Ex-post Evaluation of Exceptional Financial Assistance Operation to Kosovo

Final Report

Framework Contract ECFIN-006-2011/Lot No.2

Specific Invitation to Tender ECFIN/R/9/2011/023

Client: European Commission, Directorate General for Economic and Financial Affairs

Rotterdam, September 30, 2012

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Client: European Commission, Directorate General for Economic and Financial Affairs

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Abbreviations and Acronyms

Acronym	Explanation
BOP	Balance of Payments
CARDS	Community Assistance for Reconstruction, Development and Stabilisation
CBK	Central Bank of Kosovo
CPI	Consumer Price Index
CHU	Central Harmonization Unit
DSA	Debt Sustainability Analysis
EAR	European Agency for Reconstruction
EC	European Commission
ECLO	European Commission Liaison Office
ELA	Emergency Liquidity Assistance
EFA	Exceptional Financial Assistance
EU	European Union
FDI	Foreign Direct Investment
FRY	Federal Republic of Yugoslavia
GDP	Gross Domestic Product
GoK	Government of Kosovo
IBRD	International Bank for Reconstruction and Development
IMF	International Monetary Fund
IPA	Instrument for Pre-Accession Assistance
KEK	Kosovo Energy Corporation
KFOR	Kosovo Force
KPST	Kosovo Pension Savings Trust
KTA	Kosovo Trust Agency
LOI	Letter of Intent
MDTF	Multi-Donor Trust Fund
MEST	Ministry of Education, Science and Technology
MFA	Macro- financial assistance
MEFP	Memorandum of Economic and Financial Policies
MoF	Ministry of Finance
MoU	Memorandum of Understanding
MTEF	Medium term expenditure framework
PAK	Privatisation Agency of Kosovo
PEFA	Public Expenditure and Financial Accountability
PFM	Public Finance Management
PIFC	Public Internal Financial Control
PISG	Provisional Institutions of Self-Government
POE	Publicly-owned enterprises
PTK	Post and Telecom of Kosovo
REER	Real Effective Exchange Rate
SBA	Stand-By Agreements
SDR	Special drawing rights
SEDPO	Sustainable Employment Development Policy Operation
SMP	Staff Monitoring Programme
SOE	Socially-owned enterprises

Acronym	Explanation
SOK, SAK	Statistical Office of Kosovo, since 2012, Statistical Agency of Kosovo
UNMIK	United Nations Interim Administration Mission in Kosovo
UNSCR	United Nations Security Council Resolution

Executive Summary

On 30 November 2006, the Council of the EU decided "to make available to Kosovo an **exceptional financial assistance (EFA)** in the form of a grant **of up to €50 million**". The EFA was intended **to alleviate the financial situation** of Kosovo **and to support the development of a sound economic and fiscal framework**. To operationalise the decision on the EU Council, a Memorandum of Understanding was negotiated and signed on 19 December 2007. It determined that the EFA would be disbursed in two tranches – the first one of €30 million and the second one of €20 million, with specific conditionalities attached to each tranche. The overall provision of EFA was further conditional on the achievement of an understanding between the Government of Kosovo (GoK) and the IMF on an overall economic and fiscal programme, as well as on the confirmation of budgetary needs.

Throughout 2008 and 2009, the EFA was not disbursed as the GoK relaxed fiscal discipline following the July 2008 Donor Conference where the international community pledged more than € 1.2 billion for Kosovo's development. As a result, relations between the GoK and the IMF were not conducive of an agreement, a fundamental condition for EFA's disbursements. Throughout the same period, favourable macroeconomic developments held at bay the emergence of urgent budgetary needs. In July 2010, the IMF approved an agreement with the GoK on an economic programme supported by an 18-month Stand-By Arrangement (SBA) for €108.9 million. Given the agreement with the IMF, the fulfilment of the conditions attached to the first EFA tranche and the confirmation of budgetary need, **the EC disbursed the first tranche of €30 millions to Kosovo on September 2, 2010** to the GoK account at the Central Bank of Kosovo (CBK).

The execution of the 2010 budget was deemed to be largely consistent with the conditionalities set in the SBA, but the political developments in 2010 that led to the dissolution of the Parliament significantly complicated the negotiation process with the IMF. As a result, the IMF-led mission could not complete the SBA review prior to the release of the second tranche of the loan. The EC was therefore not in a position to assess whether the agreement with the IMF remained on track. **The availability of EFA funds expired in December 2010**.

Since mid 2000s, the Kosovo economy was one of the fastest growing in Europe, fuelled by domestic demand (public investment and consumption), a stable flow a remittances and donor support. Inflation was volatile, but core inflation remained low and stable. Kosovo was only moderately affected by the global economic crisis. The financial sector is stable, with the majority of banking system assets owned by foreign banks. The main weakness in Kosovo's economy remains a limited industrial base and hence a staggering level of unemployment, which poses a threat to further sustainable economic growth, social stability and the perspectives of poverty eradication.

One-off privatisation receipts and dividends from State-owned companies, as well as the first tranche disbursements of the EFA and the SBA helped the GoK to finance **a rising budget deficit**. **GoK bank balances** had to be used to finance the rest of the emerging deficit. The level of GoK bank balances fluctuated significantly over the review period, both in absolute terms and as a percentage of the GDP.

Maintaining GoK's bank balances above a minimum level has been an important consideration in the decision to provide and extend the validity of the EFA support. However, there is no consensus on the optimal level of bank balances for Kosovo. Given that Kosovo has adopted the euro as national currency, the government has accumulated euro denominated cash balances at the Central Bank of Kosovo to be used mainly as a buffer against fiscal risks but also as a potential insurance against balance-of-payments shocks, similar to foreign exchange reserves in a country with its own national currency.

In 2010, **the IMF developed a rule-of-thumb for adequate bank balances for Kosovo** that equals one month of government expenditures plus 10% of the bank deposits plus 30% of public short term debts less Kosovo's SDR allocation received. According to this rule, **the recommended minimum bank balances for 2010 amount to 5.7% of GDP**. By the end of 2010, the GoK bank balances stock was at 5.8% of GDP (€244 million). In 2011, bank balances dropped further reaching a low of an estimated 3.5% of GDP.

Most stakeholders interviewed in Brussels, Washington and Pristina concur that the most likely **counterfactual scenario** regarding the disbursement of the first tranche of the EFA/SBA is that the GoK would have **kept its spending unchanged** throughout the period 2007-2010. To compensate for the lack of EFA/SBA funds, **the GoK would have used a larger proportion of its bank balances**. It would not have reduced public spending or increased its revenue. One of the explanations provided during the interviews is that the on-going State expansion, which accounted for part of the expenditures, was crucial at the time in light of the discussions on Kosovo's status. As a result, GoK bank balances could have fallen short of the IMF target by some 0.6% of GDP or by approximately 10% of the recommended minimum amount. This figure appears to be negligible when considering the much more important drop of the bank balances in 2011 by about 2.3 percentage points, down to 3.5% of GDP. Moreover, ranging well below the level recommended by the IMF (5.8% for 2011), **reduced bank balances had no specific impact**, as economic growth in 2011 was robust (5%) and government revenues increased faster than expenditures.

A **second (highly improbable) scenario refers to an "extreme" situation, in which the GoK borrows externally the amount of the EFA assistance**. A standard debt accounting framework was used in order to simulate an increased external indebtedness (i.e. 0.65% in terms of 2011 GDP) and its effect on four possible impact channels. The equivalent accounting effects on the equally weighted channels are a 0.16% of GDP increase of the current account deficit, combined with about half a percentage point decrease both in GDP and inflation growth rates, as well as an increase of the interest rate by 55 base points. Most of these **values are of an order which is often surpassed by regular data revisions each year**.

Although the overall macroeconomic effects of the EFA were limited in size, the disbursement of **the first tranche of the EFA in 2010 provided a useful contribution in the stabilization of the bank balances** following the steep reduction observed in 2009 and 2010. Some recovery of bank balances is visible in the 2012 data, and their level is expected to fully recover in 2013 through expected privatisation receipts. Thus, **in line with its first objective, the EFA operation** has contributed to supporting Kosovo's financial stability.

Reforms targeted through the EFA structural conditionality have progressed due to a variety of factors, including the commitments made in the context of the EFA agreement itself. EFA' s structural conditions were relevant and had the potential to contribute to putting in place a framework for sound economic and fiscal management, hence contributing to the achievement of . **second objective of the EFA operation**.

The gross effect of EFA conditionality was highest on "quick win" technical issues and more problematic on contentious issues. Many of the reforms that the EFA conditionality was targeting would have occurred regardless of the EFA conditions being included in the MoU.

EFA's most important legacy was its political reinforcing impact both domestically and internationally. On the first dimension, it provided Kosovo's authorities with an additional tool to push for critically important reform at home. This impact was at its strongest in the early days of the operation and diminished over time. A second important political reinforcing effect of the EFA was to lend international credibility to the GoK in its early days.

Some of the lessons learned and **recommendations** based on the results of this evaluation include the following points:

- Negotiating a set of more clearly defined conditions and, where appropriate, indicators to determine the progress recorded on fulfilling EFA conditions can be helpful both for the EC and for the recipient government – especially at the operational level – to get a sense of clarity of what the expectations are and what level of effort/ progress is (or is not) enough; an annex with definitions/ indicators, similar to the one included in IMF agreements could be considered;

- In other (unlikely) similar cases, the EC should consider including in the MoU (or an addendum thereof), a set of macroeconomic conditions, in addition to the structural conditions. These macroeconomic conditions would have to be negotiated with the beneficiary government and worked out in close cooperation with the IMF. The macroeconomic conditions could be (automatically) replaced with the IMF conditions when/if the beneficiary country enters in a formal programme with the IMF;

- In situations where EFA disbursements are delayed, the EC should engage in a formal dialogue/review of the operation with the counterpart government authorities to ensure all parties understand the situation and establish a commonly agreed way forward; two options can be envisaged: a) including a "flexibility clause" in the initial MoU allowing for certain changes to be made though simple agreement between the EC and the beneficiary government or b) re-negotiating the MoU, and having the new version approved through the regular procedure;

- The EC should consider ways in which more coordination could be attained between its different interventions (i.e. EFA and IPA), for example by more active involvement of Delegation/ Liaison office staff and other Directorate Generals in Brussels in the EFA design and implementation.

1 Evaluation Objectives and Approach

1.1 Objectives

Under its Financial Regulation (Art. 27.4), the European Commission (EC) is legally obliged to evaluate its main programmes. This ex-post evaluation focuses on the EC Exceptional Financial Assistance (EFA), approved in 2006 and provided to Kosovo in the period 2009-2010[1]. It aims to assess the contribution of the EFA operation to macro-economic stability, external financial sustainability and structural reforms in Kosovo. The evaluation ensures that the EC meets its transparency and accountability standards but it is also meant to support institutional learning and ensure that future performance improves.

This Report is the result of the work carried out in the various phases of the evaluation, including:
- A thorough review of available documents;
- Interviews with World Bank and IMF officials in Washington (mission from 16 to 19 April);
- Interviews with key relevant stakeholders in Pristina (1st mission from 7 to 11 May and 2nd mission from 23 to 26 July);
- Counterfactual analysis and modelling;
- Analysis and synthesis of information collected.

1.2 Overall Evaluation Approach

The overall evaluation approach follows the “Guidelines for the Ex-post Evaluation of Macro-Financial Assistance and Balance of Payment Assistance Operations” (May 2010 update)[2].

Core Impact Areas

The evaluation focuses on three core areas:
- Macroeconomic impact, assessed from a short-term perspective (up to two years after the initial disbursement);
- Impact on the sustainability of the external financial situation (three years or more after the initial disbursement);
- Structural impact on the economy and institutions in the short and medium term (up to four years after the initial disbursement).

Three-Step Approach

The Guidelines suggest a three-step approach to assessing the impact of an MFA/EFA operation:
1. Identify the gross short-term macroeconomic effects and short and medium-term structural impact on the economy. This gross impact refers to the actual macroeconomic and structural developments and are not necessarily related to the MFA/EFA operation;

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1 In previous reports we produced for this evaluation, we referred to this operation as “MFA”. However, the accurate term (in accordance with the Council Decision) is EFA. This has been used throughout the text except for instances where we refer to generic aspects that are relevant both to MFA and EFA operations (e.g. the Evaluation methodology guidelines). We have also kept the term MFA in Annex 3 (the electronic survey questionnaire), as this is the exact formulation of questions that respondents received and answered.

2 The extent to which the MFA Evaluation Guidelines are relevant for the evaluation of the Kosovo EFA operation has been discussed with the Steering Committee in the Interim Report meeting of 15 June 2012. While it is recognized that not all details of the Guidelines might be applicable, this suggested methodology remains the basis of the current evaluation.

2. Establish and analyse two separate counterfactual situations: one referring to the absence of the total assistance package (EU and IMF) and the other one where only the IMF package is in place without the MFA/EFA assistance operation of the EU;
3. Determine the net effects of the operation, which, for both macroeconomic issues and structural issues amount to the difference between observed developments and the counterfactual situation. Unexpected and indirect effects, as well as consequences of programme design are also analysed.

Net effects are intrinsically linked with gross effects. The latter can be influenced by many other factors, in addition to the EFA operation. Particular attention is paid to the political and economic context both in Kosovo and in Europe as well as to discrete events that could impact the gross effects.

Evaluation Questions

The main evaluation questions listed in Table 1-1 below are extracted from the ToR. They coincide with the main questions listed in the *Guidelines*. Questions 7 and 8 have been added based on discussions at the kick-off meeting where the Steering Group showed a strong interest in these issues.

Table 1-1: Generic evaluation questions from the Guidelines

Nr.	Evaluation Question	Section in this document
Q0	How would the economy of Kosovo have evolved in the absence of the EFA assistance?	Sec. 3.4 & 4.3
Q1	To what extent has the EFA assistance been effective in terms of the short-term macroeconomic stabilisation of Kosovo?	Sec. 3.1 &3.2
Q2	To what extent has the EFA assistance been effective in terms of supporting structural reform in Kosovo?	Sec. 4.3 & 5
Q3	What have been the indirect and/or unexpected effects of the EFA assistance?	Sec 3.5 & 4.5
Q4	To what extent has the EFA assistance contributed to returning the external financial situation of Kosovo to a sustainable path over the medium to longer-term?	Sec. 3.6
Q5	How has the way in which the EFA assistance operation was designed and implemented conditioned its effectiveness and efficiency?	Sec 6.1
Q6	To what extent has EU added value been maximised?	Sec 6.2
Q7	How did the EFA operation interact with other Commission activities and programmes such as the IPA?	Sec. 4.4 & 6.3
Q8	How was the interplay between the EU EFA operation and the IMF assistance operations?	Sec. 6.4

Evaluation Instruments

The data for this evaluation is gathered and analysed by means of:
- Document analysis;
- Interviews;
- Analysis of comparable countries;
- Electronic survey[3]; and
- Macroeconomic modelling.

[3] The electronic survey was initially designed in order to apply the Delphi technique, especially with a view of establishing the counterfactuals. However, due to a weak response rate in the second round, the Delphi technique could not be fully applied. The results of the questionnaire are nonetheless used as a source of information in its own right in order to further triangulate information received from other sources (interviews, documents etc.).

Figure 1-1 below shows how these instruments are used in relation to the 'three step methodological approach' described above.

Figure 1-1: Evaluation Approach

Methodological step	Use of evaluation instruments			Findings
Gross effect	Document analysis		→	Actual developments in: GDP, fiscal, debt
Counterfactual	- Interviews - Historical analysis - Electronic survey Assumptions on the counterfactual scenario	Modelling	→	Developments in GDP, fiscal and debt in the absence of EFA support
Net effect			→	Gross effect -/- counterfactual (Percentage change in GDP, fiscal and debt attributed to EFA)

One of the main challenges in the evaluation is the determination of the counterfactual scenario. For the macro-economic counterfactual, the key instrument is economic modelling. The modelling approach includes three steps:

1. Prepare a consistency model of the Kosovo economy;
2. Determine the parameters of the counterfactual;
3. Calculate the macro-economic indicators in the counterfactual.

The parameters of the counterfactual model were determined by using information collected from the interviews, an electronic questionnaire, and historical analysis of other countries that experienced constraints similar to the ones Kosovo faced. More details on the macro-economic counterfactual scenario are given in section 3.4.

Methodology Adaptations

Since the support to Kosovo was not a "regular" MFA but an EFA operation, not all features of the Evaluation Methodology Guidelines could be applied as such. Some other factors have further required minor methodological and presentation adjustments. These are listed below:

- The utility of macro-economic modelling has been limited due to the relatively small amounts disbursed through the EFA and SBA operations. Although several modelling exercises have been carried out, only the results of the most significant ones are presented in the report;
- For the counter-factual analysis the team intended to use the Delphi methodology, whereby a set of experts is asked to agree on the most likely scenario of a given situation. This approach has been used with a certain degree of success in other MFA evaluations. In the case of this study, the number of experts that could be invited to form part of the panel was quite small (under 20). While the response to the first round of the Delphi questionnaire was good (50%),

the response to the second round was much lower. As a result, the Delphi methodology could not be validated. The responses received in the first round were used as those of a regular electronic questionnaire, to triangulate and further validate information obtained from other sources;

- The analysis of external sustainability issues is presented in the same chapter as the macro-economic impact analysis; the team opted for this presentation in agreement with the Steering Committee in order to avoid over-emphasising the issue of external sustainability, knowing that the EFA operation did not specifically target these aspects.

2 The EFA Operation in Kosovo

2.1 Background and Overview of the EFA Operation

2.1.1 Political and Economic Context in Kosovo

Following the conflict in 1999, the UN temporarily took over the governance of Kosovo. It set up an interim administration mission (UNMIK) for the newly autonomous territory within the borders of Serbia. One of UNMIK's aims was to set up and run provisional institutions of local self-government. A peacekeeping force, KFOR, was put in place to ensure post-conflict stability.

By 2006, the international community had advanced in talks on the determination of the final status of Kosovo. In 2007, the Special Envoy for Kosovo, Martti Ahtisaari, prepared a plan for the "supervised independence" of Kosovo, which foresaw the gradual adoption of State powers for the province (among others the right for membership in international institutions), and thus the finalization of its status settlement. The plan was not implemented due to the unwillingness of both the Kosovar and the Serbian Government to give in on their position regarding the final status of the Kosovo territory. However, it reinforced the process of determination of Kosovo's political status.

Kosovo declared its independence on February 17, 2008, and is currently recognized as an independent state by 85 UN member states. While the EU maintains a neutral position on the legal status of Kosovo, it has granted Kosovo the status of a potential candidate country. It is up to the Member States to decide unilaterally on their position on Kosovo's independence. Up to date, 22 of the 27 EU Member States have recognized Kosovo. In 2009, Kosovo became an official member of the IMF and the World Bank.

UNMIK relinquished its remaining administrative and executive powers when Kosovo's Constitution came into force in June 2008. In October 2010, Kosovo's ruling coalition dissolved after the conservative Democratic League of Kosovo withdrew from the government. The President dismissed the Assembly and announced early national elections for December 2010. The elections were perceived to have suffered from serious shortfalls, in particular fraud and vote-buying. The results were only made public in early February 2011. Later that month, the new Government, a coalition between the Democratic Party of Kosovo and the New Kosovo Alliance, took office.

As regards the macroeconomic background, since 1999 Kosovo has been experiencing steady economic growth (on average 5% of GDP annually in the period 2003-08). The two main drivers of economic growth have been public investments and private consumption. The former can be related to the high share of donor funding coming to Kosovo until recently, and the latter is fuelled by the significant inflows of remittances coming from the Kosovo diaspora. The main economic challenges of Kosovo are inflation, unemployment, poverty, as well as low productivity and a very limited export base.

Kosovo adopted the euro as its legal tender in 2002, and therefore does not have an independent monetary policy. As a result, Kosovo has to rely on fiscal policy as the main anchor to pursue macroeconomic stability.

2.1.2 *Decision to Provide EFA Support*

On 30 November 2006, the Council of the EU decided “to make available to Kosovo[4] an exceptional financial assistance in the form of a grant of up to €50 million”. A “classical” MFA operation was not possible, since by design, an MFA operation is linked to a country having a disbursing programme with the IMF. In 2006, Kosovo’s status did not allow it to become member of the IMF. As a result, the EU operation was labelled “exceptional” and was made conditional on an understanding with the IMF on a framework of macroeconomic and fiscal policies[5].

The EU decided to provide assistance to Kosovo *inter alia* to support institution-building, which was further progressing under the UNMIK governance. In addition, the international community expected that the new autonomous government would rapidly run a budget deficit by spending more than its revenues. Since Kosovo was not able to borrow on the financial markets[6], new instruments needed to be applied, and EFA appeared to be the most suitable tool to improve the macroeconomic and fiscal position of Kosovo.

This EFA operation was conceived as a bridging support to close the residual gap in Kosovo’s estimated budgetary financing needs for 2006-07. The estimation of the budgetary need was made by the IMF in the context of a “shadow” macroeconomic support programme that it had been running in Kosovo since 2005. This programme anticipated Kosovo becoming an IMF member and the expected rapid donor withdrawal upon status settlement. The IMF assessment showed that notwithstanding donor support to Kosovo’s budget (in particular from IMF, the World Bank and other forms of EU assistance), a fiscal gap would persist.

The financial need was explained by an increase in government spending in the spring of 2006, which contrasted with fiscal consolidation efforts that had started in the preceding year that had led to a relatively low deficit level of 2.9% of GDP for 2005. After the April 2006 Donor Conference, GoK’s spending policy started deviating from its foreseen course so that for 2006 and 2007 it was estimated that the fiscal deficit would be close to 3%. GoK bank balances at the CBK were deemed sufficient to finance a part of this deficit. Still, upon reduction of these reserves beyond the precautionary level estimated by the IMF (€50 million), a substantial fiscal gap was projected for 2006-07, requiring additional financing[7]. This need is connected to the fact that the government’s own deposits at the CBK have to serve not only for normal cash management, but also as a lender of last resort, since Kosovo does not issue its own currency. In 2006 the fiscal forecast and the MTEF showed a rapid downward trend in the GoK bank balances.

Maintaining those at least at the minimum level, essentially implied that the deficit should be financed through external assistance. Table 2-1 gives an overview of the estimated financing need for the period 2006-2008.

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[4] Under its interim civil administration- the United Nations Interim Mission in Kosovo (UNMIK).

[5] Council Decision 2006/880/EC.

[6] A public debt law, allows the authorities to borrow both domestically and externally, was only adopted in 2010. The law sets a ceiling on the overall public debt stock at 40% of GDP, which also includes public guarantees and municipal debt.

[7] The IMF Aide Memoire of April 2008 mentioned a much higher precautionary balance, of 9% of GDP (around €300 million).

Table 2-1: Budgetary needs, 2004-2008, in millions of euros

	2004	2005	2006	2006	2007	2008
	Actual	Preliminary	Budget Regulation	as per MTEF	as per MTEF	As per MTEF
Total budget revenues	611	628	656	624	618	622
Total budget expenditures	748	674	700	700	685	685
Budget balance estimate	**-137**	**-46**	**-44**	**-76**	**-67**	**-63**
Financing	**137**	**46**	**44**	**76**	**67**	**63**
Provision of loans	0	-22	0	0	0	0
Repayment of loans	0	1	6	6	0	0
Change in Bank balance	**-137**	**-67**	**-38**	**-70**	**-67**	**-63**
Bank balance (estimated level of reserves, end of year)	173	106	68	36	-17	-13
Minimum bank balance requirement	50	50	50	50	50	50
Estimated financial gap/ budget support requirement				**14**	**67**	**63**

Source: EFC Consultation note 14.02.2006 (EFC 2006).

The intention of the EC was to ensure coverage of the largest part of the financial gap, while at the same time bilateral support from Member States was encouraged.

2.1.3 Memorandum of Understanding

To operationalize the Decision on the EU Council, a Memorandum of Understanding was negotiated and signed on 19 December 2007. It determined that the EFA would take the form of a grant and comprise two tranches – the 1st one of €30 million and the second one of €20 million, with specific conditionalities attached to each tranche. The overall provision of EFA was further conditional on the achievement of an understanding between the GoK and the IMF on an overall economic and fiscal programme, as well as on the confirmation of budgetary needs.

Table 2-2 summarizes the conditions attached to each disbursement.

Table 2-2: Design of the EFA operation in Kosovo

Tranche	Conditional upon
Framework conditions	
1st tranche	• Understanding with IMF on economic and fiscal programme and satisfactory track record on implementing such programme; • Confirmation of budgetary financing needs; • Positive evaluation by the Commission of progress made with respect to specific conditionalities on economic stabilisation and structural reforms.
2nd tranche	• Positive evaluation by the Commission of progress made with respect to (other) specific conditionalities on economic stabilisation and structural reforms.
Specific conditions	
1st tranche	a) Ensure implementation of financial and economic policies consistent with the understanding reached with the International Monetary Fund and development needs of Kosovo; b) Ensure a regular and appropriate update of the Medium Term Expenditure Framework in order to enhance medium-term policy planning and support the budget process; c) Implement the 2007 Strategy for the Internal Audit Function in the PISG, and in particular start the operation of the Central Harmonization Unit (CHU) on Internal Audit in the Ministry of

Tranche	Conditional upon
	Finance and Economy, in order to ensure sound and effective public finance management; d) Ensure completeness and accuracy of data inputting the Treasury Software Freebalance and carry out the necessary training of staff in accordance with the Auditor General's recommendations; e) Continue ensuring full compliance of the use of the privatisation/ liquidation proceeds, including their ring fencing, with existing legislation in force.
2nd tranche	f) Ensure that a fiscal impact analysis is carried out by the Ministry of Economy and Finance and attached to each draft law before submitting it to the government and/or Parliament, in order in particular to ensure that social policies addressing poverty and social exclusion are compatible with the long-run sustainability of public finances; g) Establish annual targets for improved billing and bill collection rates of the electricity utility (KEK) and define and implement strategies to reach such targets, in particular with a view to strengthen its viability; h) Develop a strategy for privatisation, and restructuring where necessary, of public-owned enterprises, with a view to strengthening corporate governance and performance of these enterprises and reducing subsidies to the enterprise sector; i) Further develop and strengthen the debt management capacity, in particular in view of potential status related debt obligations; j) Within the existing central public procurement institutions, set up a public procurement help desk, with the aim of facilitating preparation and execution of capital expenditure; k) Accelerate the pace of liquidation of socially owned enterprises (SOEs) and continue with privatisation; l) Establish a roadmap for compiling and publishing comprehensive statistics on national accounts and labour market in order to provide policy making with timely and high-quality statistics.

Source: MoU, 2007.

2.2 Implementation of the EFA Assistance to Kosovo

A succinct chronological overview of political, economic, and other events indirectly or directly relevant for the EFA operation is included in the Annex of this report. Below, the main developments in the implementation of the EFA operation are presented.

2.2.1 2006-2008

Between the Council Decision (end of 2006) and the signature of the MoU (end 2007), the context for the provision of EFA had changed considerably. The growth projections used when estimating the budgetary gap in 2006 proved to be too conservative, and the budget showed a surplus of 3.6% in 2006 and 7.1% in 2007.

The favourable macroeconomic developments put on hold the disbursement of the EFA, since there was no confirmation of urgent budgetary needs. In the framework of the IMF shadow programme, Kosovo received generally positive feedback from the IMF throughout 2006 and 2007, but also some warning signals related to the need to contain public sector wages and social security spending. The IMF feedback was deemed as sufficient to fulfil the EFA condition. So, although no disbursement occurred, the EFA operation continued, as the EU wanted to give a strong political signal to the Kosovo authorities about its support for the process of stabilization in the country. EFA was seen as an appropriate instrument to demonstrate the EU's willingness to provide the necessary financial assistance in the political context of an unclear status settlement [8].

A Donor Conference for Kosovo was organized in July 2008 in order to obtain donor support in light of the recent independence declaration of the country. On this occasion the EC re-confirmed the availability of the EFA funds.

2.2.2 2009-2010

Despite the commitments made in the Donor Conference in July 2008, the €50 million EFA to Kosovo was due to expire in December 2009, two years after the signature of the MoU[9]. Throughout 2008 and 2009, the EFA was not disbursed due to deteriorating relations between Kosovo authorities and the IMF following the change in government in February 2008. The shadow programme went off-track after the 2008 Donor Conference, owing to disagreement about GoK's fiscal policy, which was largely incompatible with the spending path envisaged in the MTEF.

This disagreement was largely linked to increases in public sector wages and war-related social benefits. A further important issue in the context of the negotiations with the IMF was the major investment project of GoK to build a highway to Albania, Route 7. The estimated costs of the project amounted to 24.4% of GDP, and were initially foreseen to be incurred over only two years, thus posing a considerable burden on the budget. While the construction of the highway was recognized by the IMF as strategically important, there was disagreement on the modalities of the project. The IMF wanted to spread the payment obligations over four years in order to limit the fiscal impact. The ensuing negotiations were delayed and therefore one of the key pre-conditions for EFA disbursement, namely reaching understanding with the IMF, was no longer fulfilled.

