional Journalists of Kosovo, the Press Council of Kosovo, and the Independent Media Commission have raised their voices against political interference. Kosovo has to put into force changes in the Criminal Code regarding criminal liability of media and protection of journalist sources. The Public Broadcaster needs to make operational the channel in the Serbian language, as envisaged by the Law on the Public Broadcaster.

There are nine dailies operating in Kosovo, with a circulation between 25,000-35,000 copies each, which is relatively low by regional standards. Electronic media dominate the market, and television is the main source of information. The main broadcasting outlets are three nation-wide TV channels (RTK, KTV, and RTV21). Recent years witnessed explosive growth in Internet access.

Multiple channels of civic and political participation

Multiple channels of civic and political participation are in place. The Parliament has improved its outreach activities, including public hearings, and is currently one of the most transparent institutions in the country. The Government has put in place a mechanism for consultations with civil society for the new draft bills. However the overall track record of public participation in decision making needs improvement.

Freedom to form political parties and existence of organised opposition

The freedom to form political parties is both guaranteed by the Constitution and implemented in practical terms, as highlighted by the existence of a significant opposition able to campaign freely and oppose government initiatives. More than 20 different political parties are represented in the national Parliament. The main opposition political party currently holds more than 20 per cent of seats in the national Parliament. Representatives of this and other parliamentary opposition parties head a number of parliamentary committees, and they are also in majority in a number of municipal assemblies.

Rule of Law and Access to Justice

Supremacy of the law

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

Kosovo is actively assisted by the EU Rule of Law Mission (EULEX), which has more than 2,000 people on the ground and whose mandate, including certain executive powers, has been extended into 2014. Kosovo authorities have committed to cooperate fully with EULEX, including its Special Investigative Task Force, which investigates the allegations raised by the Resolution 1782 of PACE adopted in January 2011.

The agreement reached between Kosovo and Serbia on 19 April 2013 regarding arrangements for northern Kosovo should improve access to justice and the rule of law in the north of Kosovo.

Independence of the judiciary

The independence of the judiciary is guaranteed by the Constitution and key safeguards are in place to ensure its impartiality, although enforcement is uneven. Strengthening the independence and efficiency of the judiciary has been, according to EU, which provides significant assistance to Kosovo in this area, one of the main objectives of the on-going comprehensive reforms. Both the EU and PACE have assessed that significant progress has been achieved to this end. The new comprehensive legal framework was adopted in 2010, including laws on courts, on the Kosovo Prosecutorial Council, the Judicial Council, and on Prosecution, and a new court system entered into force on 1 January 2013. The independence of the system is further supported by the functioning of the independent Supreme Court (the highest judicial authority in Kosovo), the Constitutional Court, the Prosecutorial Council, and the Judicial Council, which has a direct mandate to ensure the independence and impartiality of the judiciary.

At the same time, relevant EU reports mention serious challenges to the independence of judiciary. The election procedure of the Judiciary Council needs to be brought in line with relevant European standards to ensure that the majority is elected by peers, which has also been the recommendation of the Venice Commission. There are allegations of external influences, and of corruption in the judiciary, which undermine its impartiality.

Government and citizens equally subject to the law

The authorities have stepped up measures to prevent abuse of authority by public office-holders. Inspection departments have been established in various state institutions to address abuse of office and corruption within the institutions. The laws on the declaration of assets and on preventing conflicts of interest were adopted by the

Parliament. However, the sanctions envisaged by these laws (prohibition to exercise a public function for one year or a fine up to a maximum of Euro 2,500) are rather symbolic and more dissuasive sanctions may need to be introduced in the future. The recent reforms in public administration, inspired by modern approaches in place throughout the EU, create conditions for the gradual establishing of a stable and professional civil service, which should be an important avenue to prevent abuse of authority. The reforms included the adoption of an advanced law on civil service, establishment of the institutions of the Ombudsperson (Ombudsperson Institution of Kosovo) and of the Independent Oversight Board.

The Law on Free Access to Public Information is in place, although some provisions are worded vaguely enough to leave scope for arbitrary interpretation.

Effective policies and institutions to prevent corruption

Corruption remains a serious problem. According to the 2012 Transparency International Corruption Perception Index (CPI), Kosovo had a score of 3.4, which places it 105th out of 176 countries. Although an improvement has been achieved as compared to 2011, Kosovo is still among the worst performers in South Eastern Europe. There have been certain improvements of late, especially in the areas of investor protection and starting a business, which should not only make it easier to do business in Kosovo, as reflected in the World Bank's Doing Business Report for 2013, where Kosovo jumped 26 places, but also improve the overall atmosphere of integrity.

The authorities have made important steps over the last few years in fighting corruption by adopting the necessary elements of the legal framework, including laws on the declaration of assets, preventing conflicts of interest, whistle-blowers, public procurement, and financing of political parties. The current legal and institutional framework is by and large adequate to bring tangible results.

As regards the institutional framework, an independent Anti-Corruption Agency was set up in 2006, and is currently the lead institution to monitor the implementation of the anti-corruption strategy and relevant action plans, as well as specific laws in this area. A National Anti-Corruption Council was set up in 2012 in order to further improve coordination among all bodies and institutions involved in the fight against corruption. The prosecution and police have been reorganised in order to strengthen their capacity to fight corruption. The Prosecution has established an anti-corruption taskforce composed of prosecutors and police investigators, including from EULEX. There is also a dedicated Directorate against economic crime and corruption within the police.

Despite progress in certain areas, the EC's Feasibility Study for a SAA with Kosovo pointed to significant remaining weaknesses. It recommended adopting a new Strategy and Action Plan for the fight against corruption, improve the law on financing of political parties, adopt the legislation on confiscation of assets and revise the law on prevention of money laundering and financing of terrorism. The above-mentioned measures are of a short-term character and *de facto* condition the opening of the negotiations on SAA, which gives them greater weight. All these measures were completed by the Kosovo authorities in April 2013.

More important – and more difficult - would be to ensure the tangible and sustainable results of anti-corruption activities. This includes launching new investigations and ensuring efficient prosecution.

Civil and Political Rights

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

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

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

While fundamental rights are broadly enforced by the state institutions and respected, the latest EU reports pointed to remaining weaknesses in the areas of the freedom of expression (protection against, and prosecution of, physical attacks against journalists) and property rights (both the legal framework and the implementation, which suffers from the backlog of cases). The weaknesses in the consistent enforcement of the guaranteed rights include also the unresolved fate of persons missing after the conflicts of the 1990s (according to the UN, more than 1,700 cases as of the end of 2012), and the inadequate socio-economic position of people with disabilities.

