

BTI 2012 | Kosovo Country Report

Status Index	1-10	6.28	# 41 of 128	
Political Transformation	1-10	6.70	# 43 of 128	➔
Economic Transformation	1-10	5.86	# 58 of 128	➔
Management Index	1-10	5.28	# 59 of 128	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2012. The BTI is a global assessment of transition processes in which the state of democracy and market economy as well as the quality of political management in 128 transformation and developing countries are evaluated.

More on the BTI at <http://www.bti-project.org>

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Key Indicators

Population	mn.	1.8	HDI	-	GDP p.c.	\$	-
Pop. growth ¹	% p.a.	0.6	HDI rank of 187	-	Gini Index		-
Life expectancy	years	70	UN Education Index	-	Poverty ³	%	-
Urban population	%	-	Gender inequality ²	-	Aid per capita	\$	436.5

Sources: The World Bank, World Development Indicators 2011 | UNDP, Human Development Report 2011. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

Executive Summary

After three years of independence much progress has been made in Kosovo, but many challenges remain for the new country. Elected representatives continue to share power with an international presence, while territorial integrity and security is maintained by the NATO-led Kosovo Force (KFOR) peacekeeping mission.

The state's administrative structures are effective, but not efficient. The biggest problem the administration faces is widespread corruption. The second problem is the politicization of public administration with political clients, who hold different positions without adequate qualifications.

Kosovo's most recent parliamentary elections during the period under review were held on 12 December 2010. The first parliamentary elections since the country's declaration of independence were organized and run without involvement from Kosovo's international administration, and were marred by multiple instances of fraud and manipulation.

The elections saw the Democratic Party of Kosovo (PDK) of Prime Minister Hashim Thaci winning 34 seats in the country's 120-seat parliament. After PDK, the Democratic League of Kosovo (LDK) took second place; while an electoral surprise was the success of the more radical Movement for Self-Determination (Vetevendosje) of former student leader Albin Kurti, which ran for the first time and won 14 seats. The Alliance for the Future of Kosovo (AAK) of former Prime Minister Ramush Haradinaj won 12 seats, while businessman Behgjet Pacolli's Alliance for a New Kosovo (AKR) won eight seats. The Kosovo Serb votes were divided, and are represented by two parties in parliament; the Independent Liberal Party (SLS) held eight seats while the United Serbian List (JSL) held four seats.

The biggest challenge for Kosovo remains the economy. Economic growth in recent years has not been sufficient to change Kosovo's situation with regard to poverty and unemployment.

Kosovo remains the poorest country in the region, with 45% of population living below the poverty line and 15% in extreme poverty. The country needs to double its economic growth in order to achieve an income level similar to neighboring countries. The poorest part of the population is concentrated in rural areas, and is characterized by large households, elderly members and a number of dependents.

A large informal economic sector, widespread corruption and a weak rule of law are the main barriers for a functional market economy in Kosovo. Furthermore, the complicated and costly procedures required to operate a business or obtain a business license has pushed the country's economy further into the informal market.

Kosovo's budget for social benefits is very limited, and social provisions are kept at a low level to ensure fiscal sustainability. With a large population of impoverished citizens, the current social protections are seen as not adequate, and Kosovo must come up with new strategies and legislation to deal with pressing social issues. Due to the government's limited budget, the country's social welfare scheme still recognizes the family as a base unit.

History and Characteristics of Transformation

Kosovo became an independent state on 17 February 2008 with its declaration of independence and subsequent recognition by most Western countries. With the declaration it became the last country to emerge from the 17-year process of dissolution of the former socialist state of Yugoslavia.

In 1912, Kosovo was occupied and annexed by Serbia and then integrated into Kingdom of Yugoslavia (1918) and, later, into the Socialist Federal Republic of Yugoslavia (1945). These historic events did not include the consent of Kosovo Albanians, a group that constituted the vast majority of the territory's population. In post-World War II Yugoslavia, Kosovo was an autonomous province and its status was gradually enhanced in the period between the Federal Constitution of 1946 and the Federal Constitution of 1974. Beginning in 1974, Kosovo enjoyed veto rights at both the federal and Serbian level. Kosovo's consent was required for all executive, legislative and judicial decisions at both levels. In all aspects, Kosovo's status as an autonomous province was virtually the same as that of other republics, and it remained part of Serbia in name only.

In 1989, in violation of both Kosovo's and the Federal Constitution, Belgrade abolished Kosovo's autonomy and established a repressive police and military regime in the region. Kosovo Albanians were expelled from public service. Throughout the 1990s, Kosovo was ruled directly from Belgrade, with the local Serbian community playing a significant role in implementing Serbia's rule over Kosovo. The majority of Kosovars, led by the Democratic League of Kosovo (LDK), chose peaceful resistance that aimed at defying the exercise of Serbia's authority over the territory and building a system of "parallel government institutions."

The failure of peaceful resistance to provide a way out and political solution combined with increasing repression by Belgrade culminated in the emergence of the Kosovo Liberation Army (KLA) and armed conflict in 1998. The conflict was brought to an end through the military intervention of the North Atlantic Treaty Organization (NATO) in the spring of 1999. Following the end of the war, in June 1999, an international administration was established in Kosovo through U.N. Security Council Resolution 1244, which administered the territory until early 2008. The U.N. Interim Administration Mission in Kosovo (UNMIK) was designated as the authority holding civilian responsibility over Kosovo, while NATO's presence in Kosovo (KFOR) was responsible for the security portion of this international mission.