Given the possibility to extend the availability of EFA funds with one year, the EC asked the IMF for a revised assessment of Kosovo's budgetary needs and for the prospects of reaching an agreement on the economic and fiscal programme. Based on the results of a mission to Kosovo in late October 2009, on November 13, 2009, the IMF released a statement confirming that an agreement could possibly be reached with the GoK and that discussions on a policy programme would begin in early 2010[10]. The assessment submitted to the EC was generally positive, but it also pointed out that despite the limited impact from the global economic and financial crisis, Kosovo´s fiscal sustainability continued to be problematic. The rising expenditures and in particular the loans given to KEK were seen as the main problems.

Due to a much more expansionary fiscal policy, Kosovo´s budget reached a slightly negative balance in 2008 at 0.2% of GDP, and went further into deficits of 0.7% of GDP in 2009 and 2.6% in 2010. Those numbers mask the real budget deficits due to large dividend receipts from the Kosovo Telecommunications Company, PTK. Without these one-off revenues, the underlying deficit would have been much higher, namely at 6% of GDP in 2009. Estimates for 2011 show that the fiscal deficit was 1.9%, and the projections for 2012 point to a deficit of 2.8%. Since 2008, an actual financing gap existed, justifying the need for the EFA disbursement. Table 2-3 reveals the external financing needs of Kosovo for the period 2009-2011, as estimated in 2010:

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8 EFC Consultation note November 2007.

9 MFA-EFA agreements are concluded by default for a period of two years and can only be extended for one other year if needed.

10 IMF staff assessment letter to the EC, 13.11.2009.2.

Table 2-3: Kosovo financing needs 2009-11, in millions of euros

	2009	2010	2011
	Actual	**As per MTEF**	**As per MTEF**
Total budget revenues	1149	1112	1157
Total budget expenditures	1180	1326	1478
Budget balance estimate	**-31**	**-214**	**-321**
Budget balance excl. motorway expenditure	**-31**	**-84**	**-46**
Total Financing	**31**	**96**	**183**
Domestic	82	101	187
Foreign	-52	-5	-4
Change in Bank balance	**-82**	**-101**	**113**[11]
Bank balance (estimated level of reserves, end of year)	342	123	216
Minimum bank balance requirement		241	354
Estimated financial gap/ budget support/ BoP requirement		**118**	**138**
IMF borrowing		43	63
EU		**50**	
World Bank		25	25

Source: Note to EFC, 19.10.2010.

In July 2010, the IMF approved an agreement with the GoK on an economic programme supported by an 18-month Stand-By Arrangement (SBA) for €108.9 million. Of this, €22.1 million were made directly available upon Board approval, and the rest was to be disbursed into tranches, subject to achievement of pre-agreed conditionalities and targets. Given the agreement with the IMF, the fulfilment of the conditions attached to the first EFA tranche and the confirmation of budgetary need, the EC disbursed the first tranche of €30 millions to Kosovo on September 2, 2010 to the GoK account at the CBK.

While the execution of the 2010 budget was deemed to be largely consistent with the conditionalities set in the SBA, the political developments in 2010 that led to the dissolution of the Parliament[12] significantly complicated the negotiation process with the IMF. In October 2010, the IMF undertook a review mission on the compliance with the SBA. During the mission, the Ministry of Finance (MoF) reached agreement with the IMF on the draft budget for 2011, but this draft budget could not be approved by the Parliament, as it was dissolved. As a result, the IMF-led mission could not complete the SBA review prior to the release of the second tranche of the loan. The EC was therefore not in a position to assess whether the agreement with the IMF, which was a key condition for the release of the outstanding second EFA tranche of €20 million, remained on track. The availability of EFA funds expired in December 2010.

The World Bank had also planned to disburse its first budget support operation to Kosovo soon after the SBA was signed. Yet, due to the political developments in September 2010, this disbursement eventually took place only in December 2011 (see Box 6-2).

[11] Change in bank balance partially offset by a €300 million privatisation receipt.

[12] In September 2010, the President of Kosovo, Fatimir Sejdiu, resigned following allegations of a constitutional breach. At the same time, disagreement over privatisation issues caused the coalition government to fall and early elections were called.

3 Impact on Macroeconomic Stabilisation and External Sustainability

In this Chapter, we address the evaluation questions linked to the area of macroeconomic stabilisation and external sustainability.

Table 3-1 Evaluation question and sub questions on macroeconomic stabilisation and external sustainability[13]

Q1. To what extent has the EFA assistance been effective in terms of the macroeconomic stabilisation of Kosovo?	
Q1.1	What are the short and medium-term macroeconomic objectives* of the assistance?
Q1.2	To what extent have the short and medium-term macroeconomic objectives* of the assistance been achieved?
Q1.3	What has been the contribution of the grants and/or loans provided by the operation to the achievement of objectives?
Q3.2	What, if any, has been the contribution of actions resulting from the respect of structural conditionality criteria to the achievement of short and medium-term macroeconomic objectives of the assistance (i.e. the indirect effects of structural conditionality criteria)?
Q3.3	Has the assistance given rise to any unexpected short and medium-term structural and/or macroeconomic effects? What were they and how did they occur?
Q4. To what extent has the EFA contributed to returning the external financial situation of Kosovo to a sustainable path over the medium to longer-term?	
Q4.1	How did the external financial situation of the recipient country evolve prior to and during the operation?
Q4.2	What are the main internal and external factors on which the current trend in the country's external financial situation and its prolongation into the future are conditional?
Q4.3	How is the country's external financial situation likely to evolve in the 5 years following the final disbursement given the likelihood of changes to current conditions?
Q4.4	What is the EFA contribution to medium and long term external sustainability prospects?

* Or expected effects if explicit objectives cannot be identified.

3.1 Macroeconomic Objectives of the EFA

Q1.1 What are the short and medium-term macroeconomic objectives of the assistance?*

The Council decision of November 2006 states the objectives of the EFA as follows:

> "with a view to alleviating the financial situation in Kosovo, supporting the development of a sound economic and fiscal framework, facilitating the continuation and strengthening of essential administrative functions and addressing public investment needs."

The Council Decision specifically refers to the budgetary financing need of Kosovo until the end of 2007, which was estimated at about €81 million. It also explains that:

[13] See pp. 9-11 of the "Guidelines for ex post evaluation of MFA/BoP assistance", May 2010.

"[…]Kosovo is not in a position to borrow either domestically or on the international financial market and under its current status it is not eligible for membership in the international financial institutions. It may therefore not benefit from lending assistance associated with their programmes.[…] Such assistance will provide crucial bridge support pending a settlement of Kosovo's status."

The twin objective of the EFA to Kosovo was therefore to:
- Alleviate the financial situation in Kosovo;
- Support the development of a sound economic and fiscal framework.

3.2 Macroeconomic Gross Impact of the EFA

Q1.2 To what extent have the short and medium-term macroeconomic objectives of the assistance been achieved?

To answer this question, we will compare the EFA objectives with the actual macroeconomic developments by means of a quantitative analysis. In order to do this, we will select macroeconomic indicators which can indicate progress in fulfilment of the objectives. Since the MoU conditions are only formulated in very general terms and do not include specific macroeconomic targets, the analysis will cover the overall macroeconomic developments in Kosovo, focusing in particular on the period from 2007, when the MoU was signed, until 2010, when the first tranche of the EFA was disbursed. Where possible, the analysis also casts a look beyond the 2007-2010 period. We use data from the IMF, the SOK and the CBK. Table 3-2 below presents some of the macroeconomic indicators underpinning the analysis.

Table 3-2: Macroeconomic indicators

Category	Effect Indicators
Macroeconomy	GDP growth rate
	Development of GDP components
	Inflation
	Unemployment
	Financial sector development
Public finance	Level of government revenue
	Level of government expenditure
	Composition of government expenditure (key spending items)
	Government deficit
	Financing of the government deficit

3.2.1 Macroeconomic Performance

Economic Growth

Kosovo's economy has been one of the fastest growing European economies over the last five years (together with Albania and Poland). In 2007 and 2008, economic growth averaged 6.6% annually. After a drop in 2009 (see below), economic activity recovered in 2010 and 2011, reaching growth rates of 4% and 5% respectively. GDP projections for 2012 and 2013 foresee further economic expansion along a 4% growth trajectory.

As Table 3-3 demonstrates, GDP growth has been driven predominantly by domestic demand through public investments and consumption related to the building of the state apparatus and improvements in infrastructure. Domestic private consumption also played an important role Donor support has been essential for economic growth in Kosovo, in particular through its role in public investment. However, its share in financing investment and consumption in the country have been progressively declining in recent years.

Given Kosovo's relatively low degree of economic integration in terms of exports and international finance, economic growth performance over the recent years was only moderately affected by the global economic crisis and the crisis in the euro zone compared to other countries in the region. Still, in 2009, growth dropped by 4% percentage points as exports and private consumption weakened due to the fall in international demand and some reduction in remittances respectively. There was a significant slowdown in the growth of private sector credits, leading to weaker consumption. Also, in 2009-2010 the nominal value of exports decreased compared to the years before, due to a strong increase in domestic inflation which led to an appreciation in the real effective exchange rate.

Growth recovery followed quickly in 2010-11, although it could not reach the same pace as in 2007-2008. It was once again triggered by an increase in public investments due to start of the construction of the Route 7. While remittances continue to play an important role in Kosovo's economy, both donor inflows and public investments are currently diminishing. The completion of the Route 7 in 2014 is expected to lead to lower economic growth for that year as a result of a slowdown in public investment. A 5% GDP growth rate is still projected for 2015[14].

Table 3-3: Real growth rates, 2007-2012 (in percentages)

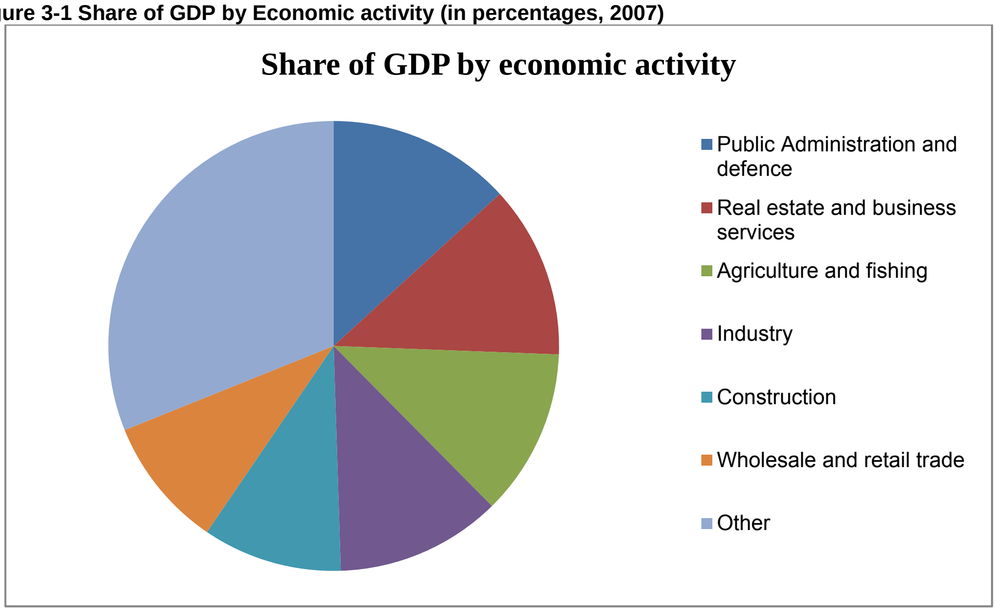
	2007	2008	2009	2010	2011 (est.)	2012 (proj.)
GDP	6.3	6.9	2.9	3.9	5	3.8
GDP per capita		5.6	1.4	2.4	3.4	2.2
Consumption	5.3	4.3	1	2.9	2.9	2.5
Public	-5.4	-5.9	3.9	-1.5	2.3	1.5
Private	8	6.4	0.4	3.8	3	2.6
Investment	15.2	18.1	11.7	8.8	7.6	6.0
Public	-9.7	109.2	29	12.6	8.4	11.5
Private	21.6	0.6	4.8	7	7.2	3.2
Exports	13.4	4.7	7.8	24.2	13.6	6.4
Imports	11.0	5.9	5.3	11.9	5.6	3.7

Source: IMF (July 2012). Data for 2007 from IMF Aide Memoire 2008.

The 2007 data on GDP by economic activity (latest available data) reflects the poor labour market situation in Kosovo. Figure 3-1 below displays graphically this information:

14 IMF (2012): Republic of Kosovo: First Review Under the Stand-By Arrangement, and Request for Modification of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion .IMF Country Report No. 12/80 July 2012.

Figure 3-1 Share of GDP by Economic activity (in percentages, 2007)

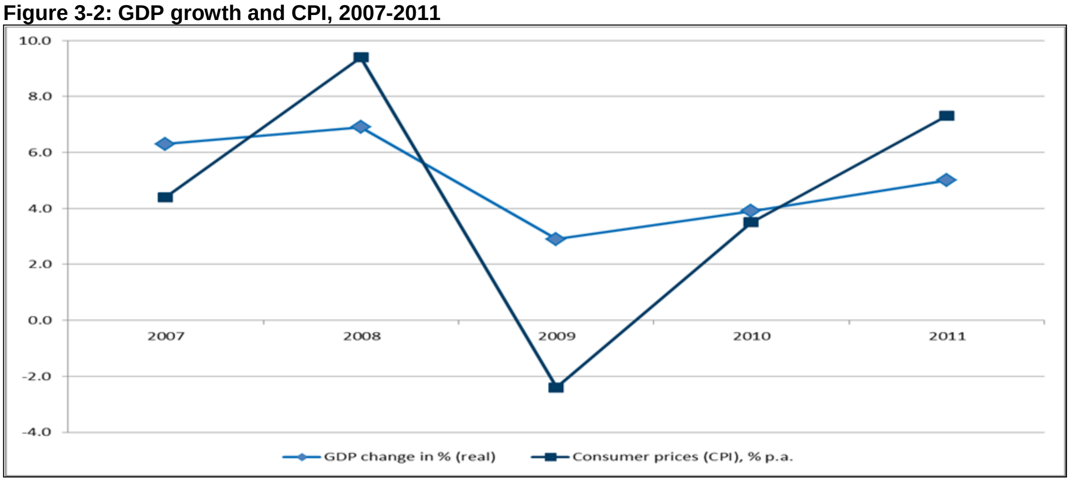


Source: SOK, 2007.

Inflation, Unemployment and Social Development

Economic growth in Kosovo has been associated with volatile consumer price inflation (CPI) (see Figure 3-2). Over the past five years, headline inflation rates have ranged between 9.4% and -2.4%, and in the beginning of 2011 food inflation peaked at 15%. However core inflation (excluding food and energy costs) remained very stable between 0% and 3%. Given the high share of food consumption in the overall Kosovo consumption basket, and volatile international food prices, Kosovo CPI will remain hostage to international trends in the commodity markets.

Figure 3-2: GDP growth and CPI, 2007-2011



Source: Statistical Office of Kosovo, IMF GDP projection for 2011.

At the same time, Kosovo has the worst employment rate on the European continent at about 29% in 2010. Overall unemployment rate hit 47% in 2010, while youth unemployment in the age bracket 18-25 is an alarming 72%[15]. The lack of employment possibilities is considered as the main cause of the substantial brain-drain affecting the country. Given the fact that the 18-25 age bracket comprises 20% of total population, which effectively makes it the youngest in whole Europe, the very unfavourable labour market development poses significant challenges for a sustainable economic growth path in Kosovo.

[15] UNDP Kosovo, Economic Development 2011, available at: http://www.ks.undp.org/?cid=2,91.

High unemployment has also been a major factor for the persistent severe poverty in Kosovo. A 2007 poverty assessment found that the overall poverty rate was 45%, and 18% of the total population was estimated to live in extreme poverty. Non-monetary poverty is also high, with 25% of households lacking access to at least one basic service such as water, education and sanitation[16]. While the poverty assessment is somewhat outdated, UNDP confirmed in 2010 that those figures were unlikely to have improved[17].

Financial Sector Development

More than three quarters of Kosovo's financial sector assets are held by commercial banks. For several years now, eight commercial banks continue to operate in the banking system. Foreign-owned banks dominate the market with a share of around 90% of the total banking system assets. Concentration in the sector is high, as three quarters of the banking system's assets are held by three banks only. The sector is continuously and increasingly delivering new loans to firms and households. The average amount of monthly new loans for the total economy has increased between 2007 and 2011 by 35%. In the same period, average new investment loans to nonfinancial corporations have increased by only 13% while average new consumer loans to households have soared by as much as 84% (although from a very low level). Almost 80% of the banks' liabilities were in local deposits in June 2011, while total liabilities of Kosovo's banking system to the external sector amounted at only 8.5% of GDP (€213 million). The latter figure was slightly increasing over the recent years. The quality of the banks' credit portfolio appears to be fairly sound. IMF's projections for 2012 reveal that only about 6% of total loans are classified as non-performing loans, which is much less than in neighbouring countries.

3.2.2 Public Finance

Revenues and Expenditures

In recent years, Kosovo general government revenues account for between 24 and 30% of GDP (see Table 3-4). Out of this, direct taxes only represent about 4% of GDP and indirect taxes between 17 and 20% of GDP. Direct tax revenues are rather stable, mainly due to continuous efforts to establish and improve the tax collection and tax administration. Nevertheless, tax compliance is still a serious issue in Kosovo, and there is a need to further strengthen the tax base. Indirect tax receipts have been traditionally high due to the large share of imports in the economy, and revenues have been further boosted by one-off receipts mainly connected to privatisation, as well as licencing fees and dividends from the PTK. If such dividends are excluded from the deficit calculation, the underlying budget deficit would have been almost 6% of GDP in 2009. Among indirect taxes, VAT accounts for the largest proportion (about 9-10% of GDP in the period 2007-2011). In 2010, the GoK undertook selective increases in the excise taxes, which are estimated to have brought additional revenue in the amount of 1% of GDP. In 2010, the tax amnesty for foreign companies was abolished, thus leading to additional income. International donor grants have been another important source of revenue for the GoK, but they declined strongly in recent years. While they were as high as 10% of GDP in 2007, in 2011 they amounted to less than 6%, and are projected to further drop to around 3% of GDP by 2015. The data also suggests that decline in donor sector investment, which averaged about 11% of GDP per year in the period 2007-2011.

Compensation of employees and intermediate consumption make up the largest share of expenditures. The GoK is the largest employer in the country and it repeatedly used wage increases and hiring to ensure political support. This type of measures account for much of the

[16] World bank, Kosovo Poverty Assessment 2007.

[17] UNDP Kosovo, Human Development Report, 2010.

tensions in GoK discussions with the IMF and the EC in the context of EFA. Social transfers are rather low. They remained stable, at around 4% of GDP in recent years, despite announced plans of the GoK to increase war-related benefits for veterans. One expenditure item that strongly increased after 2007 is government investment in gross fixed capital formation. In 2010, government investment amounted to 12% of GDP, triple the share of 2007. A large chunk of this is dedicated to highway construction (2.9% in 2010 and an estimated 5.3% in 2011). These expenditures are expected to remain high also in the years to come, as the Kosovo transport infrastructure is outdated and needs upgrading.

Table 3-4: Government accounts, in % of GDP, 2007-2012

	2007	2008	2009	2010	2011 (est.)	2012 (proj.)
Total revenue	**26.3**	**24.5**	**29.3**	**27.6**	**28.1**	**28.0**
Direct taxes	4.7	5.2	3.4	3.2	3.4	3.4
Indirect taxes	19.6	17.1	18.4	19.6	20.2	20.6
Donor grants	**9.3**	**7.5**	**10.3**	**8.6**	**5.9**	**…**
Total expenditure	**19.2**	**24.7**	**29.9**	**30.0**	**29.8**	**30.6**
Social transfers*	3.4	3.6	4.0	4.1	3.9	…
Investment*	4.1	9.8	11.7	12.0	11.4	…
Government balance	**6.8**	**-0.2**	**-0.7**	**-2.6**	**-1.9**	**-2.8**
PTK dividend	**…**	**…**	**5.2**	**2.0**	**1.3**	**…**
Stock of Government bank balances	**11.6**	**10.8**	**8.7**	**5.8**	**3.5**	**3.8**
Recommended minimum level of balances[18]	**…**	**…**	**…**	**5.7**	**5.8**	**6.1**

Source: IMF (2012), and IMF (2010).
*Source: Statistical Office of Kosovo, own calculations.

Financing of the Deficit

Kosovo's public deficit path has been strongly influenced by the on-going State- and institution - building process. In early 2000s, growth in spending, in particular capital spending was less prominent than growth in revenues, which ensured stable fiscal performance. In 2004 the budget recorded a deficit of 6% of GDP, owing to rapid expansion in recurrent spending. This led to the commitment of GoK in 2005 to a package of conservative measures in order to limit the forecasted budget slippage. In 2005, in the framework of the IMF programme GoK issued a Letter of Intent introducing a Memorandum of Economic and Financial Policies, including a commitment to tight spending policies[19]. Some of the measures envisaged in the MEFP were the reduction of civil service staff by 10% by 2008 and a fiscal rule to limit the growth of real spending to 0.5% of GDP per year. In April 2006 a Donor Conference was organized successfully, after which spending policies started deviating from the path envisaged in the Letter of Intent.

In 2006-07, contrary to initial expectations of the international community and to the forecasts included in the MTEF, the GoK reached a budget surplus. This can be explained, on the one hand, by the boost in indirect revenues that resulted from stronger than expected economic growth and by the cut in recurrent spending as a result of civil service reform. On the other hand, significant shortfalls in the projected capital expenditure, rising revenues through additional tax measures, such as a monopoly tax on the Telecom and delays in VAT refunds have also contributed to the

[18] IMF has started recommending a minimum level of bank balances in 2010.
[19] Kosovo: Memorandum of Economic and Financial Policies, 02.11.2005.

surplus. Furthermore, the dividends received from the monopolist PTK provided another source of one-off revenues that fed into the surplus.

In in 2008, it became evident that the positive fiscal balance would not last. The new government, which took office in February 2008, introduced a number of expansionary fiscal measures, such as increasing the number of teachers, changes in the social security system, raising public sector salaries and providing higher subsidies to the Kosovo Energy Corporation (KEK), the national electricity provider. Those policies signalled that the trend of under-spending would come to an end. They also coincided with the onset of the global financial crisis, which implied a possible decrease in revenues. Thus, while in 2008 and 2009 the deficit remained close to neutral due to boosts by one-off receipts, it went into a significant deficit in 2010.

In 2010, the budget deficit was financed by two main sources. The GoK received a total of €50 million, €30 million EFA grants from the EC and €20 million from the IMF in the form of a credit. The remainder of the fiscal deficit was financed by the GoK's bank balances that had been accumulated during the years of fiscal surplus.

This trend continued in 2011, and was driven by increases in both recurrent and capital spending. In the political campaign preceding the elections held in December 2010, the Prime Minister announced an increase in civil service salaries. In April 2011, the newly constituted Assembly ultimately adopted the budget for 2011. This budget included a rise in civil servant salaries of 30% on average. The other parts of the budget were largely unchanged compared to the draft budget from October 2010.

Role and Development of GoK Bank Balances

Maintaining GoK's bank balances above a minimum level has been an important consideration in the decision to provide EFA support, and also to extend it. Given that Kosovo has adopted the euro as national currency, the government has accumulated cash balances at the Central Bank of Kosovo to be used: (i) as a buffer against fiscal risks; and (ii) as insurance against balance-of-payments shocks[20]. (see also Box 3.2). For Kosovo, the buffer against fiscal risk seems to be more relevant given the soundness of the banking system and the fact that the banking system is largely foreign-owned. Under the European Bank Coordination "Vienna" Initiative (EBCI) that was launched in January 2009, foreign banks operating in Central-, East- and Southeast Europe have agreed that parent bank groups maintain their exposure and recapitalise their subsidiaries in the region during the current financial crisis.

As pointed out in Chapter 2, around the time of the EC's decision to provide EFA support, a steep depletion of GoK's bank balances below their minimum level had been forecasted for the period 2006-08. Back then, a very minimum level of €50 million was set as a threshold. Given the positive fiscal balance of those years, this forecast did not materialize, and in 2007 the bank balances amounted to 11.6% of GDP, or about €400 million (see Table 3-5). However, in 2008, despite a slight increase in nominal terms, the balances fell to 10.8% of GDP, and in 2009 they amounted to 8.7% of GDP. The decision to prolong the availability of EFA funds at the end of 2009 was taken in order to address this downward trend and the upcoming fiscal needs of the GoK.

Based on data provided by MoF, Table 3-5 gives an overview of the level and structure of the GoK's bank balances between 2004 and 2011. While these figures are higher than the IMF figures

[20] IMF, Republic of Kosovo: Request for Stand-By Arrangement—Staff Report; Press Release on the Executive Board Discussion, IMF Country Report No. 12/100, April 2012.

quoted in the previous paragraph (see Box 3-1 for an explanation), they show the same trend in overall development.

Table 3-5: GoK's bank balances and their structure, 2004-2011, in millions of euros

	2004	2005	2006	2007	2008	2009	2010	2011
Central Bank of Kosovo	181.3	111.5	195.7	445.1	202.6	88.3	48.8	89.3
Government Securities	0	0	0	0	266.5	0	84.6	0
Commerzbank AG - Frankfurt	19.7	16.2	11.9	0	0	0	0	0
Term deposits in Central Bank	0	0	0	0	0	125	140	105
Term deposits in Commercial banks	0	0	0	0	0	163.9	11	0
Accounts in Commercial banks	0.4	2.3	3.1	0.4	0	0	0.8	0
Cash in transit	0	0.2	0.2	4.2	5.8	5.8	4.3	7.1
Kosovo Embassies accounts	0	0	0	0	0	0.6	0.5	1
Cash in hand (petty cash)	0	0	0	0	0.6	0.3	0.9	1.2
Total financial assets in cash	**201.5**	**130.2**	**211**	**449.8**	**475.5**	**383.9**	**290.8**	**203.6**
In % of GDP	**6.9**	**4.3**	**6.8**	**13.3**	**12.3**	**9.8**	**6.9**	**4.4**

Source: GoK, MoF.

Box 3-1 Data issues on GoK bank balances

The data on government bank balances provided by the MoF (see Table 3-5), reveals consistently higher numbers than the data provided by the IMF (see Table 3-4). One possible explanation for this is the difference in the methodology used for the calculation of the bank balances. IMF's definition of bank balances in Kosovo, on the basis of which estimations are made, is formulated as follows: "*Bank balances are funds usable and readily available (i.e., liquid or marketable, and free of any pledges or encumbrances), held and controlled by the general government for the purposes of making payments and transfers. Bank balances include Undistributed Funds of the Government of Kosovo plus funds specifically reserved for policy purposes including emergency assistance but do not include the balance of unspent Own Source Revenues (OSR) carried forward, or funds encumbered or pledged as Donor Designated Funds and funds relative to on lending operations*"[21]. The IMF does not include in the calculation the rollover of municipal revenues, nor does it count pledged donor funds that were not disbursed, as for instance the second tranche of the EFA. Stakeholders interviewed for this evaluation have repeatedly indicated that the GoK has counted those two items towards its bank balances.

MoF also provides for data on the detailed structure of the bank balances. Until 2007 more than 90% of the bank balances were deposited at the CBK. Since 2008 this share was closer to about 50%. Additional funds were deposited with commercial banks or invested in government securities. However, by 2011 again more than 90% of the funds were with the CBK.

The strong fluctuations in bank balances call for an analysis of the minimum and optimal level thresholds and their adequacy. Between 2004 and 2007 a minimum level of bank balances was fixed in nominal terms at €50 million, which represented less than 2% of GDP for that period. Although the amount was small, it was deemed sufficient to cover unexpected financial needs, given the weak capacities of State institutions at that time.

Some of the interviewed stakeholders indicated that a general consideration for a minimum level of balances would be to keep enough reserves to cover a quarter of government spending plus one additional month. Given the positive fiscal developments in 2006 and 2007, the stock of balances

21 IMF (July 2012).

increased substantially. The growing pressures on the GoK since 2009, brought the issue of the optimal level of government bank balances back on the agenda.

Box 3-2 Optimal level of bank balances in Kosovo

In 2010, IMF developed a rule-of-thumb for adequate bank balances for Kosovo that equals one month of government expenditures plus 10% of the bank deposits plus 30% of public short term debts less Kosovo's SDR allocation received. According to this rule, the recommended minimum bank balances for 2010 amount to 5.7% of GDP. By the end of 2010, the GoK bank balances stock was at 5.8% of GDP (€244 million) according to the IMF. In 2011, bank balances dropped further reaching a low of an estimated 3.5% of GDP in 2011, again according to the IMF. For that year, it was envisaged that the fiscal deficit would be financed through receipts from the planned privatisation of PTK, but the procurement procedure was cancelled and the privatisation is expected to be finalized only by 2013.