Political inclusiveness for women, ethnic and other minorities

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

Six ethnic communities are specifically mentioned in Kosovo's Constitution. According to the 2011 Census, ethnic Albanians make up 93 per cent of the population; ethnic Serbs 1.5 per cent; ethnic Turks 1 per cent; Roma, Ashkali, and Egyptians (RAE) 2 per cent; Gorans 0.6 per cent; Bosniaks 1.5 per cent. It should be noted, however, that the Serbs totally boycotted the Census in northern Kosovo and their participation in the Census elsewhere was uneven. Unofficial estimates derived from the data used for practical purposes by the international presence in Kosovo puts an estimated share of ethnic Serbs in the total population of Kosovo up to 7 per cent, including about 70,000 in northern Kosovo.

The legislative framework for the protection of ethnic minorities and their cultural heritage is in place in Kosovo. Their rights are guaranteed by the Constitution and by the Law on the Protection of the Rights of Minorities. The Council of Europe Framework Convention for the Protection of National Minorities is directly applicable in Kosovo and takes precedence over Kosovo legislation. The interests of minority ethnic communities are protected by a complex mechanism in place at the central level. By regional standards, they are very well represented in the national parliament and in the government. In the parliament, there are 20 seats set aside for minorities out of the 120 MPs, of which ten seats are specifically set aside for ethnic Serbs. Two of the five Deputy Speakers of the Parliament represent non-majority communities. The current governing coalition includes overwhelming majority of the political parties representing ethnic minorities, including ethnic Serbs, who have three ministerial positions and one position of Deputy Prime Minister. Serbian is one of the two official languages in Kosovo, alongside Albanian.

Efforts have been made to improve the situation at the local level, including through the establishment of municipalities where ethnic Serbs make up a majority of the population, in order to facilitate their access to basic services. Compared to the situation in 1999, when there were a total of 30 municipalities in Kosovo, seven new municipalities have been established specifically to accommodate the interests of ethnic minorities. As of today, out of a total of 37 municipalities, seven have either a majority or considerable Serbian population.

Kosovo has taken steps to implement the UNESCO and Council of Europe conventions on cultural rights, as well as physical protection of the cultural and religious sites of the Serbian Orthodox Church. The EC recommended, among specific measures related to human rights, establishing a special body enabling direct consultation on the promotion and protection of religious and cultural heritage with minority communities. In February 2013 the Implementation Monitoring Council (IMC), which includes representatives of the Serbian Orthodox Church, was created and held its first meeting.

Nevertheless, the lack of trust between the Kosovo Albanian and some of the Kosovo minority communities persists. Various agencies report occasional incidents motivated by ethnic and religious hatred and cases of discrimination, as well as physical attacks against ethnic minorities. The latest Resolution of PACE on the situation in Kosovo voiced regrets that “concerns for the safety and the full respect of the rights of ethnic Serbs persist” and expressed the view that the “interaction between the Kosovo Serb and Kosovo Albanian communities needs to be further promoted”.

The authorities will have to do more to ensure the genuine integration of ethnic minorities into the new Kosovo. The OSCE Community Rights Assessment Report, published in July 2012, noted that despite an advanced legislative framework in place to protect and promote the rights of minorities, limited progress has been seen in its implementation. In order to further improve language equality the Public Broadcaster needs to make operational the Serbian language channel, as envisaged by the Law on the Public Broadcaster. More remains to be done to protect smaller ethnic minorities, particularly the most vulnerable RAE community. Regarding Roma, several measures have been taken, notably to address the issue of persons without documents and to integrate IDPs and Roma refugees from Kosovo. The new strategy on social inclusion of Roma for 2012-2014 was adopted, along with an Action Plan. The Roma health mediator programme started in 16 municipalities. Education projects continued to be implemented leading to certain increase in the enrolment rates of Roma children in secondary education. However, implementation of existing strategies needs to be strengthened. High unemployment rates persist, while access to unemployment benefits remains problematic, same as access to basic health services. Stereotyping against Roma persists, including in the media.

The key legislative elements for gender equality are in place in Kosovo. By regional standards, women have an impressive representation in the national parliament, exceeding 30 per cent. The President of Kosovo is a woman, and there are currently three female members of the Cabinet, including two deputy prime ministers.

On the local level, however, the situation is different. Although the representation of women in the local assemblies is reasonable, there is currently not a single female Mayor in Kosovo. There are very few ethnic minority women that have senior political positions. Discriminatory customs and stereotypes are still present in the rural areas, undermining women's basic rights. A remarkable 14 per cent of rural women, according to UN data, are illiterate, compared to four per cent of rural men.

Freedom from harassment, intimidation and torture

Constitutional guarantees against harassment, intimidation, and torture are in place and are largely upheld in practice. Efforts have been made to increase police officers' knowledge of European standards. However, certain gaps remain regarding zero-tolerance strategy for ill-treatment. Following the October 2011 Report of the Council of Europe's Committee for the Prevention of Torture and Inhuman and Degrading Treatment or Punishment (CPT), conditions in some dentition facilities have improved. EU Special Investigative Task Force (SITF) was set up to investigate allegations of a range of crimes in the period 1998-2000 contained in the Resolution of the PACE of January 2011 on the allegations of inhuman treatment of people and illicit trafficking in human organs.

ANNEX 2: ASSESSMENT OF TRANSITION CHALLENGES

Infrastructure

Regional integration through high-quality transport infrastructure is critical for Kosovo given the country's small size and geographically landlocked position. However, limited progress has been made in advancing reforms in this sector in recent years. The road infrastructure is not being maintained properly due to inadequate funds. As a result, transport costs in Kosovo are among the highest in the region and a major deterrent for trade. The sector is in significant need of investments in the extension of the existing road network (Kosovo has 3.6 road-km per 1000 people, while the equivalent regional average for Europe and Central Asia is 8.6 road-km per 1000 people). Kosovo also lags behind regional peers with respect to traffic safety and high speed road / motorway requirements.

Very little progress has been made in reforms in the railways sector. The unbundling of the railway infrastructure (Infrakos) and train operations is under way. Two new companies (Trainkos and Infrakos) were registered in September 2011, but their operational and financial unbundling has yet to be achieved. The Railways Regulatory Body is now operational, but it lacks capacity, both human and financial, to carry out its tasks effectively. The Railway Safety and Accident investigation functions need to be separated.