The mission established an interim constitutional framework for provisional self-government in 2001 and organized democratic elections on 17 November 2001. It also represented Kosovo internationally. Serbia still recognizes UNMIK alone as being legally empowered to negotiate with it on behalf of Kosovo.

Interethnic clashes in March 2004 left many Serbs fearful for their future. The experience of the March riots led to a growing belief in much of the international community that a continued failure to resolve the final status of Kosovo would lead to yet more insecurity and instability. The result was the 2005 report by U.N. Special Envoy Kai Eide, a Norwegian diplomat, who recommended independence as the best way to promote long-term stability and security in Kosovo. The Ahtisaari Plan built on this report.

The period under international administration has been characterized by competing goals when it comes to state building. The international administration was guided by a vague aim to establish substantial autonomy, which was also ambiguously stipulated in U.N. Security Council Resolution 1244. Kosovo was administered under the authority of Chapter VII of the U.N. Charter in the name of pacifying a threat to international peace and security and less in terms of genuine state-building. This factor was not only in conflict with the aspirations of the Kosovo Albanian majority, but it has also hampered genuine institution building efforts and the empowerment of the local citizenry. During the UNMIK administration, Kosovo established democratically elected institutions of self-government, but the special representative of the U.N. secretary-general retained so-called reserved powers, that is, exclusive legislative authority in sovereignty-related matters.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 10 (best) to 1 (worst).

Transformation Status

I. Political Transformation

1 | Stateness

Question
Score

Three years after its declaration of independence, Kosovo still does not maintain a monopoly on the use of force. Elected authorities share power with an international presence.

Monopoly on the
use of force

7

Kosovo's territorial integrity and security is under the auspices of the NATO-led Kosovo Force peacekeeping mission (KFOR). The force coordinates its work with the Kosovo Police and the European Union Rule of Law Mission in Kosovo (EULEX). EULEX personnel, consisting of judges, prosecutors, police and customs officers, work alongside Kosovar counterparts. EULEX, however, has an exclusive mandate in combating war crimes, organized crime and corruption.

Kosovo's monopoly on the use of force is mainly hindered by Serbia and its illegal security and intelligence structures that continue to operate throughout Kosovo. These illegal forces operate especially in the Serb-dominated, northern part of Kosovo. As of January 2011, Kosovo authorities and international administrators had declared their opposition to these structures but had as yet taken no concrete steps to eliminate them.

Kosovo population is ethnically mixed, with the vast majority comprising ethnic Albanians (more than 90%) who accept the nation-state as legitimate. Other non-Albanian communities also accept the legitimacy of Kosovo except for Kosovo Serbs, which make up some 6% of the population, most of whom openly oppose Kosovo's statehood.

State identity

7

This sentiment of Serbs living south of the Iber River has changed as the country has embarked on a decentralization process and created new municipalities along ethnic lines. This policy, established as part of Kosovo's independence and within

its constitution, has given more power to municipal governments and offered less reason for Serbs to question the legitimacy of Kosovo's statehood.

Every individual who has lived in Kosovo since 1998 is eligible for citizenship rights. There is no discrimination with regard to citizenship rights. Some citizens, however, mainly from the Serb population living in northern Kosovo, have expressed that they do not want Kosovo citizenship.

Kosovo's constitution defines the country as a secular state, excluding religious dogma from political institutions. No elements that could endanger this constitutional provision have been identified in 2010.

No interference of
religious dogmas

9

Although some political parties clearly include religious issues as part of their political program, no party has been able to translate these beliefs into an actual political context. Two separate groups, an Albanian Democratic-Christians group that promotes catholic values and the Justice Party, which promotes Islamic values, do not have substantial electoral support.

Having merged with other political parties in different coalitions, the Democratic-Christians have since relinquished their religious agenda. The Justice Party, on the other hand, has been consistently gaining more votes. In a wide coalition with other conservative parties, Justice Party candidates garnered enough votes to win two seats in the new parliament.

The country's more politically involved religious organization remains the Serbian Orthodox Church, and its clerics still influence the politics of the Serb national minority.

The state's administrative structures are effective, but not efficient. The biggest problem in administration is widespread corruption. An additional problem is the politicization of the public administration with political clients, who hold positions without adequate qualifications. The negative effect of such politicization was witnessed at the end of 2010, when the efficiency of the administration fell significantly following the withdrawal of one of the political parties from the governing coalition.

Basic
administration

8

A problematic factor in state administration remains the existence of Serbia's parallel structures, mainly in the north. These include parallel health and education systems alongside Serbia's state administration. In other Serb areas, this phenomenon has been minimized as part of the country's decentralization process.

2 | Political Participation

Kosovo has a proven track record of credible free and fair elections since 2000. This record, however, was tarnished following parliamentary elections on 12 December 2010. The first parliamentary elections in Kosovo since the country's declaration of independence were organized and run without involvement of the international presence in Kosovo, and the contest was marred by multiple instances of fraud and manipulation.

Free and fair
elections

7

International observers said that the election maintained some international standards, while local civil society observers failed to record and report most instances of fraud. Incidents of fraud were mainly noted in areas considered strongholds of main political parties, such as the Drenica and Dukagjini regions. Examples included individuals voting multiple times and ballot stuffing. In many polling stations, the number of ballots did not match the number on voting lists, while in some polling stations turnout exceeded 100%.

As a consequence of this systematic fraud, the Central Election Commission (CEC) decided to repeat elections in four municipalities. The level of fraud in these contests was much lower.

The final results show that the Democratic Party of Kosovo (PDK) of Prime Minister Hashim Thaçi retained its dominance with more than 30% of the votes. Thaci will likely be given the mandate to form a government in February 2011.