There has been certain criticism on the applicability and relevance of the optimal level rule in the situation of Kosovo. This rule is a derivative of another rule applicable to fixed exchange rate regimes. There, the level and development of foreign currency reserves is determined in order to keep enough reserves so that possible negative shocks do not lead to a decline in reserves to such a level that it may invite a speculative attack against the fixed exchange rate. Once the exchange rate is deemed adequate, especially not overvalued, the reserves need to only cover the possible shocks to the balance of payments from any given source. That, in a way, determines the optimal level of reserves and thus possible needs for additional financing.

Since Kosovo uses the Euro as a legal tender, there is no currency risk. So, the IMF takes into account only the risk to the balance of payments, to bank deposits, and to short term public debt. Given the reserve requirements and prudential measures, the optimal reserves dedicated to this should not be very high (if any) in equilibrium. The first item that is targeted by the IMF formula is the BoP. The BoP risk is quantified as a fall in exports. Kosovo does not export very much, although growth has been continuous and is expected to persist. The IMF projects that exports will continue to grow faster than imports until 2017, calling for a commensurate (and diversified) reserve cover. As regards risks to bank deposits, financial sector performance in Kosovo has been good and banks have shown resilience to the global pressures. The last item that poses risk according to the IMF approach is short term government debt, which is currently low but is expected to increase and can reach a level of up to 40% of GDP. This is the key risk and is the most relevant one because of the way that bank balances are created and maintained. Most of those are accumulated fiscal surpluses and thus should be there to cover possible fiscal deficits in the future. Seen in that way, the risk that should be covered is that of exceptionally high fiscal deficits of the kind that either are the consequence of fiscal irresponsibility or of prolonged recession. As long as growth is expected to remain positive, fiscal risks due to short term debt accumulated through fiscal deficits should prove to be rather low.

Overall, the floor on GoK balances as established by the IMF programme appears to be rather high, but in any case seems sustainable under current forecasts and policy commitments. The witnessed steep decline in bank balances has been worrisome, yet the issue of whether it is feasible to block a high amount of financial resources remains a highly debated one, especially from the perspective of the GoK.

3.3 Counterfactual

Q0.1 What would have been the macroeconomic and structural effects if the total assistance package (EU + IMF) had not been granted?
Q0.2 What would have been the macroeconomic and structural effects if only EU assistance (EFA) had not been granted?

These questions refer to the situation which would have emerged if the EFA and IMF financial assistance had not being granted. Several features make the construction of the counterfactual very challenging in the case of the EFA assistance to Kosovo:

- The amount of the assistance, albeit being substantial as a percentage of GDP, is less substantial as compared to other donor support provided to Kosovo;
- There was a significant time lag between the decision to provide EFA assistance (2006), and the actual disbursement of the amount (2010). In this period, many of the conditionalities attached to the EFA had already registered significant progress (see Chapter 5 of this report), despite lack of actual financial assistance. This makes the assessment of the counterfactual as compared to macroeconomic and structural objectives complicated, as in practice for the period until 2010, the actual developments refer to a situation where the package had indeed not been disbursed;
- The availability and quality of data presents substantial limitations, making the results of a quantitative counterfactual analysis indicative at best;
- There was no obvious or imminent pressure on BoP-related indicators when the decision to provide EFA was taken. This implies that no distress in such indicators could have been expected in a realistic counterfactual scenario. Therefore, the counterfactual analysis rests on strong assumptions on any related changes in macroeconomic and external sustainability indicators.

We have therefore assessed several options for the design of the quantitative approach. As agreed with the Steering Committee, the most likely counterfactual scenario is the one that reflects the actual situation, i.e. unchanged spending behaviour by the GoK. This finding has also been validated by the responses to the electronic survey questionnaire. Hence, no modelling has been undertaken to quantify its effect.

In addition, we have carried out, in agreement with the Steering Committee, two modelling exercises- a Vector Autoregression (VAR), as well as a reverse accounting exercise following the Milessi-Feretti approach. The latter was applied to an extreme, highly improbable counterfactual scenario, for illustrative purposes only. The results of the VAR analysis were presented to the Steering Committee, but since they were not used for the purposes of the analysis, they are not included in this report.

3.4 EFA Net Impact on Macroeconomic Stabilisation

Q1.3 What has been the contribution of the grants and/or loans provided by the operation to the achievement of objectives?

In order to address this question, three scenarios have been developed and examined. The first scenario, most probable, is based on the hypothesis of GoK not changing its spending behaviour in the absence EFA/IMF assistance. The second scenario assumes that GoK would start issuing debt in 2011 in order to cover the financial gap resulting from the non-disbursement of the EFA and SBA funds. The third scenario builds on the second one, but explores the reverse situation, i.e. what would have happened if the second tranche of the EFA had been disbursed.

Table 3-6 summarizes the results of these quantitative exercises, while the two sub-sections below discuss the findings in more detail.

Table 3-6: Counterfactual scenarios and effects

Scenario	Variables	Effect	Impact
Scenario I: No EFA assistance, GoK keeps spending unchanged and uses a large proportion of bank balances (*most probable scenario*).	-Public spending; -Bank balances.	Reduction of bank balances by 0.6% of GDP.	Negligible given budget surplus. Certain risk in situation of depletion, but probability of both depletion of balances and additional fiscal pressure in the absence of balances is low.
Scenario II: GoK incurs external debt in the amount of EFA assistance (*extreme scenario*).	-Public debt; -Current account deficit; -Effective nominal interest rate.	-0.16% of GDP reduction in non-interest current account balance; -0.55% reduction in real growth rate of GDP; -0.52% reduction in domestic GDP deflator inflation; -0.55% increase in effective nominal interest rate.	Negligible as scenario is improbable (debt issuing started in 2011 only) and effects are in the order that is regularly surpassed by data revision.
Scenario III: GoK receives both EFA tranches and reduces public debt in the amount of the second EFA tranche.	-Public debt; -Current account deficit; -Effective nominal interest rate.	-0.11 % of GDP increase in non-interest current account balance; -0.38% increase in real growth rate of GDP; -0.38 % increase in domestic GDP deflator inflation; -0.38% reduction in effective nominal interest rate.	Limited, as scenario is improbable (but more probable than Scenario II) and effects are in the order that is regularly surpassed by data revision.

3.4.1 Scenario I: GoK Spending Unchanged

Most stakeholders interviewed in Brussels, Washington and Pristina concur that the most likely counterfactual scenario is that the GoK would have kept its spending unchanged throughout the period 2007-2010. To compensate for the lack of EFA/IMF funds, the GoK would have used a larger proportion of its bank balances. It would not have reduced public spending or increased its revenue. One of the explanations provided during the interviews is that the on-going state expansion, which accounted for part of the expenditures. was crucial at the time in light of the discussions on Kosovo’s status.

This hypothesis was further validated by the respondents of the electronic questionnaire, even under the additional assumption that no budget surplus was achieved in 2006-07. The results of the questionnaire also point out that even if no EFA funds had been disbursed, the GoK would not have changed its spending patterns, despite a widening fiscal deficit at that time. This would have resulted in an increase of the fiscal deficit in the amount of 0.5-1 percentage points.

As a result, GoK bank balances could have fallen short of the IMF target by some 0.6% of GDP[22] or by approximately 10% of the recommended minimum amount. This figure appears to be negligible when considering the much more important drop of the bank balances in 2011 by about 2.3 percentage points, down to 3.5% of GDP. Moreover, ranging well below the level recommended by the IMF (5.8% for 2011), reduced bank balances had no specific impact, as economic growth in 2011 was robust (5%) and government revenues increased faster than expenditures.

In this most probable scenario, the net effects of the EFA operation on macroeconomic and fiscal stabilization can be described as follows:

- EFA had a positive impact on the level of bank balances, equivalent to the disbursed assistance (€30 million, or 0.6% of GDP);
- EFA had no quantifiable impact on GoK's spending behaviour until 2010, hence neither the delay in the disbursement, nor the disbursement itself led to significant measurable impacts in macroeconomic or fiscal indicators;
- The non-disbursement of the second tranche of EFA had some restrictive, but not quantifiable impact of GoK's spending behaviour. This latter conclusion is validated through the electronic questionnaire response that reveals that the non-disbursement of the second tranche of EFA has a positive impact on GoK's fiscal discipline.

3.4.2 *Scenario II: GoK Debt Increased*

This second scenario refers to an "extreme" situation, in which the GoK borrows externally the amount of the EFA assistance. This scenario is highly improbable given that the GoK only started issuing debt in 2011. However, it reveals what could have been the effects of external borrowing (had that been an option) on the country's macroeconomic and external stability.

In 2011, the total external debt level (i.e. public and private) of Kosovo stood at roughly 30% of GDP. An interesting path is to follow the methodology presented in Milesi-Ferretti and Razin (1996) and later applied e.g. in Bonato and Leigh (2005) and Vamvakidis (2008). Here external debt as a share of GDP (d) is determined as a function of the effective nominal interest rate (r), the real growth rate of GDP (g), the non-interest current account balance as a share of GDP (ca), and the change in the domestic GDP deflator in euro terms (ρ). Applying the following formula allows to project the debt ratio as a dynamic function of the variables mentioned above:

$$d_{t+1}-d_t = (1 / (1 + g_t + \rho_t + g_t\,\rho_t))\,(r_t - g_t - \rho_t\,(1+g_t))\,d_t - ca_{t+1}.$$

This standard debt accounting framework was used in order to simulate a set of scenarios, which represent a change from the baseline (where t = 2010 and t+1 = 2011) to alternative states, following changes in the level of the interest rate, inflation, the growth rate and the current account balance. The extreme scenarios are based on the assumption that instead of the €30 million EFA disbursement in 2010, the GoK would have borrowed this amount and increased external indebtedness (i.e. 0.65% in terms of 2011 GDP). We develop two sub-scenarios, A and B in order

[22] Calculated as 30 million euro EFA disbursement less the actual level of GoK bank balances as a share of GDP and compared to the IMF target.

to test separately the respective changes in current account, growth, inflation and interest rate that would be equivalent to the 0.65% change in the external debt share in GDP. In the sub-scenario IIB we combine changes in all the four categories with an equal equivalent share of 0.16% external debt in GDP each. Table 3-7 shows the results of the Milessi-Feretti and Razin approach for Scenario II:

Table 3-7: Scenario II: GoK assumes external debt

Macroeconomic indicators	Baseline 2010	Scenario IIA Separate effects, changes to baseline	Scenario IIB Combined effects, changes to baseline
Non-interest current account balance in GDP	-18.3	-0.65	-0.16
Real growth rate of GDP	3.9	-2.15[23]	-0.5
Domestic GDP deflator inflation	3.7	-2.15	-0.5
Effective nominal interest rate	4.0	2.20	0.55

Source: CBK, IMF, own calculations.

Data on external debt was taken from the CBK and the remaining data from the IMF (2012). Information on overall Kosovo interest payments on total external debt (i.e. public and private) is not available. Thus a 4% interest rate was assumed. Scenario IIA accounting exercise shows the respective effects equivalent to an increase of Kosovo's external debt by 0.65% of GDP. This could have either happened via an increase of the current account deficit by the same amount of 0.65% of GDP, or in low growth with a GDP growth rate decline of about 2.15 percentage points to a growth rate of some 1.8%, or alternatively via a drop of price increases of similar size, or finally via an increase of the effective nominal interest rate by 2.2 percentage points.

The reason for the GDP, inflation and interest figures to appear quite large as compared to the current account change or the equivalent change in the indebtedness figure lies in the very different quality of the respective variable. The change in the current account balance is expressed as a share in GDP. The GDP and inflation variables represent growth rates. Finally the interest rate is expressed in percent of the principal. Hence, the change in the current account balance in % of GDP is of the same size as the respective change in external debt in % of GDP. However, in order to achieve an equivalent effect to the respective increase in external debt in % of GDP by reducing the denominator – i.e. GDP, it needs a larger figure. In our case this is a reduction of GDP growth by 2.15 percentage points.

The rising current account deficit is the most likely accounting effect related to increasing external debt, as Kosovo's GDP growth is mostly determined by household demand, inflation is determined by world commodity prices, and effective nominal interest rates are determined by the IFI's credit to Kosovo. In any case, we have calculated an additional sub-scenario IIB, where all the four possible impact channels contribute equally to cover the total 0.65% of GDP external debt increase. Here the results are smoother. The equivalent accounting effects are a 0.16% of GDP increase of the current account deficit, combined with about half a percentage point decrease both in GDP and inflation growth rates, as well as an increase of the interest rate by 55 base points.

[23] This apparently sizable effect can be explained by the accounting operation that underlies it – in order to increase a certain share in GDP via a GDP drop, the change in the growth rate has to be a multiple of the share value.

3.4.3 *Scenario II: GoK Debt Reduced*

This last scenario employs the same methodological approach as Scenario II, however it simulates an extension of the EFA and a disbursement of the 2nd tranche of €20 million in December 2010. This would have reduced Kosovo's external debt level by 0.43% of 2011 GDP. Again, two sub-scenarios are developed. In sub-scenario IIIA the equivalent effects due to changes in the four categories are considered separately. In the sub-scenario IIIB equally weighted combined effects are calculated (0.11% external debt to GDP ratio each). Table 3-8 shows the results of the counterfactual analysis in Scenario III:

Table 3-8: Scenario II: GoK reduces external debt after 2nd tranche

Macroeconomic indicators	Baseline 2010	Scenario IIIA Separate effects, changes to baseline	Scenario IIIB Combined effects, changes to baseline
Non-interest current account balance in GDP	-18.3	0.43	0.11
Real growth rate of GDP	3.9	1.46	0.38
Domestic GDP deflator inflation	3.7	1.48	0.38
Effective nominal interest rate	4.0	-1.45	-0.38

Source: CBK, IMF, own calculations.

In sub-scenario IIIA we find equivalent separate effects of either: a reduction of the current account deficit of 0.43% of GDP; or almost a 1.5 percentage points higher GDP growth rate; or inflation rate; or an effective nominal interest rate lower by 1.45 percentage point. The most likely equivalent effect related to a reduction of external debt would have been a reduction of the current account deficit.

Finally in sub-scenario IIIB equally weighted combined effects equivalent to a 0.43% of GDP reduction of the external debt level were calculated. This includes a drop in the current account deficit by 0.11% of GDP; a rising GDP growth rate as well as inflation rate by 0.38 percentage points; and lower interest rates by 38 base points.

Taken separately, some of these equivalent accounting effects appear to be significant. However, most of them (especially GDP growth, inflation and interest rate) seem very unlikely as they should be determined mostly endogenously. While changes in the current account deficit in the order of about half a percentage point of GDP are regularly related to additional foreign capital in- or out-flows and would not have caused major concerns. Moreover, the combined effects scenarios show values of an order which is often surpassed by regular data revisions each year.

3.5 Indirect and Unexpected Macroeconomic Effects of Structural Conditionality

Q3.2 What, if any, has been the contribution of actions resulting from the respect of structural conditionality criteria to the achievement of short and medium-term macroeconomic objectives of the assistance (i.e. the indirect effects of structural conditionality criteria)?

In essence, all conditions attached to the two tranches of the MoU signed in 2007 are structural and they have the potential to induce an impact on macroeconomic and fiscal development. For instance, conditionality related to statistics fosters sounds macroeconomic planning, while conditionality related to debt management capacity stimulate the development of the domestic financial market and ensure that the government has room for fiscal manoeuvre. Since all structural conditions are analysed in Chapter 4, we examine at this stage the potential and realized indirect macroeconomic effects that came from implementing conditions in three different areas:

1. *MTEF (condition b)*:
   A reliable framework for expenditure planning is a prerequisite for maintaining stable macroeconomic policy. An MTEF is a useful tool to improve the efficiency and effectiveness of expenditure allocation and enhance sectoral performance by dedicating resources according to policy priorities. It can also contribute to a more prudent government spending behaviour;
2. *Privatisation (conditions e, h and k)*:
   If carried out carefully, the transfer of property rights from the public to the private can contribute to fiscal stabilization through limiting budget deficit and public debt. It can also reduce unemployment, and stimulate technological change[24];
3. *Fiscal impact analysis (condition f):*
   Fiscal impact analysis seeks to bridge planning and local Economics by calculating costs and revenues associated with capital investments and other spending measures. Fiscal impact analysis of proposed legislation limits the scope for populistic spending proposals aimed at securing electoral support. It also ensures that proposed policies have a certain degree of effectiveness and efficiency.

If these conditions were implemented as a result of the EFA operation, and if they had significant macroeconomic effects, then these effects may have contributed indirectly to the achievement of the macroeconomic objectives of the operation.

Q3.3 Has the assistance given rise to any unexpected short and medium-term (…) macroeconomic effects? What were they and how did they occur?

The EFA has indirectly contributed to the successful organisation of the July 2008 Donor Conference. Three arguments can be invoked:
- The conference represented a sign of confidence in Kosovo's institutions by all participants. Building this trust may not have been possible if there was no agreement over macroeconomic and fiscal policies between the GoK and the EU/IMF;
- One of the preconditions for the Conference was that the GoK presented a functioning MTEF that accurately outlined Kosovo's financial needs over the medium term. The strengthening of the MTEF process was one of the conditions included in the EFA MoU;
- I is unlikely that the Conference would have taken place if the GoK and the EU/IMF disagreed on the macroeconomic policies and directions formulated in the MoU and the 2005 MEFP.

The pledges made at this conference, amounting to €1.2 billion (see Table 3-9), contributed to the macroeconomic stabilisation of Kosovo. Pledges included more than €500 million of EU funds, committed mainly through IPA, CARDS, the Instrument for Stability and other initiatives. The EC pledged an additional €100 million as budget support, in addition to the EFA agreed on in 2006.

[24] See Yannis Katsoulakos and Elissavet Likoyanni (2002): Fiscal and other macroeconomic effects of privatisation, as well as Jeffrey Davis, Rolando Ossowski, Thomas Richardson, and Steven Barne (2002): Fiscal and Macroeconomic Impact of Privatisation, IMF Occasional Paper 194.

Table 3-9: Donor pledges to Kosovo, 2008 Donor Conference

Donor	Pledge (million Euro)
European Union	508
EU Member States	258
USA	256
Turkey	30
Norway	50
Saudi Arabia	30
Others	68
Total (billion Euro)	**1.2**

Source: EC (2008).

Interviewed stakeholders considered that the Donor Conference had mixed effects. Many of the disbursed pledges facilitated macroeconomic and structural reforms. But the fact that so much support was promised to some extent led to the laxer spending policy of GoK in the aftermath of the Conference, thereby causing negative effects on the fiscal balance and hindering macroeconomic stability.

3.6 Evolution of External Sustainability Indicators

As mentioned in Chapter 1, the EFA did not explicitly target any external sustainability issues. The analysis of BoP and debt sustainability in this section is therefore not specifically linked to the EFA operation.

Table 3-10 provides an overview of the macroeconomic indicators that are used to assess the progress in achieving external financial stability.

Table 3-10: Overview of indicators of external sustainability

External Financial Situation	Indicator
Balance of Payments	• Current account balance; • Components of current account: exports, imports, current transfers; • Capital and financial account balance; • Inflow of foreign direct, portfolio and other investment; • International reserves; • Remittances.
Debt Sustainability	• External and domestic debt; • Debt service payments; • Foreign-currency debt ratings; • Liabilities of banks.

3.6.1 Balance of Payments

Table 3-11 summarizes the main indicators related to Kosovo's current account in the period 2007-2012.

Table 3-11: BoP indicators for Kosovo, 2007-2012, in millions of euros, unless otherwise indicated

	2007	2008	2009	2010	2011*	2012**
Exports	177	196	177	305	322	355
Imports	1545	1930	1851	2081	2412	2442
Exports in % of GDP	5.2%	5.1%	4.5%	7.2%	6.9%	7.2%
Imports in % of GDP	45.3%	50.1%	47.3%	49.3%	52%	49.7%
Coverage ratio (Exp/Imp, %)	11.45%	10.2%	9.6%	14.7%	13.4%	14.5%
Trade Balance	-1368	-1668	-1673	-1375	-2090	-2087
Current account balance, incl. official transfers	-302	-615	-604	-732	-943	-899
Current account balance, incl. official transfers, in % of GDP	-8.8%	-16.0%	-15.4%	-17.4%	-20.3%	-18.3%
Capital and financial account	69	494	543	553	743	608
- Capital account;	1	-2	108	25	6	2
- Financial account.	69	495	435	527	737	605
Capital and financial account, in % of GDP	2.02%	12.8%	13.9%	13.1%	16.0%	12.4%
FDI, net	431	341	277	358	371	423
FDI, in % of GDP	12.6%	11.2%	7.1%	8.5%	8.0%	8.6%
Remittances	516	516	506	512	548	553
Remittances in % of GDP	15.1%	13.4%	12.9%	12.1%	11.8%	11.3%

Source: IMF (2012) and IMF (2011). * Estimates **Projections.

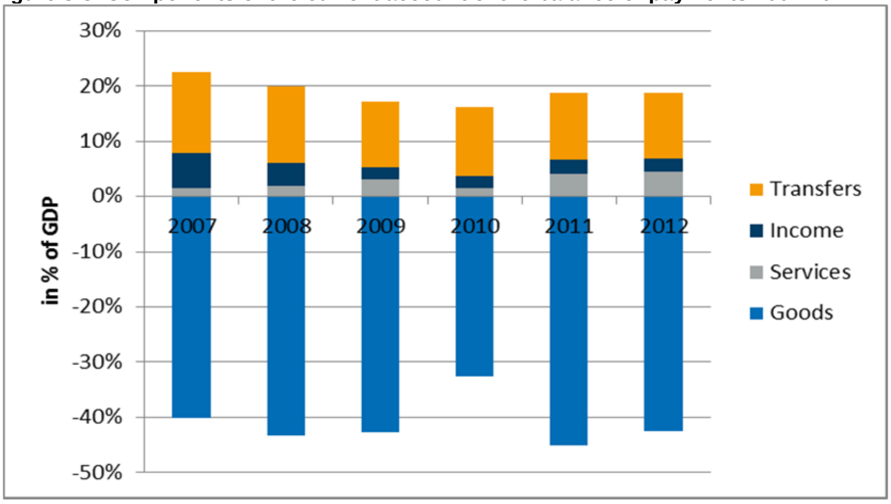
Overall, the trade deficit has been increasing over the last five years, and imports registered a significant jump from 45% of GDP in 2007 to above 50% in 2011. This reflects the more lax spending policy of the Government and the associated increase in both public and private consumption. Increases in imports are also related to the motorway construction, which led to a higher demand for both goods and services from abroad. Exports are still very low and have not been able to compensate the growth in imports, even though the export value doubled between 2007 and 2012. The coverage rate of exports as a share of imports has improved over the period, and is expected to reach 14.5% in 2012, from 10.2% in 2008 (see Table 3-11).

Current Account and Its Components

Since 1999, Kosovo has been running wide current account deficits. Figure 3-3 shows the composition of the current account deficit for 2007-2012. The deficit can be primarily explained by the trade balance deficit, which is a consequence of Kosovo's low production capacity and of the significant imports related to post-conflict reconstruction. In recent years, the growth in imports has been associated with the overall economic growth and the increased demand for construction goods resulting from infrastructure investment. This improved the structure of imports even though consumption goods still take the lion's share. The domestic market displays insufficient - though increasing- capacities to provide substitution for imported goods. Kosovo is highly dependent on official transfers and remittances, and its current account has been influenced by some one-off transactions[25]. The income account, which is driven by the compensation of employees, has declined since 2007, most notably due to the reduction of local staff employed by KFOR.

[25] Most notably receipts through the MDTF in connection with the repayment of the Kosovo C loan - a past Federal Republic of Yugoslavia debt to the International Bank for Reconstruction and Development (IBRD) amounting to about €381 million.

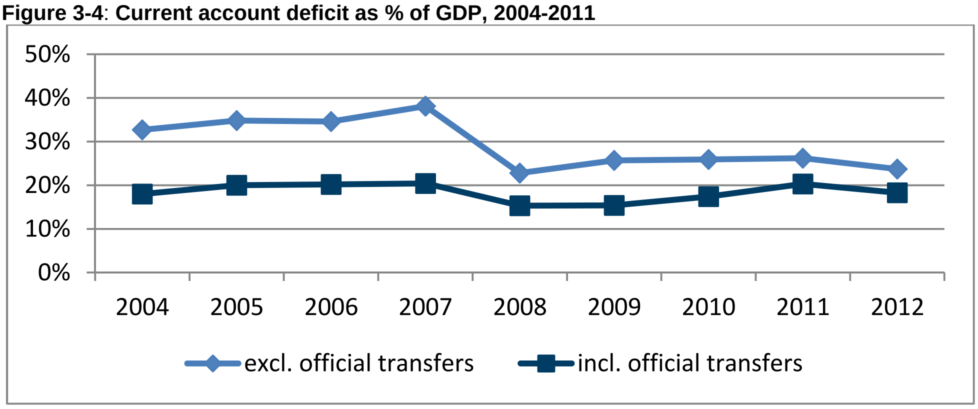
Figure 3-3: **Components of the current account of the balance of payments 2007-2012**



Source: IMF (2011) and IMF (2012).

Figure 3-4 shows the development of the current account deficit, before and after official transfers for the period 2004-2012. The current account deficit (including official transfers) reached its lowest level in 2008 at 15.4% of GDP (of which 7.5% official transfers). Exports growth resulting from the privatisation and the re-activation of production in some factories drove this trend, as well as a sharp rise in base metals prices in 2008. In nominal terms, exports increased over 250% between 2006 and 2008, but starting from a low base. Exports achieved a real growth rate of 24.2% in 2010, and their share in GDP reached 7.2% the same year from 4.5% in 2009.The current account deficit widened significantly since 2008, in particular due to growing imports of commodities, and to a deteriorating service account associated to construction in 2010. The latter has the potential to offset significant improvements in the performance of exports. In addition, export performance was weaker in 2011, causing the current account deficit to further widen to 20.3%. This deficit is estimated to go down in 2012 due to expected higher metal exports and lower infrastructure-related imports.

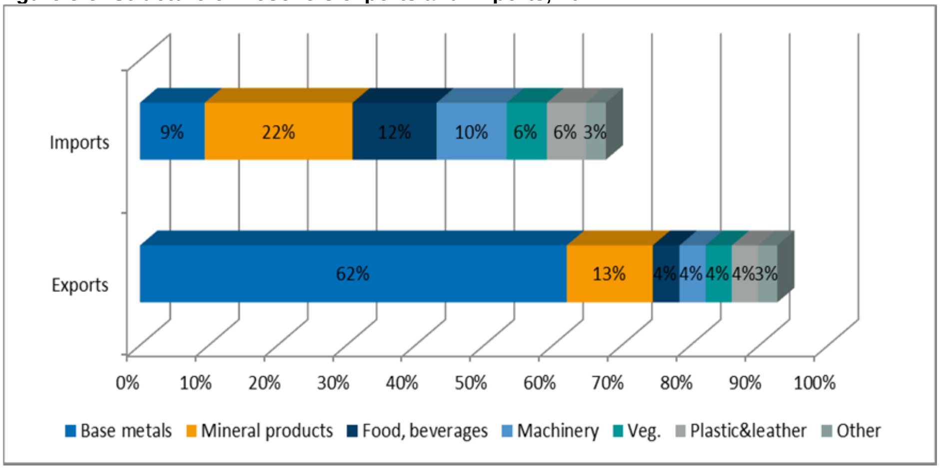
Figure 3-4: **Current account deficit as % of GDP, 2004-2011**



Source: EC (2007) and IMF (2012).

Imports in Kosovo were estimated at about 50% of GDP in 2008. The current account deficit has therefore been very high, but the structure of import has improved after 2008. While energy and consumption-related goods still represent the bulk of imports (20.1% and 19.7% of total imports for 2008 respectively), machinery, base metals and chemistry products combined amounted to about 27% of all imports. This suggests that Kosovo is developing its production capacity, which could lead to future improvement in the current account balance. Exports have also diversified slightly, yet base metals are still traditionally very strong. Figure 3-5 presents Kosovo's export and import structure for 2011.

