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# **Kosovo**

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## **2005 Progress Report**

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## A. INTRODUCTION

### 1. Preface

In June 2000 in Feira, the European Council confirmed that:

*“its objective remains the fullest possible integration of the countries of the [Western Balkans] region into the political and economic mainstream of Europe through the Stabilisation and Association process, political dialogue, liberalisation of trade and cooperation in Justice and Home Affairs. All the countries concerned are potential candidates for EU membership”.*

Ahead of the EU-Western Balkan Thessaloniki Summit in June 2003, the General Affairs and External Relations Council adopted “The Thessaloniki agenda for the Western Balkans: moving towards European integration”. The Thessaloniki agenda strengthened the Stabilisation and Association process by introducing new instruments to support reform in these countries and their European integration efforts, including European Partnerships. This agenda was endorsed by the European Council and by the countries of the Western Balkans in June 2003. This agenda also applies to Kosovo as governed under the auspices of UN Security Council Resolution 1244.

In June 2005, the European Council reiterated that:

*“... each country’s progress towards European integration, taking account of the evolution of the acquis, depends on its efforts to comply with the Copenhagen criteria and the conditionality of the Stabilisation and Association process. Moreover, in this process, regional cooperation and good neighbourly relations will remain essential elements of EU policy.”*

The structure of the report is largely the same as that used in previous years and assesses the implementation of the Stabilisation and Association process. The report:

- describes the relations between Kosovo and the Union;
- analyses the political situation in Kosovo in terms of democracy, the rule of law, respect for human rights and the protection of minorities;
- assesses the economic situation in Kosovo in terms of economic developments and progress towards economic stability and competitiveness;
- reviews Kosovo’s capacity to implement European standards, i.e. in gradually making legislation in key policy areas more compatible with European legislation and standards;
- examines the extent to which Kosovo has addressed the European Partnership priorities.

This report takes into consideration progress since the 2004 report. It covers the period from March 2004 to 30 September 2005. It looks at whether the planned reforms referred to in the 2004 annual report have been carried out and examines new initiatives, also assessing the overall level of implementation.

Progress has been measured on the basis of decisions *actually* taken, legislation *actually* adopted and the degree of implementation. As a rule, legislation or measures that are in various stages of either preparation or Parliamentary approval have not been taken into account. This approach ensures equal treatment for all

countries and permits an objective assessment of each country/entity in terms of their concrete progress in implementing the Stabilisation and Association process.

The report draws on numerous sources of information. Kosovo has been invited to provide information on progress made since the publication of the last report. Council deliberations and European Parliament reports and resolutions have been taken into account in drafting the report. The Commission has also drawn on assessments made by various international organisations, in particular the contributions of the Council of Europe, the OSCE, the international financial institutions, and non-governmental organisations.

## **2. Context**

Kosovo's institutional set up is governed by the United Nations Security Council Resolution 1244 establishing an interim international civilian administration, the United Nations Mission in Kosovo (UNMIK) with the Special Representative of the Secretary General (SRSG) as ultimate responsible. The Constitutional Framework for Provisional Self-government of Kosovo divided responsibilities between UNMIK and the Provisional Institutions of Self-Government (PISG) for the purposes of developing a meaningful self-government in Kosovo pending a final settlement. The Commission's assessment in this report refers to all Kosovo authorities regardless of their respective competences.

The reporting period started marked by the wave of violent riots which swept throughout Kosovo in March 2004 and reflected the fragility of Kosovo's reconciliation process. In this context, the Secretary-General of the United Nations asked Ambassador Eide to review the policies and practises of all actors in Kosovo. This report provided the basis for his recommendation to the Security Council on November 2004 of an integrated strategy on a way forward in Kosovo until mid-2005 and in preparation for the future status process.

During this period, the European Union has given its full support to Mr Jessen-Petersen, the new Special Representative of the Secretary General who took up his post in June 2004 for the implementation of this integrated strategy. Under his leadership, there has been a noticeable improvement of cooperation between UNMIK and the provisional institutions resulting in renewed impetus to the process towards the compliance of on the eight standards: Functioning of Democratic Institutions, Rule of Law, Freedom of Movement, Sustainable returns and Right of Communities, Economy, Property Rights, Dialogue and Kosovo Protection Corps.

Furthermore, the European Union has continued to support UNMIK restructuring efforts in the direction of increasing the responsibilities, capacities and accountability of the provisional institutions of self-government so that they take full ownership of the situation on the ground.

In June 2005, Ambassador Eide was appointed as special envoy tasked to conduct the comprehensive review of the Kosovo standards. His report has been the basis for the UN Secretary-General decision to move to the next stage of the political process. The conclusions of the review are in line with this report. In particular, the EU will ensure that the respect of the standards remain of prime importance in the context of Kosovo's long term European perspective. To this effect, the monitoring of the Standards implementation will be progressively merged with the EU integration process as the European Union will be gradually taking the lead role in promoting

reforms in Kosovo. On 24 October the UN Security Council endorsed the launching of talks on the future status of Kosovo.

### **3. Relations between the EU and Kosovo**

Recent developments in bilateral relations

The vehicle currently keeping Kosovo firmly anchored in the EU policy for the Western Balkans is the *Stabilisation and Association Process Tracking Mechanism* (STM). This mechanism was set up in November 2002 aiming to assist Kosovo authorities to benefit fully from the core elements of the Stabilisation and Association Process, notably, EU assistance, policy advice, monitoring of EU standards and trade concessions. The STM contributes to institution building and administrative reform, increasing understanding within the administration of the principles and aims underlying European policy and practice. In the reporting period, the Commission met regularly with Kosovo authorities in this context.

The European perspective of the Western Balkans is also open to Kosovo. This is reflected in the adoption of the European Partnership published in June 2004 which formulates – as overarching recommendation – the implementation of the Standards. Kosovo adopted its Action Plan for the implementation of the European Partnership Priorities on in January 2005 and provided the Commission with updates on its progress in implementing the Action Plan in April, June and September 2005.

In April 2005 the Commission published a Communication reiterating its determination to helping Kosovo, provided political leaders demonstrate a clear commitment to democratic principles, human rights, protection of minorities, rule of law, market economic reform and the values on which the European Union is based. This communication provides a support agenda to enhance socio-economic development and closer integration of Kosovo into the region.

In June 2005, the EU High Representative for the CFSP and the EU Commissioner for Enlargement submitted a joint report to the Council on the *future EU Role and contribution in Kosovo*. This report served as the basis of the European Council declaration of 16 and 17 June 2005, recalling the European Union's contribution to the implementation of United Nations Security Council Resolution 1244 on Kosovo and reaffirming that any future solution for Kosovo must be fully compatible with European values and norms and contribute to realising the European prospects of Kosovo and the region. The European Council also stressed the EU's willingness to play a full part in the future international presence in Kosovo, in close cooperation with the relevant partners and international organisations.

Two informal inter-parliamentary meetings between the European Parliament delegation for relations with the countries of South East Europe and the Kosovo Parliamentary Assembly were held in Pristina in March 2004 and in Brussels in June 2005. In January 2005, the EU Commissioner for Enlargement visited Kosovo. Furthermore the Commissioner hosted a ministerial delegation visit to the Commission on June 2005, organised by the OSCE Mission in Kosovo. These contacts with Kosovo's provisional institutions aim to help them in better understanding their role and encouraging the implementation of the standards as a mean to get closer to the EU.

The EU is Kosovo's largest trade partner. Imports from the EU represent a share of 67.3% of total imports, amounting to around EUR 190 million.

## Community assistance

Community assistance to Kosovo has been provided since 1999 under a variety of instruments including humanitarian aid, exceptional financial support and financing to Pillar IV of UNMIK. Since 2000, the CARDS programme has been the main financial instrument for Kosovo, with programmes mainly implemented by the European Agency for Reconstruction. To date, this assistance amounts to more than € 1.6 billion, and if topped up with bilateral aid from EU Member States – exceeds the EUR 2 billion.

In 2004 the CARDS allocation amounted to some EUR 78.9m; in 2005 an additional EUR 59.5m were provided in programmes designed to reflect the priorities of the European Partnership and support the implementation of the Standards. As an example, institution building support was earmarked for the two new ministries of communities and returns and local government as well as the prime minister's office. Local government reform and the delivery of public services were supported. In the economic field, assistance was designed to support the privatisation process and the incorporation and restructuring of the public owned enterprises, strengthen the SME sector and develop coherent economic strategies.

As in previous years, in 2005, funding was provided to finance the operation of UNMIK Pillar IV. The Pillar together with the Provisional Institutions of Self-government is responsible for economic development and is an integral part of the UNMIK pillar structure. The 2004/2005 EC funding for Pillar IV amounted to about EUR 45 m.

Assistance is coordinated with EU member states, other donors and international financing institutions, including the World Bank and the IMF. As donor funding decreases for Kosovo, the European Commission has been encouraging Kosovo institutions to improve their donor coordination within the provisional institutions of self-government in order to maximise donor funding effectiveness.

## **B. IMPLEMENTATION OF THE STABILISATION AND ASSOCIATION PROCESS**

### **1. Political situation**

The conditions for the Stabilisation and Association process were set out in the conclusions of the General Affairs Council in April 1997. To become EU members, the countries concerned need to satisfy the criteria established in the Copenhagen European Council conclusions of June 1993. The Copenhagen political criteria stipulate that countries must have achieved “stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities.”

Elements to be examined include democratic principles, human rights, the rule of law, respect for and protection of minorities and regional cooperation. In addition to these, specific elements of relevance to individual countries are also examined, including respect for international obligations such as peace agreements and cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY).

In its 2004 report, the Commission found that:

*“The UN key decision to operationalise the Standards for Kosovo, and the launch – although amidst difficulties – of the Dialogue between Pristina and Belgrade on issues of common concern, were the main developments over the reporting period.*

*Just at the time when the direct dialogue between Pristina and Belgrade seemed to be finally on track and the Kosovo standards implementation plan was about to be finalised, the ethnically motivated violent incidents that occurred in March 2004 marked a serious setback to the establishment of a secure, democratic and multi-ethnic Kosovo.*

*Over the reporting period, the performance of the Provisional Institutions of Self-Government (PISG) and public administration has started to improve, but significant deficiencies still need to be addressed with determination. The transfer of non-reserved competencies from the United Nations Interim Administration Mission in Kosovo (UNMIK) to the PISG was completed by the end of 2003. Now the PISG need to make full use of the transferred competencies to take greater responsibility for the reforms and their implementation under the ultimate responsibility of UNMIK, which in addition holds the reserved powers. The late and inadequate reaction of the PISG to the events of March 2004 raises serious concerns. The rule of law needs to be strengthened, in particular as regards effective implementation and enforcement of the legislation.*

*While some efforts were made notably in the second half of 2003, substantial and sustainable return of displaced persons to Kosovo was hampered by the unfavourable socio-economic conditions and precarious security situation. The March 2004 violent incidents have led to the forced displacement of members of minority communities and have exacerbated the climate of insecurity with a very adverse impact on the overall process of returns.*

*The European perspective means that Kosovo people will be able to benefit from the peace and prosperity that the process of European integration has secured in*



*a free and democratic manner throughout most of the continent. To achieve this aim, Kosovo needs to be firmly anchored in the Stabilisation and Association process. However, the March 2004 incidents show that Kosovo people and the PISG need to engage seriously in the process.”*

The section below provides an assessment of political developments in Kosovo since the 2004 report, including the overall functioning of its executive and judicial system, the rule of law, respect for human rights and protection of minorities and regional issues. Such developments are closely linked to Kosovo's ability to implement the reforms and reach the standards that are required to make further progress in the Stabilisation and Association process and towards the EU.

### **1.1 Democracy and the rule of law**

Overall, the **provisional institutions of self-government** have shown a higher commitment towards the implementation of the Standards for Kosovo and have made particular efforts to redress the consequences of the March violence and to regain credibility after such a major setback. However, democratic deficits and efficiency in their functioning need to be addressed and more commitment is needed by the political leadership in the institutions at central and local levels to guarantee impartiality in the exercise of their public functions.

The reporting period was marked by a fast changing political environment and the absence of Kosovo Serbs from the political scene. Provisions in the Constitutional framework designed to protect minority rights in the Assembly and Government continued to reserve ten seats in the Assembly, three Ministerial, three Deputy Ministerial and one Assembly Presidency positions for minority communities. However, the boycott of the 2004 elections by Kosovo Serbs (0.3%) reduced their Assembly representation from twenty two members to the reserved ten, of which only two members of the Serb Civil Initiative took their seats in the Assembly and have participated regularly. The absence of the Serbian List for Kosovo and Metohija representatives in the Assembly and the Government has prevented the promotion of the legitimate Kosovo Serb interest in the institutions. However, neither the Provisional institutions nor the majority media have succeeded to create the necessary confidence building measures to facilitate the Kosovo Serb participation into the political process. In February, President Tadic visited a number of municipalities with significant Kosovo Serb population. The first visit to Kosovo by a Serbian President since 1999 took place in relative calm but failed to help encourage the participation of Kosovo Serbs into the political process.

Direct dialogue between Pristina and Belgrade has resumed in the reporting period. Four working groups on technical areas of mutual interest are in place: Energy, Returns, Transport and Telecommunications and Missing Persons. Both delegations have been able to travel to both Pristina and Belgrade without hindrance. In general, there is a need to intensify the frequency of the dialogue and the preparation of the Kosovo delegations in terms of technical experience and seniority in order to get more fruitful results. Regarding political dialogue, Kosovo's president and prime minister have declared that they are ready to meet their Serbian counterparts. However, no meetings have been set and both the Kosovo and the Serbian side have not been constructively seeking a compromise solution that would satisfy both parties.

Relations between the main Kosovo Albanian political parties have been strained and tensions between them mounting. The main opposition parties were highly critical of procedures in the assembly and openly accusing some government members of engaging in criminal activity. Under pressure of the international community, Kosovo's **president** formally retired from his position as president of the Democratic League of Kosovo party in 2005. However no successor has been identified and he continued chair party meetings and continues to play a key role within his party. A private security service guarding the presidency was replaced by the Kosovo Police Service in April. The president's role at the Kosovo forum is generally acknowledged to be positive and constructive. His role in the forming of an inclusive team of Kosovo Albanian political representatives for the Status negotiations has been instrumental. Despite his health problems, the PM has pledged to continue fulfilling his political functions.

### *Parliament*

The **Kosovo Assembly** is still in the process of developing a truly democratic culture. Its new rules of procedure were only adopted in May 2005. Since this adoption there have been no reports of serious procedural violations. Eleven Assembly committees have been established. However, not all of them are fully operational with particular concern on the shortcomings of the Committee on Rights and Interests of Communities. The Assembly secretariat has not made the best efforts to provide free access to official documents for members of the Assembly and the public. The Assembly has not always exercised well its activity in executive oversight, especially with regard to the (non) implementation of Assembly laws and financial expenditure. Decisions on important matters, such as budgetary spending, have often been reached in a manner that was not transparent and excluded the majority of the Assembly. It has not been convened frequently enough to guarantee full political debate and the delivery of quality legislation and right overseeing of the work of the executive branch. For the first time, Kosovo's Assembly saw the emergence of a true parliamentary opposition. Technical issues have become highly politicised bones of contention between government and opposition parties, which are still growing into their new role.

In this context the joint statement of the Informal inter-parliamentary meeting between the European Parliament delegation for relations with the countries of South East Europe and a delegation of the Kosovo Parliamentary Assembly the June in June 2005 outlined the need for the Kosovo Parliamentary Assembly to pay more attention to its role of legislator and for monitoring law implementation. It outlined that the Parliament should ensure full respect of the rules and should become the place for fair political debate and constructive confrontation between the governing and the opposition parties.

### *Government*

After the multi-party coalition which dominated the political scene between 2000 and 2004, the elections of October 2004 resulted for the first time in Kosovo in a **government coalition** formed between the Democratic League of Kosovo (LDK) and the Alliance for the Future of Kosovo (AAK). The AAK's president Ramush Haradinaj was given the post of prime minister which he held until March 2005, when he was indicted by the International Criminal Tribunal for the Former Yugoslavia (ICTY). He immediately resigned, voluntarily surrendered and was

transferred to The Hague. He was released on bail and returned to Kosovo in June. Neither the indictment nor the return sparked unrest.

The end of the former broad coalition strengthened the role of the prime minister and allowed for a more coherent political agenda, but it also resulted in the politicisation of more technical issues. The swift designation of Mr Haradinaj's successor Bajram Kosumi allowed the smooth continuation of the government coalition..

The new government has established three new Ministries (Ministries of Local Governance Administration, Communities and Returns and Energy and Mines) and ensuring a multi-ethnic composition (three ministries are allocated to minorities and three deputy ministerial positions). However, the key cabinet post of minister of agriculture, forestry and rural development reserved to a Kosovo Serb has remained empty. Although there has been an effort to grow as a government and improve joint rather than individual leadership, the government's work has been tainted by corruption accusations.

The administration attention has focused on the implementation of the Standards for Kosovo with a view to meet the UN Comprehensive review date. However, the long term commitment to substantial reforms beyond this date needs to be assured. The central coordination capacity of the prime minister's office has developed but still needs to be significantly further strengthened in order to provide effective strategic direction, planning and government coordination. Additional efforts are necessary to build up efficient and effective government mechanisms, in particular in relation to coordinating ministries and developing coherent policies that are implemented consistently at central and municipal level.

### *Public administration*

One of the major cross cutting issues to be tackled in Kosovo is the strengthening of public administration, as overall Kosovo's public administration remains extremely weak inefficient and overstaffed.. Basic public services provision needs to be reinforced across all sectors.