Kosovo Serbs were split regarding their participation in the parliamentary election. Following a clear message from Serbian President Boris Tadic, Serbs living north of the Iber River boycotted the election. Some one-third of Kosovo Serbs live in the north, in the municipalities of Mitrovica, Leposavic, Zvecan and Zubin Potok. Serbs living in other Kosovo regions participated in the election and managed to win three additional seats, on top of the 10 reserved seats in the 120-seat parliament.

Participation of Serbs was crucial, especially in local elections. The newly created Serb-majority municipalities were charged with organizing municipal assemblies and local governments after local elections. The Parteš/Partesh municipality voting held in June 2010 was successful, with more than 65% voter turnout from the Serb community.

Kosovo's independence continues to be supervised by the International Civilian Office (ICO), an international body which is accountable to the International Steering Group (ISG), consisting of countries that have recognized Kosovo. This system ensures the implementation of the Comprehensive Status Proposal, a

Effective power to
govern

8

detailed document drafted by former U.N. Envoy for Kosovo Martti Ahtisaari and the basis on which Kosovo's independence from Serbia was declared.

Democratically elected representatives have the effective power to govern within this framework of supervision. The head of the ICO, the International Civilian Representative (ICR), has the power to annul decisions made by any Kosovo institution. However, since 2008 when the ICO was established, the ICR did not use the veto power for any decision made by Kosovo authorities.

Another hindering factor for elected representatives to use their effective power to govern remains the existence of Serbia's parallel structures that operate in the country's north. Legitimate authorities have no real power in this part of the country.

The freedom of association and assembly is a key pillar of Kosovo's constitutional democracy. Individuals and social or political groups have unrestricted rights to associate and assemble. However, the criteria used to evaluate requests for permits to assemble are not sufficiently transparent.

Association /
assembly rights
9

Freedom of expression remains partially limited in Kosovo, and in the period under review has shown a worsening tendency. The government has not been successful in implementing constitutional provisions on the freedom of expression while it continues to put pressure on media outlets. The European Commission's 2010 Progress Report for Kosovo states that the media "remains conducive to the strong influence by partisan and ownership interests on journalists" and that the media structure "is conducive to strong political interference." Political interference has been noted both in publicly owned and private media.

Freedom of
expression
6

The government's interference in the public broadcaster Radio Television of Kosovo (RTK) has continued. Kosovo authorities have not succeeded in guaranteeing RTK's independence and financial sustainability, making it vulnerable to political interference. Meanwhile, RTK is seen to lose its public status and may be turned into a state TV station which simply transmits government news.

Government pressure on private media has also increased. The Kosovo government continues to be the biggest advertiser, thus generating most of the income for private media. Institutions in Kosovo, both locally and nationally, have a tendency to control the editorial content of newspapers by favoring them when it comes to the publication of government-sponsored ads. The newspaper that benefits mostly from ads financed by public funds is Infopress, which has the lowest share of the media market but is a strong supporter of the Democratic Party of Kosovo (PDK). A few local media outlets, such as Koha Ditore, have reported tighter tax administration checks by government authorities.

During 2010, pressure and threats against independent media increased. The media company Koha Group, which broadcasts Kohavision TV and publishes the daily newspaper Koha Ditore, has been particularly targeted. On 22 May, the street sign of Pristina's main avenue was covered with a poster that read "UDB Street Veton and Flaka Surroi," referencing the names of the founder and the current managing director of the Koha Group with the acronym of the former Yugoslav secret service. In Kosovo's political context, this reference is considered hate speech and could lead to violence. It took the public's reaction and a letter from U.S. Ambassador to Kosovo Christopher Dell to ease tensions.

Another independent outlet, the Zeri daily newspaper, experienced pressures and threats from both the government and state-owned companies. Two Zeri investigative reporters, Arbana Xharra and Lavdim Hamidi, were threatened for their investigative reports on corruption within the state-owned Post and Telecom of Kosovo (PTK). Following typical patterns, the PTK, whose board was mainly appointed by the government, refused to publish ads in or give any interviews to the newspaper.

Internet-based media has grown but its impact remains low, and blogging in Kosovo is still in its initial phase of growth.

Threats against individual journalists have also increased, and authorities, albeit amid public condemnation, have not succeeded in ensuring a free environment for journalists to work. Law enforcement agencies and Kosovo's judiciary have not succeeded in returning any verdicts in cases of threats against journalists. The inconsistency between the law on defamation and insults and Kosovo's criminal code still needs to be addressed, as each body of law regulates defamation and insults differently. This creates legal uncertainty over provisions regarding insults and defamation.

Kosovo has no law guaranteeing freedom of information, but does have a law on access to official documents. Authorities, however, do not respect this law and have denied journalists access to public documents in some cases (for example, regarding the Pristina-Tirana highway construction contract).

The Association of Professional Journalists of Kosovo (APJK), the Press Council of Kosovo (PCK) and the Independent Media Commission (IMC) have participated in various activities and eventually raised their voice against political interference in independent media. However, their performance has not resulted in any concrete improvement in the state of freedom of media and expression in Kosovo.

3 | Rule of Law

The separation of powers is defined in Kosovo's constitution as well as a system of checks and balances between the legislative, executive and judiciary. However, this constitutional provision is not respected in practice. The executive branch has constantly and repeatedly interfered in the work of the legislative and judiciary.

Separation of
powers
6

The Kosovo Assembly has been repeatedly criticized for not exercising its constitutional mandate of controlling the government. Parliamentary committees in the Assembly have been ignored by the executive branch, in essence diminishing their parliamentary oversight role.