Figure 3-5: Structure of Kosovo's exports and imports, 2011

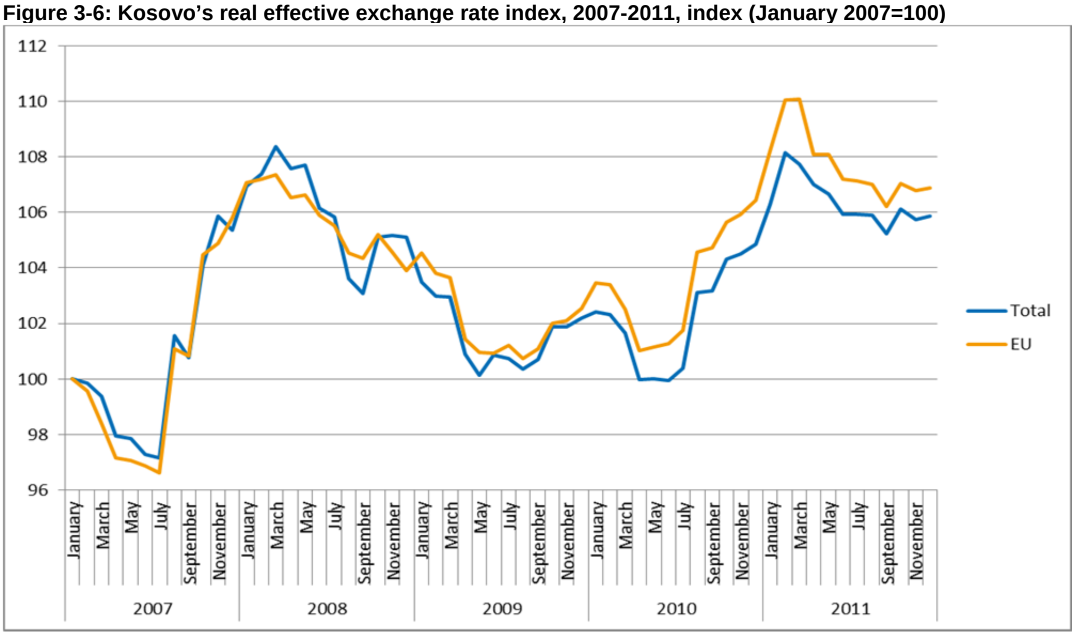


Source: CBK (2011).

In 2010, Kosovo's exports went primarily to Italy (27.1% of the total export volume) and to Albania (10.4%). Most imports came from Macedonia and Germany (14.8% and 13% respectively).

The real effective exchange rate (REER) of Kosovo depreciated with about 8% over the last ten years, in particular in the period 2003-2006. The REER follows closely import price dynamics and has been driven by increases in the inflation rate compared to Kosovo's trading partners[26]. Since 2007, Kosovo's REER has appreciated (see Figure 3-6), as domestic inflation increased more rapidly than inflation in the EU and in Kosovo's trading partners. In the period 2007- 2011 the REER appreciated against the EU by almost 8% therefore posing an additional burden on Kosovo's competitiveness. Still, while REER has an impact on the current account balance, its potential as a policy tool to influence trade dynamics is limited in the absence of independent monetary and exchange rate policy.

Figure 3-6: Kosovo's real effective exchange rate index, 2007-2011, index (January 2007=100)



Source: Central Bank of Kosovo.

[26] At the same time, a cautionary note should be put with respect to reliability of the data, which is suggested to suffer under-reporting, in particular as regards real wages (IMF 2011).

Remittances

Kosovo's economy relies on current government and private sector transfers. Remittances from the diaspora form the largest part of private transfers (see Figure 3-7). Around 400,000 Kosovars are estimated to have flown the country and to live abroad since 1998[27], mostly in Germany and Switzerland. In 2010, around 20% of the households received cash remittances worth €192 million and an additional € 250 million non-cash remittances representing in total around 13% of the GDP. This share is much higher than in other countries in the region, but already lower than the estimated 15% of the GDP in 2007. The ongoing economic crisis, although not impacting Kosovo's economy in any other major way, has had some impact on remittances. This impact seems to be smaller than in most neighbouring countries, because Kosovo immigrants are located predominantly in Northern European countries, as well as Germany and Switzerland, while diaspora from other Balkan countries is located in countries harder hit by the crisis such as Italy and Greece. CBK notes in its June 2011 Financial Stability Report that there was renewed growth in the remittances flow for the first half of 2011.

Capital and Financial Account

If the amounts for debt forgiveness for the Kosovo C loan are excluded from the calculation, Kosovo's capital account balance has been very low, yet stable. It ranged between 0 and €5 million in the period 2007-2011.

FDI is a major factor partially compensating the current account deficit. Like remittances, FDI originates in Kosovo's diaspora in the EU and Switzerland. Net FDI was negligible immediately after the 1999 war, but it improved substantially after 2004, building to a large extent on the improvement in Kosovo's external relations and the stabilization of the economy. In 2007 FDI reached 12% of GDP. Since then, it has fluctuated between 7% and 9% of GDP, and its net value could not regain the 2007 level of €431 million. The decline has been both in capital and re-investments, explained by a decline in the profits of foreign bank subsidiaries and other foreign companies present in Kosovo.

FDI in Kosovo is still at a very low level compared to other transition countries in the region, owing mainly to low productivity, poor infrastructure, and unfavourable business climate[28]. The share of FDI in financing Kosovo's current account deficit has been diminishing since 2008. Nonetheless, improvements to stimulate investments have been made in 2009, when the government introduced a 10% corporate income tax and a progressive personal income tax system. A small positive trend in FDI is expected for 2011-12, as another round of privatisation is ongoing, and the economic situation is stabilizing in countries such as Germany, a strategic trade partner of Kosovo. Currently, the banking, mining and construction sectors attract the highest shares of FDI. Germany and Slovenia are the countries of origin with the largest net FDI in 2010.

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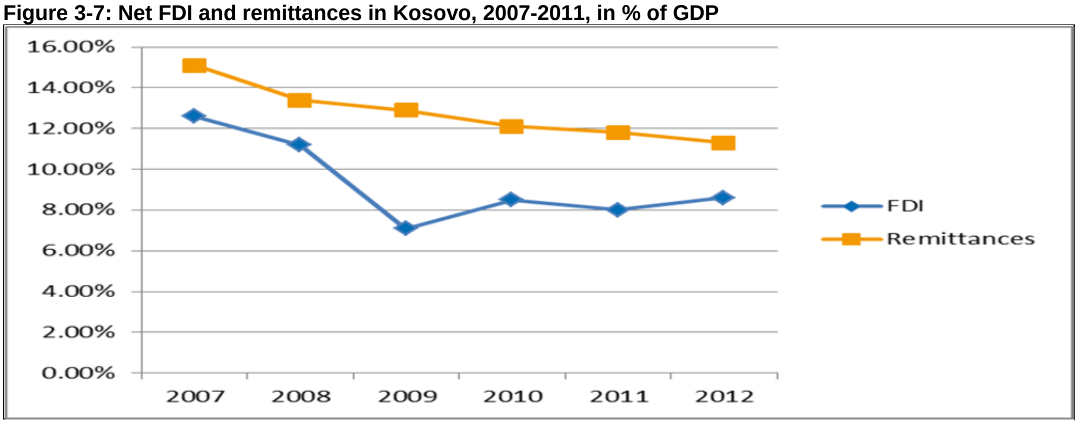
27 UNDP (2010), Kosovo Remittances study 2010.

28 The World Bank Doing Business Report 2011 ranks Kosovo 119th of 183 countries. The three main challenges identified are electricity, corruption, as well as the impact of informal practices.

Figure 3-7: Net FDI and remittances in Kosovo, 2007-2011, in % of GDP



Source: IMF (2012) and IMF (2011).

The portfolio investments made by commercial banks as well as by the KPST decreased sharply in 2009-10 due to the impact of the global economic and financial crisis on the securities and capital markets, which made such types of investments unattractive. In 2011 portfolio investments recovered slightly, mainly driven by increased investments by KPST.

3.6.2 *Debt Sustainability*

Public Debt

The relatively low level of public debt can be explained by a combination of several factors. Those include the conservative fiscal policy pursued in the period before 2008, paired with low administrative capacity and only recently removed inability to issue debt in terms of sovereign debt obligations and thus borrow domestically from the CBK. In 2010, the gross public debt to GDP ratio amounted to16.7%, and estimates for 2011 indicate that it might even lower somewhat to 15.3% (see Table 3-11).

After the 2008 status settlement, two major events affected the development of Kosovo's public debt. First, in 2009, the Parliament elaborated a Public Debt Law, which placed a ceiling on public debt at 40% of GDP. Second, Kosovo had to start repaying the "Kosovo C" loan of €381 million to the IBRD, which had been contracted when it was still part of Yugoslavia. A MDTF was established under the administration of the World Bank in order to assist the repayment of the loan, and in 2009 the MoF pre-paid a third of the total amount through the MDTF[29].

Kosovo faces further contingent liabilities, most notably to the Paris and London Clubs creditors. These could be similar or even larger than the IBRD debt. IMF estimates them to amount to about €442 million[30]. In the event that Kosovo assumes these liabilities, the consequences for debt sustainability would be significant. Otherwise, the debt sustainability analysis (DSA) undertaken by the IMF and the Bank indicates Kosovo's risk of debt distress is moderate.

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29 Thus far, the trust fund has received US$ 150 million from the United States, €5 million from the European Commission, and US$ 0.75 million from the Swiss Government. World Bank (2009), Interim Strategy Note for Kosovo 2010-2011.

30 Amount mentioned in WB Public Expenditure Review 2010.

Table 3-12: Total public debt 2009-2015, in millions of euros

Description	2009	2010	2011 (est.)	2012 (proj.)	2013 (proj.)	2014 (proj.)	2015 (proj.)
Total public debt	690	729	789	929	1,190	1,334	1,485
- External;	690	729	789	829	924	1,020	1,115
- Domestic.	0	0	0	100	266	314	370
(Total public debt in % of GDP)		16.7	15.3	17.6	20.0	20.5	21.3
Debt service to export ratio (in %)	21.9	2.6	2.2	2.4	2.3	2.8	3.7

Source: IMF (2011).

This DSA projected that total public debt would increase sharply throughout the construction period of Route 7. Upon completion of the project, in the period 2012-15, the debt service is projected to increase substantially due to re-payment of construction-related loans, as well as due to obligations to the IMF[31].

In 2012, the Government of Kosovo issued short-term debt and successfully auctioned three-month government bills (T-bills) for the first time in its history. The amount raised from three auctions was around €30 million. Kosovo still lacks a credit rating from an international agency in order to also be able to tap into international financial markets and sell government papers with increased maturity. Although domestic borrowing is projected to increase in the coming years, external borrowing is still expected to finance the bulk of financing needs in the medium term according to the DSA.

Private Sector Indebtedness

Bank lending to the private sector has been increasing as a share of GDP since 2008. The growth rate of the credit market slowed down from 32.7% in 2008 to around 10% in the subsequent years, reflecting a more cautious approach to lending both to households and to the commercial private sector. Overall loans to households account for approximately 30% of all private sector lending activity. In the same period, the ratio of non-performing loans[32] has been increasing, and it is projected to double in 2012 as compared to its 2008 level (see Table 3-13). Although non-performing loans have had a certain negative impact on the banking sector' s credit portfolio quality, they are fully covered with reserves against losses, and their share is still the lowest in the entire region. The slight decrease in interest rates on loans to the private sector reflects the perceived moderate to modest risk associated with non-performing loans. In 2011, average interest rate on loans to households went down by 0.4 percentage points to 12.4% compared to one year before, and interest rate on loans to the business sector decreased by 0.6 percentage points, to 15.6%[33].

Table 3-13: Debt sustainability indicators, 2008-2012

	2008	2009	2010 (est.)	2011 (proj.)	2012 (proj.)
Bank credit to the private sector (in % of GDP)	30.7	32.9	34.6	35.0	35.9
Deposits of the private sector (in % of GDP)	29.6	35.6	40.9	41.1	42.2
Loans to the private sector (annual % change)	32.7	8.9	12.6	12.9	11.0
Non-performing loans (% of total loans)	3.3	4.3	5.2	5.9	

Source: IMF (2010): Debt Sustainability Analysis.

31 IMF/ World Bank (2010): Debt Sustainability Analysis of the Republic of Kosovo.
32 This includes increases both in"suspicious" and "lost" loans.
33 CBK (2011), Financial Stability Report December 2011.

Subsidiaries of foreign banks (based, among others, in Austria, Slovenia and Germany, as well as Turkey) dominate Kosovo's banking sector. Of the eight commercial banks present in the country in 2011, only two are domestic. The three largest banks concentrate about three-quarters of the total assets of the banking system. The banking sector is considered to be stable, with non-equity liabilities consisting up to 70% of household deposits. The share of non-resident deposits is growing (5.1% in 2011 compared to 4.3% in 2010). Favourable interest rate on deposits as well as the increasing use of official channels for remittance transfers from the Kosovo diaspora account for this trend. The expansion of private sector credit prior to the global crisis was mostly based on this substantial deposit base rather than on foreign borrowing, thus posing some risk for liquidity pressures. The CBK solved those pressures through decisive measures in order to lower the loan-to deposit ratio[34].

3.7 Identification of Major Risks

Q4.2: What are the main internal and external factors on which the current trend in Kosovo's external financial situation and its prolongation into the future are conditional?

Uncontrolled Government Spending

In recent years, the GoK has shown a tendency of deviating from the tight fiscal adjustment path negotiated with the international community. This contributed to an initially estimated fiscal deficit of about 5% of GDP for 2011, subsequently revised to the current figure of 1.9%. Medium-term projections foresee some deterioration of the fiscal deficit for 2012-13, but expect a return of fiscal deficit to levels below 3% after that. However, based on recent experience, turning these projections into reality might prove elusive.

Kosovo is now in a position to borrow on the financial markets. Despite the legally-defined ceiling, the DSA carried out in 2010 did not rule out pressures on debt sustainability. It estimated that in the case of an increase of 2% in the primary fiscal deficit until 2031 would se the path of public debt on a largely unsustainable trajectory. In a scenario with low growth and high fiscal deficits, the DSA projects that by 2030, the present value of debt-to-GDP ratio would reach 36% and the present value of debt-to-exports ratio would reach 181%. Currently the GoK and IMF discuss on lowering the legally accepted level of debt to 30% of GDP, to account for the Kosovo's small export base.

Remittances

The on-going global economic crisis might impact the remittances flow to Kosovo and pose an additional risk on the large current account deficit. Stronger negative shocks to remittances could limit the availability of resources for the financial sector. This could also increase credit risk, because part of bank lending is based on the borrowers' receipts from remittances.

Export Performance

The continued and accelerated development in export sectors is a necessary condition for ensuring macroeconomic stability in the long term. Kosovo's exports have been sluggish, mainly due to the lack of a solid production base in the country. Although the situation is improving, the small exports base is one of the main challenges for the future external sustainability of the country.

[34] IMF (2010): Republic of Kosovo. Request for a Stand-by Agreement.

Lack of Clarity of Loan Repayment Issues

The status of the liabilities of Kosovo to the Paris and London Club creditors is unclear, especially related to the past FRY debt. In case those need to be repaid, debt sustainability projections might show significant deterioration in the country's external position.

4 Impact on Structural Reforms

4.1 Introduction

One of the key EFA evaluation questions pertains to the structural reforms that were attached as conditionality to the EFA operation. This question is supported by five sub-questions, which are presented below.

Table 4-1: Evaluation question on structural reform and sub questions[35]

Q2.	**To what extent has the EFA assistance been effective in terms of supporting structural reform in Kosovo?**
Q2.1	What are the short and medium-term expected structural effects* of the assistance to Kosovo?
Q2.2	How relevant are the short and medium-term expected structural effects of the assistance to the needs of Kosovo?
Q2.3	To what extent have the short and medium-term expected structural effects* of the assistance to Kosovo occurred as envisaged?
Q2.4	What has been the contribution of actions resulting from the respect of structural conditionality criteria to the occurrence of expected structural effects?
Q2.5	To what extent have structural effects been enhanced, if at all, by complementarities between the EFA assistance and other EU instruments?

* Or explicit objectives if there have been identified.

Several of the other questions are partially concerned with the structural reform conditionality:

Table 4-2: Evaluation questions relevant for EFA assistance effects on structural reform

Q0.	**How would the economy of Kosovo have evolved in the absence of the assistance?**
Q0.1	What are the macroeconomic and *structural* effects if the total assistance package (EU + IMF) had not been granted?
Q0.2	What are the macroeconomic and *structural* effects if only EU assistance (EFA) had not been granted?
Q3.	**What have been the indirect and/or unexpected effects of the EFA assistance?**
Q3.2	What, if any, has been the contribution of actions resulting from the *respect of structural conditionality* criteria to the achievement of short and medium-term macroeconomic objectives of the assistance (i.e. the indirect effects of structural conditionality criteria)?
Q3.3	Has the assistance given rise to any unexpected short and medium-term *structural* and/or macroeconomic effects? What were they and how did they occur?

In total, the EFA MoU set forth 12 conditions, the first five (“a” to “e”) linked to the first tranche and the last seven (“f” to “l”) linked to the second tranche. The list of conditions is presented in Table 2-2 of this report. The conditions can be roughly grouped in three categories:
- Framework of economic and fiscal policies (conditions a, b and l);
- Public Finance Management (PFM) and audit (conditions c, d, f, i and j);
- Privatisation and liquidation of SOEs and POEs (conditions e, g, h and k).

This chapter puts the EFA operation in the context of structural reforms and presents our main findings. Following discussions on the interim report, the Steering committee opted for a presentation of the analysis by condition rather than by sub-question.

[35] See page 10 of the “Guidelines for ex post evaluation of MFA/BoP assistance”, May 2010.

4.2 Expected Effects of the Structural Conditions

Q2.1 What are the short and medium-term expected structural effects of the assistance to Kosovo?

The EFA and the conditions attached to it were expected to support Kosovo authorities to engage on the path of reform in a number of key areas that could impact macro-economic stability positively. Table 4-3 presents the expected and potential impacts of the 12 conditions as reconstructed by the evaluation team based on various interviews and based on the documents available (including the formulation of the conditions in the MoU).

Table 4-3: Expected and potential effects of the EFA conditions

Condition	Short term effect	Medium term effect
a: IMF	Kosovo continues its dialogue/ relationship with the IMF.	Kosovo develops / implements policies in line with international best practices.
b: MTEF	Ensure MTEF is produced *and* regularly updated.	"enhance medium term policy planning and to support the budget process" (MoU).
c: Central Harmonization Unit (CHU) – audit	Give an impulse to institution building on internal audit according to international best practices.	Ensure appropriate checks and balances are in place for maximum accountability; "ensure sound and effective PFM" (MoU).
d: Freebalance – treasury	Improve availability of data through better use of the system.	Improve basis for swift financial decision making.
e: Privatisation proceeds	Ensure the use of proceeds is in full compliance with existing laws.	Ensure resources are used for the benefit of the economy.
f: Fiscal impact analysis	Increase awareness of financial implications of legislation and improve quality of debates.	"Ensure that social policies addressing poverty and social exclusion are compatible with the long run sustainability of public finances" (MoU).
g: KEK	"Strengthen KEK viability" (MoU).	Reduce the burden that KEK represented to the public finances of Kosovo.
h: Strategy for privatisation of POE	"Strengthening corporate governance and performance of POEs" (MoU).	"Reducing subsidies to the enterprise sector" (MoU) and therefore the implications for the government budget.
i: Debt management capacity	Build capacity to deal with potential inherited debt.	Develop and strengthen debt management capacity to reduce the future fiscal risks related to a high debt burden.
j: Public procurement help desk	Ensure support on public procurement to spend allocated investment budgets.	"Facilitating preparation and execution of capital expenditure" (MoU).
k: Privatisation SOE	"Accelerate the pace of liquidation of SOEs" (MoU).	Continue with privatisation and improve the structure of the economy.
l: Statistics	Improve Statistical Office of Kosovo (SOK) and its quality of national accounts and labour market statistics.	"Provide policy making with timely and high-quality statistics" (MoU).

Source: table generated by the evaluation team.

4.3 Relevance and Impact of Structural Conditions

The MFA/EFA evaluation methodology asks for an assessment of the structural conditionality of each operation in terms of relevance and impact (gross and net). Based on the information available, each condition is assessed on a three-point scale: good, moderate or limited. The table below presents a summary of this assessment, which is further explained in this chapter's subsections.

Table 4-4: Assessment of Relevance and Impact of Structural Conditions

Condition	Relevance	Progress (gross effect)	EFA role (net effect)
A: IMF	Good	Moderate	Limited
B: MTEF	Good	Good	Moderate
C: Internal audit MoF	Moderate	Good	Moderate
D: Freebalance	Moderate	Good	Limited
E:Privatisation proceeds	Moderate	Good	Moderate
F: Fiscal impact assessment	Good	Moderate	Moderate
G: KEK billing/collection	Good	Moderate	Limited
H: POE privatisation strategy	Good	Moderate	Moderate
I: Debt management capacity	Good	Good	Limited
J: Public procurement	Moderate	Good	Limited
K: SOE privatisation rhythm	Moderate	Moderate	Moderate
L: Statistics roadmap	Good	Moderate	Limited

Relevance

Q 2.2 How relevant are the short and medium-term expected structural effects of the assistance to the needs of Kosovo?

The evaluation team assessed the conditionality attached to the EFA in Kosovo in the institutional, economic and political context of Kosovo in 2006. At that time, Kosovo was an emerging state recovering from difficult years. It still needed to develop functioning institutions at all levels.

The EC discussed at length the EFA conditions with the UNMIK and PSIG authorities to retain those elements likely to:

- address the most critical issues (for example speeding up privatisation);
- reinforce on-going positive processes (such as the drawing up and update of MTEFs); or
- jump-start reforms that faced a difficult take-off (such as costing proposed policies).

A number of these conditions were also closely related to subjects covered in the “shadow” programme laid down in the MEFP agreed with the IMF in November 2005.

The interviews with different key stakeholders shed some light on the logic underpinning the choice of the 12 conditions of the MoU. From the Commission's perspective it was important that the conditions be appropriate to the situation of Kosovo at the time (aspiring to statehood and needing to build an entire State apparatus). The conditions had to:

- cover topics perceived as important by the Kosovo authorities so that they could assume ownership for them;
- be achievable in the short-term in order to allow for the disbursement of the EFA funds; and
- touch on issues that could use an additional impulse for swift implementation.

The Kosovo counterparts in the agreement were acutely aware of the need to address many fundamental needs concomitantly. Interviewees pointed out that the conditions addressed topics on which the authorities were already working or planning to work. Therefore, the conditionality represented an additional incentive towards enacting and sustaining reform.

Gross Impact

Q 2.3 To what extent have the short and medium-term expected structural effects of the assistance to Kosovo occurred as envisaged?*

Gross impact refers to the overall progress recorded in the different areas of reform targeted through the MFA/EFA conditionality. Our assessment of reform progress is based on the IMF interim review, IMF Mission findings, IMF staff reports and country reports and EC Progress Reports as well as interviews with key stakeholders in Pristina and Washington DC.

Overall, the situation in Kosovo in 2012 is quite different from that of 2007, when the EFA MoU was negotiated and signed. In 2007, the Kosovo public administration had little experience and capacity to plan and carry out its functions. Although building a competent public service is still work in progress, it is no longer the major constraint it once was. In 2007, Kosovo's status was still undetermined. Over the past five years Kosovo has acted in practice as an independent State, working hard on the construction and reinforcement of its institutions and policy frameworks. Good progress was recorded in most areas concerned by the EFA conditionality.

Counterfactual

The MFA evaluation guidelines and methodology require that the evaluation team generates some hypotheses on the dynamics of the *structural* reforms in the absence of:

- the MFA/EFA *and* IMF package provided (Q0.1);
- the MFA/EFA assistance only (Q0.2).

In the case of Kosovo, these are several elements that need to be kept in mind when constructing the structural counterfactual:

- the challenge of building a public administration and a full legal framework in Kosovo has been and remains immense; numerous changes have been enacted with various degree of success, and the State-building process is still in full swing;
- the EFA conditionality has been developed to support already on-going reforms and processes in Kosovo rather than to initiate new ones;
- the interest of the international community for Kosovo is non-negligible. Kosovo received support and advice from many international sources, making it difficult to distinguish and attribute the various influences on policies and on the decision-making process;
- the IMF and the EC have negotiated and made available their macro-economic support to Kosovo at various moments in time[36]. This time-lag makes the tasks somewhat complicated, as conditions were de facto not simultaneous. The counterfactual needs to focus not on the specific formal conditions, but more broadly on the "like-mindedness" of the EC and IMF in speaking with a common voice towards Kosovar authorities over the period – in other words considering what the progress in reforms would have been in the absence of the on-going *dialogue* with the donors rather than in the absence of the combined IMF/EFA package which in fact only existed in practice from June to December 2010.

[36] Pro memoria: The EFA MoU was signed already in 2007 while an agreement with the IMF was only reached in 2010.

Net Impact on Structural Reforms

The question guiding the analysis of the net impact of structural reforms is:

> *Q2.4. What has been the contribution of actions resulting from the respect of structural conditionality criteria to the occurrence of expected structural effects?*

Our analysis suggests that the net impact of the EFA on structural reforms in Kosovo has been limited. While progress was achieved in most areas, an issue being part of the EFA conditionality is never invoked as a (main) explanatory factor for success.

The important time-lag between the design of the operation and the disbursement of the first tranche meant that Kosovo had about three years to prove compliance with the conditions for the first tranche. When the disbursement came on the agenda (2010), the political and institutional situation of the country was much different than three years before, and certain practices had taken root – for example the regular update of the MTEF which was enshrined in the 2008 Law on Public Financial Management and Accountability (LPFMA). Although the second tranche of the EFA was never disbursed, progress had also been recorded on the majority of the conditions linked to it. Since conditions were designed to *reinforce* already existing processes, even in the absence of EFA disbursements, these moved on, often with important (TA) support from the EC and other donors.

> *Q3.1 What, if any, has been the contribution of the political signalling, i.e. confidence boosting effects, of the assistance?*

The "reinforcing effect" of the EFA assistance on structural reforms is defined on two levels:

- *Political reinforcing effect*, assessed in terms of familiarity of relevant stakeholders with the EFA conditions and extent to which these conditions are considered as an incentive to pursue reform;
- *Operational reinforcing effect* assessed on the basis of it having sped up reform implementation or having improved its quality.

Political Reinforcing Effect

Many interviewees do not spontaneously recall the details of the EFA conditionality, as it has not been on the agenda as such for the past couple of years. However, the improvements it called for are still work in progress. Stakeholders can therefore discuss quite easily the progress that has been achieved since 2006.

Reconstructing the "historical" perspective is more difficult as many interlocutors do not remember all details. Some of them did not hold positions of power and were unaware of the higher political stakes. Other do recall pressure from the hierarchy to act on specific issues (for example the viability of the KEK), but they do not recall the EFA conditionality as such being invoked. Nonetheless, most decision-makers at the time emphasise that the most important aspect of the EFA conditionality was providing the government and particularly the MoF with an additional tool to develop and keep the momentum for reform. This was very important in a context in which institutions were still being built and the balance of power depended as much on personalities and relationships as on legal frameworks and collective decisions. As time progressed, the value of this tool appears to have diminished. By 2010, invoking the non-disbursement of the second tranche of the EFA or the SBA going off-track did not seem to have a deterring effect on the decision to increase the wage bill.

A second and equally important political reinforcing effect was to lend the Kosovo government the international credibility it needed in its early years. The willingness of the EC to provide budget support to the Kosovo government by pledging €50 million in EFA had an important effect on reinforcing the status of the Kosovo authorities on the international scene. The fact that the GoK secured EFA implied that the IMF had a favourable view on the overall macro-economic systems of the country. Kosovo authorities further used EFA to push for the organisation of the 2008 Donor Conference, hence launching a reiterative positive effect.

Operational Reinforcing Effect

The extent to which the speed of reform can be attributed to the EFA conditionality is difficult to assess. The period that the GoK had available to fulfil the conditions outlined in 2007 was quite long. The first disbursement was also contingent on a number of issues that delayed it (the settlement of the issue concerning the status of Kosovo, the existence of a financing gap and the existence of a programme with the IMF). At the same time the EFA conditions were phrased in such a way as to be achievable and implemented in the short run. These two factors combined meant there has been no need to rush in fulfilling the conditions.

The first disbursement of EFA occurred in early September 2010. This left little time for preparing the second disbursement that needed to occur before 11 December 2010[37], less than 3 months after the disbursement of the first tranche. It could be expected that this created some pressure on the speed of reforms linked to the second tranche. Our research refutes this hypothesis. As it transpires from the October 2010 Compliance Report, most of the conditions linked to the second tranche had been worked on throughout the 2007-2010 period already. For instance the LPFMA (2008) already enshrined the requirement of the fiscal impact analysis into law. The procurement help desk was set up in September 2009 and the privatisation of SOEs and POEs has been slow, but continuous throughout the period. Since there was no quantitative target attached to any of those conditions, the GoK considered all conditions as fulfilled in October 2010 (see Compliance Report for second tranche). During the autumn of 2010 only one of the seven conditions linked to the second tranche of the EFA was an issue of discussion between the EC and the Kosovo authorities, condition "l" concerning a statistics road map. More information on this condition is presented in section 4.3.12 below as well as in section 5.2 (case study).