Major transition challenges exist in the municipal sector. The country has virtually no wastewater treatment. Only approximately 40 per cent of Kosovo's total population and less than 10 per cent of the rural population have access to a sanitation system. The drinking water supply system remains poorly developed, with significant technical and commercial losses, and a considerable part of the population is still not connected to the system. Tariffs are not cost reflective and the investment needs in this sector are high. Very little progress has been achieved in waste management or waste recycling and separation. The rate of waste bill collection slightly increased in 2010, but it remains low. District heating is also widely absent, with only five per cent of households having access to central heating.

Energy

The energy sector in Kosovo faces significant transition challenges. Private sector participation in the sector is still relatively minor. In the electricity sector, which is now fully unbundled, only the distribution company has been privatised, and most mining and extractive companies in the natural resources sector are still state-controlled. Kosovo has considerable potential to improve energy efficiency and increase the share of renewables in power generation. However, the implementation of the legal framework on energy efficiency and renewables is lagging behind.

Significant investment is needed in the power generation infrastructure, as nearly all domestically produced electricity comes from two old, inefficient and highly polluting lignite fired power plants. Because of the age of the plants, only 0.8 GW of the 1.5GW installed capacity is available. Improvements are also needed in the transmission infrastructure, particularly in increasing the interconnection capacity, which is currently one of the key factors constraining imports. Distribution losses are among the highest in the region at about 40 per cent. The energy regulator is not de facto independent, and tariffs are not cost-reflective.

Industry, Commerce and Agribusiness

The corporate sector in Kosovo faces significant challenges. Extensive corruption, weak rule of law, the presence of a large informal sector and still relatively high administrative red tape represent considerable obstacles for businesses in Kosovo. Some progress has been made recently to improve the business environment. Largest improvements were achieved in the areas of investor protection, construction permits and starting a business (reduced minimum capital requirements and business registration fee; streamlined business registration process). This progress has been reflected in a sizable improvement in Kosovo's ranking on the 2013 World Bank's Doing Business Report – a jump of 28 places to 98th place (out of 185 countries) on overall ease of doing business. However, Kosovo still remains among the lowest ranked economies in the transition region.

A Law on Competition was adopted in 2010, and the capacity of the Competition Commission was increased with additional staff the same year. The privatisation agenda remains unfinished, and the biggest monopolies in the country still remain among the state-owned enterprises, such as Kosovo Energy Corporation (KEK), Kosovo Electricity Transmission (KOSTT), Kosovo Railways, Post and Telecom of Kosovo (PTK). Kosovo has significant potential to boost its agricultural production and exports, but the sector is facing sizeable challenges. The majority of farms in Kosovo operate at subsistence or semi-subsistence level, while the commercial producers face critical obstacles to business expansion, including access to finance, land, quality inputs and high-value markets. The relative size of subsidies has also put Kosovar producers at a disadvantage compared to regional competitors.

In the telecoms sector, the main outstanding challenge is the privatisation of PTK. Other priorities include strengthening competition in the mobile market, further improvement in broadband access and aligning regulations with those of the EU.

In the property and tourism sector, significant challenges are related to ensuring transparency of property rights, improving the property and land administration system, improving building standards and increasing supply of modern commercial property.

Financial Institutions

The financial system of Kosovo is bank dominated, and the banking sector penetration (total assets to GDP just under 60 per cent) is commensurate with the country's general economic development. Banks are mostly foreign-owned and well-capitalised (CAR around 17 per cent, mostly Tier 1), and NPLs are at manageable levels (6.5 per cent of total loans in June 2012) but growing, also due to the slow-down of lending. Interest rate spreads between deposit and lending rates are typically among the highest (above 10 percentage points on average) in the EBRD region, potentially reflecting the need for more competition, efficiency improvements and better information on borrowers. However, there have been significant institutional improvements in the financial sector recently with a new law on banking and MFIs (focusing on corporate governance), the establishment of the deposit insurance scheme and the credit bureau (with the help of the USAID).

Notwithstanding a significant presence of micro-finance institutions, access to finance is a considerable challenge for private sector companies, especially MSMEs, and it is particularly constrained in rural areas.

There is a relatively large funded pension system (13 per cent of GDP in 2012) investing mostly in foreign assets. A gradual reallocation to domestic investments (including government securities issued from 2012) would provide significant opportunities for local capital market development, which is at an early stage of development, but should go hand in hand with the development of the market infrastructure and the regulatory environment.

ANNEX 3 – LEGAL TRANSITION

Kosovo's legislation is modern and largely EU-compatible, due the substantial amount of technical assistance received from the UN and the EU in recent years. The level of implementation is however less advanced.

Private sector development

Secured transactions

Taking and enforcing security over immovable property (mortgage) and movable property and intangible rights (pledge) in Kosovo is regulated by the Law No. 03/L-154, on Property and Other Real Rights, introduced on 25 June 2009 (The Property Law). Generally speaking the Property Law provides a modern framework for taking security.

A mortgage is created by registration of a written agreement between the owner of an immovable property whose signature needs to be certified and the mortgage creditor into the Immovable Property Rights Register. The Kosovo Cadastral Agency has the authority for the overall administration of the Immovable Property Rights Register. However, although the procedures for registration are formally simple and registration of mortgages does not take too much time (around a week) a substantial problem arises from the fact that much of the land is not registered and the historic land documentation is missing due to the turbulent past.

The law No. 04/L-136 on the Registration of a Pledge in the Registry of Movable Property introduced on 5 November 2012 (The Pledge Registry Law) repealed UNMIK Regulation No. 2001/5 on Pledges. It sets out the procedure and requirements for registration of pledges in the new Pledge Registry System which is a computer-based system. The registry is operated by the Kosovo Business Registration Agency and is accessible on line for registering (using User Account) and searching (using User Account or free but with less detailed information). The User Account Owner is deemed to have full authority to create, amend or cancel a registration made through its User Account. Searches are available on line against the name of the debtor or the serial number of the pledged asset.

Corporate Governance

The concept of corporate governance is relatively new in Kosovo. The Government has made reforms to enhance the business environment a policy priority. Consequently, the legal framework regulating corporate governance has improved in the recent years. However, implementation is still lagging behind.