The judiciary is formally separate and independent. However, political interference of the executive branch in judicial matters is rampant.

The judiciary is formally independent from unconstitutional interventions. Nevertheless, the judiciary continues to be hampered by structural weaknesses. More than 200,000 civil and criminal cases remain unresolved. The system of checks and balances is weak, with the executive branch often interfering with judicial institutions. The European Union Rule of Law Mission in Kosovo (EULEX) is fully operational but has struggled to act fully on its executive mandate, suffering with a lack of unity in Brussels, as five European Union states have not recognized Kosovo as an independent state. The District Court in Mitrovica continues to work only with EULEX judges.

Independent
judiciary
5

In 2010, Kosovo's Constitutional Court issued a number of decisions on the interpretation of the constitution. In September 2010, the court declared it unconstitutional to simultaneously hold the office of president and lead a political party. Following the court's decision, the president resigned but kept his position as the president of a political party. Following his resignation, mutual accusations arose between two main governing parties with the Democratic League of Kosovo (LDK) withdrawing from the coalition, which led to early December elections.

The 2010 Annual European Union Report noted deficiencies in the implementation of the new Kosovo law on pardons. The president pardoned 62 prisoners, including prisoners serving sentences for serious crimes and prisoners who had been refused conditional release. This action showed that political interference has been used to pardon in a few cases.

Kosovo adopted several important judicial reform laws, including laws on courts, state prosecution, a prosecutorial council and a judicial council. The laws however were adopted almost three years later than envisaged by Kosovo's constitution, and reforms will be implemented in 2013. As of January 2011, the Kosovo Prosecutorial Council had not yet started its work and the new criminal code and criminal

procedure code had not yet been adopted. Few cases have been reported of suspects being held in longer pre-trial detentions, especially in the north. The backlog of court cases and the limited capacities of the Mitrovica court continue to hamper the effective delivery of the rule of law in Kosovo.

Judicial reform also included a higher financial remuneration for judges and prosecutors. The increase of salaries will directly influence the situation of judges and prosecutors, but depends on the allocation of sufficient budgetary resources.

There is an overall perception that officeholders can engage in corruption and be immune to prosecution. This is mainly a result of widespread and high-level corruption which dominates the public's perception in addition to the lack of results in the fight against corruption.

The media has been quite successful in revealing the corrupt activities of many officeholders. In many cases, these reports have inspired investigations by prosecutors and in some cases officials were even suspended from their duties. However, there have been only a few cases of officials who have been found to have broken the law who were also properly prosecuted.

The Office of General Auditor has found multiple abuses of public funds by the government and governmental agencies. Authorities, on the other hand, have failed to follow-up on these reports and hold officials accountable. Efforts to eliminate the involvement of political elite in economic life and investigations of political corruption have overall been weak.

During 2010 Kosovo adopted the law on the declaration of assets of public officials and the law on financing of political parties. The recent asset declarations of senior officials have been partially implemented by public officials. In a few cases discrepancies have been noted between asset declarations and the incomes of public officeholders.

The government adopted an anti-corruption strategy and action plan for 2009–2011, but its implementation was hampered by a lack of commitment. Prime Minister Hashim Thaçi dismissed some managers of independent state agencies due to mismanagement in 2010, but the judiciary did not follow suit with any legal accusations.

The European Union Rule of Law Mission in Kosovo (EULEX) has been helping Kosovo investigators, prosecutors and judges, but the mission is made up of far too many police officers and only a handful of prosecutors and judges. In 2009, EULEX initiated a series of investigations in what they called, "hunting the big fish." In this spirit, the mission raided the premises of the Minister of Transport, Post and Telecommunications from the leading government party, the Democratic Party of Kosovo (PDK), including the minister's governmental and private

Prosecution of
office abuse
5

premises. The government reacted hastily to the investigations by condemning the work of EULEX. This case is still under investigation.

In September 2010, the governor of the Central Bank of Kosovo was charged for misuse of official position and for bribery. His trial is pending. Just before the parliamentary elections in December 2010, the former parliament speaker and head of the Democratic League of Dardania (LDD), Nexhat Daci, was convicted on misuse of office. Despite Daci's appeal of the case, his party fared poorly in the elections and did not win enough votes to make it past the 5% threshold to sit in parliament.

Civil rights are guaranteed by the constitution and all institutions are obliged to respect a citizen's civil rights. In addition, Kosovo's constitution defines a list of international provisions that are directly applicable in the Republic of Kosovo, including the Universal Declaration of Human Rights, the European Convention for the Protection of Human Rights and Fundamental Freedoms and its Protocols, the International Covenant on Civil and Political Rights and its Protocols, the Council of Europe Framework Convention for the Protection of National Minorities, the Convention on the Elimination of All Forms of Racial Discrimination, the Convention on the Elimination of All Forms of Discrimination Against Women, the Convention on the Rights of the Child, and the Convention against Torture and Other Cruel, Inhumane or Degrading Treatment or Punishment. However, many public institutions do not take into account provisions of these international documents, including municipal and district courts.

The ombudsperson is a constitutional institution for the independent protection of civil rights and freedoms. This institution's role has been diminished due to a prolonged and heavily politicized parliamentary process of appointing the ombudsperson. Since the new ombudsperson has been appointed, civil society groups and professional personnel from this institution have been spotting inefficiency and negligence in its work.

Civil rights have often been ignored and de-prioritized due to the country's economic situation, with statistics reflecting 45% of the population unemployed and 15% of the population living in extreme poverty. The country's poor economic conditions have also resulted in the diminishing of labor rights.