A final aspect that we explored was the effect that the EFA had on the negotiation process between the GoK and the IMF over the 2006-2010 period. The majority of key stakeholders interviewed concur that the budget support operation from the World Bank (SEDPO, see Box 6.2) and the EFA of the EC were "sweeteners" or incentives for the authorities to keep negotiating with the IMF. Kosovo authorities would not have given up discussions with the IMF if they did not receive EFA or budget support from the World Bank, but the perspective of unlocking multiple sources of finance by reaching an agreement with the IMF was an incentive to keep negotiating.

4.3.1 Policies Consistent with Understandings Reached with the IMF (a)

Relevance	Progress (gross effect)	EFA role (net effect)
Good	Moderate	Limited

In 2006, Kosovo was not a member of the IMF and only had a "shadow" programme with that institution. The formulation of condition "a" was therefore specifically chosen to ensure that a link

[37] The expiry date of the EFA operation.

was made with the IMF, but was also reflecting the special situation of Kosovo. The condition further aimed to encourage Kosovo to maintain and develop its relationship with the IMF. This was relevant for a fledging State, as it would lend it credibility in the international arena.

Kosovo has had a continuous, albeit at times uneasy, relationship with the IMF. Already in 2005 (2/11/2005), the PISG and the UNMIK co-signed a shadow programme which enshrined the preparatory work done with the IMF to develop a realistic macroeconomic framework. This programme pointed out to the issues that were problematic at the time – high unemployment, heavy wage bill, need to improve control and management of the budget, risk of donor disengagement, burdensome POEs and SOEs etc. The IMF has undertaken regular staff missions to Kosovo, resulting in aide-memoires taking stock of progress.

Kosovo became a member of IMF in June 2009 and an 18-month SBA (€109 million) was signed in July 2010. Only the first disbursement of €20 million was made (in August 2010). The programme was declared formally off-track in 2011 after the newly-elected government fulfilled its electoral promise and raised public sector salaries by double digit figures. In June 2011 the authorities agreed on a six-month Staff-Monitored Program with the IMF until the end of 2011 to establish a track record of disciplined policy that could lead to a new SBA in 2012[38]. Following satisfactory implementation, the two parties negotiated a new SBA (€107 million), which was approved by the IMF Board on April 27, 2012.

Establishing and maintaining relationships with the large international players such as the IMF, the World Bank and the EC was crucial for Kosovo in order to strengthen its credibility as a State. Even in the absence of the EFA condition, the relationship with the IMF is likely to have been sustained. This points out to a limited (though not inexistent) role for EFA in influencing the GoK’s relationship with the IMF.

The limited influence of the financial support of the IMF (SBA) and the EFA is illustrated by the fact that Kosovo politicians did not hesitate to strain relationships with both institutions when larger domestic political interests were at stake. For example, Kosovo authorities stuck to their decision concerning the construction of Route 7 to Albania (early-2010), promised wage increases in the late-2010 elections campaign and further carried out these promises in 2011. These represented clear set-backs for the relationship of Kosovo authorities with international bodies such as the EC and IMF.

4.3.2 Regular and Appropriate Update of the MTEF (b)

Relevance	Progress (gross effect)	EFA role (net effect)
Good	Good	Moderate

An MTEF is an essential document for proper PFM, so encouraging Kosovo to produce, update and use such a document was a first necessary step to strengthening the PFM system. Following the agreement with the IMF in November 2005, the authorities prepared a first MTEF towards the end of the year covering the period 2006-08. At the time, the MTEF document was not much more than a compilation of the multi-annual plans sent by budget organisations.

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38 An SMP is an informal agreement between the authorities and the IMF staff to establish a track record. This agreement is sent to the Board, but not for Board approval, and no financial assistance is provided.

Through the LPFMA (passed in March 2008), preparing and updating an MTEF became a legal obligation for the Kosovo government. The government has provided regular updates of the MTEF in accordance with this Law and the quality of the MTEF has improved over time. Currently, efforts are concentrated on making the MTEF more of a working document and a framework for increased discipline. The budget and the MTEF have also become more coherent and driven by a vision/strategy. In 2011, the MoF introduced a sectoral MTEF approach for all line ministries.

Kosovo authorities were persuaded already in the mid 2000s of the need to align to international best practices for budget and policy planning, also in order to gain credibility. Producing an MTEF is one such practice and all donor insisted that it be followed. In 2007, the MoF was only in the early stages of developing such a document by itself, so some extra pressure coming from the EFA condition was welcome. The LPFMA in 2008 provided clear requirements and deadlines for the update of the MTEF and the government met these ever since.

4.3.3 *Internal Audit and an Operational Central Harmonization Unit in the MoF (c)*

Relevance	Progress (gross effect)	EFA role (net effect)
Moderate	Good	Moderate

In 2007, the 2008-2012 Strategy for the Functioning of the Internal Audit in the PISG was adopted. This was an indication that the Kosovo authorities understood that a functional internal audit function was a stepping stone for a sound PFM system and were committed to implementing it. All internal audit activities have been implemented in compliance with the requirements of the 2008-2012 Strategy for the functioning of the Internal Audit in Kosovo, including the setting up of the CHU (April 2008). The internal audit function is now decentralized with all public sector entities having their own audit units. The EFA condition was meant to reiterate an on-going implementation process and to prevent that it went off-track. This has indeed happened but the result cannot be entirely attributed to the EFA.

4.3.4 *Data Input in the Treasury Software and Related Training (d)*

Relevance	Progress (gross effect)	EFA role (net effect)
Moderate	Good	Limited

Freebalance is a treasury-execution software used mainly in post-conflict countries with good results. Following the (re-)organisation of the Treasury which was achieved with support primarily from USAid, Kosovo was already using *Freebalance* in 2007. The number of officers trained to use the programme at the time was quite limited and according to some interviewees, the software was effectively used only at central level. Municipalities were sending information through conventional reports that then needed to be input in the system in the regional offices[39]. Agents needed additional capacity building to be able to operate the system properly.

Currently, *Freebalance* is used by all government levels. On the expenditure side, completeness and accuracy is ensured as the payments have to go through *Freebalance* in order to be executed by the Central Bank. On the revenue side, monthly reconciliation takes place between revenue

[39] Regional offices were dissolved in 2010.

collecting budget organisations, bank account statements and the Treasury systems. Automatic reconciliations between the Treasury system and the Treasury main bank account have been on-going since 2010. The Treasury further has a permanent training programme in place for budget organisations' staff to ensure proper use of *Freebalance*[40].

Over the period USAid was the main donor to provide continued support in strengthening the functioning of the Treasury, with good results. The relative influence that the EFA conditionality had on progress in this field is therefore limited.

4.3.5 *Use of Privatisation/ Liquidation Proceeds (e)*

Relevance	Progress (gross effect)	EFA role (net effect)
Moderate	Good	Moderate

The liquidation of SOEs and privatisation of POEs has been on the agenda in Kosovo since the early 2000s. During the UNMIK period, it was part of Pillar IV, the economic pillar, which was under the responsibility of the EC. Bad experiences in the region added impetus to the EC being keen to ensure that expected privatisation resources are accounted for and used transparently and for the benefit of the country. The EFA condition added pressures that resulted in the passing of a Law on the Privatisation Agency of Kosovo, approved by the Assembly in May in 2008. Separate accounts (trust funds) were set up for storing the SOE privatisation proceeds at the CBK. By December 2011, the SOE privatisation and liquidation process yielded € 557 million. Of these, € 228 million were accumulated in time deposits and current accounts held in trust at the CBK[41].

The ring-fencing put in place through the Privatisation Law of 2008 has been successful in ensuring that the privatisation-related funds are planned and spent transparently. The rules set forth in this law have been respected while the specific EFA condition was present, but also beyond, showing a specific area where the rule of law prevailed. A new Privatisation Law was voted in 2011 and a number of initiatives are ongoing to allow for these funds to be distributed and used in order to enhance economic growth in Kosovo[42]. Since 2012, the GoK got access to these funds, with € 30 million already transferred to the budget and another € 30 million expected before the end of the year.

4.3.6 *Fiscal Impact Analysis of Draft Laws (f)*

Relevance	Progress (gross effect)	EFA role (net effect)
Good	Moderate	Moderate

The Assembly of Kosovo has been active since 2001 on building and updating the legislation of Kosovo. In mid' 2000s, there was little guidance on the form of projects of laws that were introduced for discussion in the Assembly, and very few of these projects were accompanied by an estimation of their costs. As a result, debates in the Assembly did not take into account the impact of their

40 Compliance Report Jul 2010.

41 Privatisation Agency of Kosovo, Annual Report 2011, p. 19, http://www.pak-ks.org/repository/docs/Annual_Report_2011_ENG_FINAL_(2).pdf.

42 Some specialists question whether the unlocking of privatisation proceeds will benefit Kosovo's economy, as it appears that most creditors having a right to the proceeds (at least from the first waves of privatisation) are mostly Serbian. (Petra Farcnik, "The privatisation process in Kosovo: An overview and some recommendations" Diploma Paper University of Ljubljana (December 2007) - http://www.cek.ef.uni-lj.si/u_diplome/farcnik3121.pdf.

decisions on the public finances, which at times could be potentially very important. In 2007 and 2008, the IMF repeatedly recommended to the Kosovo authorities to proceed cautiously " with social initiatives to ensure they do not endanger fiscal sustainability" (Aide Memoire, April 2008) and to shelve legislative processes until a better understanding of their cost, financing options, and economic impact is developed (Aide Memoire, February 2007).

Since 2008. the LPFMA requires that a fiscal impact analysis be submitted with every draft-law proposal. Government Procedural Regulations pre-dating the approval of the LPFM outline the content of such an analysis. According to the Compliance Report of October 2010, the MoF has conducted over 70 assessments, including 5 for laws that were directly linked to social policies.

Interviewees pointed out that the fiscal impact analysis is not updated to reflect discussions in the Parliament and amendments of the draft law. As a result, the initial fiscal analysis of draft laws no longer reflects the reality of the final law resulting from the approval process. Hence, although the condition "f" was formally met, more efforts are needed for the medium-term expected results (i.e. compatibility between (social) policy objectives and fiscal sustainability).

The specific requirement that laws be accompanied by fiscal impact analyses remains high among the items that donors include in their conditionality. The IMF has included this demand as one of the structural benchmarks in both the SMP-2011 and its SBA-2012. Furthermore, it included as safeguard another benchmark in the SMP-2011 and the SBA-2012 that all new benefit–creating laws should have a paragraph that explicitly allows cutting the level of benefits in case sufficient budgetary funds are unavailable.

4.3.7 Targets for Improved Billing / collection rates of the electricity utility KEK (g)

Relevance	Progress (gross effect)	EFA role (net effect)
Good	Moderate	Limited

Kosovo's energy sector has been and remains fragile. The KEK was confronted with important external constraints (e.g. the need to import coal, the raw material used to generate electricity). It was also afflicted by important internal weaknesses and a legacy of poor management and lack of maintenance, which led to the company needing significant support from the government. In 2006, the total support provided by the GoK to KEK amounted to € 55 million. This amount represented an important burden for the government budget and a risk factor for the overall macroeconomic and fiscal stability of Kosovo. This triggered the inclusion of condition "g" in the EFA MoU.

The performance of the KEK since 2006 has improved. The trends in billing and bill collection rates are positive, and electricity supply has visibly improved. Blackouts are less frequent, at least in in Pristina. Figures from the Ministry of Economic Development show a relatively positive picture concerning commercial and technical losses of KEK from 2006 to 2011 (see the case study on this condition in section 5.1). The amounts of support allocated to KEK from the budget have also been decreasing since 2009. This suggests that the medium term objective of making KEK more viable has been worked on with some degree of success. The Compliance Report of October 2010 focussed on the steps taken to improve billing and collection, which included the legal obligation of KEK to prepare a two-year detailed action plan and quarterly billing and collection targets, hence formally meeting the requirement set forth in the EFA conditionality[43].

[43] Kosovo Energy Strategy (2009-2018).

The inclusion of a condition on improving billing and bill collection in the EFA MoU in 2007 was particularly relevant and pragmatic. It focussed on a core problem that could be acted upon immediately, on which the GoK could put pressure without being accused of politicking and which could improve the financial health of the KEK relatively fast. The “shadow” programme that was agreed with the IMF in 2005 also made reference to increasing the KEK’s payment ratio[44] from 37% in 2005 to 46% by the end of 2006, in line with KEK’s financial recovery plan for 2004-2010. Improvement in meter reading and billing were mentioned as core tools to achieve this. The EFA condition linked to KEK was conceived as additional reinforcement of an issue that was amply clear to Kosovo authorities. The World Bank and USAID have also been very much involved in trying to address this issue. Interviewees consider that regular blackouts have put more pressure on the concerned stakeholders than the EFA condition. Attributing the progress made in this field to the EFA condition alone is not possible.

4.3.8 Strategy for POE Privatisation and Restructuring (h)

Relevance	Progress (gross effect)	EFA role (net effect)
Good	Moderate	Moderate

Privatisation has been ongoing in Kosovo since the early 200s, but it progressed at a slower pace than initially planned. One of the reasons why privatisation was slow in Kosovo at the time the EFA operation was designed had to do with a legal framework which was not conducive of achieving results. The view of the donor community in the mid-2000s was that the stalled privatisation process represented a loss of potential revenue for the government. In Kosovo, as elsewhere, opinions are split with regards to the urgency and the benefits of privatisation. Irrespective of the pressure/ opinion in favour or against privatisation, it was relevant to ask Kosovo authorities to develop a vision/ strategy that would guide the process in the medium term.

By 2010, no comprehensive strategy had been developed for the privatisation of POEs in general. The Compliance Report of October 2010 sent by the GoK to the EC makes the point on the status of the privatisation process for individual companies. In light of the loose phrasing of the condition, the fact that only company-specific strategic plans were made cannot be considered as a breach of the condition.

The specific progress mentioned in the October 2010 Compliance report concerned the approval by the GoK of PTK privatisation strategy in June 2010. The privatisation process of PTK took much longer than initially foreseen and will probably not be completed before 2013. The concession of the Pristina airport was completed in August 2010, as was the privatisation of the KEDS (Electricity Distribution). The liberalization of the waste sector and of the transport infrastructure (railways) are in their early stages.
Privatisation was one of the main battle horses of the EC since UNMIK times. EC’s constant reminders that the process must continue has likely played a relatively important role in maintaining momentum for privatisation.

[44] The payment ratio is the collected energy bills as % of the value of the energy available for sale.

4.3.9 Debt Management Capacity (i)

Relevance	Progress (gross effect)	EFA role (net effect)
Good	Good	Limited

During the negotiations concerning the status of Kosovo, it emerged that Kosovo would inherit and would need to manage debt linked to a loan contracted by the former Yugoslavia specifically for the development of Kosovo. Developing capacity for debt management was not only relevant, but urgent. Before 2010, the Government lacked the legal authority to issue debt, but the situation changed early that year with the approval of the law permitting the central government, as well as municipalities, to access domestic and external source of finance. The first rounds of T-bills were issued in early 2012, at an interest rate was between 3 and 3.5% (remarkably low). The projected overall borrowing in 2012 will be at the level of €74 million.

A separate unit for debt management was created within the Treasury in June 2010 according to international best practices, with a front, middle and back office with clear responsibility in the debt management cycle. The newly-hired staff in this unit was reported to be competent and well trained.

Kosovo got support primarily from the World Bank, USAid and other donors in the area of debt management, first through a provision to cover the inherited debt from Yugoslavia, then though TA projects. The influence of the EFA conditionality on the pace of events in this area appears limited.

4.3.10 Public Procurement Help Desk (j)

Relevance	Progress (gross effect)	EFA role (net effect)
Moderate	Good	Limited

The procurement capacity and low value-for-money results were recognized as one of the core weaknesses in the PFM system in Kosovo (see for instance PEFA 2007 and 2009). These weaknesses also made it difficult for government departments to spend allocated resources in a timely and efficient manner. This constituted a risk for budget execution with potentially important implications for the economy at large. The establishment of a help desk on procurement is just a small step and would not have been sufficient to solve this risk.

A public procurement helpdesk was set up in 2009, within the Public Procurement Regulatory Commission, to support contracting authorities undertaking procurement activities. This helpdesk handled approximately 10 calls and 5 emails per day in 2010. In October 2011, Kosovo passed an amended Public Procurement Law (PPL) that has largely brought its procurement legislative framework in line with the EU legislation and establishing a stronger mandate to conduct centralized and consolidated procurement on behalf of Government. Secondary legislation and manuals were updated and came into force on March 1, 2012 to avoid ambiguities in implementing the law. The new PPL replaces the 14 Public Procurement Agency functions with the Central Procurement Agency under MOF. This should increase value-for-money by exploiting economies of scale, while reducing risks of non-compliance with legal procedures that resulted from low capacity in many contracting authorities. Under the current decentralized system, low capacity plus high levels of discretion among contracting authorities leads to wide price discrepancies for the same goods or services among contracting authorities, creating waste and mistrust of the public procurement process. A number of stakeholders such as the World Bank were actively supporting the government in the procurement area. One of the achieved prior actions under the SEDPO2 in

2012 was the approval of this secondary legislation for the public procurement law and issuing the authorization for the central procurement agency to conduct consolidated procurement.

4.3.11 Accelerated Pace of Liquidation of SOEs and Privatisation (k)

Relevance	Progress (gross effect)	EFA role (net effect)
Moderate	Moderate	Moderate

As in the case of the privatisation of the POEs, not all stakeholders supported for the privatisation process of the SOEs. The condition in the EFA is softly formulated and not accompanied by any more precise indicators but the EC has applied continuous pressure for the process to continue.

The PAK is responsible for the management of the privatisation of SOEs and has about 600 SOEs in its register. Of these, 400 were deemed viable businesses, while the rest need to be liquidated. Up to August 2011, about half of the existing SOEs had been privatized (partly or completely) and another 175 liquidation sales of other assets had been completed.

The PAK is in existence since 2008. Its predecessor the KTA had been active for the previous 6 years (2002-2008). The speed of privatisation and liquidation of SOEs seems to have accelerated, if measured by the number of privatisation rounds and number of contracts signed. However, in terms of value of the contracts the two periods the annual amounts are comparable:

Period	Privatisation Rounds	Number contracts signed	Value (million EUR)
2002-2008	30	454	356
2008-2011	22	340	173

Eventually, all SOEs will have to be liquidated[45]. The PAK admits in its Stakeholder report that liquidations have been lagging. The liquidation process of 179 SOEs was launched, but little progress had been done on the majority of these. Various estimates based on existing legislation and practice indicated that it would take 20 years to complete the liquidation process at a very significant cost estimated at over €100 million.

The EFA condition has had a moderate effect on the pace of SOE privatisation. An acceleration is evident in recent years by some standards (e.g. number of privatisation/ liquidation started), but not by others (e.g. value of contracts signed). The adjustment of the legislative framework played an important role in the evolution of the situation in this field.

4.3.12 Roadmap for Comprehensive Statistics (l)

Relevance	Progress (gross effect)	EFA role (net effect)
Good	Moderate	Limited

The SOK has received on-going support from several donors since 1999. Despite the volume of support, progress has been slow over the years. The SOK suffered inter alia of weak management,

45 According to the PAK August 2011 report, this is the only legal method available to identify creditors and owners who are entitled to the proceeds of privatisation and any assets sold during the liquidation process.

a lack of dynamism in its institutional culture and an unsupportive legal and institutional framework. The diversity of approaches and methods proposed by various donors also proved counter-productive to the development of a coherent strategy and action plan.

Prior to 2011, managers and action plans succeeded each other with little result on the availability and quality of statistics. The SOK had four different (acting) Directors between 2006 and 2011 and several strategies/ action plans, including the “Action Plan for compiling and publishing comprehensive statistics on national accounts and labour market” which was annexed to the Compliance Report of October 2010, with a note that it had been approved by the acting head of the SOK and that it was already being implemented. These plans were either not adequate or not properly carried out, since in 2011 the SOK still did not have a minimum statistical standard package; needed DFID funding to be able to complete its labour survey; only produced statistics concerning the expenditure side of national accounts; and had to drop many of its activities in order to undertake the 2011 Population Census. With the recent revamping of the SOK into an independent Statistical Agency of Kosovo (SAK) under the responsibility of the Prime Ministers’ Office, the nomination of a new Director and the renewal of staff, it is hoped that the institution will start delivering more regular and better quality statistics.

Several donors have been supporting the SOK through the period, including by drawing up strategic and action plans (DFID project in 2006 and 2008). Interviewed donors were not aware that the disbursement of one EFA tranche was contingent on improved statistics and therefore the level/intensity of their support was not determined by the existence of condition “I” of the EFA operation.

4.4 Impact of Complementarity with Other EU Instruments

Q2.5. To what extent have structural effects been enhanced, if at all, by complementarities between the EFA and other EU instruments?

The complementarities between EFA and other instruments used by the EC in Kosovo have been explored by conducting a number of interviews with relevant stakeholders and then cross-checking the information with existing records. The EC has provided significant support to Kosovo, first through the CARDS instrument, then through IPA. Support provided via these instruments is expected to be subject to the same broad principles and specific EC regulations as the EFA assistance.

These principles are agreed through high level political dialogue. They are laid down in strategic documents such as the European Partnership of 2007[46]. For Kosovo, the strategic priorities are linked to the Resolution 1244 of the United Nations Security Council and cover a long list of fields in which Kosovo needs to improve its track record:

- **Key priorities**: the respect for the rule of law, human rights, the protection of minorities and freedom of religion; the guarantee of democratic governance and the provision of public services; the set-up of a transparent and accountable public administration; the continuation of reforms of self-government and administrative capacity building; the fostering of a climate for reconciliation, inter-ethnic tolerance and sustainable multi-ethnicity conducive of the return of

[46] Council Decision 2008/213/EC of 18 February 2008 on the principles, priorities and conditions contained in the European Partnership with Serbia including Kosovo as defined by United Nations Security Council Resolution 1244 of 10 June 1999 and repealing Decision 2006/56/EC. Accessed 27/08/2012 at http://europa.eu/legislation_summaries/enlargement/western_balkans/r18015_en.htm.

displaced persons; the fight against corruption, organised crime and terrorism; the creation of a society free of discrimination, incorporating disadvantaged groups; and the strengthening of property rights, the legal framework and the accessibility of courts etc.;

- **Political criteria**: all of which are also include as key priorities. In addition Kosovo is to strengthen regional cooperation and good-neighbourly relations, including the implementation of the Central European Free Trade Agreement – CEFTA;
- The **economic criteria** include maintaining sound budgetary policies; long-term viability of social policies targeting poverty and social exclusion; higher recovery rates for public-utility invoices, better governance and improved quality and quantity of education; privatisation and restructuring; financial efficiency of public-sector companies; creation of an official labour market; the strengthening of property rights, the rule of law and access to courts; implementation of active labour-market policies and an increase in export capacity;
- **European legislation** – Kosovo must strive to bring its legislation in line with the Community *acquis* and ensure its implementation through a reinforced administrative capacity.

These strategic objectives and key priorities have been further operationalized in recent years through the IPA Multi-Annual Programming Documents (2007-2009 and 2009-2011) and reviewed annually (last report presented in October 2011[47]).

The analysis of various EFA and IPA-related documents reveals that the two instruments do build on the same broad basis of principles laid down in the documents mentioned above. Moreover, the two DGs primarily in charge of managing these instruments are in constant contact, with DG ECFIN in particular informing DG ENLARG of its intentions and actions in Kosovo. The European Commission Liaison Office (ECLO) is also involved, primarily in the programming and managing of IPA projects.

Interviews have revealed that there has been limited coordination between the EFA and other EU interventions in Kosovo over the period. IPA (and CARDS before it) supports specific interventions in a number of sectors, including projects and programmes, but it is off-budget support. EFA was essentially a budget support operation. Due to the very different nature of the two instruments, direct coordination between the two is difficult to achieve. The two types of support coexist and mutually reinforce each other. By striving to improve the fiscal discipline in Kosovo, is a good catalyst for improving the environment in which DG ENLARG programmes operate. On the other hand, at least some of the programmes and project funded through IPA, Taiex and other similar instruments equip the government with the capacities and tools needed to fulfil the EFA conditionality. Some examples are provided in section 7.3 below.

On the ground, and outside the highest government circles and the MoF, the EFA operation is barely known, even by project personnel that have been working on EC or other donor projects for many years. There are several plausible explanations for this situation. The EFA operation was steered primarily from Brussels, with only a limited number of counterparts directly involved on the Kosovo side and within the Political Affairs Section of the EU Delegation. The lifespan of the EFA operation to Kosovo has gone much beyond the “normal” duration of such an intervention. The size of the operation was small as compared with other support received from the EC and other donors.

[47] Commission Staff Working Paper, Kosovo 2011 Progress Report accompanying the Communication from the Commission to the European Parliament and the Council “Enlargement Strategy and Main Challenges 2011-2012” SEC (2011) 1207final accessed last 27/08/2012 online at http://ec.europa.eu/enlargement/pdf/key_documents/2011/package/ks_rapport_2011_en.pdf.

4.5 Unexpected Impact on Structural Reforms

Q3.2. Has the assistance given rise to any unexpected short and medium-term structural effects? What were they and how did they occur?

No unexpected impacts of the EFA assistance have been identified.

One specific hypothesis that was explored concerned the effects that the EC decision not to disburse the second tranche of EFA had on the authorities and on the ongoing processes at the time (end 2010) in Kosovo. As virtually all conditions from the EFA MoU were formally met, the decision of the EC not to disburse was – expectedly and despite EC explanations – perceived as unfair by the Kosovo authorities.

Politically, the decision came at a time when higher stakes were occupying the centre-stage, notably the impending December 2010 elections. The debates between politicians were on a different scale, and the blame that the government would "lose" €20 million[48], although brought up by the opposition, could not overshadow the other, much more important campaign promises (e.g. the wage increase). Although the campaign promises might have been made regardless of the circumstances, some key interviewees suggest that by late 2010, top politicians no longer believed that the EC would actually disburse the second tranche of the EFA. This made it easier to decide in favour of the wage-increase electoral promises rather than the fulfilment of EFA conditionality.

Once the elections were won, and despite disapproval by the main donors, including the EC and the IMF, the new GoK went ahead with fulfilling its campaign promise. On the one hand, this might suggest that the non-disbursement of the second tranche of the EFA had a very limited 'sobering' effect – if at all. On the other hand, the GoK also started the negotiations with the IMF on an SMP with clear steps to restore fiscal sustainability and signed in June 2011 a 6-month SMP. Figures suggest that with the exception of the wage-related "binge spending", the GoK went back to a certain level of fiscal discipline and savings later in the year.

[48] It is worth mentioning that the SEDPO1 of US$ 24.4 million of the World Bank could also not be disbursed in 2010 because the governing coalition fell apart before the financing agreements were signed, although this operation was approved by the World Bank Board on 30 September 2010 (see Box 2.1 in chapter 2).

5 Structural Reforms - Case Studies

In order to further explore the causal relationship between the EFA conditions and actual reforms in Kosovo we carried out two case studies. Case studies provide a more in depth understanding of a specific structural condition and explain the key reforms in the specific area of this condition, their effects and the progress made. Of the four possible subjects for case studies proposed during the inception phase, the Steering Committee selected condition “g” dealing with the viability of the KEK and condition “l” dealing with the statistics roadmap. This chapter presents our findings on these two issues.

5.1 The Viability of the Kosovo Energy Corporation (KEK)

Origin and Overall Rationale

Weak and unsustainable billing and bill collection of KEK has been a major factor for its lack of financial viability. This has been translated into the need for large government subsidies and continued high-energy intensity of the economy. The following condition was linked to release of the second tranche of EFA.

Condition “g” in the MoU
Establish annual targets for improved billing and bill collection rates of the electricity utility (KEK) and define and implement strategies to reach such targets, in particular with a view to strengthen its viability.

Energy is one of the greatest challenges for Kosovo. The GoK has declared as one of its priorities the need to deal with the increasing energy demand, continuous imports and the increasing indebtedness of the energy sector. Progress in this area should support the economic development in Kosovo and contribute to a reduction in subsidies and transfers to the energy sector and to a more sustainable macroeconomic and fiscal situation.

Power Generation in Kosovo

By 1960, the first coal-based thermal power plant, Kosovo A, was under construction. By 1975 this power plant had a total installed capacity of 800 MW. Between 1977 and 1984 a second thermal power plant, Kosovo B, was built, with a total capacity of 678 MW. In the last decades of the 20th century Kosovo’s energy supply came both from these two thermal power plants and from other sources of energy production located throughout the territory of the former Yugoslavia. In the 1990s, during Yugoslavia’s dissolution the energy system of the country received very little maintenance or investment.

The National Strategy on Energy

The KEK is the public energy company in Kosovo with GoK as only shareholder. In April 2010 the GoK adopted the Kosovo National Strategy on Energy 2009–2018. The key objectives of this strategy were overcoming chronic problems with the power supply, meeting the demands of local consumers and becoming more efficient and environmental friendly. This strategy focused mainly on developing the country’s energy sector by supporting projects for lignite-based energy generation and on raising the level of private investments, specifically through the privatisation of this sector. Recently the GoK has legally unbundled the distribution and supply functions of the KEK with a view to privatisation.