A key highlight of the reporting period has been the positive trend in the recruitment of minority communities in the PISG. Minority employment at central level is estimated at 11%. Sixteen of the thirty municipalities have met or exceed targets. Special recruitment campaigns are underway at the central and municipal level but an overarching strategy for ensuring sustainable minority representation in the PISG is needed including adequate access to information for vacancies in the long-term.

An UNMIK commissioned assessment in April 2005 concluded that the foundations for a functioning system of public administration were gradually being established. It furthermore found that the legal basis was in place and the required institutions existed for managing the civil service and financial management processes, a comprehensive public administration reform strategy or action plan has yet to be agreed upon. However, serious efforts to improve the public administration could not be witnessed.

The Civil Service Law was promulgated by the SRSG on in December 2001 (UNMIK Regulation 2001/36) and governs all civil service employment covered by the Kosovo consolidated budget. It stipulates a contract-based employment system based on an extendable contract of limited duration of three years. Two institutions, an independent oversight board and a senior public appointments committee are

established by the law. All appointments, except senior appointments are decentralised to Kosovo's institutions which determine job descriptions and classification. Recent dismissals of several permanent secretaries have given rise to concerns about transparency and independence of public selection procedures and dismissals. For the sake of ensuring the efficiency and independence of the civil service, there is merit in the consideration of senior public service staffing contracts not to be decided by lapse of time. Furthermore, decisions to renew or end public servants employment should be made after a sound evaluation process. Proper performance appraisal procedures also need to be put in place.

In May 2005, the ministry of finance and economy and the ministry for public service established a working group at the deputy minister's level to implement a new pay and grade system in the public sector. The creation of the working groups between the ministry of finance and economy and the ministry for public services was intended to improve control over the calculation of wages, the definition of job description and related harmonised payment structures in addition to the reduction in the budget expenditures. In September 2005, the government announced that due to technical problems, the Pay and Grading Scale Review could not be implemented. Any solution for this problem should be kept in line with International Monetary Fund recommendations. It is very important that any salary balancing exercise is kept budgetary neutral.

The capacities of the Kosovo institute of public administration have been further enhanced and the number of training courses delivered has increased. However, the institute has not managed to grow into a role as independent and authoritative provider of generic public administration training and it suffers from low acceptance among line ministries as they continue to operate their own training departments and do not sufficiently make use of the services the institute can offer.

Administrative capacity at the municipal level is also weak both at the administrative and at the strategic planning level, e.g. when it comes to developing medium to long term economic development strategies. Furthermore, the relationship between the central and the municipal level needs to be further defined in terms of clearly determining the roles and obligations of each level.

Belgrade-sponsored *parallel administrative structures*<sup>1</sup> continue to operate in most predominately Kosovo-Serb municipalities. The March 2004 event severely hampered the efforts made by UNMIK and the PISG at integrating the two structures.

The main areas of parallel activities are courts, education, administration and health care. In terms of education, two systems of education continue to operate in Kosovo and there is little mutual recognition of certificates and diplomas. Furthermore, there are still parallel administrative structures with regard to property registration, which cause legal uncertainty for property rights holders. The Serbian ministry of Internal Affairs has several offices in Kosovo that administer drivers' licences, passports, identifications cards and vehicle registration plates. A number of Kosovans rely on these services, especially those that wish to travel to Serbia proper, as UNMIK documents are not recognised there. The parallel health care system continues to

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<sup>1</sup> The term parallel structures is used to define bodies that have been or still are operational in Kosovo after 10 June 1999 and that are not mandated for under the UNSCR 1244. In the majority of the cases, these institutions operate under the de facto authority of the Serbian government and assume jurisdiction over Kosovo from Serbia proper, or operate on the territory of Kosovo.

function alongside the PISG-run health care, and is financed by the Serbian ministry of Health.

Improving basic public services provision to all communities is needed including as a contribution to reducing demand for services provided by parallel structures. In the absence of meaningful and sustainable guarantees of equal access to quality services for all minority communities, the dismantling of parallel structures has to be seen in the wider context of the reform of local government.

*Decentralisation* has become one of the most controversially discussed issues in Kosovo politics. The framework for the reform of **local government** in Kosovo was endorsed by the government in July 2004. The ministry for local government developed a working programme in 2005 for the reform of local government leading up to the full implementation of the reform in 2008.

The implementation of the decentralisation process has proved to be difficult. The international community had to exercise pressure on Kosovo's institutions on several occasions to move the decentralisation process forward. The main issue is the area and population size of the pilot municipality units. The initial proposal was changed to accommodate mainly Kosovo Serb concerns and a second, so-called "plan B", proposed amendments, addressing those concerns, and increasing the number of cadastral units within the pilot municipality units. In August 2005, five executive decisions were signed by UNMIK, establishing the territorial delineation of the five pilot municipality units. Subsequently the Government nominated councillors and inaugurated the three Provisional Assemblies of the three pilot municipal units of Hani I Elezit and Junik (Kosovo Albanian majority) and Mamusha (Kosovo Turk majority). However, Kosovo Serb leaders have continued to reject the process and in consequence; the two Kosovo Serb majority pilot municipalities of Gracanica and Partesh have not been inaugurated.

A positive step was, however, taken on 16 September, when delegations from Pristina and Belgrade met to discuss decentralisation, in a meeting organised by UN Secretary-General's Special Envoy and hosted by the Austrian Foreign Ministry. This encounter facilitated an exchange of views and greater understanding of respective positions. There needs to be now a greater compromise that allows more concrete progress to be achieved in this important issue.

The lack of reliable demographic data is a serious impediment for Kosovo's policy makers to design policies related to local government reform and economic development. The last census was held in 1991 but boycotted by the majority of Kosovo's population. In December 2004, the *Kosovo Population and Housing Census* law was promulgated followed by a Government declaration on the intention to carry out a census in 2006. This census should provide reliable data on the number and geographical distribution of the population, the demographic structure and main socio-economic characteristics of the population, as well as information on dwellings and buildings used for housing. However, the present capacity of the Statistical Office of Kosovo is insufficient to undertake such a complex exercise. Early indications show that the conditions are not fulfilled to carry out a reliable census in full respect of international standards in 2006. The European Commission Statistical Office is working in close cooperation with the Council of Europe and key agencies in this field to support the Government in making the preparations for a Census pilot project due to start by the end of 2005..

*The Kosovo Protection Corps (KPC)* made some progress in becoming a multi-ethnic civil emergency organisation. Its involvement in the implementation of civil reconstruction and humanitarian projects has been appreciated by the international community. A publicity campaign for minority recruitment has helped to increase the number of minority members to 5.5 percent. Nevertheless, the ubiquitous display of the Albanian flag and of pictures of Albanian national and Kosovo Liberation Army war heroes at Kosovo Protection Corps premises and gatherings remains discouraging to minority members. This is an issue to be addressed if KPC is genuinely committed to become an organisation representative of all communities in Kosovo. A civil protection brigade as the future core of the KPC was created in June 2005 but without any consequent budget assignments. A certain improvement in disciplinary trends has been seen. The KPC needs to continue its streamlining and professionalisation. It should ensure that it performs its mandated functions in a transparent and accountable way and in full compliance with human right standards and the rule of law.

### *Judicial system*

Kosovo's judicial institutions remain weak and unable to deliver a proper service, both in the civil and criminal sectors, needing to be substantially improved. One underlying difficulty is the legal uncertainty in relation to the laws that govern Kosovo. An extensive, coherent and comprehensive body of law governing Kosovo has yet to be defined. The main issue in this respect is the applicability of laws in Kosovo which is divided between UNMIK regulations and certain (Yugoslav) laws in force in Kosovo on 22 March 1989. While the applicability of laws has been defined by UNMIK regulations in theory, exactly which laws are in force is not always clear to practitioners thus undermining the rule of law and creating legal uncertainties.

The court system of Kosovo comprises a supreme court, a commercial court, a high court for minor offences, five district courts, 24 municipal courts and 25 minor offences courts. Supreme Court chambers dealing with constitutional matters or human rights have not been created. Kosovo does not have a system of administrative courts.

The efficiency of the judicial system is still very low. The length of procedures and the case overload remains a major problem. Due to the absence of a modern case management system and the increasing number of complaints lodged, the number of backlogs of cases is steadily increasing. Appointment procedures for judges can take up to one year.

Deeper structural reforms are required for a professional justice system to take root. Judges and prosecutors generally graduated under the Yugoslav system and were forcedly out of work between 1989 and 1999. Initial legal education programmes have started to be delivered by the Kosovo Judiciary Institute but continuous legal education remain to be made compulsory. The new provisional criminal and criminal procedure codes entered into force in April 2004, but both judges and prosecutors are not always able to properly implement the quite extensive legal and practical changes these codes brought about. When and where judgements are delivered there are concerns that the execution of justice remains selective at times.

The enhance role of prosecutors under the new criminal code and criminal procedure code, directing and supervising the work of judicial police in the petrial stage of

criminal proceedings, makes more urgent the need to establish institutional safeguards to guarantee the autonomy and impartiality of the prosecution system.

Major crimes are dealt with by international judges and prosecutors. An efficient witness protection –also in the face of intimidation- does not yet exist. Care should be taken to further develop the legal framework for witness protection, in such a way as to ensure that the safety of vulnerable witnesses is appropriately balanced with the accused's right of defence. No war crimes cases are currently being directly handled by local courts and/or prosecutors. The majority of cases relating to the March 2004 events are being handled by the local judiciary, with cases against 423 persons resulting in 209 guilty convictions to date. International prosecutors are working on all cases that resulted in death, involving the burning of Serb houses, churches and monasteries, cases against the organizers/leaders of the riots, flagrant cases of inter-ethnic violence and cases involving significant violence against police. International prosecutors are handling approximately 44 cases; verdicts have been reached in 11 cases. The highest sentence was handed down in July 2005, when the defendant was sentenced to 18 years imprisonment for attempted murder.

The judicial inspection unit received appropriate funding in 2005 but still has to develop its capacities. The judicial police unit foreseen in the new provisional criminal code of procedure that will undertake certain investigatory task under the supervision of the public prosecutor has been set up.

Recruitment of qualified staff from the minority population remains a critical issue, especially with regards to the Serb minority. About 10% of judges and 9% of prosecutors are from minorities. The recruitment of members from the Serb community is hampered by the continuous existence of Serb community parallel courts especially in the northern municipalities. Intimidation of potential Serb recruits from their own communities, uncertainties concerning their future pension rights and a perceived lack of freedom of movement by members of this community are among the factors having negative impact on members from the Serb minority. Full access to justice for minority communities in Kosovo still need to be achieved.

Whereas there is a downward trend in the overall crime rate, with crime clearance rates broadly comparable for majority and minority communities, the general security situation has been undermined in the first half of 2005 by the failure to identify the authors of several high-profile crimes against politicians, journalists and members of the police service. Low level crimes on minorities are common but rarely reported. Law enforcement agencies need to significantly increase the effectiveness of the investigations of reported crimes to bring perpetrators to justice and remedy the prevailing atmosphere of impunity. Without more decisive action, the general feeling of insecurity will remain and inter-community trust and dialogue will not be restored.

### *Anti-corruption policy*

Corruption in Kosovo is wide-spread at all levels. Kosovo is not a party to the main international conventions in the field of anti-corruption (Council of Europe criminal law convention on corruption, Council of Europe civil law convention on corruption, and its additional protocol and the UN convention against corruption). Although some of these provisions have to some extent been interpreted in the domestic legislation such as the provisional criminal code of Kosovo and the law on the

suppression of corruption, more effort is required to launch a more cohesive and forceful action against corruption.

The law on the suppression of corruption was promulgated in May 2005 providing; inter alia, for the creation of a Kosovo anti-corruption agency. The law prescribes that an anti corruption strategy should be prepared by the anti corruption agency for the Government to be approved by the assembly. Both the Agency, the strategy and the Action Plan for the implementation of the Anti-Corruption strategy need to be put in place as a matter of priority.

Since 2003, a financial investigation unit, staffed by *Guardia di Finanza* officers, has the mandate to conduct financial inspections of public bodies and public enterprises as well as other organisations receiving public funds and launch criminal investigations. Also an investigation task force - comprised of representatives of the UN office of internal oversight services, the European anti-fraud office and the financial investigation unit – has received a wide mandate to undertake administrative investigations to identify fraud in the expenditure of public funds. The Office of the SRSG is coordinating the implementation of recommendations issued by the investigation task force. Internal investigation services have been set up in the police and the judiciary.

There are frequent reports about irregularities in public tendering procedures. The recent revision of the public procurement law is a step forward. The law reflects EU standards in terms of defining a clear division between the executive and regulatory functions. It has yet to be passed by the Assembly. It is expected that the implementation of the new law in coordination with the external audit activities of the Auditor General Office will contribute to the improvement of the situation and better use of public funds.

## **1.2 Human rights and the protection of minorities**

### *Observance of international human rights law*

Pursuant to the constitutional framework for provisional self-government in Kosovo, the main international human rights and fundamental freedoms instruments are directly applicable in Kosovo.

Hence, a) The Universal Declaration on Human Rights; b) The European Convention for the Protection of Human Rights and Fundamental Freedoms and its Protocols; (c) The International Covenant on Civil and Political Rights and the Protocols thereto; (d) The Convention on the Elimination of All Forms of Racial Discrimination; (e) The Convention on the Elimination of All Forms of Discrimination Against Women; (f) The Convention on the Rights of the Child; (g) The European Charter for Regional or Minority Languages and h) The Council of Europe's Framework Convention for the Protection of National Minorities, are all directly applicable in Kosovo. Furthermore, the rights of minorities are protected under the Constitutional Framework.

As the Kosovo legal system does not have a human rights court, the ombudsperson continues to be an important institution to monitor and protect the human rights situation in Kosovo. The mandate of the ombudsperson is somewhat limited by the fact that UNMIK and KFOR are not judicially accountable. In 2004, the ombudsperson was contacted by approximately 4000 people who sought advice or



lodged a complaint. The ombudsperson's fifth annual report (2004 – 2005) was published in July 2005. The mandate of the current international ombudsperson expires on 31 December 2005. There are concerns that it may be premature to transfer the post as inevitable pressures may prove too difficult for a Kosovan ombudsperson to be accessible to all communities and remain independent. The PISG will have to provide a full and active support to ensure that the new ombudsperson can pursue this crucial mandate successfully and show higher respect for the implementation of the Ombudsperson recommendations.

No developments are accounted for in the field of protection of personal data.

### *Civil and political rights*

There is no death penalty in Kosovo. Prisons generally meet international standards although facilities are sometimes overcrowded. Prison overpopulation has improved in comparison to last year as some units of Dubrova prison have been renovated. The new criminal law requires special places for the detention of mentally disabled people, but due to the lack of specialised institutions, there is a lack of capacity to receive such persons. The Kosovo Correction Service (KCS) is fully multiethnic. Women make up 18% of the KCS (comparing favourably with Western European norms). The Constitutional Framework and the Criminal Procedure Code prohibits practices of torture and ill-treatment.

*As regards freedom of expression and media*, a series of measures were introduced towards the development of professional and self regulated media. A Code of Conduct for print media was adopted by leading media in April 2005. Most daily and weekly newspapers followed suit and subscribed to the Code, which is only partially implemented. Another important step towards media self-regulation was taken in August 2005 when the press council statute was signed by leading print media representatives. Future complaints will be handled by the press council.

The Temporary Media Commissioner has licensed 111 broadcast stations, of which 72 broadcast primarily in Albanian, 33 in Serbian, three in Bosnian, two in Turkish, one in Gorani and ten partly in Roma, although an application for a full Roma-language radio station in Prizren remains under review by the office of the temporary media commissioner. The proportion of public broadcasting in minority languages is 9.6% of televised programmes and 12.5% of radio broadcasting. However, the government has yet to implement its strategic plan for minority media.

The law on the independent media commission was promulgated in July 2005. The law governs the establishment and the functioning of a permanent broadcast regulator that will replace the temporary media commissioner by end 2006.

Private and public broadcasters' roles during the March 2004 riots were questionable and contributed to fanning the riots. In December 2004, the temporary media commissioner reached settlements with the broadcasters Koha Vision TV, TV 21 and the public broadcaster Radio Television of Kosovo (RTK) where the broadcasters acknowledged their violations of principles embodied in the Code of Conduct for the Broadcast Media in Kosovo in their broadcasting during the March 2004 events. The settlements established that the broadcasters would earmark funds to provide professional training for their journalists.

. In 2005 two new academic institutions were established: the Kosovo institute of journalism and communication and the Kosovo media institute, aiming to help build

up the professional capacity in the media sector. The question of funding both institutions remains to be addressed.

UNMIK regulations and the Constitutional Framework provide for the *freedom of assembly*. Although still weak in terms of capacity and influence, local non-governmental organisations continue to operate and are increasing their experience and capacity. However, this process is mainly donor driven and participation in public life is still quite limited.

*As far as property rights*, the institutional framework regulating and protecting property rights is very weak. Moreover, there is a general sense of lawlessness and a perceived culture of impunity surrounding property issues. Property rights suffer from incomplete and sometimes missing records, inadequate property related legislation, implementation problems, ineffective municipal regulation of construction, discriminatory practices and lack of coordination between responsible actors.

Overall, the illegal occupation of property, including agricultural land and commercial property continues to affect individuals' rights to property and hamper economic development, the returns process and the establishment of the rule of law.

The Housing Property Directorate and Housing and Property Claims Commission (HPD/HPCC), the international quasi-judicial body with exclusive jurisdiction over certain conflict related residential property claims, has adjudicated 97% of its 29,131 residential property claims. By September 2005, more than 15,395 HPCC decisions had been implemented resulting in 1220 evictions and 264 properties released voluntarily. The completion of directorate's work is foreseen for the end of 2005. Repossession of property to the rightful owner remains a serious challenge; only 1,691 (11%) of implemented claims have resulted in repossession.