Kosovo's civil society has played an important role in protection of civil rights in general. Many civil society organizations remain the only voice in this field. However, their capacity to influence government policies and actions remains limited.

Civil rights

6

4 | Stability of Democratic Institutions

The building a legitimate and capable state continues to be the focus of Kosovo authorities and international missions. State-building efforts have been hampered however by the weak and non-transparent activities of the government, led by the prime minister's party.

The law on government was never adopted, and government has continued to work under a United Nations Interim Administration Mission in Kosovo (UNMIK) regulation. In April 2010, Prime Minister Hashim Thaçi reshuffled his government, changing six ministers and creating a new Ministry of European Integration. The changes came as a result of growing public criticism regarding the performance of the government; however, the changes were symbolic rather than substantive.

The Thaçi government collapsed after an Assembly debate over the privatization of the Post and Telecom of Kosovo (PTK). The Democratic League of Kosovo (LDK) requested that the debate be postponed, but the motion did not pass. Prime Minister Thaçi insisted that the strategy be passed by pressuring the Chairman of the Parliament, Jakup Krasniqi, to put the strategy to a vote. Upon the prime minister's insistence, the strategy was passed without a quorum yet annulled the next day by Krasniqi. Direct interference by the government in legislative branch matters and the dissatisfaction of the LDK party grew after Krasniqi's resignation from the party, which then led to the withdrawal of the LDK from government and the breakup of the government coalition. The LDK also saw this as an opportunity to redeem itself from its oft-criticized coalition with the Democratic Party of Kosovo (PDK). In November 2010, MPs from the party Alliance for a New Kosovo (AKR) initiated a successful no-confidence vote, which led to the dissolution of the Assembly. Early general elections were scheduled for December 2010 even though the country was already expecting elections in February 2011, agreed to after the president's resignation in September. The earlier elections motion was in the PDK's interest in order to affirm its position as the leading party in Kosovo.

During the period under review, the Assembly adopted a set of laws on procedural rules, on the rights and responsibilities of MPs and on parliamentary investigations. Parliamentary oversight sessions were attended by government representatives but not ministers. The overall impact of the sessions was limited, as they lacked implementation, such as the request and delivery of written reports. Overall, the scrutiny of the legislative branch over the executive branch was weak as the government continued to interfere with the legislative agenda and activities.

The Assembly Secretariat strengthened the research capacities of the committees. More public hearings were organized but their impact remained minimal. Legislative working groups had difficulties overseeing government activities due to

Performance of
democratic
institutions
6

the dominant role of the governing PDK-LDK coalition. NGOs advocated amendments to the new public procurement law to include that administrative and political staff sign valuable contracts, yet this provision was not voted on in the final adopted version of the law. Further, the recruitment of professional staff for committees was hampered by government's unwillingness to pay staff salaries. Acting through its ministers with parliamentary mandates, the governing coalition prevented the Assembly from adopting the budget necessary to enhance the capacity of parliamentary committees. This shows the lack of autonomy of the legislature from the executive. The 2010 European Union Annual Report also noted that the financial independence of the Office of Auditor General should be strengthened, as the government continues to influence its budget and role as well.

The legitimacy of democratically elected institutions in Kosovo was never questioned until late 2010. The cases of severe fraud that were witnessed during the December 12 elections resulted in many political party, both great and small, questioning the legitimacy of the Assembly and the new government.

Commitment to
democratic
institutions
7

5 | Political and Social Integration

More than a decade since the first political parties were founded, parties remain leader-based with no ideology, shifting policies from left to right depending on the opportunity at hand. Political parties' internal democratic practices remain one of the biggest challenges of the party system. Internal elections are purely formal, while party presidents are not often challenged for their positions. There is also a high polarization of political parties, not only based on ethnic background but also with respect to social values, ranging from left-wing parties (of limited relevance) to parties that stand for unification with Albania.

Party system
7

In the parliamentary elections of 12 December 2010, the Democratic Party of Kosovo (PDK) of Prime Minister Hashim Thaçi won 34 seats in the country's 120-seat parliament. After PDK, the Democratic League of Kosovo (LDK) took second place; while an electoral surprise was the success of the more radical Movement for Self-Determination (Vetevendosje) of former student leader Albin Kurti, which ran for the first time and won 14 seats. The Alliance for the Future of Kosovo (AAK) of former Prime Minister Ramush Haradinaj won 12 seats, while businessman Behgjet Pacolli's Alliance for a New Kosovo (AKR) won eight seats. The Kosovo Serb votes were divided, and are represented by two parties in parliament; the Independent Liberal Party (SLS) held eight seats while the United Serbian List (JSL) held four seats.

Interest groups remain weak and fragmented, and heavily influenced by the largest political parties. The trade unions remain ineffective and very much dependent on the government. Political parties have also sought to influence the Kosovar

Interest groups
6

Chamber of Commerce and the Association of Kosovar Businesses for their own ends.

According to a public opinion survey conducted by the European Bank for Reconstruction and Development in 2010, 68% of Kosovo's citizens consider democracy preferable to any other form of political system and 31% trusted parliament. These percentages fall above European averages.

Approval of
democracy
7

Although there are no real surveys that evaluate social solidarity among citizens, there exists a cultural element of solidarity within society that is strong. However, this solidarity is based on family ties and not around issues that bring interested citizens together.