The legal framework in respect of corporate governance is laid down mainly in the Law on Business Organizations (Law No. 02/L-123, dated 27 September 2007), the Law on Publically-Owned Enterprises (POEs) (Law no 03/L-087, dated 15 June 2008); the Law On Banks, Microfinance Institutions and Non-Bank Financial Institutions (Law No. 04/L-093, dated 12 April 2012) and the Law on Accounting, Financial Reporting and Audits (Law No. 04/L-014, dated 29 July 2011).

Kosovo needs to continue to focus its efforts on strengthening the corporate governance framework. Financial and non-financial disclosure should be improved and the implementation of legal provisions, including their monitoring and supervision need to be improved. Finally, efforts should be paid to increase the capacity of directors to understand and exercise their duties and obligations.

Contract enforcement

A new court structure was introduced in Kosovo by the *Law on Courts*¸ which entered into force on 1 January 2013. There are now seven first instance ‘Basic Courts’ organised by territory, vested with general jurisdiction. However, special arrangements apply to commercial and administrative matters; these fall within the exclusive jurisdiction of the Basic Court of Pristina, and are heard in the commercial and administrative chambers of that court. The commercial chamber in effect takes over the work of the former Commercial Court, preserving a system of specialisation for commercial matters. The Court of Appeal in Pristina hears appeals from judgments of all seven Basic Courts. The Supreme Court of Kosovo remains the supreme judicial authority in the country and the final court of appeal.

The *EBRD Judicial Decisions Assessment 2012* found that the quality and predictability of court judgments in commercial law matters in Kosovo was generally poor. Weak reasoning was prevalent. This was considered to be linked to judges’ lack of knowledge and experience in specialised areas of law. Many such areas have been newly regulated as a result of Kosovo’s partnership agreement with the EU, under which it has agreed to adopt the *“acquis communautaire”*; however the pace of legislative progress has outstripped the institutional capacity of the courts to implement the new laws. Judicial decision-making is further complicated by the multiple sources of law which derive from Kosovo’s complex recent past.

For example, laws passed by the Kosovo Assembly after the Constitution came into force in 2008 prevail over other laws, provided they are consistent with the *Comprehensive Proposal for a Status Settlement for Kosovo* (the ‘Ahtisaari Plan’); and laws from the period when Kosovo was under direct rule from Belgrade (1989-1999) can be applied only if they are necessary to fill a legal gap, and are not discriminatory. Thus, judges in Kosovo must grapple with additional interpretative issues not faced by judges in other countries. A further difficulty is that judicial decisions are generally not publically available; the case law is therefore not well-known, which adversely affects uniformity in judicial decision-making. As a result, judicial decisions are not considered highly predictable.

Perceptions about judicial corruption and bias persist, although a number of recent measures have been taken to combat these concerns. For example, judicial salaries have been significantly increased and now approximate salaries received by members of the government. The President of the Supreme Court now receives a salary equal to that of the Prime Minister. Speed of justice is another problem affecting Kosovo’s court system. In 2012, several thousand cases in the Commercial Court’s list were carried over from previous years, although this figure was dwarfed by the number of general civil claims outstanding from previous years. The court system is now functioning at a level where it has the capacity to dispose of new cases; the biggest problem is addressing the backlog of cases that has accumulated since 1999.

Much progress has been made in building the capacity of Kosovo’s judiciary, with significant support having been provided by the international community. However, further intensive efforts are needed in the coming years in order to ensure an efficient and well-functioning judiciary. Measures to strengthen contract enforcement and judicial capacity should include judicial training in commercial law areas as well as judicial skills such as legal drafting and reasoning. Judges also need appropriate court support staff, such as court clerks and judicial assistants, to help them manage their day to day work and administration. In addition, all court judgments should be made publicly available within an easily accessible and searchable system that facilitates transparency and oversight of the court system.

Private sector involvement in infrastructure

The Public-Private-Partnership Policy Directive issued by the Government of Kosovo on 4 July 2008 is the centrepiece of policy framework in the PPP sector in Kosovo and sets forth, *inter alia*, the government’s commitment to support and develop PPP projects, to stimulate private sector participation in public infrastructure and public services sectors, as well as to support implementation of PPP projects through competitive, fair and transparent procedures.

The new Law on Public Private Partnership No. 04L-045 was promulgated on 15 November 2011 (the “PPP Law”) and replaced the previous Law on Public-Private-Partnerships and Concessions in Infrastructure and the Procedures for Their Award No. 03-L-090 dated 25 June 2009.

The PPP Law was drafted with a view to further harmonising the national legislation with the EU *acquis* as part of the country’s efforts towards becoming a EU member candidate. Progress made was acknowledged by the EU in its analytical report issued in October 2012, which noted, inter alia, that “[Kosovo’s legislation on public-private partnerships] establishes a consistent legal framework on work concessions and … is largely compatible with EU legislation.”

A specialised PPP unit (Public Private Partnerships Committee, the “PPPC”) has been established within the Ministry of Finance to oversee and coordinate PPP projects. The PPPC is responsible, *inter alia*, for development and management of the national PPP program, issuance of PPP policies and implementing regulations, reviewing project proposals, as well as for oversight and review of performance compliance and project execution. In addition, a Central Public-Private-Partnership Department (the “PPP Department”) has been set up within the Ministry of Finance to assist and advise the PPPC, the Minister of Finance and other public authorities on all activities relating to PPPs. The PPP Department is accountable to the PPPC and is responsible, *inter alia*, for providing technical assistance and advice to public authorities regarding PPPs, reviewing project proposals for their viability and making recommendations to the PPPC and public authorities, outreaching to stakeholders and undertaking public education campaigns on PPPs, as well as coordinating activities relating to PPPs.

Several PPP projects have been undertaken by the government, including a 20-year contract awarded in 2010 to an international consortium to operate the Pristina airport, as well as a project relating to the Electricity Distribution and Supply Company, tender for which has been completed in June 2012.

Sustainable development of energy sector

The relevant legislation can be found in the Law on Energy in force since 1 December 2010, The Law on Electricity and Law on Energy Regulator in force since 1 December 2010, the Law on Natural Gas of 11 December 2009, and the Law on Energy Efficiency of June 2011.