However, there is an important backlog of property related court cases which amount to more than 44,000 cases at present. Moreover, international monitors have identified irregular practices regarding the verification of property transfers and the use of the Office of the Temporary Representative.

Illegal construction is rampant. The government has made efforts to complete the existing legal framework in order to enable the municipalities to address the issue. Delays in the development and approval of new spatial and urban plans have created additional difficulties in this regard. Furthermore, municipal authorities need to more effectively ensure that public works are conducted in accordance with the legal framework regulating expropriations and that adequate compensation is provided in all cases.

The registration of property is also under reform, with a newly established Immovable Property Rights Register in place. The lack of access to judicial and cadastral records that were removed or destroyed before and during the 1999 conflict adversely affects the reliability of both the cadastre and immovable property rights register. Moreover, further accountability mechanisms and internal oversight are required to prevent fraud.

Finally, a number of individuals lack security of tenure and suffer the legacy of years of discrimination and the weakness of local institutions. Thus, a significant portion of Roma, Ashkali and Egyptian property right holders did not register or legally secure their rights because, at the time, they either were not fully aware of its value or implications or felt the registration fees were too high. Further measures are

required to confer these individuals with legal security of tenure and access to all services provided by the cities, in accordance with international human rights standards. Specific measures directed to protect their right to sustainable return, in cases where their settlements were destroyed is also necessary. A positive step has been taken in respect of informal settlements which have been almost completely mapped. Work is undergoing on an action plan for their regularisation.

### *Economic and social rights*

Kosovo experiences the worst unemployment in the region with young people and women disproportionately represented among the unemployed. A legislative framework is in place which provides for basic labour standards, protection of workers' rights, prohibition of child labour, rights of association and equal opportunities. This also provides for a labour inspectorate, which is operational but requires further support in terms of policy development and capacity building particularly on enforcement.

A tri-partite advisory council provides a framework for social dialogue. However, more exposure by the relevant authorities and social partners in making social partnership more effective is necessary. In particular, more capacity building support is required for employers and trade unions to reinforce social dialogue and partnership structures at local and national levels.

Capacity of the public employment services in assisting the unemployed with labour market integration has been developing steadily but its ability to deal with the chronic numbers of jobless is severely constrained. A network of eight vocational training centres provides training courses reflecting local employers' needs but demand on courses far outweighs supply. Similarly, employment advisory services which provides counselling, sign-posting and support to job-seekers is grossly overstretched.

Support to ethnic minorities continues to be a difficult area. For the Serb community part of the problem is non-recognition of Kosovo based services. More efforts are needed by the employment services to engage the Roma and Ashkali communities. Further cooperation with civil society and non-governmental organisations could facilitate this process.

UNMIK regulations and the Constitutional Framework provide for *freedom of religion*. However the connection between religion and ethnicity has an impact on the freedom of religion of Kosovo Serbs. Some members of the Kosovo Albanian community continue to be hostile to and suspicious of the Serbian Orthodox Church. A law on religion was adopted by the Assembly but is yet to be promulgated by the SRSG.

The *health care* system in Kosovo is faced with numerous challenges due to insufficient funds and lack of access, especially for minority communities. The legal framework protecting people with mental disabilities remains unclear. The situation of persons with physical disabilities remains difficult due insufficient legislation in this area, lack of access to health care, lack of disability-friendly infrastructure and discrimination is common.

Young women and men in Kosovo, under the age of 25, constitute 52% of the population. Infant mortality is high; 35 per 1000 live births. This is mainly due to poor delivery practices and poor quality of new born care. Furthermore, there are

some noteworthy child protection problems, such as the growing incidence of child labour and cases of child trafficking. Other societal abuses include discrimination and intimidation of homosexuals.

The education system is facing serious quality problems. Laws on primary and secondary education and on higher education were adopted but the administrative and financial responsibility for primary and secondary school has been devolved to municipalities who lack necessary administrative skills. There is a lack of infrastructure; schooling remains to be provided in up to three shifts in extreme cases. Kosovo higher education is in a critical situation. It needs to reform the curriculum, ensure staff development, improve administration and promote research. The Universities of Mitrovica and Pristina remain highly politicised. The rector of the University of Pristina was replaced by an interim board on the pressure of the Ministry and the international community and the University of Mitrovica remains inaccessible for Kosovo Albanians. Education and training is underfinanced and lack the necessary resources and infrastructure for quality outcomes. Many vocational training and higher education programmes lack not only laboratories and equipment but also relevance to the labour market. The education system is characterised by high levels of early school leavers, in particular of vulnerable groups.

*Regarding gender equality*, women in Kosovo are seriously disadvantaged. Around 31% participate in the labour force while the figure for men is 75%. Furthermore, women earn four times less than men. Men have, on average, two more years of schooling than women. Domestic violence is rampant and Kosovo is still a place of origin, transition and destination of trafficking in human beings. Although official statutory law gives women the right to own, rent and inherit property, customary law does not. This results in women giving up their property rights, and by doing so, hampering their improved economic perspective.

In recent years, developments in terms gender equality include the promulgation of a law on gender equality and the anti-discrimination law in 2004. The Kosovo Action Plan on the Achievement for Gender Equality was adopted by the Government in 2004. There is also a regulation on Prohibition on Domestic Violence and Trafficking of Persons and in May 2005 the Action Plan to Combat Trafficking was adopted by the government. However the family law that was adopted by the Assembly was rejected by the SRSG. This law needs to be reviewed on priority basis.

Other gender equality mechanisms consist of the establishment of gender officers in every ministry and the establishment of an inter-ministerial working group on gender equality. At municipal level, there are municipal gender officers assigned in every municipality and there are gender equality committees in 18 municipalities. The Office of Gender Equality that is foreseen in the Gender Equality Law was set up in June within the Prime Ministers Office. Despite existing legislation and mechanisms of gender equality, the Assembly continues to adopt laws that discriminate directly and indirectly against women. Furthermore, there is a lack of skills, capacity, and financial resources to enforce the implementation of the gender equality laws. For example, in the case of the Municipal Gender Officers, their mandate is not clearly defined and they lack skills and budget to be able to perform their duties optimally.

Women are not adequately represented within the PISG. Women rarely occupy leadership posts. The government includes one female minister and one female deputy minister. 28% of assembly members are women but there is no female member of the Presidency of the Parliamentary Assembly. The presence of women

in the executive and legislative bodies reflects the legal requirements for gender representation in the electoral lists. Approximately the same percentage applies to the woman representation in the municipal assemblies but only one (of 30) is a Municipality Chief Executive Officer and there is no President of a Municipal Assembly. 14% of Kosovo Police Service Staff are female.

### *Minority rights, cultural rights and the protection of minorities*

While the human rights situation in Kosovo has improved, these developments need to be sustained and enhanced especially when it comes to minorities. Minority communities, mostly Serbs and Roma, face discrimination, restrictions in freedom of movement, access to education, health care, public utilities and social assistance due to poor quality of services and security concerns. The extent of discrimination varies to a greater and lesser extent, depending on each community.

In August 2004 an agreement was signed by UNMIK and the Council of Europe related to the Framework Convention for the Protection of National Minorities. According to the agreement, the Committee of Ministers of the Council of Europe, assisted by the Advisory Committee on the Framework Convention, shall monitor the implementation of this treaty in Kosovo. In May 2005, UNMIK submitted its first official report to the Council of Europe. The Shadow Report, prepared with contributions from the civil society was published in October.

The anti-discrimination law that was adopted in 2004 has been facing difficulties in the area of implementation as there is lack of budget and subsidiary legislation. Furthermore, the Office of Good Governance, Human Rights, Gender and Equal Opportunity in the prime minister's office, is currently working on a strategy for human rights. The strategy aims at promoting and protecting human rights and focuses on people with disability, missing persons, minorities, women, and children.

The need to enhance the use of minority languages in central and municipal authorities remains. While some improvements have been made in municipal translation services, they are still not sufficiently developed due to lack of funding and sometimes political will. There has been an increase in signs in minority languages, especially on public buildings, although many multi-lingual signs have recently been subject to vandalism. There is still widespread use of Albanian nationalistic symbols which are perceived as intimidating by minority communities.

There are still cases where members of minority communities are targets of harassment, threats and violence based on their ethnicity, but in general the situation has improved, and a declining trend in crimes against minorities can be detected. However, perpetrators are rarely apprehended. There has been a decrease in the number of minorities that use military escorts. Since August, no regular KFOR escorts are required. Steps have been taken to increase cooperation between KFOR, UNMIK police and the Kosovo Police Service. An example would be the transfer of responsibility of the bridge in Mitrovica over to Kosovo Police Service. Furthermore, experimental lines for an integrated transport system started in June 2005. Nevertheless, there have not been sufficiently vigorous outreach actions by the authorities at central and local level to help overcome the perception of insecurity, which is still very much present amongst the minority communities.

Kosovo has significant *cultural and religious heritage* sites that constitute important symbols for different communities inside and outside of Kosovo. In July 2004 the Decan monastery became the first site located in Kosovo to be added to UNESCO's

world heritage list. In May 2005, UNESCO, in collaboration with UNMIK, the Council of Europe and the Commission, hosted the first international conference of donors for the cultural heritage in Kosovo with a view to raise funds for the restoration and preservation of 75 Orthodox, Muslim and vernacular cultural heritage sites in Kosovo. 34 of the above sites were damaged in the 2004 violent events or subject to vandalism. Approximately €10m were pledged including € 2m allocated by the EU.

In March 2005, a significant step was achieved with the signature by representatives of the Serbian Orthodox Church of a memorandum of understanding with the PISG relating to the reconstruction of churches destroyed in March 2004 for which the PISG allocated € 4.2 m. The memorandum started being implemented in June 2005. A joint Pristina-Belgrade Reconstruction Implementation Commission has been established. Significant progress has been achieved in the last months with eleven sites tendered for restoration. Bids are currently under evaluation while tendering documentation is under preparation for the restoration of 16 additional sites. However, more progress in the field of legislation related to Cultural heritage and the establishment of adequate structures for the preservation of Cultural sites is necessary. In addition, more funding should be allocated to finalise the reconstruction of the Orthodox sites damaged during the March riots. Following the successful visit in September of the PISG Minister of Culture, Youth and Sports to his counterpart in Belgrade, the Minister announced that an additional €1.5m will be added for the reconstruction of Orthodox sites.

Important obstacles remain to a sustainable returns process, resulting in few returnees. The overarching obstacle *for the return of refugees and internally displaced population (IDP)* is security concerns. This is coupled with a sense of uncertainty of over the future status of Kosovo as well as limited opportunities in Kosovo to sustain a livelihood. Another major impediment of return are property-related obstacles as returnees have difficulties in repossessing property left behind when fleeing Kosovo. Consequently, many of those displaced, in particular Serbs and Roma, have not yet found a durable solution.

The March events of 2004 were profoundly destructive as they damaged confidence in the return process. According to UNHCR statistics, as of 30 August, 1,364 people remain displaced as a result of the March 2004 violence. Of those over 200,000 that have been displaced since 1999, only 3,144 people returned voluntarily in 2004 and 2005. The perspective of return varied considerably according to the region and ethnic group. The highest number of returns took place in the regions of Pec and Pristina. The total number of minority returnees since 1999 is estimated at around 13,060. However, no reliable statistics are available on how many of those returnees stayed in Kosovo. Although dialogue with Belgrade on this important issue has not progressed, some cooperation could be witnessed between Kosovo and Montenegro with the establishment of a joint protocol between Kosovo and Montenegro on the return of IDP.

There are an estimated 22,000 minority IDP in Kosovo. The situation of Roma, Ashkali and Egyptians deserves particular attention. A high percentage of the displaced Roma still live in hazardous and very precarious conditions in northern Kosovo and in the Pristina region. Attempts to dismantle the camps are ongoing but have to be pursued more vigorously. The Roma, Ashkali and Egyptians suffer from a lack of documentation and education. Both factors represent an obstacle for them to reclaim land and access social structures and services. Furthermore, there is an

almost complete absence of Roma, Ashkali and Egyptian at the level of public institutions. This explains partly the difficulties met by these minorities to advocate their rights and protection.

Three IDP camps in northern Mitrovica for Roma, Ashkali, and Egyptian are situated on sites heavily lead-polluted caused by the former Trepca mining activities and thus pose a serious health risk to the inhabitants. In July 2004, the World Health Organisation released a report on elevated blood lead levels in the IDP communities and recommended a set of emergency measures, including the evacuation of the centres. An agreement was signed in April 2005 by UNMIK, UNHCR, OSCE and the Mitrovica Municipal Assembly President creating a framework for the return of former residents of the Roma Mahalla to their homes in southern Mitrovica. However, the returns process has not yet started. Return is unlikely to happen this year as work is ongoing to rubble clear the site and to chose the design of the buildings. The question of funding also remains unclear. This situation is unsustainable and need to be fully addressed without further delay.

Following a March 2005 UNHCR assessment that returns should be considered unsafe for Kosovo Serbs and Kosovo Roma as well as Kosovo Albanians where they are in a minority situation but that returns for Ashkali, Egyptian as well as Gorani and Bosniak could be considered safer in certain circumstances. Kosovo Albanians have been forcibly returned to Kosovo, mainly from Germany, Switzerland and Sweden. Some 4000 Kosovo Albanians were returned in 2004 while the figure was 1500 in 2005. In May, Germany - in agreement with UNMIK- also started a process of forced returns for members of the Ashkali and Egyptian communities. Since then, some 100 members of these communities have been forcibly returned to Kosovo. It is very important that the forced return of members of the Roma community happen in a framework that ensure their safe and sustained reintegration into Kosovan society. There are serious concerns that this may not be yet the case.

In November 2004, the SRSG announced the creation of a new ministry of communities and returns and in January 2005 a Kosovo Serb was appointed minister. The government has allocated approximately €10m for return activities; most of those funds are managed through UNDP. The establishment of the ministry of Communities and Returns and its cooperation with existing institutions in the area of returns has proven to be challenging.

In July 2005, the SRSG and the prime minister launched a strategic framework on communities and returns in order to revitalise the returns process. The Framework outlines the future for the returns process and builds on three main priority areas; the promotion of safety and freedom of movement; the creation of sustainable conditions for returns; and the enhancement of institutional support for returns. While the framework foresees the creation of a programme of action on communities and returns, this has yet to be designed. It is still necessary to ensure the full and concrete participation of all minorities in the design of long term sustainable returns projects including income generating components and measures to facilitate freedom of movement.

Sufficient security guarantees for minorities remain a key question to be addressed. Although efforts have been made, the situation still is not yet satisfactory. On the positive side, it can be said that basically no major inter-ethnic incident has been recorded since March 2004 and the freedom of movement has increased. Officially all municipalities have functioning Local Crime Prevention Councils.. However,

episodes of harassment and intimidation of minority groups are still widespread, e.g. through anti minority graffiti, stone-throwing incidents.

Although there have been positive developments such as the endorsement by most municipalities of the 2005 Municipal Returns Strategy, appointments of municipal returns officers and more support to “Go-and-See” and “Go-and Inform” visits, the unconditional commitment at municipal level to explicitly condemn all manifestations of anti-minority-communities sentiment and publicly promote the return process is still insufficient to create the conditions for safe and sustainable returns.

### **1.3 Regional issues and international obligations**

The reporting period has been characterised by significant progress in the participation and presence of Kosovo in regional co-operation initiatives. Under the UN Security Council Resolution 1244, Kosovo’s participation in regional fora and negotiation of international agreements falls under UNMIK authority. However, PISG line ministries are closely associated in these initiatives to ensure that the Kosovo government is fully capable of fulfilling its obligations under the constitutional framework for self-government.

In May 2003 UNMIK submitted a statement of intent to the Stability Pact, committing itself to the obligations set out in the Memorandum of Understanding on Trade liberalisation and facilitation. Kosovo signed a free trade agreement with Albania in 2003 and a temporary free trade agreement with the former Yugoslav Republic of Macedonia in September 2005. Negotiations are ongoing with Bosnia Herzegovina.

Relations with the former Yugoslav Republic of Macedonia have been enhanced as demonstrated with the opening of a Trade Office in Pristina in March 2005 and the more fluid dialogue at senior level. However, the problems in relation to the physical demarcation of the border on the part of Kosovo have not yet been resolved.

Also in March 2005, Kosovo participated to the opening of the negotiations on an agreement on a European common aviation area. The objective of the negotiations is to create a common area for aviation based on the rules and standards applicable in the European Union.

Kosovo is a member of the Athens process on energy and signed the South East Europe Energy Community Treaty in October 2005. This is a significant step for Kosovo on the way to increased regional co-operation and secure energy supply in the region as this is essential for economic and social development and stability. Within this context, Serbia raised obstacles in the participation of Kosovo in the South East Europe Transmission System Operator Task Force (SETSO TF). With the support of the Commission these difficulties have been overcome lately and the Energy Regulatory Office of Kosovo will be represented in the SETSO TF.

The sixth meeting of the national coordinators for the EU Charter on Small and Medium Enterprises was held in Pristina in April 2005; the first time Kosovo hosted this event. The ministry of trade and industry adheres to the principles set out in the EU Charter and has committed itself to their implementation.

Kosovo became a signatory to the memorandum of understanding on the Development of a South East Europe Core Regional Transport Network in June 2004. The signatory countries, the Commission, the Stability Pact and International



Financial Institutions are working jointly to expedite the implementation of the Memorandum. A Kosovo delegation participated in April 2005 in the first South East Europe Transport Observatory (SEETO) steering committee that was held in Tirana. In June 2005 Kosovo hosted the second SEETO meeting where coordinators from all signatory countries/entities met.