Social capital
5

II. Economic Transformation

6 | Level of Socioeconomic Development

Question
Score

Economic growth in recent years has not been sufficient to change Kosovo's situation with regard to poverty and unemployment. Kosovo remains the poorest country in the region, with 45% of the population living below the poverty line and 15% living in extreme poverty. The country needs to double its economic growth to achieve an income level similar to that of neighboring countries. The poorest part of the population is concentrated in rural areas, characterized by large households, elderly members and more family dependents.

Socioeconomic
barriers
5

According to the EU Commission, most employment in Kosovo is concentrated in trade (17%), education (13%), public administration (10%) and construction (8%), whereas the share of manufacturing workers is only 10%.

The unemployment rate in Kosovo is approximately 45%. Unskilled workers in 2010 accounted for some 60% of total registered unemployed. About 90% of those who are not working have never worked before, and even among those who have worked before, 98% have not worked for two or more years.

Unemployment among women is higher than among men. Gender differences in employment are due to education levels, cultural norms and labor legislation.

Unemployment continues to be the country's largest problem. Kosovo has one of the youngest populations in Europe, and some 30,000 young people, mostly low-skilled, enter the labor market each year. Despite the country's economic growth, Kosovo's economy does not provide sufficient jobs to absorb new labor market entrants. High unemployment levels and problematic trends make it very difficult

for the country to deal with poverty. However, a large-scale informal employment sector limits the validity and relevance of these statistics. Kosovo has no health insurance system, and the health care budget for 2010 is 3% lower than for the 2009 budget.

Economic indicators		2007	2008	2009	2010
GDP	\$ mn.	4677.4	5641.6	5434.8	5552.3
GDP growth	%	6.3	6.9	2.9	4.0
Inflation (CPI)	%	4.4	9.4	-2.4	3.5
Unemployment	%	46.3	-	-	-
Foreign direct investment	% of GDP	12.9	9.5	7.5	7.4
Export growth	%	-	-	-	-
Import growth	%	-	-	-	-
Current account balance	\$ mn.	-	-	-	-
Public debt	% of GDP	-	-	-	-
External debt	\$ mn.	-	-	358.5	342.2
Total debt service	\$ mn.	-	-	230.3	21.1
Cash surplus or deficit	% of GDP	-	-	-	-
Tax revenue	% of GDP	-	-	-	-
Government consumption	% of GDP	19.6	17.8	18.0	17.8
Public expnd. on edu.	% of GDP	3.7	4.3	-	-
Public expnd. on health	% of GDP	-	-	-	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	-	-	-	-

Sources: The World Bank, World Development Indicators 2011 | International Monetary Fund (IMF), World Economic Outlook 2011 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2011.

7 | Organization of the Market and Competition

A large informal economic sector, widespread corruption and weak rule of law are the main barriers to a functioning market economy in Kosovo. Furthermore, the complicated and costly procedures for opening or licensing a business function as an incentive to push economic actors toward the informal market. Tax administration remains weak and lacks capacity on national and municipal levels. Only 300 tax inspectors are charged with inspecting some 48,000 registered businesses in Kosovo. Thus the informal economy persists and remains an important challenge for the country's economic growth.

Market-based
competition
5

Kosovo recently initiated a program for consumer protection and established a Center for Consumer Protection in Pristina to provide advice to customers on consumer products and services.

In October 2010 the Assembly adopted a law on the protection of competition. The purpose of the law is to align Kosovo's competition rules with the European Union's Acquis Communautaire, in particular by clarifying rules on the abuse of dominant market positions and introducing merger rules. Kosovo's Competition Commission (KCC) investigated several suspected violations of competition rules. Its capacity increased in 2010 with the hiring of additional staff. The KCC investigated cases of price rigging among oil importers and two distributors of cash registers.

Anti-monopoly
policy
7

Major monopoly industries in Kosovo belong to publicly owned enterprises, namely to the Kosovo Energy Corporation (KEK), the Kosovo Electricity Transmission, the System and Market Operator (KOSTT), Kosovo Railways (KR), Post and Telecom of Kosovo (PTK), Pristina International Airport (PIA), among others.

Some organizations lost their monopoly status, such as the PTK, when authorities started issuing licenses for private telecommunication operators. However, most of the other public companies, such as KEK, PIA, KR and KOSTT still have retained monopoly status in their markets. KEK and PTK alone are the two biggest commercial employers in Kosovo, with more than 3,000 employees. On the other hand, the PTK and PIA are the most profitable companies, with combined net profits of more than €50 million (€44 million for PTK and €10 million for PIA).

Corruption within these public enterprises is believed to be widespread and systematic. The enterprises' monopoly status is guaranteed in order to boost profits and serve as massive source of employment, mostly accompanied with graft and nepotism. Private companies in contrast are not given any particular monopoly status.

Regulatory law and institutions are in place but the actual enforcement and integrity of the system is weak; therefore companies most of the time operate under no regulatory pressure. Authorities have placed a five-year moratorium on the issuance of mobile telephony licenses, giving current companies in essence market protection and thus harming consumers by reducing competition. KEK continuously receives annual subsidies from the state budget for importing electricity. Regulatory oversight is inconsistent and weak.

Kosovo's exporters formally enjoy free access to a market of over 500 million consumers. This is because Kosovo is a member of Central European Free Trade Agreement (CEFTA) and benefits from non-reciprocal, customs-free access to the EU market, based on the Autonomous Trade Preference (ATP) regime. The ATP is scheduled to end January 2011, but the regime is expected to be continued as Kosovo aspires to EU membership. Goods from Kosovo also enjoy preferential treatment in the U.S. market.

Liberalization of
foreign trade

9

Despite this formal access, exports to CEFTA countries declined by 15.3%, but the share of total exports remained almost unchanged at 32% in 2009. The European Union and CEFTA countries remained the main origins for imports, with shares of 38.7% (36.4% in 2008) and 36.1% (37.2% in 2008), respectively.