UNMIK is a signatory to the Treaty establishing the Energy Community and as such Kosovo has undertaken to adhere to the Energy Community legal framework.[1] Kosovo has an energy policy and energy law framework, as well as an independent regulatory authority, the Energy Regulatory Office (ERO), which is responsible for economic regulation in the electricity, district heating and natural gas sector. Kosovo has no natural gas supply domestically and no infrastructure to facilitate gas transport. Kosovo's electricity sector is dominated by the Kosovo Energy Corporation J.S.C. (KEK), a vertically integrated public utility company with responsibility for generation, mining, operation of the electricity distribution system and supply of electricity. There is a degree of (but not full) functional unbundling within KEK, with each of the four core functions operated by a separate division. The tendering process for privatisation of the distribution and supply functions is currently underway. Power cuts are a regular occurrence.

ERO has approved a regulatory framework for the energy produced from renewable energy sources and has provided for feed-in tariffs, which are currently under review. Only modest progress has been made to improve energy infrastructure and efficiency.

Kosovo plans to shut down a 40-year-old power plant, called Kosovo A by 2017, which is one of the worst sources of pollution in Europe. The European Commission is supporting the gradual decommissioning of Kosovo A and a number of other projects, including improvements of energy efficiency in public buildings.

The Law on Energy Efficiency envisages the adoption of an action plan, which would aim to increase efficiency by 9% in 2018 but work on the plan has not started yet. The Law provides for alignment with the energy efficiency *acquis* in areas such as energy labelling, energy performance of buildings, energy end-use efficiency and ecodesign. The Law provides the legal basis for establishing an energy efficiency agency and establishes the procedures for setting up an energy efficiency fund to promote projects on energy efficiency and renewable energy sources.

Kosovo prepared a simplified renewable energy action plan within the framework of the Energy Community. Further efforts are needed to attract investment in the sector and to promote the use of biofuels in transport.

[1] The total primary electricity supply in 2007 was 372.63 ktoe (thousand tons of oil equivalent), of which 2.0% is hydro power and 98% is coal; CO_2 emissions from coal combustion are 6.34 per annum (measured as Mt of CO_2).

Improved energy efficiency in buildings and in the industry sector should remain as top priorities to the government because of low levels of energy production and high levels of energy demand. Developing transport and energy cooperation with neighbouring countries is essential for meeting the energy needs of the population. Kosovo should continue improving energy efficiency and promote energy conservation. In addition, Kosovo should promote the use of renewables, strengthen environmental management and improve access to good quality water.

In order to meet Kosovo’s current and future energy shortages, it is recommended that a further attention is paid to efficiency improvements, demand-side management, construction of small hydropower plants and other renewable sources, regional interconnections, and additional thermal generation.

ANNEX 4 – SMALL BUSINESS SUPPORT

The EBRD supports economic transition by achieving enterprise change in potentially viable micro, small and medium enterprises (MSMEs) and contributing to the development of a sustainable infrastructure of MSME support and local business advisory services. This is achieved through two complementary instruments, the Enterprise Growth Programme (EGP) and Business Advisory Services (BAS), which are implemented by the EBRD Small Business Support (SBS) team.

Previous SBS experience in Kosovo

EGP has been active in Kosovo since 2001 with almost €3.2 million of donor funding mobilised from the EU, the ESSF, Denmark and other bilateral donors. Until today, 64 enterprises in Kosovo have received EGP assistance, with food processing and construction being the most common sectors of intervention. To date, 31 projects have been evaluated of which 24 per cent were rated as highly successful. Furthermore, 23 per cent of beneficiaries reported an increase in the number of employees, and almost 77 per cent an increase in turnover. In addition, EGP has carried out various Sector Development Activities (SDAs) and assisted in organising business matching trips to industrially advanced countries.

Since inception in 2004, BAS Kosovo has received a total of more than €3.5 million in donor funding from the EU, the ESSF, the Netherlands and Taipei China, which has been supplemented by almost €2 million in client contributions. To date, BAS has implemented 430 projects, mainly related to market analysis, quality management and certification and development planning across a wide range of industries. 330 projects have been evaluated to date, of which 84 per cent were rated successful or highly successful. 90 per cent of BAS assisted enterprises have reported an increase in turnover, and 65 per cent an increase in their workforce. In addition, 9 per cent have received financing in an average amount of more than €1.5 million. BAS has also undertaken 24 market development activities (MDAs) to help develop an adequate MSME support infrastructure.

In terms of cross-cutting issues, the SBS has recently completed a large EU IPA funded programme which also entailed an on hands support and business development trainings for social enterprises and women entrepreneurs.

The MSME and consultancy sector in Kosovo

The MSME sector

MSMEs form the backbone of the private sector economy in Kosovo, representing around 99 per cent of all businesses. Most enterprises are family-run micro-enterprises, and the vast majority operates in the trading and service sectors. Kosovan enterprises benefit from a relatively cheap labour market, and lack of international competition. Notwithstanding, insufficient quality management, limited management sophistication and corporate professionalism, lack of accreditation systems and weak production technologies, significantly constrain private sector development and export activity, resulting in low levels of efficiency and value added.

The consultancy market

The consultancy sector in Kosovo faces large transition challenges with regard to MSMEs. Demand is lacking and the supply is limited to a few types of services. Most consultants offer a variety of service but the large majority is qualified for marketing and strategy. The number of consultants with an expertise in ICT solutions and quality management is increasing, while those offering advice related to engineering solutions and other technical services, such as resource efficiency and environmental management remains limited. Generally the quality of consultancy projects is gradually improving but the role of BAS remains essential in elevating consultants' professional skills and developing an expertise in some areas. The presence of consultants outside of Pristina is slowly increasing, yet advisory services remain largely inaccessible in rural areas. Lastly, the formalisation of the industry is progressing through the recently established Kosovo Business Consulting Council and Kosovo Appraisers Association.

Infrastructure of MSME support

Institutional support for the development of the MSME sector focusses largely on improving the regulatory and legislative environment for businesses and export promotion. Kosovo has improved significantly in the latest World Bank Doing Business Report and ranks in 98th position, but many efforts remain un-coordinated and lack sufficient resources, and therefore continue to be heavily donor-dependent. Private sector development falls under the responsibility of the Ministry of Trade and Industry. An SME Development Strategy 2012 – 2016 is in place, envisaging further improvements in the business environment, improving access to finance, increasing entrepreneurial culture and increasing the competitiveness of Kosovan SMEs. The strategy is executed by the SME Agency SMESA, which has recently merged with the Investment Promotion Agency Kosovo IPAK.

Private sector MSME support institutions are weak in their capacity to provide meaningful direct support to enterprises, and the international donor community continues to largely support them in exercise their role.