In June 2005, the Committee of the Regions and the Congress of the Council of Europe, in partnership with the European Commission, the Council of Europe and the Stability Pact for South-Eastern Europe, held a conference on the role of EU regional and local authorities in the process of democratic consolidation in the Western Balkans Regions. The conference was attended by delegates from the whole region.

As regards international obligations, cooperation with ICTY has been satisfactory as shown by Kosovo's cooperation in relation to case (*IT-04-84*) *Haradinaj et al.* ICTY indictees Ramush Haradinaj, Idriz Balaj and Lahi Brahimaj were immediately transferred to The Hague after the indictment was made public.

#### **1.4 General evaluation**

The **political situation** in Kosovo remained stable during the parliamentary elections and the subsequent establishment of the coalition government, as well as on the occasion of the ICTY indictment and voluntary surrender of the former Prime Minister. However, substantial democratic and efficiency deficits weaken the performance of the provisional institutions of self-government.

Relations between Kosovo Serbs and Kosovo Albanians have remained strained. The Kosovo Serbs' boycott of the 2004 elections undermined their capacity to address their community's legitimate concerns through democratic means. At the same time, the Kosovo Albanian majority failed to create the necessary conditions to facilitate Kosovo Serb participation in the political process. The implementation of local self government reform was significantly hampered by this situation.

Overall, the rule of law needs to be significantly strengthened. One underlying difficulty is the legal uncertainty which exists in relation to the laws that govern Kosovo. The administration of justice continues to be a major problem as the backlog of cases increases. The judicial institutions and the law enforcement agencies need to be substantially improved to be capable of fully enforcing the law, notably as far as property rights and fighting organised and financial crime is concerned. Corruption is widespread and there is a lack of cohesive and forceful action against it.

Kosovo's administrative capacity remains extremely weak. Its public administration is inefficient and subject to political interference, and does not always act equitably. Although a legal basis for the civil service and for public finance management is in place, there is a lack of transparency and accountability. Government coordination must be enhanced and the relationship between the central and municipal level needs to be further defined. Improving basic public service provision to all communities is a priority, not least to help reduce the demand for services provided by the parallel structures that continue to operate in most predominately Kosovo-Serb municipalities.

There has been further progress in enhancing freedom of expression, with the establishment of the regulatory framework for independent media and the

establishment of two new academic institutions to foster quality journalism. An anti-discrimination law was adopted but now needs to be fully implemented if it is to properly protect the rights of the most vulnerable, in particular children and women. The ombudsperson institution has continued to play a crucial role in safeguarding human rights and the protection of minorities.

Some outreach efforts have been made on the part of Kosovo's institution to condemn acts of violence against minority groups, to increase minority representation and to encourage return of refugees but they remained just declaratory statements without being translated into practice on the local level. Thus the situation of ethnic minorities continues to be extremely difficult. The use of minority languages in central and municipal authorities is insufficient and hinders participation into the institutions. Minorities' access to public services is also a problem. Regarding the return of refugees and internally displaced people, the number of returnees remains very low. Uncertainty over Kosovo's future status and fears about security, coupled with bleak employment prospects, is discouraging the return of Kosovo Serbs and other communities. Particular attention is required to ensuring a sustainable livelihood for all minority communities already living in Kosovo but the situation of Roma, Ashkalija and Egyptian communities, notably those living in health-hazardous conditions, requires urgent action.

The technical dialogue with Belgrade has resumed and the participation of Kosovo in regional co-operation initiatives has enhanced.

The opening of discussions on Kosovo's future status is a challenge for the entire region. The strong commitment of all parties to a multi-ethnic, stable and democratic Kosovo will be essential to achieve a sustainable settlement that reinforces the security and stability of the region and its further progress towards the EU.

## **2. Economic criteria**

In its 2004 Report, the Commission found that:

*“Despite some improvements, the economic situation remains a cause for concern: Kosovo’s economy is still heavily dependent on foreign aid and remittances and is far from being viable. Unemployment is high and likely to increase, thus creating fertile soil for social and political unrest. Privatisation of socially-owned enterprises and restructuring of public utilities have not advanced satisfactorily. The management of public finances need to be more efficient and transparent.”*

In examining the recent economic developments in Kosovo, the Commission’s approach is being guided by the conclusions of the European Council in Copenhagen in June 1993, which stated that membership of the Union requires:

- the existence of a functioning market economy;
- the capacity to cope with competitive pressure and market forces within the Union;

and by the Conclusions of the Council of Ministers of 29-30 April 1997, which stated that contractual relations with the EU require:

- macroeconomic institutions and policies necessary to ensure a stable economic environment;
- comprehensive liberalisation of prices, trade and current payments;
- setting up of a transparent and stable legal and regulatory framework
- de-monopolisation and privatisation of state-owned or socially-owned enterprises;
- establishment of a competitive and prudently managed banking sector.

In the analysis below, the Commission has followed the methodology applied in previous annual Regular Reports, to the extent applicable in the case of Kosovo: the lack of information, in particular the absence of national accounts, or the often limited reliability of available information, inhibits analytical work and calls for cautiousness on conclusions which can be reached.

### **2.1 Economic developments**

#### *Macroeconomic developments*

*Economic developments in 2004 and the first half of 2005 have to a large extent been influenced by the decline in donors’ support and a lack of dynamism of the economy. GDP growth - which is now estimated by the IMF<sup>2</sup> to have been negative in 2002 and 2003 - increased significantly in 2004 to an estimated 3.7% level, on the back of a substantial increase in public expenditure towards the end of the year, which led to a high budget deficit (5.9% of GDP). An adjustment in consumer prices, which had been inflated by the international community’s presence, is under way: CPI inflation turned negative in the second half of 2004, and prices further*

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<sup>2</sup> In the absence of national accounts in Kosovo, and except otherwise indicated, macroeconomic data in this report are based on latest available IMF staff estimates.

decreased by 0.5%<sup>3</sup> in the first eight months of 2005 (year-on-year). Owing to a considerable trade deficit, the current account balance has continued to post high negative figures (close to 30% of GDP in 2004), and provisional data for the first semester 2005 suggest a further deterioration in the trade balance. Given the absence of sizeable foreign direct investment inflows, the financing of the current account deficit continued to rely on foreign assistance (around 23% of GDP in 2004) and, to a lesser extent, private capital transfers.

### Kosovo - Main Economic Trends

|  |                   | 2001  | 2002  | 2003  | 2004  | 2005         |
|--|-------------------|-------|-------|-------|-------|--------------|
| Real GDP growth                            | %                 | 16.6  | -2.9  | -1.4  | 3.7   | n.a.         |
| Inflation rate                             | % (average)       | 11.7  | 3.6   | 1.7   | 0.2   | -2.1 Jan-Aug |
|  | % (end-of-period) | n.a.  | n.a.  | 1.6   | -2.5  | -0.5 Aug     |
| Unemployment <sup>1</sup>                  | % of labour force | n.a.  | 47    | 49    | 42    | n.a.         |
| General government balance <sup>2, 3</sup> | % of GDP          | 3.4   | 4.0   | 2.0   | -5.9  | n.a.         |
| General government balance <sup>4</sup>    | % of GDP          | 5.0   | 4.4   | 2.0   | -5.7  | n.a.         |
| Trade balance                              | % of GDP          | -39.2 | -34.3 | -33.6 | -33.9 | n.a.         |
| Current account balance <sup>5</sup>       | % of GDP          | -45.2 | -36.0 | -31.1 | -30.1 | n.a.         |
| Current account balance <sup>6</sup>       | % of GDP          | 2.3   | 0.3   | -2.6  | -7.5  | n.a.         |
| Foreign direct investment                  | % of GDP          | n.a.  | n.a.  | 0.1   | 1.2   | n.a.         |
|  | Million €         | n.a.  | n.a.  | 3.0   | 31.0  | n.a.         |

(1) Labour Force Survey, revised active population data in 2004 (2) Before grants (3) Excluding significant donor-funded investment and technical assistance outside the budget (4) After grants (5) Before foreign assistance (6) After foreign assistance, which include UNMIK budget, PIP and KFOR

Source: IMF, Statistical Office, Ministry of Labour. A large number of data are estimates, which may be subject to significant corrections.

### Structural reforms

While privatisation resumed in mid-2004 and progressed markedly thereafter, progress in other key structural reform areas, such as public enterprises restructuring and law enforcement, have been more limited. The main development in the area of structural reforms since the 2004 SAP report has been a renewed focus on the privatisation of socially-owned enterprises (SOEs) following changes in the Kosovo Trust Agency's (KTA) management in summer 2004. Several "waves" of privatisation have been launched since July/August 2004. On the side of publicly-owned enterprises (POEs), restructuring has been progressing more slowly and has been hampered by the slow pace of POEs' incorporation as a necessary preceding step. Preparations for the incorporation of KEK, the electricity utility, are ongoing. Following the effective transfer of the budget responsibility to the PISG in 2002, continued improvements in the process of institutional capacity building took place, notably in the Ministry of Finance and Economy. A new regulatory environment has been established in the area of energy, with the adoption of a series of laws in June 2004, the establishment of a regulatory authority and the signature of the Energy Community Treaty establishing a Regional Energy Market in South East Europe.

<sup>3</sup> Source: Statistical Office of Kosovo, CPI for August 2005.

## 2.2 Progress towards economic stability and competitiveness

### *Establishment of market principles*

The development of market principles requires that prices, as well as trade, are liberalised and that an enforceable legal system, including property rights, is in place. Macroeconomic stability and consensus about economic policy enhance the performance of a market economy. A well-developed financial sector and the absence of any significant barriers to market entry and exit improve the efficiency of the economy.

*Consensus about the essentials of economic policy has been strengthened, but, at times, achieving it remains a challenge.* The particular institutional setting of Kosovo, with responsibility of the budget preparation and implementation transferred to the PISG, while budget approval remains ultimately an SRSG power, have led to long and difficult discussions between PISG and UNMIK before the approval of the 2005 budget. The current year's budget was eventually only agreed in February 2005 and approved in March. Budget implementation also suffered from weaknesses in economic governance and monitoring, as evidenced by the uncontrolled of expenditure disbursements towards the end of 2004, to some extent due to a change in budget management, which led to a high fiscal deficit. Given the absence of independent monetary policy - with the euro as the main currency in circulation - fiscal policies are the core element of macroeconomic policies in Kosovo and do require a solid and sustainable framework based on a high degree of consensus among the parties. Recent improvements took place with the PISG Council of Ministers approval in June 2005 of a Medium Term Budget Framework, in agreement with UNMIK.

*Growth in Kosovo remains highly vulnerable to declining donor assistance.* Assistance by foreign donors - even though sharply declining - still contributed to some 23% of GDP in 2004, against 36% in 2002 and 28% in 2003. Additionally, the local consumption of international community expatriates in Kosovo (which is accounted as "exports") represents another 5.7% of GDP in 2004 and is also on a declining trend. According to IMF estimates, growth in 2004 amounted to 3.7%. In spite of an increase of regular exports in 2004 by some 14%, even though from a very low level, remittances continued to constitute the main channel of transmission from the international economic environment to the local economy. Local consumption increased in 2004 by an estimated 4.3%, and continued to rely heavily on imports which represent 40% of consumption. There is continuous and rapid shift from declining donor financed investment - in the context of the Public Investment Programme (PIP) which remains off-budget - to investment financed from the budget, which considerably increased in 2004. Private sector investment in machinery and equipment (i.e. without taking housing investment into account) remained weak and continued to be constrained by high real interest rates. The unresolved status situation also remained an impediment to improved investment and growth dynamics.

*The trade deficit remained very high.* While imports in 2004 did not increase markedly against 2003 (+3.8%), data of the Statistical Office of Kosovo for the first eight months of 2005 point to a high growth (+23%, year-on-year) and a subsequent apparent increased trade deficit. However 2005 import data are being distorted by a revised tax regime applying to cars, which led to increased numbers of cars registered as imports in 2005, even though they had been imported in Kosovo in

previous years. The coverage ratio of exports on imports remained extremely low in 2004 (around 19% including the local consumption of international community expatriates, or only 5.4% without the latter, i.e. for only “regular exports”). The local consumption of international community expatriates continued to decline: this regular loss of “exports” (in the IMF methodology) driven by the local market of expatriates consumption is a real challenge for Kosovo’s economy which is currently not yet able to fully replace such local “exports” by regular ones abroad. The trade deficit overall remained considerable in 2004, around 34% of GDP as in 2003. The current account deficit after foreign assistance is estimated to have increased markedly - by five percentage points - to 7.5% of GDP in 2004, mainly owing to the continued decrease in donors’ disbursements. Given the absence of sizeable FDI inflows, the closing of the substantial current transactions’ gap (after donors support) appears to have been taking place through private persons’ capital transfers

*Unemployment remains very high.* According to recent data from the Central Employment Service, the number of registered job seekers increased in 2004 by 7% to 302.000. By the end August 2005, the number of recorded job seekers further increased to around 314.500<sup>4</sup>. The 2004 Labour Force Survey conducted by the Ministry of Employment however estimates a reduction in the unemployment rate from 49% (end 2003) to 42.3% end 2004, owing to a revision of active population data, notably the integration of an estimated 100.000 employed in the agricultural sector. The weak economic activity, the decline in donors support and continued structural adjustments in socially-owned and publicly-owned enterprises are estimated to have negatively affected the labour market situation. These figures should, however, be interpreted with caution given the particularly unreliable character of employment and active population data and the very large size of the informal sector. The rise in registered unemployment also appears to have been influenced by toughened enforcement of eligibility criteria for social assistance. The World Bank, taking into consideration seasonal and informal employment, estimated unemployment to be lower than suggested by official data and to be comprised between 23 and 33% of the labour force in 2004.

*Inflation, which had already been low in previous years, was negative in the second half of 2004 and in early 2005.* Consumer price inflation (CPI) reached for 2004 as a whole 0.2%. It turned negative as of September 2004 and reached -2.5% by the end of 2004 (year-on-year). This negative trend in CPI inflation continued in the first eight months 2005 with a -0.5% decrease (year-on-year). Housing-related prices fell, pointing to a reduction of the share of international community expatriates’ consumption in local demand. This, combined with gains of productivity in the retail sector and the overall sluggish growth developments, contributed to the negative evolution of prices.

*The use of the euro as legal tender and as the main currency in circulation continued to provide a stable monetary environment.* This excludes any independent monetary policy or the monetisation of budget deficits. BPK, the Banking and Payments authority of Kosovo, continued to impose tight reserve and liquidity requirements upon banks (e.g. loans cannot exceed 75% of deposits) in order to avoid any liquidity crisis. The use of the euro has also continued to facilitate economic transactions with Kosovo’s main trading partners, the Western Balkan countries - most of which have a formal or managed peg to the euro - and the euro

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<sup>4</sup> Source: Kosovo Employment Office.

area. M2 money<sup>5</sup> increased by 9.2% in 2004 and 6.1% by August 2005 (year-on-year)<sup>6</sup>.

*Considerable increases in expenditure, in the context of an important reform of budget rules, have resulted in a sizeable deficit in 2004.* These increased payments depleted a large share of budgetary cash reserves accumulated over the previous years. The growth of general government spending had, until 2003, been financed through the expansion of domestic fiscal resources, which increased five-fold from 2000 to 2004. The budget posted significant surpluses in cash terms in 2001-2003, resulting in a reserve of accumulated cash deposits of EUR 307 million by the end of 2003. In the course of 2004, the authorities switched from commitment-based to cash-based budget management. Other changes were made, such as a very restricted possibility for budget users to carry forward budget endowments from one year to another. This resulted in a considerable deficit (on a cash basis) of around EUR 147 million (5.9% of GDP), i.e. more than EUR 60 million above the initially budgeted amount. Border taxes still constituted the main source of government revenue (71.5% of the total) and remained in 2004 close to their 2003 level. The 2005 budget foresees a deficit of 3.9% of GDP, to be financed from the accumulated cash balance. Latest IMF estimates however point to a likely higher deficit of some 5.8% of GDP. A Medium-Term Budget Strategy 2006-2008 was approved in June 2005. It does not consolidate financing needs that will derive from the Public Investment Programme (PIP) or from the restructuring process of POEs, under the assumption that a large of these needs will have to be financed from donors' support and, at a later stage, borrowing. A broader consolidated approach of medium-term expenditure and financing needs was under preparation in the form of the Medium-Term Expenditure Framework expected to be finalised in autumn 2005. Budget data are based on GFS II standards<sup>7</sup>, even though not fully compliant with these standards. Given the absence of any debt servicing at the current stage, there is no difference between the primary balance and the overall one.

*The policy mix did not fully reflect the delicate juncture at which Kosovo's economy is presently situated.* The boom after the end of the war, fuelled by the arrival of the international community and the donor reconstruction support, was short-lived. The downsizing of donor support and of the international community's presence currently severely hamper growth. This process, combined with expected liquidations of non viable SOEs and POEs restructuring, results in further pressure in the labour market. The low level of local savings, high real interest rates and the limited size of the local banking sector limit finance available for investment. The very large external deficits, as well as the lack of access to foreign borrowing, call for a prudent stance of fiscal policy. Fiscal discipline associated with the continuation of market oriented reforms is the only economic option for Kosovo. However fiscal consolidation was not pursued in 2004. To achieve this, the authorities will have to make expenditure cuts over the short term and to establish a medium term sustainable fiscal framework, a process for which first steps have been taken with the adoption of a Medium Term Budget Framework.