The GoK is determined to meet its energy demand and improve its energy production sites by:

- Decommissioning Kosovo A by 2017 to comply with the Energy Community Treaty to which Kosovo is a signatory (estimated cost of decommissioning €65 million);
- Developing the country's renewable resources;
- Rehabilitating Kosovo B to comply with EU environmental standards, investing in new electricity generation capacity of 600 MW through PPP and a new lignite mine with an estimation of €1.4 billion; and
- Privatizing Kosovo's electricity distribution.

A package of three laws (on energy, on electricity, on the energy regulator) was adopted in October 2010 after extensive discussions with Kosovo government partners on the market model to attract private-sector involvement in energy generation, distribution and supply. These laws also aimed to align Kosovo's legislation with the EU's second internal energy market package.

Over the last decade, the donor community has given substantial support to reforming and improving the performance of KEK. This support was provided through various mechanisms including financial support, technical assistance and management support.

Performance of the KEK

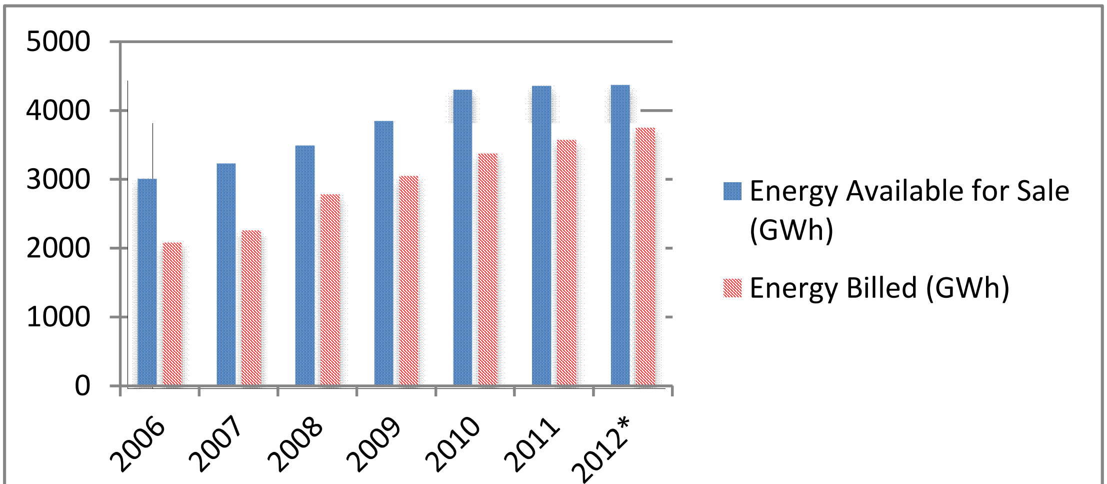
Since 2006, the KEK has made significant progress in reducing its billing and collection losses, although these losses are currently still high compared to European standards. Table 5-1 and Figure 5-1 below succinctly present this information.

Table 5-1: KEK billing and collection targets, 2006-2012

	2006	2007	2008	2009	2010	2011	2012 *
(1) Energy Available for Sale (GWh)	3008	3230	3490	3845	4301	4356	4370
(2) Energy Billed (GWh)	2080	2258	2780	3049	3374	3569	3749
(3) Billing ratio (2)/(1)	69%	70%	80%	79%	78%	82%	86%
(4) Billed (in million EUR)	130	145	178	197	202	221	230
(5) Collected (in million EUR)	96	111	135	160	178	201	209
(6) Bill collection ratio (5)/(4)	74%	77%	76%	81%	88%	91%	91%
(7) Payment ratio (3)*(6)	51%	54%	60%	64%	69%	75%	78%

Source: Ministry of Economy, department of Energy. * forecast.

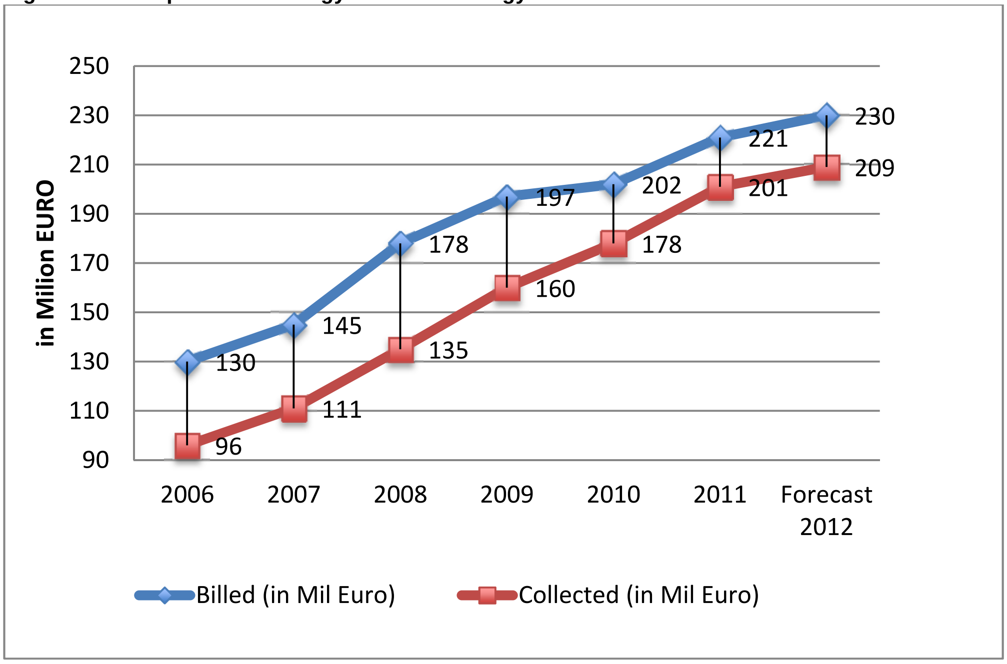
Figure 5-1: Comparison of energy available for sale and energy billed (GWh)



Over the last six years, the billing ratio has increased significantly. In 2006, the amount of energy available for sale was 3,008 GWh and only 2,080 GWh or 69% was billed. In 2011 the amount of energy available for sale has increased to 4,356 GWh and 3,569 GWh or 82% was billed (see

Table 5-1 The bill collection ratio has shown a similar improvement over this period. It increased from 74% in 2006 to 91% in 2011.

Figure 5-2: Comparison of energy billed and energy bills collected in millions of euros



The improvements in the billing and the bill collection have resulted in a better financial performance of the KEK in recent years. The payment ratio (collected energy bills as % of the energy available for sale) increased from 51% in 2006 to 75% in 2011.

In absolute terms, the reduction in energy losses in the period 2006-2011 has been much smaller because the amount of energy available for sale increased in this period by 45% (see Table 5-1). The total billing and collection losses dropped roughly from €90 million in 2006 to €70 million in 2011. The low levels of bill collection and non-cost recovery tariffs also continue to fuel an unsustainable growth in power demand.

As a result of the improvements in billing and bill collection the need for subsidies has drastically decreased after 2008 (see Table 5-2). Yet, in the coming years, further investment is needed to replace the existing equipment of the KEK.

Table 5-2: Subsidies and grants to KEK, 2006-2012 in millions of euros

	2006	2007	2008	2009	2010	2011	2012 (forecast.)
Imports	12	12	43	47	39	27	13
Working Capital	17	17	0	0	0	0	0
Misc. Operating	4	3	1	0	0	0	0
Capital	22	25	44	0	0	0	0
Total	**55**	**57**	**88**	**47**	**39**	**27**	**13**

Source: Ministry of Economy, department of Energy.

Conclusion

The GoK has declared energy as one of its priorities and adopted the Kosovo National Strategy on Energy 2009–2018. In 2010 it also adopted three energy laws, on energy, electricity and on the energy regulator. One of the aims of this strategy is to increase the efficiency of the sector and overcome its chronic problems. The overall performance of KEK has improved since 2006 but the technical and commercial losses remain high.

The EFA condition linked to KEK was conceived in Kosovo as additional reinforcement of an issue that was amply clear to Kosovo authorities. Interviewees stated that regular blackouts put more pressure on the concerned stakeholders than the EFA condition, therefore the net impact of the condition was considered limited (see section 4.3.7 above).

5.2 Statistics Roadmap

Origin and overall rationale

The availability of reliable and timely statistics is a pre-condition for sound economic management. At the time that the EFA operation was being considered and designed, the statistical system in Kosovo was highly underdeveloped and made economic planning and evaluation of policies very difficult. As a result, the following condition was included in the EFA MoU:

Condition "I" in the MoU
Establish a roadmap for compiling and publishing comprehensive statistics on national accounts and labour market in order to provide policy making with timely and high-quality statistics.

This condition has been selected in agreement with the Steering committee for a more in-depth study, because by October 2010 when the last compliance assessment was carried out in the context of the EFA operation, this was the condition which posed most problems. According to some interviewees, progress on this condition was registered but was only borderline satisfactory. A plan was produced in order to formally meet the condition, but was endorsed only at the last moment by the acting head of the Statistical Office and not discussed in any larger fora.

Background and Context

The Statistical Office of Kosovo[49] has functioned as a regional office in the Yugoslav Federation. In 1999, it restarted its work as central statistic agency under the public administration in Kosovo[50].

Most of the officers continued to be active in the office, although they did not necessarily have the right qualifications and profiles to kick start and carry out successfully the activities required of a central statistics office. The leadership of the organisation was also extremely weak and unstable.

Furthermore, the legislative framework was not conducive of the SOK becoming a full-fledged functional central statistics office. Until very recently, the SOK was under the responsibility of the Ministry of Public Administration – a choice that is not immediately obvious and that had important repercussions on the Office. Since it was not part of the "core" activities of the Ministry, it did not receive the attention and priority that it should have in light of the importance of the function it is called to perform.

As a result of these and other factors the SOK was caught in a vicious circle of poor and erratic performance that further undermined trust in its products and further dampened an already weak demand for quality statistics, especially from within Kosovo. Many organisations – the Ministry of

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49 Since 2011, the SOK has been transformed into SAK – Statistical Agency of Kosovo. However, since most of our observations refer to the 2007-2011 period, we will use SOK rather than SAK throughout this section.

50 http://esk.rks-gov.net/ENG/sok-mission.

Education to give but one example – have developed their own parallel systems of data collection and analysis.

Evolution

The 2007-2011 period marked some progress in statistics, primarily in specific subject areas but also, to a lesser extent in terms of the legislative framework and the monitoring of performance.

The production capacity of SOK has improved, as has the quality of some products. Methodological development is also visible. One positive example is the CPI which has been published regularly since 2002. The Household Budget Survey is also now of better quality than several years back and the publication of labour-force surveys has been resumed. These are now undertaken quarterly (with external support). In 2011, the SOK also led and completed the first Population Census in Kosovo (publication of the results is expected for the end of 2012). While the process was not flawless, observers commend the staff of the SOK for their achievement. The flipside of the Census operation success is that, since the SOK had to mobilize virtually all resources to carry out the Census, very little progress was recorded in the production and improvement of other sorts of statistics.

SOK has benefitted from significant support from many donors over the period. A list appearing in the SOK Strategic Development Plan 2009-2013 includes four EAR projects, two EU projects, two World Bank projects, as well as support from three different UN agencies, Estonian statistics, DFID and SIDA spanning the entire past decade. The support covered many topics, mostly technical in nature. With virtually no donor coordination and in the absence of effective strategic and operational plans, the absorption and retention of knowledge and skills by officers at SOK was highly suboptimal. A recent evaluation of the combined SIDA and DFID efforts points out that if technical support were to stop, the SOK officers would not manage to carry through the process of producing quality statistics from beginning to end in most areas of concern[51].Support in the area of management and organisational development has been more limited and has yielded little results in the difficult environment that the SOK represented. DFID specifically provided support to the strategic planning process, whereas SIDA is trying to introduce a result-based management approach, starting with the monitoring of the SOK's 130-odd employees.

Although SOK in 2011 was performing better than in 2007, the organisation remained fraught with weaknesses throughout the period:

- Frequent change in leadership. Between 2007 and 2011, the organisation had not less than seven Directors; on average, each of them had less than a year to lead the organisation; this meant that periodically, operations would slow down or stop all together while waiting for the new leadership to get a grasp of the situation and make decisions about the direction of the organisation;
- Low levels of staff capacity and understaffing in certain areas. Despite significant external support (see above) the capacity of staff to carry out its mandate has remained limited. Training and hands-on support did not result in a sustainable development of skills. Part of this has to do with the fact that the "old guard" statisticians have difficulties learning how to use new tools and technologies, especially when the training occurs in a language other than theirs. Another factor is the fact that it is difficult to hire new staff with proper statistical training – there is no Statistics programme / degree being taught in Kosovo. Understaffing is also an issue – in 2011, 1.5 staff members were working in the methodology department;

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[51] Evaluation of co-operation with the Statistical Office of Kosovo, November 2011, http://www.sida.se/Documents/Import/pdf/Evaluation-of-Co-operation-with-the-Statistical-Office-of-Kosovo.pdf.

- Passive organisational culture. The SOK officers are only very slowly developing a culture of consultation, communication and exchange, both internally (within SOK) and externally (towards statistics users). As a result mutual learning is very limited and quality control is also problematic. Motivation and an understanding of the great importance of the task they are supposed to complete are not featuring high among SOK employees;
- Weak demand for high quality statistics. Rather than putting pressure on the SOK to produce high quality statistics, throughout the period, national and international actors with a stake in accurate data have set up parallel collection and analysis systems. There is currently no description of the entire statistical system in Kosovo, nor is the SOK the centre of the statistical system, as it should be;
- Absence of operational and strategic planning, as well as unclear, shifting priorities. This crucial aspect is discussed in the section immediately below.

In 2011 a new Law on Statistics was adopted by the Kosovo Parliament[52]. This transforms the SOK in an Agency and places it directly under the authority of the Office of the Prime-Minister. This is expected to raise the profile of the institution and contribute to more independence. It also extends the legal mandate of the Agency to request data from different actors. A new CEO was appointed who has shown better managerial abilities and vision than all of its recent predecessors. A Statistics Council was instated. It has an advisory and monitoring role with respect to the activities of the SAK and especially on the preparation and implementation of the Official Statistics Program.

Planning at the SOK

The condition of EFA was formulated in such a way that it could be relatively easily fulfilled (see above). As pointed out above, the condition was indeed fulfilled, at least formally, and a road map for improving national and labour market statistics was presented in the last EFA compliance assessment in late 2010.

However, drawing a roadmap was and still is insufficient to lead to concrete improvements. First, such a plan needs to be implemented in order for it to have any value. In the interviewees held as part of this evaluation, none of the interlocutors, including those in relatively key positions were aware of the road map. There was also virtually no coordination among the main organisations involved in the production of national accounts statistics, namely the Ministry of Finance, the Central Bank and the SOK. This seems to be yet another manifestation of the observation made by the SIDA/DFID Evaluation that planning (as well as reporting and follow up on the plans) tend to be an isolated process involving not more than a handful of individuals.

A road map further needs to be part of a larger systematisation of the statistical system in Kosovo. The production of national and labour statistics cannot be improved in isolation of the overall functioning of the statistical system. Based on the information available to the evaluation team, it remains unclear which plans - strategic, operational, specific – existed over the period, to what extent they were endorsed and owned by the GoK and if they played any role in guiding the statistical activity in Kosovo.

Interviewees are unanimous in saying that planning is the weak point of the system and that before 2011 no real plan or even a general direction or prioritization of activities of the SOK existed. However, records indicate that already in 2006, DFID supported the SOK in developing a strategic plan. Between 2008 and 2011 another DFID consultant was active and already in May 2009, a draft strategic development plan was available for the 2009-2013 period. The SIDA/DFID Evaluation

[52] Law no. 04/L-036; entered into force in December 2011.

Report of 2011 characterizes the Plan as “ making a commendable effort to compensate for the lack of a SOK operational framework; setting out production priorities 2009-2010, 2010-2013, financing gaps, staff requirements and development needs, publications calendar, survey plans, international support needs etc.”[53] This plans appears to have never been translated into practice, primarily due to a lack of managerial capacity, a point of view completely accepted by SOK managers at all levels.

Conclusion

The improvement of statistics in Kosovo (including national accounts and labour statistics) is still work in progress. As highlighted by this case study, progress has been slow, but steady. Weaknesses persist and they will take time to be fully tackled. The year 2011 seems to mark a breakthrough, with a new legislative framework put in place and increased managerial capability. In 2012, the Council of Statistics was set up and an Annual Plan of Official Statistics for 2013 was drawn up (APOS). Indicators are yet to be developed. Next year will be the test for the implementation of this plan.

[53] Evaluation of co-operation with the Statistical Office of Kosovo, November 2011, p. 18 http://www.sida.se/Documents/Import/pdf/Evaluation-of-Co-operation-with-the-Statistical-Office-of-Kosovo.pdf. The evaluation team was not able to obtain a copy of the Development Plan itself.

6 Design and Value Added of EFA Operation

This chapter will address various other aspects relating to the design and the implementation of the EFA assistance:

- The efficiency of the operation;
- The EU-value added;
- The relation with other EC activities;
- The relation with other international assistance.

6.1 Efficiency of the EFA

Table 6-1 shows the first set of evaluation questions relating to the design of the operation. These questions focus on the influence of the decision-making process in the design and implementation of the EFA assistance as well on the impact of the design and implementation of the EFA assistance operation on its performance in terms of efficiency and effectiveness.

Table 6-1: Evaluation question on design and implementation effectiveness and efficiency and sub-questions

Q5. How has the way in which the EFA assistance operation was designed and implemented conditioned its effectiveness and efficiency?
Q5.1 What was the influence of the decision-making process in the design and implementation of the EFA assistance?
Q5.2 In what way has the design and implementation of the EFA assistance conditioned the performance of the operation in respect to its cost and its objectives?

6.1.1 The Decision-making Process Influence on Design

Q5.1 What was the influence of the decision-making process in the design and implementation of the EFA assistance?

The decision to provide MFA/ EFA financial assistance to a country is a combination of economic and political factors. However, economic justifications are usually preponderant.

The EC relies heavily on IMF economic data and analysis to underpin its decisions. This was also the case in providing EFA assistance to Kosovo. In mid-2000, Kosovo had run some significant deficits for a couple of years. Moreover, it was anticipated that the need to set up an entire State administration would be very costly and beyond the resources available to UNMIK and PISG at the time. IMF calculated that an important financial gap would emerge. These calculations and perceived needs were an important factor in the decision of the EC to provide EFA. The level of GoK bank balances at the time as well as parallel calculations of the Kosovo MoF staff suggested that the situation was less problematic than the IMF anticipated. There has been considerable debate about the elements that the IMF took into account in its calculations. The actual budget deficit and bank balance situation in 2007-2009 was less grim than initially estimated in 2005-2006. As a result, the urgency to disburse the EFA was attenuated.

Technically- speaking, the EFA to Kosovo was not significantly different from other MFA and EFA operations. Its main peculiarity stems from the fact that it was decided at a time that Kosovo was not (and could not be) a member of the IMF, and therefore had no "disbursing" programme[54] with that institution. This meant that the macro-economic parameters/ conditions that are normally negotiated between the IMF and the concerned government authorities did not exist in the case of Kosovo and therefore could not be taken over in the EFA agreement. To compensate for this situation, it was decided to include a number of structural conditions that would need to be fulfilled by the Kosovo authorities before receiving the first tranche of the EFA support. The choice of the specific conditions followed the experience accumulated in other MFA/EFA operations: they were actions that the government could implement in the short run in order to quickly mobilize the emergency funds made available by the EC; and they were loosely formulated in order to allow for a certain degree of flexibility in assessing their fulfilment.

The decision to provide EFA to Kosovo was also underpinned by important political factors that affected its design. In mid 2000s, the EC, like other donors, was willing to provide Kosovo significant assistance. This was the time of the negotiations concerning the status of Kosovo and the settlement of the late 1990s conflict between Serbia and Kosovo, which resulted in the drafting of the Ahtissari Plan. At this time, it was important for the emerging Kosovo authorities to mobilize the good will and support (including financial) from the key actors of the international scene such as the IFIs and the EC. At the time, providing EFA to Kosovo was an important political gesture. Partly to compensate for the variety of opinions among its own Member States, the EC made disbursement of the EFA contingent on the settlement of Kosovo's status.

6.1.2 The Design's Influence on Performance

Q5.2 In what way has the design and implementation of the EFA assistance conditioned the performance of the operation in respect to its cost and its objectives?

The design peculiarities of the operation had repercussions on the way in which it was implemented. These are succinctly presented in the table below:

Design feature	Consequences
Disbursement contingent on the settlement of Kosovo's status	Disbursement could not occur before Spring 2008. This in turn meant that the negotiations of the MoU were not urgent and took almost one year.
EFA operation (including size) determined based on the gap calculations by the IMF	While the EC was acting according to its usual procedures in basing itself on the IMF calculations, in the case of Kosovo, the budget reality in 2007-2009 did not confirm the initial projections. A financing gap did not materialize and therefore funds were also not disbursed until 2010. By that time, the initial projected size of the gap was also no longer relevant.
EFA conditions formulated loosely (few hard indicators) and geared for short term implementation	The EC could not anticipate in 2007 that the disbursement of funds would only occur more than three years after the Council Decision. However, the delays in disbursement gave ample time to the GoK to make progress on all conditions. The fact that the second tranche was not disbursed although the related conditions were reportedly fulfilled left Kosovo officials with a sense of injustice.

[54] By "disbursing" programme we mean a programme with a financial envelope attached to it under which disbursements are actually occurring (i.e. not suspended, under negotiation, off track etc.).

6.2 EU Value Added

Table 6-2 focuses on the EU value added. It is noted that this set of questions is closely related to the questions linked to section 6.3 and 6.4 , focusing on the interrelation between the EFA operation, other EC activities and the role of the IMF.

Table 6-2: Evaluation questions on EU value added

Q6. To what extent has EU value added been maximised?
Q6.1 To what extent have the expected benefits from EU intervention been obtained?
Q6.2 What is the value resulting from EU assistance which is additional to the assistance obtained at other levels?
Q6.3 To what extent have the sharing roles between the European Commission (DG ECFIN and other DGs), IMF, Member States and others contributed to optimising the impact of the assistance?

The contribution of the EFA to the macro-fiscal stability and structural reforms in Kosovo seems to have been limited, both in financial terms and through its conditionality. The disbursed amount (€30 million) was relatively small (0.6% of GDP) to make a real financial difference and most of the structural conditions linked to the EFA were relevant but their impact was limited or moderate.

The value added of the EFA was highest through its impact on:

- lifting the credibility of the country to the international community and to potential investors; and
- tilting the internal balance of power in the GoK in favour of the MoF. The MoF focused on macroeconomic and fiscal stability and was willing to reform along the lines suggested by international community. The EFA conditions helped to put pressure on other members in the cabinet who were less eager to implement reforms.

6.3 EFA Assistance vis à vis other EC Activities

Q7. How does the EFA interact with other Commission activities?
Q7.1 Which other activities did the Commission engage in Kosovo at the time of the EFA operation?
Q7.2 How and to what extent did the EFA assistance interact vis à vis these other EC activities?
Q7.3 What were the unexpected effects of the interaction, if any?

In answering this set of questions, we focus on the CARDS and IPA support to Kosovo, as these were the instruments primarily used to channel funds from the EC to Kosovo.

Table 6-3 gives an indication of the funds made available through these instruments over the past years:

Table 6-3: Cards and IPA allocations to Kosovo between 2001 and 2011

Allocations in M EUR	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
CARDS	143.2	162.54	62.28	72.60	76.50	46.50	-	-	-	-	-
IPA	-	-	-	-	-	-	68.30	184.70	106.10	67.30	68.70

Source: CARDS: EC Phare Report (2009); IPA: EC (2011), website of DG Enlargement.

As we indicated in section 4.4, in general the EFA is a good catalyst for improving the environment in which the EC provides the CARDS and IPA funds. Many projects funded through these instruments are often focused on enabling the achievement of the same objectives that EFA pursues. While there is no specific coordination between EFA and IPA/CARDS, the examples below illustrate that the various activities of the Commission converge towards the achievement of the same objectives. No unexpected effects were identified.

The EC liaison office in Kosovo currently manages more than 280 EU-funded projects in a wide range of sectors, including: strengthening the rule of law and support for public administration reform, trade and regional development, education and employment, support for the tax administration, agriculture, environment, transport and energy. Some of the most relevant interventions in area relevant to the EFA operation are presented in the box below.

Box 6-1: Selected IPA projects in areas relevant to the EFA conditionality

Support to on-going Public Procurement Reforms (EUR 1.4 million) ran from 2009 to early 2012 and assisted the Public Procurement Commission to develop the Kosovo public procurement system and ensure it is compatible and up to date with EU standards in terms of efficiency and transparency in the use of public funds. The first months of operation of the project have uncovered serious deficiencies and "grave malfeasance" in the area of public procurement in Kosovo which led to the decision of expanding the mandate of the project team to: redrafting not only secondary, but also primary legislation; organisational restructuring and design of new training modules for procurement officers' certification. Some of the most important achievements mentioned in the Closing Conference held earlier in the year are the new Public Procurement Law, in force from 5 October 2011, the secondary legislation, in force from 1 January 2012, the new organisational structures and working procedures for key institutions as well as the far-reaching programmes put in place by the project[55]. This project supported the Kosovo authorities in achieving much more important public procurement reforms than the one included in the conditionality of the EFA operation in the MoU of 2007 (setting up a public procurement help desk, condition "j").

Improving Public Management, Control and Accountability in Kosovo (EUR 1.5 million) spanned the 2009-2011 period and focussed on the operation of the financial management and control systems and the internal audit function, through the support of CHUs in the Treasury and in the MoF. This was already phase 4 of the EU support of the Public Internal Financial Control (PIFC) in Kosovo. It directly supported the CHUs in carrying out their responsibilities and in developing financial management and control systems. The project further worked on improving technical and reporting skills among internal auditors and delivering an internal audit training programme. In addition ministers, ministers' cabinets and senior civil servants received an introductory course on financial governance. This TA project directly built on the fulfilment of the EFA condition "c" that concerned the operationalization of the CHU on Internal Audit in the MoF.

Support to the Office of the Auditor General (EUR 1 million) was provided in the form of a twinning project (2009- 2011) by the UK National Audit Office and the Slovenian Court of Auditors. The focus was on improving the legal framework, the administrative and management capacity of the Office of the Auditor General and in general the skills of audit officials. The 2009-2011 twinning project followed two previous projects aimed at the reinforcement of the Audit Institutions and there were plans to provide follow up support beyond 2011 as well. [56] This continuous string of support programmes spanning the last decade are a manifestation of the same commitment to improving sound and effective public management that spearheaded the introduction of condition "c" in the MoU of the EFA operation concerning the implementation of the 2007 strategy for Internal Audit Function in the PISG.

Privatisation and Liquidation. This EUR 3.5 million project (2009-2011) provided TA with the privatisation and liquidation of SOEs and training to local counterparts to ensure the sustainability of the process. The TA prepared selected SOEs for privatisation or liquidation, provided advice concerning open bidding, spin-

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55 http://krpp.rks-gov.net/Default.aspx?PID=Home&LID=2&PCID=-1&CtlID=HTMLStatic&CID=ArkivaL.

56 http://www.formin.fi/public/download.aspx?ID=88532&GUID=%7B8B3E6035-2B3C-40DB-88F9-C560B02C18BB%7D.

off and special spin-off procedures, unbundling of SOEs etc. One of the early achievements of the TA was the drafting of Liquidation forms (templates) and of a Liquidation Guide for the PAK Liquidation Committees[57]. The activities of this project are closely linked with several of the conditions formulated as part of the MoU of the EFA operation, in particular condition “k” – accelerating the pave of liquidation of SOEs. Though this TA project, the EU actively contributed to the achievement of the EFA condition.

Improving the Quality of Public Investments in Kosovo and preparing the ground for EU funds (2009-2012) is a project meant to support the MoF in improving the quality of planning and budgeting, particularly the respect of the MTEF ceilings and the link of planning/ budgeting with sectoral and overall policy processes. One of the specific activities of this project was the introduction of modern costing techniques in the core line ministries and municipalities. Interviewees have indicated that these techniques still need to be practiced before they become second nature to Kosovo officers. However progress was recorded on the quality of planning and its link to the overall policy process. This evolution further addresses the issue that was being targeted through condition “b” (regular and appropriate update of the MTEF) and “f” (fiscal impact analysis for draft laws).

In addition to projects implemented under IPA, the EC also cooperates with the World Bank and other donors, including several of the EU member States. One illustration is the €10 million contribution to the World Bank’s “Kosovo Sustainable Employment Development Trust Fund in 2008 (see Box 6-1). Finally, the EC has also contributed to several other high-profile initiatives in support of Kosovo, including by hosting the 2008 Donor’s Conference.