Continuation of SBS in Kosovo

The EBRD will continue supporting the MSME sector in Kosovo through direct enterprise support and systemic market development interventions through SBS, thereby contributing to the development of a competitive and sustainable private sector. In close cooperation with other donors and national authorities, SBS will in particular focus on increasing export activity and regionalisation of products, product development, resource efficiency and increasing productivity in the domestic MSME sector, and will work with enterprises in priority sectors including food processing and agribusiness, ICT, as well as wood and metal processing. Particular focus will be placed on facilitating client access to finance through the EBRD and its partner financial institutions in Kosovo, and BAS will also implement the LEF financial management and reporting programme (AIP) with the objective of raising enterprise financial management practices and standards in order to facilitate clients' access to finance and to potential EBRD investments. Cross-cutting issues such as environmental improvement, rural development, gender equality and young entrepreneurship will continue to be addressed in SBS's activities.

At market level, SBS will further aim at promoting best international practises in priority sectors through dissemination of successful showcases and trainings. BAS will focus on developing a sustainable and commercially viable local business advisory services market. Furthermore, SBS will closely collaborate with local public and private institutions to strengthen institutional support to the MSME sector in order to sustain assistance to the industry in the long-term.

Subject to funding, EGP will further support the transfer of management skills and specific industry knowledge, and will work with mid-sized corporates that have good export-, investment and high growth potential. It will assist them in increasing management performance, upgrading production techniques and developing new, innovative products by enhancing enterprises exposure to international best practises and creating linkages with other companies in the region and the EU markets. Furthermore, EGP assistance will focus on types of services such as marketing and branding, strategic business planning and financial management.

BAS Kosovo plans to further enable MSMEs to access consulting services by facilitating projects with local consultants. A flexible grant scheme will be applied through annual updates of the Grant Guideline Matrix to prioritise intervention and avoid duplication of efforts with international donors and governmental organisations. Typically, higher grants will be allocated for smaller enterprises, for enterprises located outside of Pristina, for more complex consultancy services and for projects involving consultancy services where market demand is less mature. These include but are not limited to resource efficiency, advanced quality management and environmental management.

BAS assistance at the enterprise level will be complemented with MDAs in order to maximise the programme's transition impact in Kosovo, including:

(i) *visibility and dissemination* to promote the use of business advisory services, especially in rural areas, and to stimulate demand for more sophisticated consultancy services.

(ii) *consultancy capacity building* focused on investment planning and financial management, core consultancy skills and management of consulting businesses.

(iii) *MSME trainings*, which will mainly focus on addressing cross-cutting issues such as women in business, rural development, marketing, energy efficiency and environment protection, but also quality management and supply chain management.

ANNEX 5 – TECHNICAL COOPERATION

TC COMMITMENTS BY DONOR THROUGH EBRD, 2010-2012

Donor	TC Commitments (€)
EBRD Shareholder Special Fund	380,000
EU	1,801,109
Grand Total	**2,181,109**

TC COMMITMENTS BY SECTOR THROUGH EBRD, 2010-2012

Sector/Team		TC Commitments (€)
SME Development *	EGP/BAS	2,181,109
Grand Total		**2,181,109**

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

* This sector category encompasses direct assistance to SMEs and indirect assistance through policy dialogue between the EBRD, the authorities and commercial/business associations (e.g. Investment Councils)

ANNEX 6 – SELECTED ECONOMIC INDICATORS

Kosovo

	2009	2010	2011	2012 *Estimate*	2013 *Projection*
Output and expenditure			*(Percentage change in real terms)*		
GDP	2.9	3.9	5.0	2.7	3.2
Private consumption	0.4	3.8	3.0	2.6	2.6
Public consumption	3.9	-1.5	2.3	-1.3	2.9
Gross fixed capital formation	11.7	8.8	7.6	4.4	4.3
Exports of goods and services	7.8	24.2	13.6	-1.4	4.5
Imports of goods and services	5.3	11.9	5.6	0.8	3.3
Labour Market[1]			(Percentage change)		
Gross average monthly earnings in economy (annual average)	n.a	n.a	n.a	n.a	n.a
Real LCU wage growth	n.a	n.a	n.a	n.a	n.a
			(In per cent of labour force)		
Unemployment rate (end-year)	45.4	45.1	n.a	n.a	n.a
Prices			*(Percentage change)*		
Consumer prices (annual average)	-2.4	3.5	7.3	4.2	2.2
Consumer prices (end-year)	0.1	6.6	3.6	4.6	1.7
Fiscal Indicators			*(in per cent of GDP)*		
General government balance	-0.7	-2.6	-1.9	-2.7	-3.5
General government revenues	29.3	27.6	28.1	27.8	27.6
General government expenditure	29.9	30.0	29.8	30.3	30.7
General government debt	17.6	16.6	15.0	17.0	17.4
Monetary and financial sectors			*(Percentage change)*		
Broad money (M2, end-year)	n.a	n.a	n.a	n.a	n.a
Credit to the private sector (end-year)	8.9	12.6	14.7	4.6	n.a
			(In per cent of total loans)		
Non-performing loans ratio	4.3	5.2	5.8	7.0	n.a
Interest and exchange rates			*(In per cent per annum)*		
Deposit rate	4.3	3.7	3.5	3.6	n.a
Lending rate	14.3	14.6	14.1	13.4	n.a
Money market rate	n.a	n.a	n.a	n.a	n.a
			(Euros per US dollar)		
Exchange rate (end-year)	0.69	0.75	0.77	0.76	n.a
Exchange rate (annual average)	0.72	0.76	0.72	0.79	0.81
External sector			*(In per cent of GDP)*		
Current account	-15.4	-17.4	-20.3	-20.7	-21.1
Trade balance	-42.8	-42.1	-45.1	-42.5	-41.3
Merchandise exports	4.5	7.2	6.9	7.2	7.5
Merchandise imports	-47.3	-49.4	-52.0	-49.7	-48.7
Foreign direct investment	7.1	8.5	8.0	6.5	12.9
Gross reserves, excluding gold (end-year)	16.0	16.3	13.5	*14.3*	18.0
External debt stock	17.6	16.6	15.0	15.5	14.5
Public external debt	17.6	16.6	15.0	15.5	14.5
Private external debt	n.a	n.a	n.a	n.a	n.a
			(In months of imports of goods and services)		
Gross reserves, excluding gold (end-year)	4.1	4.0	3.1	3.4	4.4
Memorandum items			*(Denominatios as indicated)*		
Population (end-year, million)	1,683	1,708	1,734	1,760	1,786
GDP (in billions of Euros)	3.9	4.2	4.6	4.9	5.2
GDP per capita (in US dollars)	2,325	2,468	2,674	2,776	2,894
FDI (In million of Euros)	277	358	371	321	674
External debt/exports of goods and services (in per cent)	113.7	89.7	74.8	75.4	n.a

[1] Figures do not include emigrant workers abroad.