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<sup>5</sup> M2: measure of money in circulation which includes all physical denominations of coins and currency, demand deposits, and travellers' checks (altogether constituting the M1 aggregate), plus net time deposits (other than large certificates of deposit).

<sup>6</sup> Source: BPK, Monthly Statistics Bulletin, August 2005.

<sup>7</sup> Government Finance Statistics standards. See <http://www.imf.org/external/pubs/ft/gfs/manual/>.

*The price setting mechanism is fully free. The authorities do not intervene, even in the case of housing or utilities' prices.* Current governance arrangements as regards POEs, which remain under the authority of UNMIK – Pillar IV, further ensure the absence of government interference in the price setting mechanism of their services.

*The private sector plays a predominant role in employment and production.* However its exact size and share in the economy are difficult to assess due to the absence of reliable statistics and because of the large share of the informal economy. The IMF estimates the private sector's disposable income share of Gross National Disposable Income at 84% in 2004. Agriculture is mainly in private hands, with land under SOE property accounting for some 30% of total cultivated surfaces.

*Privatisation resumed in 2004 and progressed markedly.* The third wave of privatisation was launched in July 2004, followed by five other waves in autumn 2004 and the first three quarters of 2005. By early July 2005, 42 out of the 150 SOEs initially slated for privatisation had been privatised (a number of them were split, resulting in a total of 50 contracts being signed). The privatisation of 98 other SOEs was still ongoing. In early July the KTA board approved the sale of Ferronikeli, an industrial minerals company, for EUR 33 million. The KTA expects to have privatised by the end of 2005 around 120 companies. Privatisation of SOEs on an ongoing concern basis is however not possible for the bulk of loss-making or non-operating enterprises among the total 500 SOEs. Non-viable SOEs are expected to be liquidated, and in this context preparations in view of assets auctioning were taking place. The SRSG adopted in April an amendment to the KTA regulation which introduces an 'eminent domain' clause enabling swifter property expropriation and a more limited risk exposure of the seller. This is expected to facilitate the privatisation of a number of SOEs, notably the 140 agro-industrial ones, which has so far been delayed.

*While market entry is quite open, market exit is difficult and lengthy owing to weaknesses in the judiciary.* Enterprise registration in the Registry held in the Ministry of Industry and Trade points to a dynamic trend of enterprise creation, to the extent which can be recorded within the formal economy. The number of new firms registered increased in 2004 by around 9.800, against some 8.800 in 2003. In the first semester of 2005 new registrations amounted to 5.800, i.e. 12.4% of the total number of registered firms. According to a 2004 survey by the Ministry of Trade and Industry, new enterprises predominantly rely on private sources of funds (for two thirds of the total), the remainder being financed through bank loans. Non-profitable SOEs' liquidation has been hampered by uncertainties related to property rights and has not yet actually taken place. The bankruptcy law is not being implemented, in spite of the establishment of a special bankruptcy division in the Pristina Municipal court.

*The basic legislation of a market-oriented economy is in place. However the establishment of property rights remains a challenge, and legal uncertainty, weaknesses in law implementation, contract enforcement as well as contingent liabilities continue to constitute an impediment to economic activity and in particular to investment.* The uncertain legal situation as regards property rights continued to hamper property transfers. The determination of SOE ownership in particular raised complex issues, and left open room for litigation, thus presumably reducing the price which bidders were ready to offer in the course of privatisation. Property registers exist but are often not complete. The Serbian government authorised in early 2005 access to the cadastral documents in Belgrade, which



should also contribute to clarify the situation with regard to ownership. However, in order for such improvements as regards property determination to be effective, a functioning judiciary system is indispensable. This situation of insufficient definition and enforcement of property rights has wide-ranging effects which hamper economic activity. A good example for this is the inability of KEK, the electricity incumbent utility, to recover through litigation its unpaid bills from its customers and, as a result, considerable operating losses of the company, given the very poor degree of customers' payment compliance and discipline.

*The banking sector, newly created since 2000, still plays only a limited role in the economy's financing.* Loans to the private sector (non including households) are rapidly increasing, from a very modest base however: they increased in 2004 to 11.6%<sup>8</sup> of GDP, from 8% of GDP in 2003. Loans to households increased more than two-fold in 2004 and represented 22% of the banks' lending by the end of the year. In the second quarter 2005, banks loans in total further increased by 48.6% vis-à-vis the second quarter of 2004. The local banks remain very liquid, with a deposits-to-loans ratio of 181% by the end of 2004, pointing to a sufficiently strong refinancing base for further expansion of their loans' portfolio, provided this can take place without any deterioration of the quality of their credits which remains crucial. Nominal interest rates remained high - on average 16% for 3 months to 1 year maturities in the first quarter 2005, but nevertheless recorded a slight decrease to 15.4% by August 2005. The average lending-to-deposit spread stood at 12.9% by end 2004 (for maturities between 3 months and one year) and somewhat decreased to 12.3% by August 2005. Such levels point to high lending risks, owing notably to the difficulty to recover collateral as a consequence of weaknesses in the judiciary, as well as to lack of management skills and inefficiencies in the local banking sector.

*The structure of the banking sector remained broadly unchanged.* By the end of 2004, it consisted of seven banks, of which two banks with majority foreign ownership. All banks are privately controlled, while some minority shares are held by SOEs. The three largest banks accounted for 74% of total banks' assets and their market share in terms of loans increased by four percentage points in 2004 to 71%. The banks' network was considerably expanded over 2004 from 148 to 217 branches, thus progressively supplying a larger share of the population with banking services, including in rural areas.

*Local banks remained well capitalised.* The capital on risk-weighted assets ratio (Basel capital adequacy ratio) stood at 16.6% on 31 December 2004. All banks - except one- had by the end of 2004 a capital meeting the minimum capital requirement of EUR 4 million. The share of non-performing loans remained low (3% of total loans of a maturity superior to 3 months, May 2005 data) and only slightly increased against end 2004 levels. The establishment of prudential rules and financial sector supervision responsibilities lie with BPK which performs on- and off-site controls. There has not been any occurrence of bank insolvency over the reporting period.

*The still small insurance sector has been growing rapidly over the recent years.* At the end of 2004, there were eight licensed insurance companies in Kosovo. The number of contracted policies increased by 7.3% in 2004 compared with 2003, total premium income in 2004 was 19% higher than in the previous year. The

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<sup>8</sup> Source: BPK for banking and insurance sector data.

implementation of an on-line communication system and premium payments through banks were introduced in 2004.

### *Competitiveness of the economy*

The competitiveness of an economy depends on progress in establishing market principles and achieving a stable macroeconomic framework, allowing economic agents to make decisions in a climate of predictability. It also depends on the amount of human and physical capital, including infrastructure. State enterprises need to be restructured and all enterprises need to invest to improve their efficiency. Furthermore, the more access enterprises have to outside finance and the more successful they are at restructuring and innovating, the greater will be their capacity to adapt. Overall, an economy will be better able to take on the contractual obligations of an SAA and of future membership the higher the degree of economic integration it achieves with the Union before accession. Both the volume and the range of products traded with EU Member States provide evidence of this.

*Macroeconomic stabilisation has not and cannot be fully achieved as long as the economy relies on donors and the presence of a large international community of expatriates.* This reduction in donor support will require in due course drastic adjustments in view of the magnitude of external imbalances, which with a current account deficit close to 30% of GDP in 2004 are not sustainable. In view of these imbalances and of the absence of autonomous monetary policy, macroeconomic stabilisation policies mainly rely on fiscal policy. For such policies to be effective, fiscal governance and consolidation will need to encompass areas currently both under transferred and reserved powers. This process, while initiated, is not yet completed. Furthermore, while one of the most liberal European trade and business legislations has been introduced in Kosovo, market mechanisms are not yet effective: they are being hampered among others by a difficult situation as regards contract enforcement and contingent risks and liabilities, due to the judiciary's weakness and the unresolved status of Kosovo. This results in very significant uncertainties for businesses, high investment risks and costs, and a non efficient allocation of resources.

*The primary and secondary education system is fairly well developed.* However, while enrolment rates in primary education are high, at 95.4%, they are much lower for secondary education, at 75.2%<sup>9</sup>. Overall education expenditure amounted in 2004 to a relatively high 5.7% of GDP. However capital investment in the schooling system, which substantially increased in the context of post war reconstruction, and was to a large extent financed from donors, is on a sharply declining trend and municipalities in particular are not endowed with the necessary resources to address basic capital needs. With 73%, the bulk of budget spending in education was in 2004 devoted to wages and salaries. The overall educational attainment level of the working-age population has fallen between 2001 and 2003.

*Basic infrastructure is insufficient, of a poor quality and will continue to require considerable investment for which financing is particularly difficult to secure.* The roads network is in a poor condition and needs further rehabilitation and extension, notably highway links with the neighbouring countries: an upgrading of the highway to the border with the fYRoM is foreseen, and works on a highway connecting Serbia with Albania have not yet been launched either. The railways infrastructure is

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<sup>9</sup> Source: World Bank, Kosovo Public Expenditure and Institutional Review, June 2005.

depleted and will need further investment, which may be delayed pending the incorporation of the incumbent railways company. The penetration of the fixed telecom network is rather low, with one line per 16 inhabitants. To some extent however this is compensated by the rapid development of the mobile (Vala900 and Mobtel) networks, with a rate of penetration of about 20% of the population. KEK's electricity transmission network needs important investments of rehabilitation and extension, expected to be undertaken under the auspices of an independent transmission operator, once the company is unbundled.

*Labour market policies are broadly liberal and still in the early stage of definition. They are constrained by very scarce public resources which can be allocated in this field.* While the Ministry of Labour and Employment provides job seekers with registration and placement services, the latter however benefit only to a limited share of jobseekers: placements in 2004 amounted to only around 6400 persons, i.e. only 2.1% of recorded jobseekers (end 2004 data). Eight decentralised vocational training centres have been established. A draft law has been prepared by the Ministry of Labour and Social Affairs and foresees the establishment of an unemployment benefits fund to be jointly financed from employers and employees. In view of Kosovo's use of the euro, which does not allow for nominal exchange rate adjustments, it is however even more crucial to ensure flexible labour market wage setting mechanisms in order to enable labour price adjustments and not jeopardize the economy's competitiveness.

*Investment is estimated to have modestly grown in 2004.* Growth of gross fixed capital formation is estimated at around 4% in 2004, mainly owing to a considerable growth of public capital expenditure. According to IMF estimates, total investment amounted in 2004 to 24% of GDP. Private sector investment (about 60% of the total) remains predominantly allocated to housing. Future public investment, for which needs are considerable, will in the short and medium term be heavily constrained by the need for budget consolidation in the context of declining donors' support.

*Some modest flows of foreign direct investment are now taking place in the context of accelerated privatisation.* Foreign direct investment (FDI) had not been sizeable until 2003. The IMF estimates FDI at a very modest EUR 31 million in 2004, or 1.2% of GDP. This amount could increase in 2005-2006 if the KTA meets its privatisation programme objectives.

*Restructuring of publicly-owned enterprises has been delayed by the slow process of incorporation as well as the lack of resources to finance identified investment needs.* The Pristina Airport and PTK, the incumbent telecom operator, are financially viable -PTK is even a very profitable company and has accumulated significant cash reserves- and were the first two POEs to be incorporated in June 2005. In sharp contrast to these, KEK, the electricity incumbent utility, is running considerable operating losses, owing to the low payment rate for electricity supplied, and cannot currently supply needs without frequent disruptions. The incorporation of KEK was still under preparation by the end of the reporting period. Additionally, in February 2005 the KEK management (i.e. an international team of Turn-Around-Management) presented KTA with an ambitious financial recovery plan, requiring external finance of some EUR 400 million until 2010, for which financing has not been identified and which will need to be adjusted according to available possibilities. Restructuring measures are also needed in the context of the incorporation of UNMIK Railways, the railways operator, and may require some downsizing of the company's staff. As regards SOEs, further restructuring of non

profitable SOEs may be difficult to achieve –a number of them are not even operating any more- and liquidation is expected to be in most cases the only possible course of action.

*In the absence of reliable data on the sectoral structure of production and employment, structural change trends are difficult to trace.* A large share of the population is still active in the agricultural sector and works in small family farm units. According to the Ministry of Economy and Finance, based on data from the business register and a very indicative estimate of the active population in agriculture, 25% of the active population works in agriculture, 22% in manufacturing and construction, and 32% in services (the remainder, 21% are not allocated on a sectoral basis and work in the administration and NGOs).

*Small firms constitute an overwhelming share of the total.* The number of registered enterprises of less than 250 employees amounted by the end of June 2005 to 46.688, i.e. 99.9% of all registered enterprises, out of which very small firms (less than five employees) accounted for 94%. An SME survey conducted by the Ministry of Trade and Industry suggests that the main impediments to business development are, in decreasing order, the high interest rates, the short term maturity of loans, supply of energy and “illegal competition” presumably from the informal sector.

*Subsidies continued in 2004 to be mainly allocated to utilities - in particular KEK.* In 2004, subsidies to POEs represented EUR 62 million or 2.5% of GDP and were expected to increase to EUR 77 million in 2005. These subsidies were meant to ensure the continuous provision of basic utilities’ services. In particular, a reduction of subsidies to KEK will be contingent upon the capacity of the electricity company to improve the rate of billed sales and payment discipline from its customers, from which by early 2005 it only had recovered a third of electricity consumption value.

*The liberal trade and business environment policies facilitate the development of a private-sector-led economy. The authorities do not intervene directly in the private sector’s development and functioning.* To a large extent the authorities lack normal administrative capacity of intervention. Existing subsidies do not appear to distort competition in the private sector since they mainly aim at ensuring the provision without too heavy disruptions of public utilities’ services.

*The degree of openness of Kosovo’s economy did not change markedly against the previous year.* The sum of exports and imports amounted to 55% of GDP in 2004. This is not particularly high given the small size of the economy. It would be even lower without the considerable Kosovar sales to the local international community which are accounted for as exports. However, this aggregate measure of trade openness is shaped by the very weak level of exports, imports representing a significant share of consumption (40%). The considerable trade deficit (34% of GDP), points to lacking export competitiveness. The process of trade liberalisation with neighbouring countries continued: in July 2004 UNMIK signed with former Yugoslav Republic of Macedonia a Free Trade Agreement, the second one concluded after that with Albania. However in a transitional period until 1st January 2008 this agreement will result in the establishment of import tariffs instead of previously tariff-free access for products originating from the fYRoM. Negotiations were initiated with the aim of concluding a similar agreement with Bosnia and Herzegovina.

*Imports from the EU represent about one third of total imports.* With 36% in 2004, this share is lower than in neighbouring Western Balkan countries, but increased

over the last five years (from 27% in 2000). In value terms, imports from the EU increased more than two-fold since 2000. Exports to the EU, even though of a very modest value (in value terms, they only account for 5% of imports from the EU), also represent an increasing share of total exports (39% in the first eight months of 2005 against 30% in 2000). Kosovo's exports are mainly directed to South East European countries, which – according to the data of the Statistical Office of Kosovo – account for almost 60% of its total exports. The former Yugoslav Republic of Macedonia is presently Kosovo's main destination of exports, accounting for 23% of total exports (first eight months of 2005), followed by Greece (13%) and Italy (12%). South East European countries further represented the source of more than 45% of Kosovo's imports in the first eight months of 2005. The main countries of origin of imports were the former Yugoslav Republic of Macedonia (18%), followed by Serbia and Montenegro (13%) and Germany (12%).

*The product distribution of exports shows a high concentration on lower value-added goods.* Metals and scrap, plastics and wood, and food account for the bulk of Kosovo's exports (respectively 41%, 29% and 12%, second quarter 2005 data). Industrial manufactured products only have a limited contribution to exports.

*Reported wage levels have been rising, in contrasts with the recent negative inflation rates and raising concerns about Kosovo's competitiveness.* The average gross wage is reported to have increased from EUR 199 in the first quarter 2004 to EUR 229 in the second quarter 2005 (+15%) and is influenced by the evolution of public sector wages. While data available have to be taken cautiously and do not allow for estimates of changes in labour productivity and unit labour costs, such a rhythm of increase would not be compatible, if confirmed, with achievable productivity growth, and would imply losses of international competitiveness of Kosovo's economy.

### 2.3 General evaluation

The **economy** of Kosovo operates within an emerging framework of functioning market principles. Further vigorous reform efforts are necessary to address the serious shortcomings in competitiveness of the economy.

Monetary stability continued to be ensured through the use of the euro as the main currency in circulation. Inflation turned negative in the second half of 2004 and in early 2005. Structural reforms progressed, in particular the privatisation of socially-owned enterprises accelerated since mid-2004. Two publicly-owned enterprises were incorporated. The authorities continued pursuing liberal trade and labour market policies and ensuring relatively open market entry and a broadly favourable entrepreneurial environment. Some modest flows of foreign direct investment took place in the context of accelerated privatisation.

However, economic growth has been rather weak, also affected by the decline in support by foreign donors and a lack of dynamism of the economy. Unemployment remains very high and the current account deficit continues to be considerable. The policy mix was not fully appropriate: in particular considerable increases in expenditure have resulted in a sizeable budget deficit in 2004. Restructuring of, the electricity utility has been delayed in particular by a lack of resources to finance its investment needs. The establishment of property rights remains a challenge. Legal uncertainty and weaknesses in law implementation and contract enforcement continue to hinder private sector development and investment. Market exit remains

difficult and lengthy owing mainly to weaknesses in the judiciary. Insufficient basic infrastructure continues to impede economic activity. Rises in real wages have undermined Kosovo's export competitiveness.

### **3. European Standards**

This chapter gives an evaluation of the implementation of the Stabilisation and Association process. Alongside an evaluation of relevant developments in key areas since the 2004 report and the European Partnerships, it provides an overall assessment of Kosovo's progress towards European standards, and what remains to be done.