6.4 EFA Assistance vis à vis IMF Assistance

Q8. How was the interplay between the EU EFA assistance and the IMF assistance operations?
Q8.1 To what extent was the EU EFA aligned with the IMF assistance in its design phase?
Q8.2 To what extent was the EU EFA aligned with the IMF assistance in its implementation phase (e.g. discrepancies between the disbursement of EU and IMF tranches)?

As explained previously, the preparation of the EFA operation occurred in a context in which the IMF was only running a “shadow” programme in Kosovo. Therefore the MoU in 2007 did not include a condition that a “formal” IMF programme should be in place for the disbursement of the first tranche. However, upon Kosovo becoming an IMF member in 2009, the EC expected it to fulfil the “standard” EFA requirements for the disbursement of the first tranche, i.e. a formal and on-going IMF programme which has disbursed its first tranche. The second tranche of the EFA was ultimately not disbursed as the EC considered it “cannot assess whether the implementation with the IMF remains on-track” (EC, Note of EFC, 1 December 2010). The fact that the IMF had not completed its review of the SBA in October 2010 was the main argument for this decision. This course of events could be assessed as an indication of the close alignments between the EC and the IMF on the issue of EFA. The GoK assessed this stronger requirement as “moving the goal post” during a game.

With regard to conditionalities there were synergies or overlaps between the EFA structural conditions and some conditions in the IMF programmes. The “shadow” programme with the IMF in 2005 already focused on the KEK and on statistics and also paid attention to fiscal sustainability of draft laws. Table 6-4 presents the main elements of the 2010 SBA.

57 PAK Annual Report 2009, p. 16 http://www.pak-ks.org/repository/docs/PAK_Annual_Report_2009_Eng-final.pdf.

Table 6-4: Main elements of IMF SBA (2010) with Kosovo

Pillar	
1	Exercising restraint in current spending and raise revenues to contain the impact of their large capital investment program on the overall fiscal deficit;
2	Securing substantial budget financing from privatisation to preserve debt sustainability;
3	Pursuing reforms to broaden the tax base and strengthen public financial management;
4	Bolstering the government's bank balances with the CBK to provide scope for emergency liquidity assistance (ELA), if needed;
5	Providing the CBK with a mandate for ELA, affirm its independence, and further strengthen the banking system;
6	Improving the financial position of the energy sector.

Source: IMF Press Release No. 10/300, July 21 2010.

The SBA included the following quantitative criteria and indicative targets for 2010 and 2011:

Table 6-5: Quantitative Performance Criteria and Indicative Targets set in SBA, 2010-11, in millions of euros

Objective to be observed	Aug 2010	Dec 2010	Mar 2011	Jun 2011
Floor on the bank balance of the general government	369	241	226	457
Floor on the primary fiscal balance of the general government	21	-129	-37	-121
Ceiling on primary expenditures of the general government	700	1316	275	628
Ceiling on contracting or guaranteeing non-concessional debt by the general government	0	0	0	0
Ceiling on the accumulation of domestic payment arrears of the general government	…	…	0	0
Ceiling on the accumulation of external payments arrears of the general government	0	0	0	0
Memorandum items				
Ceiling on recurrent primary expenditures of the general government	459	780	1883	387
Program assumptions				
Total revenue (excluding grants)	805	1106	233	507
Net privatisation receipts	0	0	0	300
Non-project grants	0	80	5	60
Budget support loans	0	0	0	0
Project grants	0	1	0	0
Project loans	0	1	0	0

Source: IMF, Request for Stand-By Agreement, July 7, 2010.

The two most recent IMF programmes, the SMP-2011 and the SBA-2012 have the following two continuous structural benchmarks dealing with fiscal sustainability of new laws:

- The GoK undertakes fiscal impact assessments evaluating the budgetary impact of new benefit creating laws, amendments to such laws or regulations over a period of at least five years;
- A paragraph is included into all new benefit creating laws amendments to such laws or regulations that allow cutting benefits if the budgetary funds are unavailable.

These benchmarks have large overlap with condition "f" of the MoU dealing with fiscal impact analysis of draft laws.

The elements outline above reveal a high degree of coherence between the activities and discourse of the EC and IMF vis-à-vis the GoK. As shown in Box 6-2, the actions of the World Bank further reflect a like-minded approach to supporting the Kosovo authorities.

Box 6-2: Budget Support provided by the World Bank

The World Bank provided budget support to Kosovo under its Sustainable Employment Development Policy Operation (SEDPO). A first grant (SEDPO1) of US$ 24.4 million was disbursed in December 2011. The remaining second and third instalments, amounting to US$ 46.8 million, were disbursed in May 2012. Objectives under the SEDPO included supporting a stable macroeconomic framework through strengthened budgetary management, and laying the institutional and legislative foundations for sustainable employment and growth. SEDPO was co-financed by pledges from eleven donors, including the EC. Other donors were the UK, Finland, Switzerland, the Czech Republic, Italy, Sweden, Estonia, Norway, Denmark, and the US.

The original plan was to disburse SEDPO in three operations; each in 2009, 2010, and 2011. However, the spending initiatives from the new GoK in early 2008 put the macroeconomic framework at risk. Eventually, an SBA was negotiated with the IMF, and the SEDPO1 was approved the World Bank Board in September 2010. Before legal agreements could be signed, the governing coalition lost its majority and fell apart. This led to early elections. New spending initiatives in the electoral period were not in compliance with the commitments GoK had made under the SBA and therefore the programme went off-track. The GoK and the IMF agreed on a six month Staff Monitored Program (SMP) in July 2011, which was successfully implemented during the second half of 2011. Upon successful implementation of the SMP, which included agreement of the 2012 budget, the World Bank disbursed SEDPO1 in December 2011 after it received a Fund Relations Note from the IMF.

Sources: Program Documents, SEDPO1, SEDPO2 and Guidance Note on Coordinating with the IMF on Development Policy Lending, World Bank.

7 Conclusions and Recommendations

This Chapter builds on the evidence presented in the report and presents the evaluation team's conclusion concerning the performance and impact of the EFA operation to Kosovo decided in 2006. Being an ex-post evaluation, it presents a limited number of recommendations, useful for future similar operations. The conclusions and recommendations are structured around the four main areas that have been evaluated, namely the impact of the EFA on: macro-economic stabilisation; external sustainability; and structural reforms; as well as issues linked to the design and value added of the operation.

7.1 Macro-Economic Stabilization and External Sustainability

The EFA was intended to alleviate the financial situation of Kosovo and to support the development of a sound economic and fiscal framework. Our analysis leads us to conclude that:

1. **The macro-economic performance of Kosovo between 2006 and 2011 was overall positive**

Over the period covered by this evaluation, the Kosovo economy was one of the fastest growing in Europe, fuelled by domestic demand (public investment and consumption), a stable flow a remittances and donor support. Inflation was volatile, but core inflation remained low and stable. Kosovo was only moderately affected by the global economic crisis as suggested by a growing- yet low[58]-ratio of non-performing loans. Still, the financial sector is stable, with the vast majority of banking system assets owned by foreign banks. The main weakness in Kosovo's economy remains the staggering level of unemployment, which poses a threat to further sustainable economic growth, social stability and the perspectives of poverty eradication.

2. **Fiscal deficits fluctuated during the review period, and Kosovo's public finances remain fragile and exposed to high-probability, high-incidence risks**

The revenue base of the GoK over the review period was relatively stable due to continuous efforts to establish and improve the tax collection and tax administration. Contrary to a worrisome spending path visible already in 2005, above-expectations indirect tax revenue together with a reduction in recurrent spending and a shortfall in the projected capital expenditure led to an unexpected surplus in GoK's budgets of 2006 and 2007. However, this trend was clearly not sustainable. This was confirmed in 2008 and 2009, when GoK's neutral balance was only possible due *inter alia* to one off privatisation receipts. Larger deficits could not be averted in 2010 and 2011. These were partly financed through the funds provided by the EFA and the SBA first tranche disbursements. The rest had to be financed through the use of the GoK's bank balances, whose stability is of particular importance given that they also serve as a buffer against BoP shocks The level of GOK bank balances fluctuated significantly over the review period, both in absolute terms and as a percentage of the GDP. There is no consensus on the optimal level of bank balances for Kosovo. Nevertheless, it may be prudent to follow the IMF recommendations for minimum balances because: a) the financing of the deficit has been contingent on extraordinary revenue sources

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[58] As compared toother countries in the region.

(external budget support, privatisation benefits); and b) the planning and budgeting processes in the GoK are still far from smooth.

3. The EFA helped alleviate the financial situation of Kosovo

The first macroeconomic objective of the EFA operation was related to the alleviation of the financial situation in Kosovo. It was formulated in 2006 and based on forecasts of an impending financing gap. The forecasted distress did not materialize and the level of bank balances remained solid until 2009. The disbursement of the first tranche of EFA in 2010 provided a useful contribution to the stabilization of bank balances following the steep reduction observed in 2009 and 2010. Some recovery of bank balances is visible in the 2012 data, and their level is expected to fully recover in 2013 through the receipts from the expected privatisation of PTK. Paired with the intended reduction in fiscal deficit from 2014 onwards, these recent developments point to the fact that the financial situation of Kosovo has been supported by EFA, also by exercising some soft pressure on GoK towards more prudent spending.

4. The EFA supported the development of a sound economic and fiscal framework

Our study concluded that progress was made on the reform items included as EFA conditions due to a variety of factors, including the commitments made in the context of the EFA agreement itself. These conditions were relevant and had the potential to contribute to putting in place a framework for sound economic and fiscal management. EFA supported these developments, hence meeting the objective set forth in the Council Decision 2006/880/EC. That being said, a "sound" macroeconomic and fiscal framework calls for a multitude of regulatory and policy reforms that go beyond the specific areas targeted by EFA, several of which are only possible in the medium- and long-term.

5. Kosovo's level of public debt is low and the risk of debt distress is moderate

Conservative fiscal policies pursued before 2008 paired with low administrative capacity, which led to an under-execution of the budget kept the level of public debt low. The fact that Kosovo could not issue sovereign debt obligations further played an important role. The 2010 DSA conducted by the IMF clearly shows that the risk of debt distress may become significantly higher if the GoK does not follow conservative fiscal policies. Private sector indebtedness is rising but the quality of the credit portfolio so far is one of the best in the region.

6. Kosovo's current account deficit was consistently high but the structure of Kosovo's imports and exports has improved over the period

Imports in Kosovo continuously increased over the period, to above 50% of the GDP in 2011. Exports increased multi-fold over the period and diversified, albeit from a very low base. Despite the growth in exports, they are still unable to compensate the share of imports in the trade balance. Both FDI and remittances were at a lower level (expressed as percentage of the GDP) in 2011 as compared to 2007. This further negatively affected the situation of the BoP. Energy and consumption goods represent the bulk of imports, but production related-imports (machinery, chemical products) are on the rise.

7.2 Structural Reforms

The conditions included in the MoU reflected the situation of Kosovo in 2007, when they were negotiated and selected from a longer list through a cooperative process among the EC, the PISG and the UNMIK. The conditions also reflected the nature of MFA/EFA operations. Structural conditions attached to this kind of operations need to be carefully chosen and formulated in order for their implementation to be realistic in light of the usually short life-span of operation.

7. The structural conditions attached to the EFA operation were relevant in light of Kosovo's situation in 2007

Virtually all reforms that benefited from the extra "push" represented by the MoU conditions were already ongoing or recognized as necessary by the Kosovo authorities. Some conditions were in a more advanced state of implementation (e.g. the setting up of the internal audit function in the MoF) and already at the time appeared very likely to be carried through successfully. Others were included in the MoU due to "historical" reasons (e.g. acceleration of SOE privatisation being an issue that the EC has constantly stressed throughout the previous years). Most conditions required actions on the fundamental aspects of good public finance management (e.g. MTEF, viable statistics) and on those aspects that most threatened the State budget (e.g. KEK). Some of the issues covered by the conditions are still relevant today, as the issues have not yet been fully resolved.

8. The gross effect of EFA conditionality was highest on "quick win" technical issues and more problematic on contentious issues

Between 2007 and 2011, progress was recorded in all areas targeted by the EFA conditionality. For about half of the conditions, progress was judged good either because the issue was fully addressed (e.g. the inputting of data in the Treasury software) or because the result of ongoing efforts was solid, albeit more needing to be done (e.g. MTEF). The topics falling into this category are the more technical ones that often the MoF could address directly, without having to rely on many other actors. The conditions on which progress was moderate are those dealing with more complex issues (e.g. the privatisation of SOEs) and those on which the chain of actors involved was much longer (e.g. the billing and collection rates of KEK) or much weaker (e.g. SOK).

9. The political reinforcing effect of EFA's conditionality is its most important legacy

Many of the reforms that the EFA conditionality was targeting would have occurred regardless of the EFA conditions being included in the MoU. This is to a large extent to be expected; during the design phase a conscientious decision was made to focus the conditions on processes on which the government and the MoF in particular already had or could easily take ownership. Another explanation for the likely implementation of these reforms is that many of them were identified as key issues and also pushed by other donors. Overall the EFA conditionality did make an impact nonetheless, by giving a strong political signal concerning the need to pursue reform in a number of important areas. This impact was at its strongest in the early days of the operation and diminished over time. A second important political reinforcing effect of the EFA was to lend international credibility to the GoK in its early days.

7.3 Design and Implementation

10. The special situation of Kosovo and the strong political commitment of the EC to support it resulted in a number of design peculiarities of the EFA operation which played an important – but not exclusive – role in the disbursement delays

As Kosovo's status was not yet determined when the EFA operation was decided, disbursements were made contingent on a settlement of the status. Moreover, as Kosovo did not and could not have a disbursing IMF programme, the usual link between the macro-economic conditions of an SBA and an EFA operation could not occur. As a result, the EFA operation for Kosovo features structural conditions to be fulfilled for the disbursement of not only the second but also the first tranche.

11. The EFA operation was coherent with other EC and the IFI activities

There was no explicit coordination of the EFA operation with the other EC activities in Kosovo. However all these interventions are designed based on the same strategic documents, therefore they contribute to the same set of higher level objectives. EFA co-existed with a formal IMF programme (SBA) for only half a year. However, the prospect of accessing EFA (and World Bank) funds played an important incentive role in the determination of the Kosovo authorities to keep negotiating a programme with the IMF.

7.4 Lessons Learned and Recommendations

The relevance and impact of future EFA operations might benefit from the following set of lessons learned and recommendations, which are based on insights gained though this evaluation:

Recommendation 1

The structural conditionality of the EFA in Kosovo were loosely formulated.

> Negotiating a set of more clearly defined conditions and, where appropriate, indicators to determine the progress recorded on fulfilling EFA conditions can be helpful both for the EC and for the recipient government – especially at the operational level – to get a sense of clarity of what the expectations are and what level of effort/ progress is (or is not) enough; an annex with definitions/ indicators, similar to the one included in IMF agreements could be considered;

Recommendation 2

The EFA in Kosovo occurred in the absence of an IMF programme, hence the structural conditionality included in the MoU was not complemented by formal macroeconomic conditions.

> In other (unlikely) similar cases, the EC should consider including in the MoU (or an addendum thereof), a set of macroeconomic conditions, in addition to the structural conditions. These macroeconomic conditions would have to be negotiated with the beneficiary government and worked out in close cooperation with the IMF. The macroeconomic conditions could be (automatically) replaced with the IMF conditions when/if the beneficiary country enters in a formal programme with the IMF;

Recommendation 3

The first disbursement of the EFA to Kosovo occurred more than 2.5 years after the signature of the MoU and the operation expired before conditions could be met for the second disbursement.

> In situations where EFA disbursements are delayed, the EC should engage in a formal dialogue/review of the operation with the counterpart government authorities to ensure all parties understand the situation and establish a commonly agreed way forward; two options can be envisaged: a) including a “flexibility clause” in the initial MoU allowing for certain changes to be made though simple agreement between the EC and the beneficiary government or b) re-negotiating the MoU, and having the new version approved through the regular procedure;

Recommendation 4

The coordination between the EFA operation and other EC-supported programmes in Kosovo remained limited.

> The EC should consider ways in which more coordination could be attained between its different interventions (i.e. EFA and IPA), for example by more active involvement of Delegation/ Liaison office staff and other Directorate Generals in Brussels in the EFA design and implementation.

Annexes

Stakeholder Interviews

Brussels (March, 2012)

Name	Position and unit within ECFIN
Carole Garnier	Head of Unit D 1
Plamen Kaloyanchev	Kosovo Desk Officer, Unit D1
Chistophe Pavre de la Rochefordiere	Former DG ECFIN D1 Member, currently at DG CLIMA
Harald Stieber	Former DG ECFIN D1 member involved in EFA operation

Washington (16-19 April 2012)

Name	Institution / unit
Johannes Wiegand	current chief of mission at IMF for Kosovo since 2011
Eduardo Castro	Economist, IMF, dealing with Kosovo since 2009
Emre Alper	Fiscal economist, IMF, dealing with Kosovo since March 2010
Edgardo Ruggiero	IMF, Resident representative in Kosovo 2006-10
Gerwin Bell	IMF, Mission Chief for Kosovo, 2004-07
Ms Jane Armitage	World Bank, Country Director and Regional Coordinator For Southeast Europe and Central Asia Region
Selim Thaqi	IMF (currently)
Agim Demukaj	currently WB Chief economist
Ronald Hood	World Bank, (former) Lead Economist for the Western Balkans, 2006-2010
Mohammed Ihsan Ajwad	World Bank, SEDP0 Specialist
Anita Schwartz	World Bank, Task Team Leader (TTL) for the first Budget Support operation (SEDPP1)
Kenneth Simler	World Bank, Statistical Expert
Ruud Treffers	World Bank, Executive Director
Borko Handjiiski	World bank, current country economist for Kosovo (since July 2009)
Alexander Gupmann,	USA State Department, Assistant Coordinator for Kosovo in 2007-2011

Pristina (May 7-11, 2012)

Name	Position/ Institution
Mr. Ahmet Shala	former Minister of Finance (2008-2011)
Mr. Haki Shatri	former Minister of Finance (2004-2007)
Mr. Driton Qehaja	Advisor to Minister of Finance
Mrs. Valmira Rexhebeqaj	Head of Macro Department, Ministry of Finance
Mr. Sokol Havolli	Senior Economist, Central Bank of Kosovo
Mr. Hajdar Korbi	Deputy General Manager BPB Bank, Former Head of Macroeconomic Unit of MoF
Mr. Selim Thaqi	Economist, IMF Kosovo Office Former Head of Macroeconomic Unit of MoF
Mrs. Milva Ekonomi	Long-Term Expert, SIDA Statistical Agency of Kosovo
Mrs. Valbona Bogujevci	Dep. Programme Manager, DFID
Mrs. Rita Ruohonen	EC Liaison Office Kosovo Team Leader, Public Finance & Trade

Name	Position/ Institution
Mr. Ardi Shita	Secretary General, American Chamber of Commerce Kosovo
Mr. Visar Hapciu	Policy and Project Officer, American Chamber of Commerce Kosovo
Mr. Jose Sulemane	Resident Representative, IMF
Mr. Ilir Berisha	Director of Economic Statistics and National Account, SAK
Mr. Laurie Joshua	Team Leader, DFID/KSSD Project
Mr. Liridon Mavriqi	Advisor to the Minister of Economy, Ministry of Economy
Mr. Arbnor Kastrati	Advisor to the Minister of Economy, Ministry of Economy
Mr. Luan Morina	Director of Department of Energy, Ministry of Economy
Mr. Frymëzim Isufaj	Senior Advisor to the Minister of Economy, Ministry of Economy
Mr. Luan Shllaku	Director, SOROS Foundation Kosovo
Mr. David Jankofsky	Team Leader, EC PIP Project, Ministry of Finance
Mr. Alan Packer	Team Leader, EU Twinning Project, Ministry of Local Governance
Mr. Ramadan Islami	Programme Coordinator, GIZ
Mr. *Jan-Peter* Olters	Country Manager for Kosovo, World Bank Kosovo Office
Mrs. Flora Kelmendi	World Bank Kosovo Office

Pristina (July 23-26, 2012)

Name	Position/ Institution
Mr. Ahmet Shala	former Minister of Finance (2008-2011)
Mrs. Valmira Rexhebeqaj	Head of Macro Department, Ministry of Finance
Mr. Hajdar Korbi	Deputy General Manager BPB Bank, Former Head of Macroeconomic Unit of MoF
Mrs. Milva Ekonomi	Long-Term Expert, SIDA Statistical Agency of Kosovo
Mr. Jose Sulemane	Resident Representative, IMF
Mr. Sylejman Morina,	former Deputy Director of SOK (before 2004), Director of Census (after 2004)
Mr. Melvin Asin	Deputy Head of Operations, in Kosovo since Sep 2010 (TL, Public Administration Reform, Public Finance and Trade, EC Liaison Office Kosovo
Ms. Rita Ruohonen	TL, Public Administration Reform, Public Finance and Trade, EC Liaison Office Kosovo
Mr. Luan Morina	Director of Department of Energy, Ministry of Economy

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Chronology of the EFA Operation

Date	Event
June 2005	Letter from the Head of UNMIK Mr Jessen-Petersen, in June to President Barroso requesting that the EC organises, together with the World Bank, a donor meeting and pledges budget support in favour of Kosovo.
July 2005	ECFIN sent information note to EFC on possible exceptional assistance to Kosovo.
October 2005	Agreement between IMF staff and Kosovo authorities on a fiscal framework for 2006 and the remainder of 2005.
November 2005	IMF and Kosovo sign a Letter of Intent (LOI) on a framework of economic and fiscal policies. The LOI includes provisions on maintaining fiscal deficit below 3% of GDP in 2006, and controls on public expenditures. A new excise code, regulations regarding the Kosovo Pensions Savings Trust, were also included in the LOI.
13 December 2005	Technical meeting in Pristina on presentation of 2006 budget and first draft MTEF 2006-2008. EC, WB and IMF attend.
14 February 2006	ECFIN's note to EFC on latest political and economic developments in the context of possible exceptional financial assistance to Kosovo (ECFIN/CLR/REP/50451).
5 April 2006	Donor meeting held in Pristina co-chaired by EC. Re-confirms budgetary financing needs. The EC pledges € 50 million (subject to approval by the Council), the World Bank pledges USD 5 million and the United States USD 2 million of budget support.
12 May 2006	EC proposes draft Council Decision to provide exceptional Community assistance to Kosovo in the form of grants of up to € 50 million.
30 November 2006	Council Decision providing exceptional Community financial assistance to Kosovo (2006/880/EC) up to €50 million in the form of grants.
27 March 2007	Joint report to the Council, Javier Solana and Commissioner Rehn gives a detailed outline of the preparations and financial implications of the EU's role in Kosovo after a status settlement.
May 2007	Approval of MTEF 2008-10.
17-21 September 2007	Negotiations in Pristina on the MoU and on the provisions of the Grant Agreement.
19 December 2007	MoU and Grant Agreement signed.
July 2008	Donor Conference in Pristina pledges €1.2 billion of donor support to Kosovo.
29 June 2009	Kosovo becomes a member of the IMF with a quota of SDR 56 million.
23-30 October 2009	IMF mission to Pristina.
13 November 2009	IMF Assessment Letter for the E confirming possibility for reaching an SBA in early 2010.
27 November 2009	EFC note recommending the extension of the availability of EFA assistance to Kosovo with one year, i.e. by 11 December 2010.
10 December 2009	EC Decision to extent the expiry date of the Grant Agreement with one year (2009/918/EU).
19 January 2010	Addendum to the Grant Agreement on the extension of the expiry date signed.
May 2010	IMF mission to Kosovo confirms budgetary financing needs.
14 July 2010	Compliance Report submitted by the Kosovo authorities on the fulfilment of the conditionalities attached to the first tranche of the EFA.
19 July 2010	EFC note recommending disbursement of the first tranche.
21 July 2010	SBA agreement reached between IMF and Kosovo on an 18-month programme.
2 September	First tranche of EFA disbursed.

Date	Event
2010	
September 2010	Kosovo’s President resigns, and the Parliament is dissolved.
November 2010	Early elections announced for December 2010. IMF review mission cannot be concluded. 2nd tranche of IMF loan and of EFA assistance are not disbursed.
11 December 2010	Expiration of availability of remainder of EFA funds for Kosovo.

Electronic Survey Questionnaire and Results

Part 1: Macroeconomics and external sustainability

1. The decision to provide MFA to Kosovo was taken in 2006, based on projections made then for an upcoming financial gap in Kosovo's balances for the coming years, given:
- increased spending associated with building up of state institutions;
- the impossibility to issue debt.

However, GoK achieved surplus in the period 2006-07, so that there was no need for MFA financing.

If there had been no decision to provide MFA support, and if GoK had not reached surplus in 2006-07, how likely do you estimate following scenarios regarding GoK's expenditure policy in the period after 2007?(Each respondent could choose only ONE response per sub-question).

GoK would have pursued the same expenditure policy as it in fact did, and would have used some of its bank balances to finance the growing financial gap.

Response	Total	% of responses	%
1 Very unlikely	0		0 %
2 Unlikely	2		22 %
3 Likely	4		44 %
4 Very Likely	1		11 %
- Don't know	2		22 %
Total respondents: 9 Skipped question: 0		0% 20% 40% 60% 80%	

GoK would have increased spending, and would have used more of its bank balances to finance the growing financial gap. (Each respondent could choose only ONE response per sub-question.)

Response	Total	% of responses	%
1 Very unlikely	1		11 %
2 Unlikely	1		11 %
3 Likely	4		44 %
4 Very Likely	1		11 %
- Don't know	2		22 %
Total respondents: 9 Skipped question: 0		0% 20% 40% 60% 80%	

GoK would have curbed investment spending in light of estimated future financial needs.
(Each respondent could choose only ONE response per sub-question.)

Response	Total	% of responses	%
1 Very unlikely	1		11 %
2 Unlikely	3		33 %
3 Likely	1		11 %
4 Very Likely	2		22 %
- Don't know	2		22 %
Total respondents: 9 Skipped question: 0		0% 20% 40% 60% 80%	

GoK would have curbed recurrent spending in light of estimated future financial needs.
(Each respondent could choose only ONE response per sub-question.)

Response	Total	% of responses	%
1 Very unlikely	3		33 %
2 Unlikely	2		22 %
3 Likely	2		22 %
4 Very Likely	0		0 %
- Don't know	2		22 %
Total respondents: 9 Skipped question: 0		0% 20% 40% 60% 80%	

GoK would have sought options to improve revenue collection in light of estimated future financial needs.

Response	Total	% of responses	%
1 Very unlikely	0		0 %
2 Unlikely	0		0 %
3 Likely	4		44 %
4 Very Likely	1		11 %
- Don't know	4		44 %
Total respondents: 9 Skipped question: 0		0% 20% 40% 60% 80%	

Did you expect any other scenarios? Please elaborate:

Response	Total	% of total respondents	%
Open answer	2		22 %
Total respondents: 2 Skipped question: 0		0% 20% 40% 60% 80%	

2. In the case that the disbursement of the first tranche of the MFA in September 2010 would not have occurred, could you indicate the likelihood of the following scenarios? (Each respondent could choose only ONE response per sub-question.)

In view of widening fiscal deficit, GoK would have lowered spending and would have improved fiscal discipline.

Response	Total	% of responses	%
1 Very unlikely	0		0 %
2 Unlikely	2		22 %
3 Likely	2		22 %
4 Very Likely	1		11 %
- Don't know	4		44 %
Total respondents: 9 Skipped question: 0		0% 20% 40% 60% 80%	

Despite a widening fiscal deficit, GoK would have continued its spending programme and would have used its bank balances as a financing source.

Response	Total	% of responses	%
1 Very unlikely	0		0 %
2 Unlikely	0		0 %
3 Likely	4		44 %
4 Very Likely	1		11 %
- Don't know	4		44 %
Total respondents: 9 Skipped question: 0		0% 20% 40% 60% 80%	

Despite widening fiscal deficit, GoK would have continued its spending programme and would have looked for additional financing through IMF.

Response	Total	% of responses	%
1 Very unlikely	1		11 %
2 Unlikely	1		11 %
3 Likely	3		33 %
4 Very Likely	0		0 %
- Don't know	4		44 %
Total respondents: 9 Skipped question: 0		0% 20% 40% 60% 80%	

Despite widening fiscal deficit, GoK would have continued its spending programme and would have looked for additional financing through other IFIs or bilateral donors.

Response	Total	% of responses	%
1 Very unlikely	1		11 %
2 Unlikely	1		11 %
3 Likely	3		33 %
4 Very Likely	0		0 %
- Don't know	4		44 %
Total respondents: 9 Skipped question: 0		0% 20% 40% 60% 80%	

Did you expect any other scenarios? Please elaborate: (Each respondent could write a single open-ended response of maximum 2000 characters.)