Problems with CEFTA began following Kosovo's declaration of independence. Since then, Serbia and Bosnia and Herzegovina have rejected and blocked goods from Kosovo, as said goods would be exported with a stamp that read, "Republic of Kosovo," instead of the previous label from the U.N. mission in Kosovo (UNMIK). Kosovo exporters have complained about this blockade, which has paralyzed exports as most routes from Kosovo to European countries go through Serbia.

Following the Kosovo armed conflict 1998–1999, the country's U.N. administration in 1999 introduced a two-tier banking system and established the Banking and Payment Authority (BPK). This institution turned into the Central Bank of the Republic of Kosovo (CBK), following the country's declaration of independence, functioning as a central bank and as an integrated financial supervisory agency.

Banking system

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The Central Bank functions as a licensing authority and as a supervisory authority of financial intermediaries, ensuring proper payment systems and services offered by commercial banks. Not having a currency of its own, Kosovo unilaterally adopted the euro as legal tender in 2002 yet CBK is not a member of the European System of Central Banks or of the euro zone. It does not conduct its own monetary policy and is not a lender of last resort. Kosovo lacks its own Swift code, which can result in large financial losses since cross-border transactions are not properly tracked.

The financial sector in Kosovo is bank-based and all of Kosovo's banks are private. There are eight registered banks, of which six are in foreign ownership, hold a

dominant market share and represent around 90% of total banking sector assets. There are 17 microfinance institutions (MFI) operating in Kosovo. Capital adequacy ratio stands at 18.7%, while the minimum required ratio by the CBK is 12%. The ability of the banking sector to remain solvent against increasing non-performing loans, declining interest rates and the depreciation of the euro was assessed through a stress test performed by the CBK, where results suggest a relatively high level of banking sector resilience against the shocks assumed in a hypothetical scenario.

8 | Currency and Price Stability

The Central Bank of Kosovo is not a member of the European System of Central Banks and Kosovo is not formally part of the euro zone, although it uses the euro as its currency. Thus, the CBK cannot and does not conduct its own monetary policy and is not a lender of last resort. On the other hand, the financial sector in Kosovo is almost fully capitalized in euros with some 96% of deposits and loans. This scheme is not exposed to exchange rate risks or the need to guarantee Central Bank liabilities.

In the course of the adoption of the euro, foreign trade was made easier and Kosovo has achieved great progress in terms of maintaining inflation levels close to euro zone levels. Being mainly an import-based economy, inflation closely reflects imports price developments.

The use of the euro as the single currency in circulation has to a large extent also linked the domestic inflation rate to the euro zone inflation rate. However, changes in fiscal policy and to some extent fluctuations in world prices for essential products have contributed to a slightly higher inflation rate for 2010 (and expected for 2011).

According to the EU Commission, the annual average interest rate spread between loans and deposits dropped from 10.6% in 2008 to 10.1% in 2009. This rate, while still high, is thought to be forced by the overall business environment risk perceived by the banks.

In 2009 and the first half of 2010, growth was almost entirely driven by government consumption and investment. Private consumption growth was subdued at 2.1% in 2009, whereas government consumption grew by 16.4%. The budget deficit increased from 0.2% of GDP in 2008 to 0.8% in 2009. Further increases in government spending at this rate pose a risk to macroeconomic stability in the future.

In December 2009, the Assembly adopted a law on public debt that limited the total debt (guarantees included) of central and local government to 40% of GDP. The approval of the law on public debt and Kosovo's membership in the International

Anti-inflation /
forex policy

8

Macrostability

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Monetary Fund and World Bank represent important developments for public finances and the economic development of Kosovo.

As part of the election campaign, Prime Minister Thaçi promised massive wage increases for the public sector, which became a government decision even before the new government was formed and approved. This increased the wage bill for the current state budget and will probably result in a confrontation with the IMF.

The effects of the global economic crisis on Kosovo's economy was mostly channeled through the external sector, namely through the decline of exports, remittances and foreign direct investments, which represent important sources of finance for the economy. Real GDP grew by 4% in 2009 and 5.4% in 2008. Kosovo's economy continued to record a large trade deficit (44.5% of GDP in 2009).

9 | Private Property

Aiming to resolve numerous claims on private property, the United Nations Interim Administration Mission in Kosovo (UNMIK) founded the Kosovo Property Agency (KPA) in 2006. This agency was mandated to enforce legal decisions and administer claims on abandoned properties which remained unresolved due to the armed conflict. The KPA is organized around three pillars: the Executive Secretariat, the Kosovo Claims Commission and the Supervisory Board. So far, 40,855 claims have been recorded, of which 26,468 have been adjudicated by the Kosovo Property Agency claims commission.

Property rights

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Property disputes are unduly prolonged before reaching the courts, and court cases are often repeated due to irregularities either in the judgment or in the proceedings. There is still no law to regulate the sale of apartments where tenure rights exist. According to a report by the NGO Terra Institute, there is no single administrative system to record rights to land. Although the Kosovo Cadastral Support Program (KCSP) tried to reconstruct official records, there is still a gap between official property records and facts on the ground. The EU Commission's 2010 progress report noted that some land registry books are still in Serbia, saying that "only a few municipalities have property rights registers connected to the central land registry."

Privatization in Kosovo began in 2003 with the establishment of a Kosovo Trust Agency (KTA) that was transformed into the Kosovo Privatization Agency (KPA) following the declaration of independence in 2008. The first socially owned enterprises were privatized in July 2003, with a current total of 495, out of which some 50 enterprises are waiting for the completion of contractual agreements.