This section also incorporates an assessment of Kosovo's administrative capacity in its various aspects. Kosovo must upgrade its institutions, management capacity and administrative and judicial systems in order to make further progress towards meeting European standards. At the general level, this requires a well-functioning and stable public administration built on an efficient and impartial civil service, along with an independent and efficient judicial system.

In the 2004 report, the Commission found that:

*“Over the reporting period, progress has taken place in setting Kosovo's European perspective through the implementation of the Stabilisation and Association Process Tracking Mechanism (STM). The Commission has provided to the Kosovo authorities policy advice on a number of sectors with a view to supporting EU compatible reforms. At the same time, the STM process reinforces and strengthens the work being done on the Standards for Kosovo.”*

#### **3.1 Internal market**

##### **3.1.1. Free movement of goods**

A Standardisation body of Kosovo (KSA) was formally established in March 2005. It derives its legal basis from 2004 Law on Standardisation. It is an executive Agency within the Ministry of Trade and Industry. When KSA was formally established it was esteemed that it will take several months before KSA is fully operational (e.g. staff, premises and equipment). KSA holds currently no European or international memberships.

There is no developed accreditation system, nor an accreditation body. A new law on accreditation is now planned. No governmental or private infrastructure exists that can be used for conformity assessment activity.

The Kosovo metrology system started to develop only recently. The intention is to develop a distributed metrology system, based on a new law on Metrology, the draft of which has already been prepared. The present legal metrology system is based on the elements of the system of former Yugoslavia. Scientific metrology is not developed, and industrial metrology does exist.

EU directives on free movement of goods are not yet implemented besides a law on General Product Safety.

Horizontal legislation and coordination structures concerning market surveillance issues need to be further developed and sectoral product legislation adopted.

As regards the legislative framework, an important set of laws were adopted in October 2004, namely the Law on Domestic Trade (UNMIK REG/2004/43), which still needs to be implemented, and the Law on Consumer Protection

(UNMIK/REG/2004/42). Adopted in March 2004, the latter brings consumer protection into line with European standards. An information campaign on consumer rights and consumer protection has been launched.

### ***3.1.2. Movement of persons, services and the right of establishment***

UNMIK Regulation 2005/16 on the movement of persons into and out of Kosovo was promulgated in April 2005. While it does not create a visa regime for Kosovo, it is designed to improve border controls, particularly in relation to organised crime operations and human trafficking.

Postal codes have been determined recently in cooperation with Universal Postal Union (UPU) and have been approved by the UNMIK Legal Office. These codes for Kosovo were approved on 31<sup>st</sup> of May and are valid and in use since 1<sup>st</sup> of June 2005. Belgrade protested against the awarding of the postal codes to Kosovo, and claims that Kosovo should use sub-codes of the Serbia and Montenegro code. However, since the codes have been awarded through the UPU, they enjoy some form of legitimacy.

### ***3.1.3. Free movement of capital***

At present, no specific legislation covers the movement of capital for Kosovo and capital movements into and out of Kosovo are completely unregulated.

### ***3.1.4. Customs and taxation***

**Customs rules** are a reserved competence. UNMIK customs has a staff of 520 trained officials who collect 75% of revenues for the Kosovo Consolidated Budget. Kosovo's general trade regime is based on a 10% flat-rate customs duty on imports although there exist a few exceptions regarding custom duties on certain capital goods and raw materials. There are no customs duties on exports. UNMIK Customs started implementing the Integrated Tariff for Kosovo (TARIK) in September 2005. TARIK is based on international and European customs tariff systems. A new Excise Code was promulgated and entered into force in July 2005 in order to align this area of legislation with the *EU acquis*.

The implementation of the Customs Code, in force since March 2004, has been satisfactory. Except for IT compatibility and risk management, most areas of UNMIK Customs are compatible with EU regulations. The translation of the Integrated Tariff for Kosovo into all three official languages and its subsequent incorporation into the customs computer system was delayed.

In April 2005, UNMIK customs started, in cooperation with the Kosovo Police Service, to confiscate cars not properly registered in Kosovo and for which no customs fees and VAT had been paid. This policy substantially increased the readiness of car owners to register cars purchased abroad and to pay the relevant duties.

Smuggling of cigarettes has decreased substantially due to the harmonisation of excise duties with neighbouring countries and the introduction of Kosovo banderols in 2003.

UNMIK Customs has established a criminal investigation unit, which is now fully staffed and which has so far reported 33 criminal cases to the public prosecutor.



In the reporting period, positive steps have been taken to develop and implement a customs policy. Administrative and operational capacity needs to be further enhanced to reach European standards in this field.

In the field of **taxation**, the Law on Tax Administration and Procedures was promulgated in April 2005 by UNMIK Regulation 2005/17, providing for a comprehensive set of taxation rules and procedures in compliance with international standards.

In 2005, Kosovo moved to a simplified tax structure, reducing its current types of income taxes from three to two — personal income tax and corporate income tax. The new structure makes a clear distinction between taxes to be paid by individuals (personal income tax) and non-individuals (corporate income tax). The tax administration of Kosovo began implementing the tax laws on personal and corporate income tax in January 2005. Significant efforts are being made by the Tax Administration of Kosovo to inform taxpayers on the new law through seminars, press releases and TV programmes. Amendments are being made to the Regulation on VAT in order to use the VAT system similar to that to be found in the EU Sixth VAT Directive.

Overall, progressive developments are under way in the field of taxation, which need to be pursued in order to have a taxation system comparable with other European systems. Kosovo should also commit to the principles of the Code of Conduct on business taxation. As a first step, it should carry out a gap analysis to identify existing measures that may contradict those principles. The reform of the tax administration needs to be continued with a view to enhancing collection and control capacity. More efforts should be made in order to tackle the important problem of fraud in the area of excise duties. The fight against corruption also needs to be pursued and reinforced in order to ensure the non-discriminatory application of tax laws.

### ***3.1.5. Competition***

UNMIK Regulation 2004/44 of October 2004 on the Law on Competition defines competition policy for Kosovo and takes a first step towards the development of a sound market economy in Kosovo by prohibiting acts that restrict, suppress or distort competition. The Law provides for the establishment of a Kosovo Competition Commission. Kosovo should pay increased attention to applying competition principles in its economic regulations and decisions.

### ***3.1.6. Public procurement***

The **Public Procurement** Law promulgated in 2004 by UNMIK Regulation 2004/3 encountered serious difficulties in its application.

The law established public procurement processes and three central bodies to manage them: the public procurement agency, the public procurement regulatory commission and the public procurement rules committee. While the agency is the centralised procurement agent for procurement over a certain threshold, the commission exercises a controlling function. However, instead of simplifying public procurement processes and making them more transparent, the procurement law proved too complicated to apply properly in the Kosovo context and led to delays and higher costs to the Kosovo Consolidated Budget. The public procurement

regulatory commission is currently facing a conflict of interest between its regulatory and judicial review functions.

Secondary legislation was not implemented, which further complicated proper procurement, and decentralised procurement bodies (ministries, municipalities) did not receive sufficient support for the application of the law.

The law was revised in the course of 2005 by the Ministry of Finance and Economy in cooperation with the public procurement regulatory commission and other stakeholders. The new draft law appears to be compatible with the EU *acquis* and reflects the EU standards in terms of setting up an independent review body. It has yet to be passed by the Assembly and be promulgated.

### ***3.1.7. Intellectual property law***

There is insufficient protection of intellectual, industrial and commercial property rights in Kosovo.

Old Yugoslav laws on intellectual property rights are not being applied in Kosovo. Some efforts to develop property rights legislation are underway. No laws have yet been promulgated to protect intellectual, industrial and commercial property rights and hence no comprehensive regime has been set up to prosecute violations of intellectual, industrial and commercial property rights.

Intellectual property rights are flagrantly and visibly infringed in Kosovo. An important number of counterfeit consumer goods (notably CDs, DVDs, clothing items and computer software) are available for sale and traded openly. This situation needs to be remedied by urgent action.

### ***3.1.8. Statistics***

Generally, the statistical infrastructure in Kosovo is very weak. The Statistical Office of Kosovo (SOK) is an executive agency attached to the Ministry of Public Services. Its top management has taken part in training sessions and seminars to improve their managerial capacities. During the reporting period, however, the Statistical Office was reorganised on several occasions and subsequently employees were given new tasks requiring additional training, which has hampered progress in the short run. An area where progress has been made is the creation of an inter-institutional committee to improve coordination with external stakeholders.

As regards classifications and standards, compliance with EU standards is very limited in Kosovo. What progress has been reported is that the classification of individual consumption by purpose (COICOP) has been introduced for use in the Household Budget Survey and the harmonised nomenclature for external trade statistics has been updated.

For demographic and social statistics, the main issue has been the planned population and housing census. The draft project documents have been drafted and a national census committee has been set up. In addition, Kosovo has initiated a Household Budget Survey according to EU standards.

As regards macro-economic statistics, the development of national accounts statistics is making progress. In the meantime, crucial economic data are still missing. Weights have been determined, codes have been established and calculations made on historic data. In addition, a framework has been developed for measuring the

informal economy. A Consumer Price Index has been established based on ten municipalities.

For business statistics, the focus has been on developing a statistical business register. Administrative registers that can provide input to the statistical business register were identified and a new register developed.

As regards external trade statistics on goods, progress has been made. The latest harmonised nomenclature has been introduced. SOK and its counterparts have installed new software and been trained in its use.

As for statistics at regional level and transport statistics, no progress can be reported over the past period.

Where agriculture and fishery statistics are concerned, the subject experts have taken part in training sessions and seminars on various topics to improve their general knowledge in this area. However, no specific progress can be reported for the past period.

In general, Kosovo has made some limited progress in a few statistical areas. The overall situation is, however, far from satisfactory in terms of harmonisation and availability of basic statistical data.

## 3.2 Sectoral policies

### 3.2.1. *Industry and SME*

Kosovo has not made significant progress in the area of industry and SMEs.

Small and medium-enterprises represent almost all registered enterprises in Kosovo. Only 10% of SMEs are in the manufacturing sector and even fewer in agriculture, the bulk of SMEs being involved in trade, restaurants and other services. Kosovo was one of the Western Balkan signatories to the European Charter for Small Enterprises in June 2003, undertaking to fulfil obligations in ten principal areas of the charter. But progress here has been very limited. A draft company law (Kosovo Law on Business Organisations) is currently under discussion within the governmental ad hoc working group), while the law on support to SMEs was promulgated in September 2005 (UNMIK/REG/2005/44). This Law foresees the establishment of an SME Support Agency within the Ministry of Trade and Industry. Such Agency has not been set up yet.

In spite of the prevalence of small and medium-enterprises, the sector is faced with a poor legal and regulatory environment, infrastructure and management skills. There is no comprehensive industrial strategy or SME support framework in place in Kosovo although the lately adopted law on the support of the SMEs outlines the support to SMEs through the creation of an institutional, regulatory and financial framework.

The Ministry for Trade and Industry has yet to develop sufficient capacity to establish and implement a comprehensive industrial policy, including SME and industrial support initiatives, in line with the Kosovo Development Plan and other priorities.

Further, Kosovo should consider the increased use of research and innovation policy for the support and realisation of the economic reform and capacity building as required under the Stabilisation and Association Agreement.

An SME survey conducted by the Ministry of Trade and Industry suggests that the main impediments to business development are, in order of importance, the high interest rates, the short term maturity of loans, the deficient supply of energy and competition from the informal sector. Other factors that impede the development of the SME sector are unresolved property rights and the lack of sustainable foreign investment. Among the biggest industries, mining and energy are sectors with both growth and export potential but also with a considerable need for foreign investment. Agriculture could also be mentioned as an area for potential development. Lack of foreign investment could to some extent be attributed to the unresolved status of Kosovo.

Kosovo has started to align its legislation on financial reporting standards with the acquis. The draft law in preparation foresees that all joint companies and limited liability companies should draw up accounts in conformity with IFRS/IAS. Given Kosovo's current economic and administrative circumstances, this approach risks imposing a disproportionate cost on the domestic business sector and overwhelming the authorities' capacity to enforce financial reporting requirements. It would be more appropriate to limit the use of IFRS/IAS to "public interest entities" such as financial institutions, listed companies, etc while allowing other companies to use

more appropriate standards in line with the 4th and 7th company law directives. Similarly, consideration should be given to relieve the smaller companies from the obligation to have their accounts audited, in line with the 4<sup>th</sup> company law directive.

### ***3.2.2. Agriculture***

Kosovo's agriculture is characterised by small farm size, low productivity and the absence of advisory services. However, agriculture remains an important creator of national wealth: the agricultural sector contributes up to 30% of GDP, provides employment to two thirds of the total adult population, and accounts for about 18% of the value of total exports. The majority of agricultural land is owned by the private sector (95%). The assets of socially owned enterprises have been leased out, and privatisation of Socially Owned Enterprises in the rural field continues to proceed slowly. Kosovo's agriculture was one of the main engines of real GDP growth in 1999-2004.

In spite of its potential, Kosovo's agriculture remains under-exploited. The key problems for Kosovo's rural development are the poor state of the Cadastre as regards, more specifically, agricultural land which leads to uncertainty about property rights, the bad condition of rural infrastructure such as roads, telephony and electricity and a deprived irrigation system that is limited in coverage and technology. Commercial credit is often not affordable and micro-finance under-developed. The quality of the produce is often poor and quality control mechanisms not in place. The low level of basic education hinders the take-up of new technologies and modern business skills are not available. There are only a limited number of producers' associations, while rural advisory services are inadequate and show a lack of consistency in the technical messages disseminated. Meanwhile, there has only been slow progress in the privatisation of socially owned agricultural enterprises and the central administration remains weak.

The Ministry of Agriculture and Rural Development is currently developing a rural development strategy for the agricultural sector in Kosovo over the period 2007–2013. Further, a strategic document on the usage of agricultural land and land reform is under preparation. This document should determine the policy and regulatory framework to support the viable use and protection of agricultural land.

A law on livestock was promulgated in October 2004 (UNMIK/REG/2004/39) to regulate livestock breeding, the trading of feed materials and additives, quality standards for the classification and grading of non-farm-produced livestock products sold to the processing industry, and zoo-technical standards for livestock keeping.

As regards veterinary and phyto-sanitary issues, Kosovo has started to implement European standards in the field of veterinary and phyto-sanitary policy (framework laws include the Veterinary Law, Law on livestock, Law on Plant Protection Products, Law on Seeds and Planting Material). However, for export of live animals and agricultural products, it is crucial that the live animals are identified, the establishments upgraded and plant products controlled. Some ministries have expressed concerns as to the capacity of Kosovo to implement European standards and consider it would be more appropriate to have harmonisation with the countries in transition. The Law on Food Safety, which will establish the Kosovo Food Agency, is under preparation.

### 3.2.3 Environment

There has been some progress in the field of the environment.

Kosovo continued its efforts to align itself with EU environmental legislation, institutions and standards and made progress in several areas. An Environmental Protection Strategy was approved by the Government in July 2004. The Ministry of Environment and Spatial Planning is currently drafting a five-year environmental action plan for Kosovo. The provisional institutions of self-government are also developing an environmental legislative framework.

Progress in integrating the environment into other policies was achieved in the energy field. By signing the South East Europe Energy Community Treaty, Kosovo agreed to respect certain pieces of EU environmental legislation and requirements relevant to the energy field. As recommended in the Commission Communication on Kosovo's future, Kosovo has continued to be an active participant in the work of Regional Environmental Reconstruction Programme (REReP)

Following the adoption of the Law on Environmental Protection in 2003, the approval of the Environmental Protection Strategy in July 2004 was a step forward in the implementation of **horizontal legislation**. The Environmental Impact Assessment Regulation is in force and is being applied, as are several bylaws on specific aspects of environmental impact assessment. However, there were no particular developments in strategic environmental assessments or environmental liability legislation, which is regulated in the Law on Environment Protection.

An environmental impact department has been created within the Ministry of Environment and Spatial Planning with the task of preparing an Environmental Impact Assessment plan for Kosovo. Regulations have also foreseen the creation of an Environment Protection Agency and an Environmental Inspectorate. An Action Plan for monitoring and an information system have been developed. As regards access to environmental information, civil society participation is encouraged in environmental impact assessment procedures, the drafting of strategies and nature protection. The Ministry has also undertaken systematic campaigns to raise awareness among citizens about the environmental situation in Kosovo. However, environmental civil society remains at a low level of development, limiting the possibilities for participation.

The adoption of the Law on Air Protection in November 2004 brought **air quality** legislation up to European standards, according to the competent authorities.

The promulgation of the Kosovo Water Law in October 2004 was a step in Kosovo's efforts to approximate EU legislation on **water quality**. Following adoption of the Law on the Activities of Water, Waste Water and Waste Services Providers, the Water and Waste Water Regulatory Office issued secondary legislation in 2005 for the implementation of this law. A Waste Water Treatment Strategy exists since 2004. The lack of a sewage treatment plant in Kosovo remains a critical environmental problem. The Ministry will implement three pilot sewage treatment plan projects in small villages as a catalyst project for further implementation throughout Kosovo.

As regards **nature protection**, the Law on Nature Conservation has been approved but not yet promulgated.

In the area of **chemicals**, progress towards European standards was achieved with the Law on Transport of Dangerous Goods promulgated in 2004. This law concerns the transport of dangerous goods which by their combustible, poisonous, explosive, vaporous, infectious, and radioactive features present a danger to human and environmental safety.