Response	Total	% of total respondents	%
Open answer	3		33 %
Total respondents: 3 Skipped question: 0		0% 20% 40% 60% 80%	

3. Based on the most likely scenarios that you selected in the two previous questions, can you elaborate more on the macro-economic and fiscal consequences for Kosovo of the most likely scenario without MFA in the period after 2007-2010?

a) If there had been no agreement for MFA in 2007, and if GoK hadn't reached fiscal surplus in 2006-07, the macroeconomic and fiscal consequences for Kosovo (until 2010) would have been:

Response	Total	% of total respondents	%
Open answer	8		89 %
Total respondents: 8 Skipped question: 0		0% 20% 40% 60% 80%	

4. If in 2010 the GoK had not received the first tranche of the MFA assistance, the macroeconomic and fiscal consequences for Kosovo in the period after 2010 would have been:

Response	Total	% of total respondents	%
Open answer	7		78 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

5. In case the European Council had not decided on an MFA to Kosovo in 2006, how likely do you estimate the following scenarios for assistance received from IMF? (Each respondent could choose only ONE response per sub-question.)

The motivation of GoK to pursue the informal "shadow" programme with IMF running since 2005 would have diminished.

Response	Total	% of responses	%
1 Very unlikely	0		0 %
2 Unlikely	1		12 %
3 Likely	3		38 %
4 Very Likely	1		12 %
- Don't know	3		38 %
Total respondents: 8 Skipped question: 0		0% 20% 40% 60% 80%	

The motivation of GoK to pursue the informal “shadow” programme with IMF running since 2005 would have increased as IMF would become the most important source for additional funds.

Response	Total	% of responses	%
1 Very unlikely	3		38 %
2 Unlikely	0		0 %
3 Likely	1		12 %
4 Very Likely	2		25 %
- Don’t know	2		25 %
Total respondents: 8 Skipped question: 0		0% 20% 40% 60% 80%	

The lack of MFA agreement would have not impacted the motivation of GoK to pursue the informal “shadow” programme with the IMF and the programme would have continued.

Response	Total	% of responses	%
1 Very unlikely	2		25 %
2 Unlikely	2		25 %
3 Likely	2		25 %
4 Very Likely	0		0 %
- Don’t know	2		25 %
Total respondents: 8 Skipped question: 0		0% 20% 40% 60% 80%	

6. The table below shows the fiscal balance of GoK in the period 2008-2012. At the end of 2008, GoK significantly increased spending and started running deficits. In 2010, it received MFA support from the EU, as well as a credit from the IMF amounting together to 1.07% of GDP (EUR 30 million + EUR 20 million respectively). (Each respondent could choose only ONE response per sub-question.)

a) If this financial support was agreed, but would not have been disbursed, how do you think would Kosovo’s fiscal position have developed as from 2008?

The fiscal deficit in 2008 would have…

Response	Total	% of responses	%
1 Remained the same	3		43 %
2 Increased by 0.1-0.5 p.p.	0		0 %
3 Increased by 0.5-1.0 p.p.	0		0 %
4 Increased by 1.0-1.5 p.p.	1		14 %
5 Increased by over 1.5 p.p.	1		14 %

Response	Total	% of responses	%
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

The fiscal deficit in 2009 would have…

Response	Total	% of responses	%
1 Remained the same	3		43 %
2 Increased by 0.1-0.5 p.p.	0		0 %
3 Increased by 0.5-1.0 p.p.	1		14 %
4 Increased by 1.0-1.5 p.p.	0		0 %
5 Increased by over 1.5 p.p.	1		14 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

The fiscal deficit in 2010 would have…

Response	Total	% of responses	%
1 Remained the same	1		14 %
2 Increased by 0.1-0.5 p.p.	1		14 %
3 Increased by 0.5-1.0 p.p.	1		14 %
4 Increased by 1.0-1.5 p.p.	1		14 %
5 Increased by over 1.5 p.p.	1		14 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

The fiscal deficit in 2011 would have…

Response	Total	% of responses	%
1 Remained the same	2		29 %
2 Increased by 0.1-0.5 p.p.	1		14 %
3 Increased by 0.5-1.0 p.p.	0		0 %
4 Increased by 1.0-1.5 p.p.	1		14 %
5 Increased by over 1.5 p.p.	1		14 %

Response	Total	% of responses	%
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

b) If there had not been any prospects of receiving this financial support (no agreement on MFA and no agreement with IMF), how do you think would Kosovo's fiscal position have developed as from 2008?

The fiscal deficit in 2008 would have…

Response	Total	% of responses	%
1 Remained the same	2		29 %
2 Increased by 0.1-0.5 p.p.	1		14 %
3 Increased by 0.5-1.0 p.p.	1		14 %
4 Increased by 1.0-1.5 p.p.	0		0 %
5 Increased by over 1.5 p.p.	2		29 %
- Don't know	1		14 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

The fiscal deficit in 2009 would have…

Response	Total	% of responses	%
1 Remained the same	1		14 %
2 Increased by 0.1-0.5 p.p.	0		0 %
3 Increased by 0.5-1.0 p.p.	1		14 %
4 Increased by 1.0-1.5 p.p.	1		14 %
5 Increased by over 1.5 p.p.	2		29 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

The fiscal deficit in 2010 would have…

Response	Total	% of responses	%
1 Remained the same	0		0 %
2 Increased by 0.1-0.5 p.p.	2		29 %
3 Increased by 0.5-1.0 p.p.	0		0 %

Response	Total	% of responses	%
4 Increased by 1.0-1.5 p.p.	0		0 %
5 Increased by over 1.5 p.p.	3		43 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

The fiscal deficit in 2011 would have…

Response	Total	% of responses	%
1 Remained the same	1		14 %
2 Increased by 0.1-0.5 p.p.	1		14 %
3 Increased by 0.5-1.0 p.p.	0		0 %
4 Increased by 1.0-1.5 p.p.	0		0 %
5 Increased by over 1.5 p.p.	3		43 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

7. The table below shows the level of the bank balance (cash reserves) of GoK at CBK in the period 2008-2011. Without MFA from EU and the financial support by IMF, what would have been the level of the GoK's bank balance at the end of 2010 compared to what it was?

The level of GoK's bank balance at the end of 2010 would have ...
(Each respondent could choose only ONE response per sub-question.)

Response	Total	% of responses	%
1 Remained the same	0		0 %
2 Decreased by 1-2 p.p.	4		57 %
3 Decreased by 2-3 p.p.	1		14 %
4 Decreased by 3-4 p.p.	0		0 %
5 Decreased by over 4 p.p.	1		14 %
- Don't know	1		14 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

8. Can you explain briefly on what you have based your answer on the level of bank balance from the previous question? (Each respondent could write a single open-ended response of maximum 2000 characters.)

Response	Total	% of total respondents	%
Open answer	3		33 %
Total respondents: 3 Skipped question: 0		0% 20% 40% 60% 80%	

9. What would have happened to the level of FDI coming to Kosovo in absence of an MFA agreement in 2007 as well as without an understanding with the IMF? The level of FDI coming to Kosovo since 2009 would have been ...(Each respondent could choose only ONE response per sub-question.)

Response	Total	% of responses	%
1 Significantly lower	3		43 %
2 Slightly lower	2		29 %
3 Stayed the same	1		14 %
4 Higher	0		0 %
- Don't know	1		14 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

10. How big do you estimate the impact of the non-disbursement of the 2nd tranche of the MFA and of the IMF agreement on the Government of Kosovo's fiscal discipline after 2010?
The non-disbursement of the 2nd MFA tranche and the 2nd tranche from the IMF agreement had ...(Each respondent could choose only ONE response per sub-question.)

Response	Total	% of responses	%
1 No impact on GoK's fiscal discipline	0		0 %
2 Minor positive impact on GoK's fiscal discipline	2		29 %
3 Major positive impact on GoK's fiscal discipline	3		43 %
4 Minor negative impact on GoK's fiscal discipline	0		0 %
5 Major negative impact on GoK's fiscal discipline	0		0 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

11. How likely is it according to you that in the absence of a signed MFA agreement with the EU and of a shadow programme with the IMF, the 2008 Donor Conference would have taken place? (Each respondent could choose only ONE of the following responses.)

Response	Total	% of responses	%
1 Very unlikely	1		14 %
2 Unlikely	2		29 %
3 Likely	1		14 %
4 Very likely	1		14 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Part 2: Structural Reform

This part deals with the 12 conditionalities attached to the MoU signed between Kosovo and the EU in 2007. It aims to evaluate the specific impact of the MFA on the progress in the area of structural reforms.

12. How do you assess the relative importance of these reforms at the time they were included in the MFA agreement (2007)? (Each respondent could choose only ONE response per sub-question.)

Implementation of financial and economic policies consistent with the understanding reached with the International Monetary Fund and development needs of Kosovo;

Response	Total	% of responses	%
1 Not important	0		0 %
2 A minor, hardly relevant issue	0		0 %
3 A fairly important issue	1		14 %
4 Very important issue and top priority	6		86 %
- Don't know	0		0 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Implementation of regular and appropriate update of the Medium Term Expenditure Framework in order to enhance medium-term policy planning and support the budget process;

Response	Total	% of responses	%
1 Not important	0		0 %
2 A minor, hardly relevant issue	1		14 %
3 A fairly important issue	4		57 %
4 Very important issue and top priority	2		29 %

Response	Total	% of responses	%
- Don't know	0		0 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Implementation of 2007 Strategy for the Internal Audit Function in the PISG, and in particular start the operation of the Central Harmonization Unit on Internal Audit in the Ministry of Finance and Economy, in order to ensure sound and effective public finance management;

Response	Total	% of responses	%
1 Not important	0		0 %
2 A minor, hardly relevant issue	1		14 %
3 A fairly important issue	4		57 %
4 Very important issue and top priority	2		29 %
- Don't know	0		0 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Ensure completeness and accuracy of data inputting the Treasury Software Freebalance and carry out the necessary training of staff in accordance with the Auditor General's recommendations;

Response	Total	% of responses	%
1 Not important	0		0 %
2 A minor, hardly relevant issue	0		0 %
3 A fairly important issue	4		57 %
4 Very important issue and top priority	3		43 %
- Don't know	0		0 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Continue ensuring full compliance of the use of the privatisation/ liquidation proceeds, including their ring fencing, with existing legislation in force;
(Each respondent could choose only ONE response per sub-question.)

Response	Total	% of responses	%
1 Not important	0		0 %
2 A minor, hardly relevant issue	1		14 %
3 A fairly important issue	1		14 %
4 Very important issue and top priority	5		71 %

Response	Total	% of responses	%
- Don't know	0		0 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Implementation of a fiscal impact analysis that is carried out by the Ministry of Economy and Finance and attached to each draft law before submitting it to the government and/or Parliament, in order in particular to ensure that social policies addressing poverty and social exclusion are compatible with the long-run sustainability of public finances;

Response	Total	% of responses	%
1 Not important	0		0 %
2 A minor, hardly relevant issue	0		0 %
3 A fairly important issue	3		43 %
4 Very important issue and top priority	4		57 %
- Don't know	0		0 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Establishment of annual targets for improved billing and bill collection rates of the electricity utility (KEK) and define and implement strategies to reach such targets, in particular with a view to strengthen its viability;

Response	Total	% of responses	%
1 Not important	0		0 %
2 A minor, hardly relevant issue	0		0 %
3 A fairly important issue	5		71 %
4 Very important issue and top priority	2		29 %
- Don't know	0		0 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Development of a strategy for privatisation, and restructuring where necessary, of public-owned enterprises, with a view to strengthening corporate governance and performance of these enterprises and reducing subsidies to the enterprise sector;

Response	Total	% of responses	%
1 Not important	0		0 %
2 A minor, hardly relevant issue	1		14 %
3 A fairly important issue	5		71 %

Response	Total	% of responses	%
4 Very important issue and top priority	1		14 %
- Don't know	0		0 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Further development and strengthening the debt management capacity, in particular in view of potential status related debt obligations;

Response	Total	% of responses	%
1 Not important	0		0 %
2 A minor, hardly relevant issue	2		29 %
3 A fairly important issue	4		57 %
4 Very important issue and top priority	1		14 %
- Don't know	0		0 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Within the existing central public procurement institutions, setting up a public procurement help desk, with the aim of facilitating preparation and execution of capital expenditure;

Response	Total	% of responses	%
1 Not important	0		0 %
2 A minor, hardly relevant issue	2		29 %
3 A fairly important issue	3		43 %
4 Very important issue and top priority	2		29 %
- Don't know	0		0 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Accelerating pace of liquidation of socially owned enterprises (SOEs) and continue with privatisation;

Response	Total	% of responses	%
1 Not important	0		0 %
2 A minor, hardly relevant issue	1		14 %
3 A fairly important issue	5		71 %
4 Very important issue and top priority	1		14 %
- Don't know	0		0 %

Response	Total	% of responses	%
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Establishment of a roadmap for compiling and publishing comprehensive statistics on national accounts and labour market in order to provide policy making with timely and high-quality statistics.

Response	Total	% of responses	%
1 Not important	0		0 %
2 A minor, hardly relevant issue	0		0 %
3 A fairly important issue	5		71 %
4 Very important issue and top priority	2		29 %
- Don't know	0		0 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

13. How do you assess progress in the following topics encompassed in the MFA agreement until December 2010 in comparison to the initial situation in 2007? (Each respondent could choose only ONE response per sub-question.)

Implementation of financial and economic policies consistent with the understanding reached with the International Monetary Fund and development needs of Kosovo;

Response	Total	% of responses	%
1 No progress	0		0 %
2 Some progress	1		14 %
3 Completed formally, but with shortcomings	3		43 %
4 Completed satisfactory	1		14 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Implementation of regular and appropriate update of the Medium Term Expenditure Framework in order to enhance medium-term policy planning and support the budget process;

Response	Total	% of responses	%
1 No progress	0		0 %
2 Some progress	2		29 %
3 Completed formally, but with shortcomings	2		29 %
4 Completed satisfactory	1		14 %

Response	Total	% of responses	%
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Implementation of 2007 Strategy for the Internal Audit Function in the PISG, and in particular start the operation of the Central Harmonization Unit on Internal Audit in the Ministry of Finance and Economy, in order to ensure sound and effective public finance management;

Response	Total	% of responses	%
1 No progress	0		0 %
2 Some progress	1		14 %
3 Completed formally, but with shortcomings	2		29 %
4 Completed satisfactory	1		14 %
- Don't know	3		43 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Ensure completeness and accuracy of data inputting the Treasury Software Freebalance and carry out the necessary training of staff in accordance with the Auditor General's recommendations;

Response	Total	% of responses	%
1 No progress	0		0 %
2 Some progress	0		0 %
3 Completed formally, but with shortcomings	2		29 %
4 Completed satisfactory	2		29 %
- Don't know	3		43 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Continue ensuring full compliance of the use of the privatisation/ liquidation proceeds, including their ring fencing, with existing legislation in force;

Response	Total	% of responses	%
1 No progress	0		0 %
2 Some progress	1		14 %
3 Completed formally, but with shortcomings	2		29 %
4 Completed satisfactory	2		29 %

Response	Total	% of responses	%
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Implementation of a fiscal impact analysis that is carried out by the Ministry of Economy and Finance and attached to each draft law before submitting it to the government and/or Parliament, in order in particular to ensure that social policies addressing poverty and social exclusion are compatible with the long-run sustainability of public finances;

Response	Total	% of responses	%
1 No progress	0		0 %
2 Some progress	0		0 %
3 Completed formally, but with shortcomings	5		71 %
4 Completed satisfactory	0		0 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Establishment of annual targets for improved billing and bill collection rates of the electricity utility (KEK) and define and implement strategies to reach such targets, in particular with a view to strengthen its viability;

Response	Total	% of responses	%
1 No progress	0		0 %
2 Some progress	0		0 %
3 Completed formally, but with shortcomings	3		43 %
4 Completed satisfactory	2		29 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Development of a strategy for privatisation, and restructuring where necessary, of public-owned enterprises, with a view to strengthening corporate governance and performance of these enterprises and reducing subsidies to the enterprise sector;

Response	Total	% of responses	%
1 No progress	0		0 %
2 Some progress	1		14 %
3 Completed formally, but with shortcomings	3		43 %

Response	Total	% of responses	%
4 Completed satisfactory	1		14 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Further development and strengthening the debt management capacity, in particular in view of potential status related debt obligations;

Response	Total	% of responses	%
1 No progress	0		0 %
2 Some progress	0		0 %
3 Completed formally, but with shortcomings	2		29 %
4 Completed satisfactory	3		43 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Within the existing central public procurement institutions, setting up a public procurement help desk, with the aim of facilitating preparation and execution of capital expenditure;

Response	Total	% of responses	%
1 No progress	0		0 %
2 Some progress	1		14 %
3 Completed formally, but with shortcomings	2		29 %
4 Completed satisfactory	2		29 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Accelerating pace of liquidation of socially owned enterprises (SOEs) and continue with privatisation;

Response	Total	% of responses	%
1 No progress	1		14 %
2 Some progress	1		14 %
3 Completed formally, but with shortcomings	1		14 %
4 Completed satisfactory	1		14 %
- Don't know	3		43 %

Response	Total	% of responses	%
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Establishment of a roadmap for compiling and publishing comprehensive statistics on national accounts and labour market in order to provide policy making with timely and high-quality statistics.

Response	Total	% of responses	%
1 No progress	0		0 %
2 Some progress	2		29 %
3 Completed formally, but with shortcomings	1		14 %
4 Completed satisfactory	1		14 %
- Don't know	3		43 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

14. What, if any, was the contribution of the conditionality attached to the MFA assistance to the progress in the following areas? (Each respondent could choose only ONE response per sub-question.)

Implementation of financial and economic policies consistent with the understanding reached with the International Monetary Fund and development needs of Kosovo;

Response	Total	% of responses	%
1 Brought the issue on the policy agenda	3		43 %
2 Speeded up the reform process	1		14 %
3 Shaped the contents of reform	3		43 %
- Don't know	0		0 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Implementation of regular and appropriate update of the Medium Term Expenditure Framework in order to enhance medium-term policy planning and support the budget process;

Response	Total	% of responses	%
1 Brought the issue on the policy agenda	3		43 %
2 Speeded up the reform process	4		57 %
3 Shaped the contents of reform	0		0 %
- Don't know	0		0 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Implementation of 2007 Strategy for the Internal Audit Function in the PISG, and in particular start the operation of the Central Harmonization Unit on Internal Audit in the Ministry of Finance and Economy, in order to ensure sound and effective public finance management;

Response	Total	% of responses	%
1 Brought the issue on the policy agenda	1		14 %
2 Speeded up the reform process	1		14 %
3 Shaped the contents of reform	0		0 %
- Don't know	5		71 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Ensure completeness and accuracy of data inputting the Treasury Software Freebalance and carry out the necessary training of staff in accordance with the Auditor General's recommendations;

Response	Total	% of responses	%
1 Brought the issue on the policy agenda	0		0 %
2 Speeded up the reform process	3		43 %
3 Shaped the contents of reform	0		0 %
- Don't know	4		57 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Continue ensuring full compliance of the use of the privatisation/ liquidation proceeds, including their ring fencing, with existing legislation in force;

Response	Total	% of responses	%
1 Brought the issue on the policy agenda	3		43 %
2 Speeded up the reform process	1		14 %
3 Shaped the contents of reform	1		14 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Implementation of a fiscal impact analysis that is carried out by the Ministry of Economy and Finance and attached to each draft law before submitting it to the government and/or Parliament, in order in particular to ensure that social policies addressing poverty and social exclusion are compatible with the long-run sustainability of public finances;

Response	Total	% of responses	%
1 Brought the issue on the policy agenda	2		29 %
2 Speeded up the reform process	2		29 %
3 Shaped the contents of reform	1		14 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Establishment of annual targets for improved billing and bill collection rates of the electricity utility (KEK) and define and implement strategies to reach such targets, in particular with a view to strengthen its viability;

Response	Total	% of responses	%
1 Brought the issue on the policy agenda	1		14 %
2 Speeded up the reform process	2		29 %
3 Shaped the contents of reform	1		14 %
- Don't know	3		43 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Development of a strategy for privatisation, and restructuring where necessary, of public-owned enterprises, with a view to strengthening corporate governance and performance of these enterprises and reducing subsidies to the enterprise sector;

Response	Total	% of responses	%
1 Brought the issue on the policy agenda	2		29 %
2 Speeded up the reform process	2		29 %
3 Shaped the contents of reform	0		0 %
- Don't know	3		43 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Further development and strengthening the debt management capacity, in particular in view of potential status related debt obligations;

Response	Total	% of responses	%
1 Brought the issue on the policy agenda	0		0 %
2 Speeded up the reform process	4		57 %
3 Shaped the contents of reform	0		0 %
- Don't know	3		43 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Within the existing central public procurement institutions, setting up a public procurement help desk, with the aim of facilitating preparation and execution of capital expenditure;

Response	Total	% of responses	%
1 Brought the issue on the policy agenda	2		29 %
2 Speeded up the reform process	1		14 %
3 Shaped the contents of reform	0		0 %
- Don't know	4		57 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Accelerating pace of liquidation of socially owned enterprises (SOEs) and continue with privatisation;

Response	Total	% of responses	%
1 Brought the issue on the policy agenda	3		43 %
2 Speeded up the reform process	1		14 %
3 Shaped the contents of reform	0		0 %
- Don't know	3		43 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Establishment of a roadmap for compiling and publishing comprehensive statistics on national accounts and labour market in order to provide policy making with timely and high-quality statistics.

Response	Total	% of responses	%
1 Brought the issue on the policy agenda	2		29 %
2 Speeded up the reform process	1		14 %
3 Shaped the contents of reform	1		14 %

Response	Total	% of responses	%
- Don't know	3		43 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

15. What would have happened to the following request for policy action (conditionalities) if the MFA support operation had not taken place? (Each respondent could choose only ONE response per sub-question.)

Implementation of financial and economic policies consistent with the understanding reached with the International Monetary Fund and development needs of Kosovo;

Response	Total	% of responses	%
1 Would have been incorporated in IMF programme	2		29 %
2 Would have been incorporated in WB programme	0		0 %
3 Would have become part of Gov't agenda anyway	2		29 %
4 Would have been totally neglected	0		0 %
- Don't know	3		43 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Implementation of regular and appropriate update of the Medium Term Expenditure Framework in order to enhance medium-term policy planning and support the budget process;

Response	Total	% of responses	%
1 Would have been incorporated in IMF programme	3		43 %
2 Would have been incorporated in WB programme	1		14 %
3 Would have become part of Gov't agenda anyway	2		29 %
4 Would have been totally neglected	0		0 %
- Don't know	1		14 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Implementation of 2007 Strategy for the Internal Audit Function in the PISG, and in particular start the operation of the Central Harmonization Unit on Internal Audit in the Ministry of Finance and Economy, in order to ensure sound and effective public finance management;

Response	Total	% of responses	%
1 Would have been incorporated in IMF programme	2		29 %
2 Would have been incorporated in WB programme	0		0 %
3 Would have become part of Gov't agenda anyway	1		14 %
4 Would have been totally neglected	1		14 %
- Don't know	3		43 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Ensure completeness and accuracy of data inputting the Treasury Software Freebalance and carry out the necessary training of staff in accordance with the Auditor General's recommendations;

Response	Total	% of responses	%
1 Would have been incorporated in IMF programme	2		29 %
2 Would have been incorporated in WB programme	0		0 %
3 Would have become part of Gov't agenda anyway	1		14 %
4 Would have been totally neglected	0		0 %
- Don't know	4		57 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Continue ensuring full compliance of the use of the privatisation/ liquidation proceeds, including their ring fencing, with existing legislation in force;

Response	Total	% of responses	%
1 Would have been incorporated in IMF programme	2		29 %
2 Would have been incorporated in WB programme	1		14 %
3 Would have become part of Gov't agenda anyway	0		0 %
4 Would have been totally neglected	2		29 %
- Don't know	2		29 %

Response	Total	% of responses	%
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Implementation of a fiscal impact analysis that is carried out by the Ministry of Economy and Finance and attached to each draft law before submitting it to the government and/or Parliament, in order in particular to ensure that social policies addressing poverty and social exclusion are compatible with the long-run sustainability of public finances;

Response	Total	% of responses	%
1 Would have been incorporated in IMF programme	3		43 %
2 Would have been incorporated in WB programme	1		14 %
3 Would have become part of Gov't agenda anyway	0		0 %
4 Would have been totally neglected	1		14 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Establishment of annual targets for improved billing and bill collection rates of the electricity utility (KEK) and define and implement strategies to reach such targets, in particular with a view to strengthen its viability;

Response	Total	% of responses	%
1 Would have been incorporated in IMF programme	1		14 %
2 Would have been incorporated in WB programme	3		43 %
3 Would have become part of Gov't agenda anyway	0		0 %
4 Would have been totally neglected	0		0 %
- Don't know	3		43 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Development of a strategy for privatisation, and restructuring where necessary, of public-owned enterprises, with a view to strengthening corporate governance and performance of these enterprises and reducing subsidies to the enterprise sector;

Response	Total	% of responses	%
1 Would have been incorporated in IMF programme	0		0 %
2 Would have been incorporated in WB	1		14 %

Response	Total	% of responses	%
programme			
3 Would have become part of Gov't agenda anyway	1		14 %
4 Would have been totally neglected	2		29 %
- Don't know	3		43 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Further development and strengthening the debt management capacity, in particular in view of potential status related debt obligations;

Response	Total	% of responses	%
1 Would have been incorporated in IMF programme	3		43 %
2 Would have been incorporated in WB programme	0		0 %
3 Would have become part of Gov't agenda anyway	1		14 %
4 Would have been totally neglected	0		0 %
- Don't know	3		43 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Within the existing central public procurement institutions, setting up a public procurement help desk, with the aim of facilitating preparation and execution of capital expenditure;

Response	Total	% of responses	%
1 Would have been incorporated in IMF programme	2		29 %
2 Would have been incorporated in WB programme	1		14 %
3 Would have become part of Gov't agenda anyway	0		0 %
4 Would have been totally neglected	1		14 %
- Don't know	3		43 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Accelerating pace of liquidation of socially owned enterprises (SOEs) and continue with privatisation;

Response	Total	% of responses	%
1 Would have been incorporated in IMF programme	0		0 %
2 Would have been incorporated in WB programme	1		14 %
3 Would have become part of Gov't agenda anyway	1		14 %
4 Would have been totally neglected	0		0 %
- Don't know	5		71 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Establishment of a roadmap for compiling and publishing comprehensive statistics on national accounts and labour market in order to provide policy making with timely and high-quality statistics.

Response	Total	% of responses	%
1 Would have been incorporated in IMF programme	3		43 %
2 Would have been incorporated in WB programme	1		14 %
3 Would have become part of Gov't agenda anyway	0		0 %
4 Would have been totally neglected	1		14 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

Part 3: Value Added

16. Please indicate your view on the added value of the EU MFA support operation by providing your view on the following hypotheses? (Each respondent could choose only ONE response per sub-question.)

a) The MFA support operation added value as it supported overall political stabilization in Kosovo.

Response	Total	% of responses	%
1 Fully agree	3		43 %
2 Agree	3		43 %
3 Disagree	0		0 %
4 Fully disagree	0		0 %
- Don't know	1		14 %

Response	Total	% of responses	%
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

b) The MFA support operation added value domestically, as it used a “carrot and stick” approach towards promotion of on-going reforms.

Response	Total	% of responses	%
1 Fully agree	4		57 %
2 Agree	3		43 %
3 Disagree	0		0 %
4 Fully disagree	0		0 %
- Don't know	0		0 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

c) The MFA support added value as it increased Kosovo’s external credibility and facilitated donor pledges at the 2008 Donor Conference.

Response	Total	% of responses	%
1 Fully agree	4		57 %
2 Agree	2		29 %
3 Disagree	0		0 %
4 Fully disagree	0		0 %
- Don't know	1		14 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

d) The MFA support operation added value as it strengthened Kosovo’s external credibility to the private sector, therefore stimulating FDI.

Response	Total	% of responses	%
1 Fully agree	2		29 %
2 Agree	2		29 %
3 Disagree	1		14 %
4 Fully disagree	0		0 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

e) The MFA support operation added value as it allowed for a more meaningful dialogue between the EU and Kosovo.

Response	Total	% of responses	%
1 Fully agree	2		29 %
2 Agree	3		43 %
3 Disagree	0		0 %
4 Fully disagree	0		0 %
- Don't know	2		29 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

f) The MFA support operation added value as it strengthened GoK's motivation to continue pursuing an agreement with the IMF.

Response	Total	% of responses	%
1 Fully agree	3		43 %
2 Agree	4		57 %
3 Disagree	0		0 %
4 Fully disagree	0		0 %
- Don't know	0		0 %
Total respondents: 7 Skipped question: 0		0% 20% 40% 60% 80%	

20. Other? Please elaborate (Each respondent could write a single open-ended response of maximum 2000 characters.)

Response	Total	% of total respondents	%
Open answer	1		11 %
Total respondents: 1 Skipped question: 0		0% 20% 40% 60% 80%	

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