ANNEX 7 – ENVIRONMENTAL ASSESSMENT

Background

The state of Kosovo's environment is significantly degraded due to the legacy of old energy, mining and metallurgical processing industries. The dominant source of current pollution and environmental impacts that stem from historical activities is mining, specifically the old, poorly maintained mining and waste disposal sites. Current industrial activity and a legacy of former practices have substantial health and environmental impacts and generate economic losses. The key environmental issues relate to air pollution, lead and other contamination from mining, water pollution and availability, degradation of forests and land, and untreated municipal and hazardous waste. Kosovo's key environmental issues include:

- air pollution in urban areas, with the most significant health effects caused by particulates;
- lead contamination mainly caused by releases from the un-remediated lead and zinc mines and former lead processing facilities mostly near Mitrovica industrial park and the continuous use of leaded gasoline;
- inadequate water supply, sanitation and hygiene as well as heavy metal water pollution of surface waters; and
- inadequate solid waste collection and disposal, including that for coal ash and illegal dumpsites.

Environmental Policy and Priorities

Kosovo's Environmental Strategy ("KES") for 2011–21 and National Environmental Action Plan ("NEAP") for 2011–15 were updated in 2011. The new KES aims to reduce pollution, protect biodiversity, ensure sustainable use of natural resources, and protect valuable national landscapes. The environmental priorities in the KES and NEAP for the next five years are completing environmental legislation in harmony with the EU acquis; gradually fulfilling EU standards and efficiently carrying out and incorporating environmental legislation and methodologies in all sectors; and setting up and expanding institutions for the implementation of environmental policies (including capacity building).

The KES and NEAP's environmental objectives include:

- Gradually increasing the population's access to clean potable water, the sewage network, and municipal waste disposal, with support for programs for recycling wastewater and solid waste.
- Using natural resources such as soil, water, minerals, and forests rationally. Special attention is needed in using limited resources and orienting toward renewables.
- Expanding protected areas and further protecting the natural heritage, along with increasing capacity for efficient management.
- Applying energy-efficient concepts in all different economic sectors.

Moreover, Kosovo's Environmental Strategy commits Kosovo to following the EU strategy on the energy sector, the 20/20/20 EU plan (20-percent increase in energy efficiency, a 20-percent increase of the renewable energy share in the energy mix, and a 20-percent reduction of carbon dioxide emissions) aiming at raising the energy-efficiency levels in energy generation and consumption and developing economic incentives to reduce energy consumption as well as increasing public awareness on energy efficiency.

Kosovo has also adopted other strategies relating to environment, such as the Strategy and Action Plan for Biodiversity of Republic of Kosovo for 2011 – 2020. Several of Kosovo's key sectoral plans and strategies also incorporate environmental considerations and objectives or have implications for environmental quality, including Energy Strategy for 2009–18, Industrial Strategy for 2010–13, Agriculture and Rural Development Strategy for 2009–13, and Policy and Strategy Paper on Forestry Sector Development for 2010–20.

Sector specific issues

Energy generation

Kosovo has two lignite-fired thermal power plants, Kosovo A and B, operated by the publicly owned Kosovo Electricity Company (KEK). Kosovo A was built in 1962–75 and has an installed capacity of 800MW, of which 325 MW is effectively available. Kosovo B has been operational since 1983/84 with an installed capacity of 678 MW, of which 540 MW is available. KEK has installed Electrostatic Precipitators in Kosovo A to reduce to reduce particulate emissions to around 10 per cent of current levels. In addition, the Government's strategy is to: (i) close Kosovo A by 2017 and replace it with a new, state-of-the art, privately operated 600-MW power plant termed the "Kosovo e Re" Power Plant; (ii) attract private investment to rehabilitate and upgrade Kosovo B, including ensuring conformity with EU environmental standards; (iii) privatize electricity distribution inter alia to reduce technical and commercial losses; (iv) step up payment enforcement and raise tariffs to levels consistent with full cost recovery; (v) expeditiously address environmental legacy issues associated with Kosovo A and B; (vi) invest significantly greater resources in energy efficiency in the near term; and (vii) maximize the use of renewable energy (hydro, solar, wind, geothermal). KEK is also developing a new lignite mine in the Sibovc lignite field.

Drinking water supply and wastewater treatment

Kosovo has few water resources, in four main water basins. Groundwater reserves appear limited. Regarding sanitary biological water quality, all main rivers are classified as polluted and with unacceptable levels of biological oxygen demand as well as lack of dissolved oxygen in the rivers, particularly downstream of the discharge of untreated sewage and in addition in smaller streams. Industrial wastewater discharges acidic, with heavy metals such as cadmium and lead, further aggravate the situation.

Access to piped water supply and sanitation is limited. Seven regional water companies provided piped water supply to about 1.23 million people (65 per cent) in Kosovo in 2008, and nearly 1 million people (52 per cent) had sewerage services. Rural areas have about 200 water supply systems directly run by communities and villages, covering about 65 per cent of the rural population, though few of these systems are hygienic. Nationally, there are no operational wastewater treatment plants yet. Inadequate water supply, poor sanitation (such as toilet, sewerage, and wastewater treatment facilities), and unhygienic practices are associated with waterborne illnesses and mortality. Providing safe drinking water and sewage collection and following good hygiene practices play an important role in reducing the risk of the most common illness, diarrhoea.

Solid waste management

Kosovo lacks proper waste management for virtually all solid waste types (domestic, industrial, health care, and hazardous). Collection, classification, recycling, and treatment systems as well as infrastructure for municipal waste are missing. Illegal landfills and inappropriately constructed and managed industrial landfills abound. Appropriately constructed and operated hazardous waste facilities are lacking - Kosovo has no licensed hazardous waste incineration facilities, for example. These shortfalls cause serious health and environmental impacts, either from uncontrolled or poorly controlled waste disposal facilities or (particularly in rural areas) from the large amounts of waste simply uncollected, dumped at illegal dumpsites (often near rivers, causing additional environmental hazards), or burned. Large volumes of coal ash (from the lignite-fired power plants) and mining waste are also dumped each year, without any measures for recycling.