The European Partnership priorities provide a basic framework for Kosovo's efforts towards approximation to EU environmental legislation. Kosovo has pursued approximation to EU environmental standards, with important advances in air quality and water quality. However, there has been limited progress with other European standards in the field of environment. This will require attention in the near future. Serious lack of funds and pollution from power plants and mines are also challenges requiring continuous attention.

In those areas where some approximation has been achieved, attention must now focus on implementation and enforcement, which need to be substantially strengthened, in particular through the adoption of implementing strategies and plans, institutional capacity building and a substantial increase in funding. Raising public awareness is another aspect that needs to be reinforced.

#### ***3.2.4. Transport policy***

Kosovo has made progress in the area of transport, namely towards harmonisation with the European standards, integration in the transport regional initiatives and the restructuring of transport utilities..

Cooperation between the United Nations Interim Administration for Kosovo and the Provisional Institutions of Self-Government is being reinforced in order to develop a transport system compatible with European standards. However, a transport policy framework, which should provide the general framework approach to the whole sector and should include Kosovo in the international corridors, has not been finalised yet. As regards the development of a multi-modal strategy, a study, financed by the EAR, has just been finalised. It is expected that the EAR will fund the implementation of the recommendations of the study.

At regional level and with a view to ensuring its proper connection to the **trans-European transport network**, Kosovo is participating actively in the implementation of the June 2004 Memorandum of Understanding of the South East Europe Core Regional Transport Network, including the Transport Observatory. Kosovo is also participating in the High Level Group on the extension of the major trans-European transport axes to neighbouring countries and regions, which was established in 2004.

As regards **road transport**, the Law on Road Transport was promulgated in May 2005 (UNMIK/REG/2005/23). The law determines the principles and regulates the conditions and arrangements for the transport by road of passengers and goods, harmonised to the best international practices. It also sets the conditions for licenses for road transport operators, which are issued by the Ministry of Transport for a period of 5 years.

In the **rail transport** area, the state-owned UNMIK Railways, a sector coming under the reserved powers, is undergoing an incorporation process expected to be completed by the end of 2005. UNMIK Railways has also significantly downsized its personnel under a restructuring plan, taking into account the budgetary

constraints. Currently, it employs 320 staff, but the staffing plan provides for this number to decrease to 150 by 2008. This downsizing is necessary to make the company financially viable. The railways sector requires significant investment and its revitalisation is still at a critical stage.

In the **air transport** sector, several developments occurred. Pristina airport came under civilian control in April 2004. A master plan for the development of the civil operator of Pristina Airport - which is a public utility - for the period 2005-2025 has been produced. Kosovo participates in the current negotiations with the European Community on a European Common Aviation Area (ECAA) Agreement. The present regulatory situation is not conventional but basically in step with the liberal market approach foreseen by the ECAA Agreement. A programme for incorporating EU legislation is underway. It is important that staff in the Ministry of Transport should gain experience in the aviation matters. The recommendations of the ECAA Assessment visit carried out in June-July 2005 should be implemented.

With regard to **maritime transport** Kosovo is landlocked and not a contracting party to any convention of the International Maritime Organisation. For the time being it is without a maritime register. Therefore, the *acquis* concerning **maritime transport** is not relevant.

Kosovo needs to continue its efforts to ensure a well-functioning transport system integrated in the region and compatible with European standards.

### **3.2.5. Energy**

Despite some progress, the energy sector, in particular the current financial and operational status of the Kosovo Electricity utility KEK, remains a crucial and challenging issue.

Years of inadequate maintenance have resulted in the degradation of the electricity supply system in Kosovo. Emergency funds were provided for the repair of the damage caused by the lightening strike in summer 2002, which put one of the main generation plants out of action (Kosovo B). Kosovo A power plant is at the end of its operational lifespan and is in a state of serious disrepair. At present, only one of the five units is in operation. Kosovo B power plant has a combined maximum capacity of 560 MW, but although it is in a better state, its operation remains poor. Both B units were not brought back to full operation until November 2004. Occasional power cuts still occur, in summer as well, mostly due to the mismatch between production capacity and demand and poor maintenance. The capacity for exporting base-load electricity has been undermined by the deterioration of the transmission rings.

KEK is a vertically-integrated publicly-owned company. Preparations for the incorporation of the company are under way and should be finalised by the end of the year. Preparations for the unbundling of KEK are linked to its incorporation and have not been completed yet. The establishment of a fully unbundled Transmission System Operator not linked to power generation should be a priority. KEK is still a financially insolvent company unable to cover its cost of operations, mainly due to the extremely low level of revenue collection and high commercial losses. Only 26.8% of total electricity produced was paid by customers during the period 2004 – early 2005. Recently, some progress has been made and the general level of revenue collection amounts to approximately 35%, compared to a regional average of 85-90%. However, commercial losses have increased still further.



From July 2004, a new turn-around management, consisting of an international consortium, took over the management of KEK. The main focus of the management team is to improve billing collection and ameliorate the overall performance of the company. The turn-around management produced a Financial Recovery Plan for KEK for the period 2005-2010. According to this plan, KEK will need very substantial external financial support in 2006 and 2007 if it is to stay in operation. As of January 2005, 98 villages in Kosovo had been disconnected by KEK because they failed to pay their bills. However, there were no collective disconnections. The “network failure policy” has been mostly successful and at the end of the winter most of these villages were reconnected. In support of this strategy and measures by the turn-around management, an intensive communication and public awareness campaign started in March 2005, and a UNMIK-Government task force will be created later in 2005. The task force will be composed of five members: two from UNMIK and three from the Government. The creation of the joint task force is a sign of the overall institutional support for and common approach to the electricity problem. However, this initiative, though very welcome, comes with a considerable delay.

In the beginning of 2005, a Ministry for Energy and Mining was set up. Energy remains a power shared between UNMIK and the provisional institutions for self-government. This makes the institutional and decision-making set-up in the energy sector even more complex.

For the development of a legislative framework in line with European standards, the Law on Energy, the Law establishing the Energy Regulator as well as the Law on Electricity were all promulgated in June 2004. An energy strategy has just been adopted.

The regulatory framework in the electricity sector has further progressed. In particular, the Energy Regulatory Office is now operational. It is an independent regulator currently funded by the Kosovo Consolidated Budget, the UNMIK Pillar IV and other donors, but is scheduled to become self-financed from licensing fees in 2006.

The operational and financial situation of the electricity sector remains, however, in an extremely precarious situation. Therefore, resolving institutional issues, including the ownership of assets and increasing production capacity and energy efficiency, remains a key priority.

Kosovo has big reserves of relatively cheap and good-quality lignite. The recently published Generation Investments Study identifies Kosovo as one of the most important potential areas in the region for electricity generation in the future. Such an investment would require the development of the appropriate legislative and regulatory framework, also covering environmental and social issues, as well as significant funding for transmission infrastructure.

Kosovo has played an active role in the establishment of the Energy Community Treaty. The Treaty is aimed at creating a regionally integrated energy market for electricity and natural gas as part of the wider EU market. It was signed in October 2005. Accordingly, the deregulation of the energy market, including third party access and cross-border trade, should be a priority.

Kosovo needs to continue and intensify its efforts to ensure a viable and efficient electricity sector, which is a vital precondition for economic development.

### ***3.2.6. Information society and media***

In the area of **electronic communications and information technologies**, the market was formally liberalised by the Law on Telecommunications in May 2003. Some secondary legislation has yet to be adopted.

All fixed numbers are allocated to the fixed incumbent operator, Post and Telecommunications of Kosovo (PTK), which was incorporated in mid-2005 and remains under the direct control of UNMIK through the Kosovo Trust Agency. PTK consists of four business units: Kosovo Post (domestic and international mail and package services), Kosovo Telecom (fixed line telephony), Vala 900 (mobile telephony) and DardaNet (internet provider).

PTK has also been designated as an operator with significant market power and a cost orientation obligation has been imposed. However, a reference interconnection offer is not yet available.

Fixed-line telephony penetration is very low at just over 5% (as of 1 January 2005), while mobile telephony penetration stands at 16% (as of 1 January 2005). One mobile operator is active in Kosovo. The tender process carried out by the Telecommunications Regulatory Authority for a second mobile phone operator was found to be flawed and the validity of the licence contract, issued in October 2004, is being contested before the Supreme Court.. Another, unlicensed, mobile operator is operating *de facto* in Kosovo. It was asked by UNMIK to legalise its status by applying for a license. After it refused to do so, UNMIK requested the operator to release the frequencies. The operator is still active in Kosovo.

Because of its unresolved status question, Kosovo does not have its own international telephone code, which has financial and operational implications. In February 2005, the Special Representative of the Secretary General submitted a request to the International Telecommunication Union for the issue of a temporary code for Kosovo. Further, UNMIK signed on behalf of Kosovo the SEE broadband agreement which is expected to facilitate the development of the information society.

Even though there is full liberalisation, this has not yet led to competition and only very few operators are active in the market. There is still legislation that needs to be finalised, e.g. in the area of licensing. Some major elements important for developing competition and constituting key aspects of the EU regulatory framework, such as carrier (pre-)selection and number portability, are still lacking, which also explains the underdeveloped competition.

Substantial progress has been made in **audiovisual policy**. The Law on the Independent Media Commission was adopted on 21 May. Regarding the development of a strategic plan for minority broadcasting consistent with the European Convention on Minority Rights, a fund was created to support minority media.

In December 2004, the Temporary Media Commissioner reached a settlement with the main broadcasters on the sanctions it had imposed on the broadcasting of hate speech messages during the violent events of March 2004. Under the settlement, the 3 broadcasters acknowledge violations of specific principles embodied in the Broadcast Code of Conduct and agree to commit specific amounts of money to the professional training of journalists and editors in areas such as conflict reporting. These commitments are to be seen as a constructive approach to the problem of hate speech in broadcasting, one which will have a positive impact on broadcasting work.

On 10 August 2005, print media representatives signed the Press Council Statute. Responsibility for self-regulation will be solely with the local media. This initiative is another positive step in enhancing the quality of Kosovo's printed media, in which biased reporting and hate speech are not uncommon.

However the Law on Access to Information still has to be implemented.

### ***3.2.7. Financial Control***

The Ministry of Finance and Economy has embarked on a strategy to develop managerial accountability, internal control and functionally independent audit in the public sector. The Ministry is in the process of redrafting its January 2005 public internal financial control policy paper and drafting coherent internal control framework legislation on the basis of the Public Financial Management and Accountability Act (UNMIK Regulation 2003/17). This should be done through good co-ordination with all relevant shareholders. It is recommended to draft a specific Internal Audit Act. The Ministry should establish appropriate Central Harmonisation Units for the Financial Management and Control systems and for Internal Audit systems in such a way that an optimal use of available institutions and manpower is ensured.

Kosovo's supreme audit institution, the Office of the Auditor General, was created by UNMIK Regulation 2002/18. The Auditor General was appointed by the SRSG in November 2003. In November 2004, EC started co-funding a project to establish the Office of the Auditor General aiming in particular to set up a functioning, sustainable and independent institution and initially focusing on building the necessary capacity. In October 2004, the Office of the Auditor General was accepted as an associated member of the European Organisation of Regional External Public Finance Institutions (EUROSAI).

### ***3.2.8. Other policies***

Progress with regard to **employment and social policy** is part of the work towards European standards. Further efforts to establish economic and social rights as well as to promote employment and encourage social dialogue will contribute to improving governance and economic performance.

## **3.3 Justice, freedom and security**

### ***3.3.1. Visas, border control, asylum and migration***

Kosovo has taken steps to regulate the movement of persons, but still lacks the essential features of visas, border control, asylum and migration control.

Kosovo does not have a **visa** or an **asylum** regime.

UNMIK Regulation 2005/16 on the Movement of Persons in and out of Kosovo was promulgated in April 2005 and entered into force in July 2005. It regulates the movements of persons into and out of Kosovo, including refugee entry and the granting or denying of refugee status.

The four principal agencies with legal responsibility for the management of Kosovo's **borders** and boundaries are: the border and boundary police element of UNMIK Police (Pillar I), UNMIK customs service (Pillar IV), the department of

rural affairs and forestry (Pillar II) and the Ministry of Agriculture and Spatial Planning of the provisional institutions of self-government. The first three agencies retain reserved powers in their respective areas. Responsibility for operational border management is currently divided among a range of Kosovan and international actors, including UNMIK Border and Boundary Police, CIVPOL, KPS and UNMIK Customs Service. KFOR is responsible for control of the green border. Cooperation between the Kosovo Police Service and UNMIK Customs is good.

Kosovo is fully integrated in the Commission's regional integrated border management programme. While many matters are being addressed, considerable efforts are still needed to bring Kosovo into line with EU standards for integrated border management, including the harmonisation of information technology and communications systems among the various authorities, coordinated training activities, close coordination of operations and the establishment of the legal frameworks and systems needed to deal with refugees and migrants.

Stringent border controls are also fundamental to combat the illicit trafficking of small arms and light weapons as well as the spread and trafficking of materials which can be used to produce weapons of mass destruction.

### ***3.3.2. Money laundering***

Kosovo has made progress in putting in place the basic framework for the fight against money laundering and must now also focus on enforcing these rules and curbing the high level of money laundering.

UNMIK Regulation 2004/2 on the deterrence of money laundering and related criminal offences was promulgated in February 2004 and amended in February 2005. The law covers financial institutions and professions and obliges them to identify their customers, report suspicious transactions and keep records. The legislation provides for cooperation with third countries.

Further alignment with international standards remains necessary. Moreover, anti-money laundering legislation still needs to be effectively implemented. In this context, it is also noted that the effectiveness of anti-money laundering defences is seriously hampered by corruption, organised crime, the large informal economy and the high level of cash transactions.

Kosovo's Financial Information Centre became operational in September 2004 and is responsible for the collection, analysis and processing of data in relation to money laundering.

Profits made by Kosovan organised crime groups are invested and laundered in Kosovo through legitimate businesses that often belong to the heads of the biggest drug trafficking groups. Such Kosovo-based groups have also been known to make investments abroad, and there are reports of assets being held across Europe.

### ***3.3.3. Drugs***

Drug trafficking remains prevalent in Kosovo and local policing capacity still needs to be strengthened in view of the future transfer of responsibilities.

Kosovo is located on the major drug trafficking route through the Balkans for heroin from the opium cultivation areas in south-west Asia (Golden Crescent), such as Afghanistan, for distribution to Western Europe. Kosovo-based groups are thought

to play an important role in drugs trafficking along that route. In the past, significant drugs seizures across Europe and beyond were directly linked to Kosovan groups, showing that they are well-organised and active across the continent. Kosovan drugs traffickers are thought to be in direct contact with major suppliers in Turkey and dealing in large quantities. Heroin is the most commonly trafficked drug.

Kosovo's own market for illicit drugs is small, but appears to be growing as local drug consumption increases. The transit of heroin through Kosovo has also led to an increase in heroin availability and use amongst the native population. Marijuana is the most commonly consumed and reported illicit drug.

A special narcotics investigation section in the directorate for organised crime, which is situated within the Kosovo Police Service structure, (*see the section on organised crime below*) deals with drug-related investigations. During the first half of 2005, the narcotics investigation section dealt with 122 cases involving 172 suspects.

### **3.3.4. Police**

The Kosovo Police Service has been further developed and the transfer of competences pursued. Further long-term efforts must be pursued to develop an effective police service and strengthen local capacity.

Policing in Kosovo is carried out by the international UNMIK police and the Kosovo Police Service. The process of emancipation of the Kosovo Police Service from the UNMIK police is well under way. Recruitment and training have maintained their high momentum, and the Kosovo Police Service, with more than 6 700 members, now seems more and more capable of assuming its order-maintaining tasks.

Policing has been increasingly transferred to local authorities. 33 police stations as well as three police regions and all regional traffic units have made this transition (the Mitrovica and Pec police regions remain under international control). The crime pillar, responsible for serious criminal investigation, has not yet been transferred. However, there are some concerns about the state of preparedness of the Kosovo Police Service. Kosovo Police Service staff are well trained, but their efficiency in carrying out investigations is hampered by lack of experience and low technical capacities. Due to limited experience, they also lack the technical skills needed in highly technical or specialised positions as well as the management skills needed in hierarchical positions.

The Kosovo Police Service has been addressing certain shortcomings from March 2004 and has strengthened its command chain as well as its capacities for riot control. Kosovo Police Service staff have taken part in riot-control training based on a non-confrontational approach. The command over the bridge separating the Kosovo Serb and Kosovo Albanian communities in Mitrovica was handed over from KFOR to the Kosovo Police Service in 2005. The bridge was opened for private cars in June 2005.

The recruitment from minorities has further progressed in the Kosovo Police Service and currently stands at around 15%. Kosovo Serbs make up about nine percent of Kosovo Police Service numbers. There are mixed patrols in mixed areas in order to give every citizen the possibility of getting assistance in his or her own language, but there have been a number of complaints that police reports were written in a language not understood by the citizen.

### ***3.3.5. Fighting organised crime and terrorism***

Even though some legislation and enforcement mechanisms are in place, organised crime groups operate throughout Kosovo and pose a serious risk to Kosovo and other countries they operate in. Kosovo is not party to the UN Convention against Transnational Organised Crime and it has no formal comprehensive strategy to fight organised crime and terrorism yet. Pieces of such a strategy are devolved to UNMIK, KFOR and any relevant agency dealing with security. UNMIK and KFOR cooperate closely with regard to fight against organised crime and terrorism. Organised criminal activities are a problem throughout the Western Balkans. **Organised crime** is entrenched in Kosovo and its prevalence gives rise to serious concern. Ethnic Albanian organised crime groups from Albania, the former Yugoslav Republic of Macedonia and Kosovo are increasingly active in Western Europe and are thought to be the biggest non-native groups in Italy and Greece. Specific areas of activity are trafficking of drugs, weapons and human beings, prostitution and large-scale organised crime activities involving the infringement of copyright laws. Kosovan organised crime groups are multi-commodity dealers and can exploit and satisfy changing demands.