Biodiversity and forests

Kosovo's national network of nature protected areas contains form 97 nature protected areas with surface of approximately 48,000 ha or 4.4 per cent of Kosovo's territory and more than 195 proposed areas for protection. The protected areas include 11 Strict nature reserves, 1 National Park, 82 Nature monuments, 2 Regional parks and 1 Forest park. The Strategy and Action Plan for Biodiversity of Republic of Kosovo for 2011 – 2020 aims at increasing the protected areas to around 10 per cent of Kosovo's territory (or to around 100,000 ha) and identifying areas to be proposed to be included in EU's NATURA 2000 network.

Since 1990 forests in Kosovo have been under pressure due to illegal harvesting. The majority of illegally harvested timber is used for firewood, which is the main source of heating, even in some urban areas. It has been estimated that Kosovo needs around 1 million cubic meters (m^3) a year of fuel wood to meet heating needs. Further, heavy harvesting occurred after the war for rebuilding houses. Raw materials were taken from the forests, mainly illegally. Some 40 per cent of public and 29 per cent of private forests had been subject to illegal harvesting, and many young and middle-aged forests urgently need management interventions, including cleaning and thinning. The current forest structure and forest degradation do not provide a good enough habitat for biodiversity and wildlife. Policy and Strategy Paper on Forestry Sector Development for 2010–20 aims to improve capacity to deal with environmental issues related to forestry, enhance capacity of Kosovo institutions to implement and monitor biodiversity action plans, and establish and manage protected zones in compliance with national goals and international agreements.

Pollution from historical contamination

The dominating legacy issues are associated with the Trepca Industrial Complex (Mitrovica industrial park) and the Kosovo Electricity Company (KEK), although there are also many more former mining sites and abandoned industrial sites in Kosovo.

- The Trepca Industrial Complex consists of several mines, three ore concentrators with tailings disposal facilities, a lead smelter, a zinc smelter, and several industrial sites and auxiliary facilities with its core business in lead and zinc production. The mines and concentrators had inadequate environmental controls before 1999 and this has not changed. The key issue is that most of the environmental emissions from these sites - particularly dust emissions from contaminated sites and waste dumps as well as discharges to groundwater and surface water from mines, contaminated sites, and waste dumping areas - are continual and have little relationship with production. The environmental legacy of the Trepca sites exceeds, and over a much wider area, the direct environmental impacts of limited on-going production of concentrates from lead-zinc ores.

- KEK has been operating the lignite Bardh and Mirash mines and the lignite-fired power stations Kosovo A and B for many decades without adequate environmental controls (even at present) or plans for sustainable operations and closure of mines after depletion. Air emissions of particulates, SO_2 and NOx from the power plants are much higher than the EU Directive for Large Combustion Plants allow and are particularly relevant for Pristina’s air pollution and the municipalities surrounding them. Ensuring compliance with the emission levels set by the Large Combustion Plans Directive by the end of 2017, for both Kosovo A and B, is Kosovo's legal obligation stemming from their participation in the Energy Community Treaty. Kosovo A hosted a small lignite gasification plant producing chemicals and fertilizers. KEK’s historical activities have resulted in a range of legacy issues. The most important are: coal ash from Kosovo A and B which has been disposed on land, in a dry manner, generating dust; material (overburden) once removed to open the lignite mines was dumped on close to 1,000 ha of land, making this area at the time unsuitable for purposes such as agriculture; and hazardous chemicals and materials.

Source: Kosovo Country Environmental Analysis, Cost Assessment of Environmental Degradation, Institutional Review, and Public Environmental Expenditure Review, the World Bank, 2011.

ANNEX 8 – GENDER EQUALITY[2]

Gender Inequality and Human Development

According to the UNDP 2011 Human Development Index (HDI), Kosovo has a high human development index. It is ranked 87th of 187 countries around the world, but lags behind the rest of Europe. The HDI is comprised of three dimensions: health, education and decent standard of living.

Labour force participation and gender pay gap

Labour force participation rates are much lower for women than men in Kosovo. According to the 2012 UNDP Kosovo Human Development Report *Private Sector and Employment*, in 2009 only 29 per cent of women participated in the labour market as compared to 67 per cent for men. Unemployment rates are very high in Kosovo, with 57 per cent of women and 41 per cent of men being officially unemployed in 2009. The unemployment rates are exceptionally high amongst the young, which is particular concern in Kosovo, given that the country has the youngest population in Europe.

There are no significant gender differences reported with regards access to, and enrolment in, education. For example, according to the Kosovo Agency of Statistics, in 2010-2011, 50.7 per cent of university students were women and 49.3 per cent of university students were men. It is of note that there are gender differences reported by rural/urban location. For example, according to the 2004 Evaluation of the United Nations Children's Fund (UNICEF), 14 per cent of rural women were illiterate in Kosovo as compared to 4 per cent for rural men.

According to the World Bank's Women, Business and the Law database, maternity leave in Kosovo is 270 calendar days. However, only 63 per cent of the salary is covered during maternity leave. The law provides for paternity leave, but only two days of paternity leave are paid. The employer is obliged by law to provide the same job and position upon return from maternity leave. The law mandates equal pay for equal work in Kosovo. Women are also, by law, protected from non-discrimination practices in hiring on the basis of gender and from sexual harassment in the workplace.

Entrepreneurship, access to finance

According to the World Bank's Global Financial Inclusion database that surveys approximately 1,000 people using a randomly selected nationally representative sample, in 2011 over 57.3 per cent of male and 31.5 per cent of female adults held an account at a formal financial institution in Kosovo. According to the 2009 Business Environment and Enterprise Performance Survey (BEEPS), of the 15 per cent of 270 firms surveyed in Kosovo that applied for a loan and had a woman among the owners, 33.3 per cent were rejected. In comparison, 23.5 per cent of the 85 per cent of the firms within the same survey sample that applied for a loan and had no women owners were rejected.

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[2] The quality and amount of sex-disaggregated labour market data in post conflict Kosovo is significantly limited.

Kosovo's legislation provides women and men with equal rights with respect to inheritance and property ownership. However, according to the 2012 UNDP Kosovo Human Development Report *Private Sector and Employment*, an estimated 92 per cent of the collateral assets needed to start businesses are registered to men in Kosovo. According to the same source, only 3 per cent of commercial bank loans go to women. These figures are not surprising since the lack of asset ownership often prevents women from using property and other assets as collateral.