UNMIK Regulation 2001/22 of September 2001 on measures against organised crime defines organised crime and sets the penalties for organised criminal activities in Kosovo.

A working group on combating the **trafficking of human beings** has been established and a national plan for combating the trafficking of human beings was endorsed by the government and signed off by Pillar I in May 2005. It revolves around the three areas of prevention, protection and prosecution. In July 2005, three Albanian citizens were jailed for up to 12 years for trafficking young women into Kosovo, in what was until then the most severe sentence imposed for trafficking. In August 2005, three international UN police officers and four foreigners were arrested for involvement in human trafficking.

UNMIK Regulation 2001/12 of June 2001 on the prohibition of **terrorism** and related offences defines various terrorist offences and prosecution measures. Arm trafficking via Kosovo is an issue of growing concern. However, Kosovo is not party to the protocol against the illicit manufacturing of and trafficking of firearms, their parts and components and ammunition, also known as the “UN Firearms Protocol”. Measures to control traffic of arms need to be enforced.

An organised crime directorate was created in January 2005 within the Kosovo Police Service structure. Its creation increased synergies in the investigation of organised crime and facilitated information-sharing between different departments. The directorate is composed of four sections: an organised crime investigation section, an organised crime support and service section, a section for the investigation of trafficking in human beings and a narcotics investigation section. By mid-2005, it was staffed by some 120 international police officers and 113 Kosovo Police Service officers. The transition towards local control is ongoing. Since January 2005, a Kosovan director of organised crime is being trained in a shadow position and Kosovo police lieutenants have been appointed as shadow heads of sections. However, finding the highly skilled Kosovo police personnel needed to operate in the directorate remains a major challenge.

UNMIK and the provisional institutions of self-government have set up a special prosecutor's office as part of the office of the public prosecutor. The office will be

handling cases of organised crime, terrorism, trafficking in human beings and corruption cases. All these cases are currently handled by international prosecutors. However, problems remain in relation to the prosecution of organised crime cases, namely the limited manpower at the department of justice, resulting in a high workload for international prosecutors, the threat of information being leaked by local prosecutors and the local prosecutors' lack of experience. Efforts should also be given to combat financial crime and its links to corruption, fraud and organised crime.

#### 4. General evaluation

Kosovo has made progress in terms of alignment to **European standards** in many areas though in an uneven way.

New legislation and policies are now broadly checked for EU compliance from the phase of conception and early stages of drafting in line ministries and through the Office for European Integration Processes. Seven ministries have established EU integration units, some of them supported by external experts. The lack of qualified local legal experts in EU law is an obstacle and difficulties have been encountered in the translation of new legislation. Despite this progress, neither of these civil service structures are fully consolidated, nor is the parliamentary committee on international cooperation and EU integration fully operational yet.

In the area of *internal market*, some progress was made regarding with the adoption of new legislation. The revised law on *public procurement* is based on EU rules, although still under review by the Assembly. No progress can be reported in the area of *intellectual property law*. Positive developments have occurred in the area of *customs* mainly in the implementation of an Integrated Tariff for Kosovo and the Customs Code. Some progress has been made in the field of *taxation* where a progressive alignment with the EU *acquis* is under way. In 2005 Kosovo moved to a simplified system of two types of income taxes. The collection and control capacity of tax administration needs to be enhanced and fraud in excise duties tackled.

As regards development of *sector policies*, it continued the implementation of the European Charter for Small and Medium Enterprises. A law on support to SME has been promulgated. Despite its potential, Kosovo's *agriculture* remains under-exploited and key challenges such as poor infrastructure, property rights, inappropriate credit, inefficient quality control mechanisms and low education need to be tackled. In the area of *environment* Kosovo has made progress towards approximation to EU *acquis* with the adoption of legislation on water and air quality, and by-laws on environmental impact assessment. The government approved an Environmental Protection Strategy while a five year Environmental Action Plan is under development. Progress can be reported in the area of *transport* where Kosovo participates in the regional transport initiatives. Pristina airport came under civilian control and was incorporated. Kosovo participates in the extension of the European Common Aviation Area to South East Europe. Regarding *energy*, Kosovo is signatory of the South East Europe Energy Community Treaty. In the area of telecommunications and postal services, new postal codes became effective in June 2005.

As regards *justice, freedom and security*, the situation is still unsatisfactory. Some progress has been made in establishing the legal framework to combat *money laundering* while implementing mechanisms still need to be much improved. A

comprehensive anti-*drug* strategy has yet to be established, both in relation to trafficking and the increasing local drug abuse. The transition of power to the Kosovo Police Service is ongoing. However, further capacity building is needed, in particular for investigations and management and leadership skills. More progress is needed to bring perpetrators of crime to justice and enforce rule of law. The *fight against organised crime* and against financial crime must be stepped up and local capacities developed in view of any future further transfer of powers to local authorities.



### C. EUROPEAN PARTNERSHIP: OVERALL ASSESSMENT

Kosovo's progress and overall state of implementation of the Stabilisation and Association process has been examined above. This section briefly assesses briefly the overall extent to which the priorities of the European Partnership, adopted by the Council in June 2004<sup>10</sup>, have been implemented.

The purpose of the European Partnership is to assist the authorities by identifying the short and medium-term priorities that Kosovo needs to address to make further progress towards the EU. The priorities have been selected on the basis of realistic expectancy that the country can complete them or take them substantially forward over the next few years.

A distinction is made between short-term priorities, which are expected to be accomplished within one to two years, and medium-term priorities, which need three to four years. The European Partnership forms the basis for programming assistance from EU funds.

Overall, Kosovo has made progress in addressing the priorities of the European Partnership. At the same time more efforts will be necessary to deliver the recommendations. The European Partnership has provided a strong guiding tool for Kosovo's institutions on their way towards Europe and a useful progress monitoring tool for the European Commission. Development of the action plan for the implementation of the European Partnership has been important in focusing Kosovo's institutions on Kosovo's European vocation.

The European Partnership cited the implementation of the eight Standards for Kosovo as the overarching short-term priority. While some progress could be witnessed, none of the standards have been fully met and serious concerns remain, in particular regarding the rule of law (standard II), freedom of movement (standard III), sustainable returns and rights of communities and their members (standard IV) and property rights (standard VI).

On the priorities in relation to the **political situation**, Kosovo's authorities have redressed with funds from the Kosovo budget much of the physical destruction to private property and started to plan the rehabilitation of the damage to religious and cultural sites caused by the March 2004 events. Perpetrators of March 2004 criminal acts are being prosecuted and some efforts have been made on the part of Kosovo's institution to condemn acts of violence against minority groups. However, many of the people displaced in 2004 have yet to return as confidence has not been restored.

First steps have been undertaken to develop the EU orientation of Kosovo's administration at various levels: the prime minister's office, line ministries and the assembly. There has been some progress in passing legislation on fight against corruption and organised crime. However, the lack of legal certainty on the applicable laws and the weak judicial system affect negatively the rule of law. Some efforts have been made to increase the capacity of the Kosovo Statistical Office and improve EU compatibility of statistics but overall public administration remains weak and further serious capacity building efforts must be undertaken. A comprehensive reform strategy is still missing in order to build a professional, inclusive and accountable administration, free from political interference.

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<sup>10</sup> Council Decision 2004/520/EC of 14 June 2004 on the principles, priorities and conditions contained in the European Partnership with Serbia and Montenegro including Kosovo as defined by the United Nations Security Council Resolution 1244 of 10 June 1999 (OJ L 297, 26.6.2004, p. 21)

The working groups on energy, missing persons, returns, and transport and communications established in the context of Pristina-Belgrade dialogue on practical issues of common interests resumed in spring 2005 after they were interrupted after the March 2004 events but participants in the delegations from Pristina have not been adequately prepared nor represented at appropriate level.

Kosovo has significantly intensified its efforts in regional and international cooperation, notably in the areas of trade, transport, energy and participation in various regional fora. Kosovo has cooperated with the International Criminal Tribunal for the former Yugoslavia, as most visibly shown by the voluntary surrender of ex Prime Minister Haradinaj.

As regards the priorities relating to the **economic situation**, Kosovo has cooperated with the International Monetary Fund in aiming to develop sound economic and financial policies and has issued a Medium-Term Budget Framework. Kosovo has managed to substantially revitalise the privatisation process, notably by reenergising the privatisation process and adopting various measures to attract foreign investment.

Efforts have been undertaken to establish procedures for the detection, treatment and follow-up of cases of suspected fraud and other irregularities. The law on public financial management and accountability was amended by introducing a chapter on internal audit. Memoranda of understanding are being drawnup with some Kosovo institutions with own revenues with a view to enhancing the income base of the Kosovo budget account. The procurement law was revised but it has not been approved yet by the assembly while the public procurement agency is not yet functioning.

Kosovo's tax administration has made some improvement in its capacity. It is implementing the laws on personal and corporate tax. The law on tax administration and procedures has been promulgated, providing for a comprehensive set of rules and procedures in compliance with international standards and EU requirements. Efforts are ongoing to amend the VAT Regulation in compliance with the 6th EU VAT Directive.

The banking sector has been further stabilised by increasing its capacity to provide long-term financing to small and medium enterprises. Special credit lines have been agreed with local banks aimed at financing SMEs. The Banking and Payments Authority has started issuing a monthly statistics bulletin which is in line with IMF standards.

Progress has been made towards the establishment of a sound regulatory framework for public utilities in line with European standards and the regulators are preparing implementing legislation at least in the area of energy and waste and water. An Independent Commission for Mines and Minerals was set up and has started to implement the legal mining framework and to provide licences for mining enterprises.

As to the priorities concerning **European standards**, the new customs code and its implementing legislation has been adopted and the integrated tariff of Kosovo (TARIK) has been introduced. The TARIK is based on the "Harmonized System" of the World Customs Organization and on the "Combined Nomenclature" of the European Union. A new criminal investigation unit has been established within the customs service. The Office for Consumer Protection is operating and reviewing consumer complaints. Steps have been taken towards the gradual alignment of

Kosovo's legislation with European standards in the area of company law. A law on SMEs has been promulgated, providing inter alia, for the establishment of an SME Support Agency. Progress has been made in establishing a regulatory framework and appropriate mechanisms to ensure food safety and improved phyto-sanitary controls. Environmental legislation has continued its approximation towards the EU acquis with the adoption of legislation on water and air quality, and by-laws on environmental impact assessment. An Environmental Protection Strategy and a Waste Water Treatment Strategy have been approved by the government. A comprehensive environmental action plan and various environmental protection laws are still under preparation.

Kosovo is actively participating in the implementation of the Regional Memorandum of Understanding of the South East Europe Core Regional Transport Network including the Transport Observatory

In the air transport sector, the civil operator of Pristina Airport has been established and incorporated and a master plan for the airport over the period 2005-2025 has been developed. Kosovo participates in the current negotiations with the European Community on a European Common Aviation Area Agreement (ECAA). A programme for incorporating EU legislation is underway. A law on road transport was adopted in May 2005.

The law on energy, the law on electricity and the law on the energy regulator have all been promulgated. A ministry for energy and mining has been created. The ministry has developed an energy strategy which was approved by the government and sent to the assembly for approval. Kosovo has made efforts to establish better functioning governance structures to improve the viability and sustainability of Kosovo's electricity company KEK, notably by contracting a Turn-Around-Management team for the company. However, no substantial increase in revenue collection could be achieved and KEK remains in a precarious financial situation. The recently created joint PISG/UNMIK taskforce should provide strong institutional support for KEK's collection efforts thus ensuring that significant progress is achieved. Kosovo has actively participated in the establishment of a regional energy market leading to initiate the Energy Community Treaty which was signed on 25 October.

Kosovo's institutions have started to implement the new Criminal and Criminal Procedure Codes but this still needs to be improved. All law enforcement agencies remain weak and in particular the judiciary. The Kosovo Judicial Institute still lacks a legal basis.

Kosovo's progress in addressing the issues identified as priorities by the June 2004 European Partnership is discussed in more detail in other parts of this report, notably in part B.3. On the basis of the findings of this report, the Commission proposes a revised European Partnership for Kosovo for adoption by the Council. The European Partnership will continue to be a key tool for guiding Kosovo's efforts to move closer to the EU. It should be given the necessary political attention and should help Kosovo to set its legislative and institution-building agenda.

## STATISTICAL ANNEX

STATISTICAL DATA (as  
of 1 September 2005)

Kosovo (UNSCR 1244)

|                          |             |      | Fo<br>ot-<br>not<br>e | 19<br>95 | 19<br>96 | 19<br>97 | 19<br>98 | 19<br>99 | 20<br>00 | 20<br>01 | 20<br>02 | 20<br>03 | 20<br>04 |
|--------------------------|-------------|------|-----------------------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| GDP per capita by region | Scale       | Unit |                       |          |          |          |          |          |          |          |          |          |          |
| Region 1                 | Millio<br>n | EUR  |                       | :        | :        | :        | :        | :        | :        | :        | :        | :        | :        |
| Region 2                 | Millio<br>n | EUR  |                       | :        | :        | :        | :        | :        | :        | :        | :        | :        | :        |

|                             |              |      | Fo<br>ot-<br>not<br>e | 19<br>95 | 19<br>96 | 19<br>97 | 19<br>98 | 19<br>99 | 20<br>00 | 20<br>01 | 20<br>02 | 20<br>03 | 20<br>04 |
|-----------------------------|--------------|------|-----------------------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| Unemployment rate by region | Scale        | Unit |                       |          |          |          |          |          |          |          |          |          |          |
| Region 1                    | Unit<br>(x1) | %    |                       | :        | :        | :        | :        | :        | :        | :        | :        | :        | :        |
| Region 2                    | Unit<br>(x1) | %    |                       | :        | :        | :        | :        | :        | :        | :        | :        | :        | :        |

|                          |       |      | Fo<br>ot-<br>not<br>e | 19<br>95 | 19<br>96 | 19<br>97 | 19<br>98 | 19<br>99 | 20<br>00 | 20<br>01 | 20<br>02 | 20<br>03 | 20<br>04 |
|--------------------------|-------|------|-----------------------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| Public expenditure       | Scale | Unit |                       |          |          |          |          |          |          |          |          |          |          |
| Health expenditure, as a | Unit  | %    |                       | :        | :        | :        | :        | :        | :        | :        | :        | :        | :        |

|  |           |   |  |   |   |   |   |   |   |   |   |   |   |
|--|-----------|---|--|---|---|---|---|---|---|---|---|---|---|
| share of GDP   | (x1)      |   |  |   |   |   |   |   |   |   |   |   |   |
| Social protection expenditure excluding administrative costs (including health expenditure), as a share of GDP | Unit (x1) | % |  | : | : | : | : | : | : | : | : | : | : |
| SI: Spending on human resources (public expenditure on education) as a share of GDP                            | Unit (x1) | % |  | : | : | : | : | : | : | : | : | : | : |

|  |           |      |           |      |      |      |      |      |      |      |      |      |      |
|--|-----------|------|-----------|------|------|------|------|------|------|------|------|------|------|
| Population age structure   | Scale     | Unit | Foot-note | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
| Population: people aged under 15 as a share of the total population          | Unit (x1) | %    |           | :    | :    | :    | :    | :    | :    | :    | :    | :    | :    |
| Population: people aged between 15 and 64 as a share of the total population | Unit (x1) | %    |           | :    | :    | :    | :    | :    | :    | :    | :    | :    | :    |
| Population: people aged 65 or over as a share of the total population        | Unit (x1) | %    |           | :    | :    | :    | :    | :    | :    | :    | :    | :    | :    |

|                         |       |      |           |      |      |      |      |      |      |      |      |      |      |
|-------------------------|-------|------|-----------|------|------|------|------|------|------|------|------|------|------|
| International migration | Scale | Unit | Foot-note | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|-------------------------|-------|------|-----------|------|------|------|------|------|------|------|------|------|------|

|                      |              |        |   |   |   |   |   |   |   |   |   |   |   |
|----------------------|--------------|--------|---|---|---|---|---|---|---|---|---|---|---|
|                      |              |        | e |   |   |   |   |   |   |   |   |   |   |
| Number of immigrants | Thous<br>and | Number |   | : | : | : | : | : | : | : | : | : | : |
| Number of emigrants  | Thous<br>and | Number |   | : | : | : | : | : | : | : | : | : | : |

|  |           |      |           |      |      |      |      |      |      |      |      |      |      |
|--|-----------|------|-----------|------|------|------|------|------|------|------|------|------|------|
|  |           |      |           |      |      |      |      |      |      |      |      |      |      |
| Tertiary education                           | Scale     | Unit | Foot-note | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
| Participation rate for persons aged 18 to 24 | Unit (x1) | %    |           | :    | :    | :    | :    | :    | :    | :    | :    | :    | :    |

estimate

forecast

provisional

Note:

The full set of Key indicators is available in [http://europa.eu.int/estatref/info/sdds/en/coop\\_eur/coop\\_eur\\_base.htm](http://europa.eu.int/estatref/info/sdds/en/coop_eur/coop_eur_base.htm).

The definitions of the indicators that countries have been asked to follow can be found (in English) in

[http://europa.eu.int/estatref/info/sdds/en/coop\\_eur\\_definitions.pdf](http://europa.eu.int/estatref/info/sdds/en/coop_eur_definitions.pdf), which also includes the definitions of the few

indicators extracted from Eurostat's database and from Comext. When countries have indicated divergences

from the definitions, these are indicated in the footnotes.