Private enterprise

7

Socially owned enterprises were transformed into joint stock companies and were registered as new businesses, with shares offered to national or foreign investors

through a bidding process. Funds accumulated from the selling of assets of social enterprises amount to more than €383 million, or approximately 15% of GDP. These funds are invested outside Kosovo and are not actively used in the country's economy. During 2010 the Privatization Agency started liquidating socially owned enterprises for which there were no investors interested in privatization.

On 15 June 2008, a new law on publicly owned enterprises (POEs) entered into force. The law establishes a regulatory framework for central and local POEs, placing them under the overall authority of the Kosovo government or respective municipalities. The government hired a transaction advisor for the privatization of what is seen as the country's greatest asset, the Post and Telecom of Kosovo (PTK), and also hired a transaction advisor for the privatization of the distribution and supply functions of the Kosovo Energy Corporation (KEK).

In July 2009, the Assembly adopted a law on public-private partnerships and concessions. The government awarded the contract for concessions at Pristina International Airport to a Turkish-French consortium, Limak-Airport de Lyon, announced in April 2010. As part of the 20-year contract, the company has committed to investing €100 million, while the Kosovo government will receive 23% to 55% of the revenues.

Major government decisions over the privatization of the Post and Telecom of Kosovo (PTK) and the strategy for building the new Kosova e Re power plant were criticized by NGOs as non-transparent and undemocratic. The privatization of PTK surpassed the discussions of the national agenda and was discussed even by the U.S. Secretary of State Hillary Clinton during her visit to Kosovo in October 2010. Following a series of media addresses by the government, both coalition parties promised Clinton that the strategy for the privatization of PTK will be adopted in the next session of the Assembly. Yet the government's tradition of non-transparent decision-making eventually led to an institutional crisis and early general elections by the end of 2010.

10 | Welfare Regime

Kosovo's budget for social benefits is limited and social provisions are kept low to ensure fiscal sustainability. Due to the limited budget, the welfare regime still strongly relies on the family as a basic unit of social support.

There are several financial assistance schemes, such as the Social Assistance scheme, the Special Needs scheme, War Disability and a scheme for relatives of injured veterans, a basic contribution and pension scheme, and so on. More than 300,000 people or approximately 15% of population are covered by these social assistance schemes. Compensations for social risks are not indexed and also not

Social safety nets

5

adjusted for changes in income or inflation. Social assistance is poorly targeted and also not properly adjusted for the number of family members. In September 2010, Kosovo's parliament adopted a new law on the status and rights of war veterans, martyrs, invalids and civilian victims and their families. This scheme is expected to cost the state budget about €16 million annually, as from 2011.

The social assistance program is weak due for several reasons. Firstly, the value of benefits per recipient household is low and does not guarantee an adequate standard of living. What's more, the program itself has limited coverage due to budget limitations, does not adequately target needy individuals and social workers lack needed skills. All these factors limit the program's impact on improving the welfare of the population.

The pension scheme composes three parts. The first part is a mandatory base pension, given to citizens of Kosovo over 65 years old and without conditions. The second part is a pension based on personal savings. Every employed citizen is obliged to contribute 5% of their income, while another 5% is contributed by an employer. The third, voluntary part allows citizens to place savings with private insurance companies, licensed and monitored by the Central Bank of Kosovo.

The lack of a health insurance laws and a limited budget for health care (only 3% of GDP) shifts expenditure to patients and users and directly affects citizen's welfare and the level of poverty in the country. In principle, citizens of Kosovo have free access to public healthcare, but many health services and drugs must be financed directly by the individual.

Kosovo's anti-discrimination law has been viewed as an advanced document, yet its actual enforcement is poor. There is an overall lack of knowledge among Kosovo citizens regarding issues of discrimination.

The government has implemented an action plan for people with disabilities (2009–2011), supporting several projects such as Equal Professional Opportunities days, International Day of Persons with disabilities, International White Cane Day, and formalized sign language. The government launched a strategic plan for organizing inclusive education for children with special educational needs for pre-university education in Kosovo for 2010–2015.

Nepotism also plagues Kosovo's public sector, where the employment of relatives in senior positions is rife and decision-making is centralized and controlled. Employment opportunities in public and state sectors are heavily politicized.

Equal opportunity
6

11 | Economic Performance

Growth of real GDP slowed from 5.4% in 2008 to 4% in 2009, but is expected to increase in 2010, reflecting a recovery of Kosovo's main trade partners, remittances and increasing foreign direct investments (FDI).

Output strength
5

The demand for exports also increased, while another growth indicator was an increase in government expenditures. Government consumption grew by 16.4% in 2009, while government investment grew by over 30% and topped 10% of GDP. Private consumption growth was subdued at 2.1% in 2009.

Remittances to Kosovo total around 14% of GDP. Around 64% of remittance inflows come from euro countries, mainly from Germany. Kosovo's economy is also significantly dependent on donor funds.

Kosovo continues to maintain a high trade deficit (44.5% of GDP in 2009), reflecting the country's dependence on imports but also a low level of domestic production. Exports of goods are concentrated in only a few products, with the largest share in scrap metals, comprising 64.5% of total exports. In 2009 exports reached 4.2% of GDP, below the 5.1% recorded in 2008. In the first months of 2010, exports showed an increase in nominal terms. The total export level and trade balance largely depend on this single company export and on changes in the international price for metals. Imports of goods fell marginally. The structure of imports shifted from consumer goods to equipment and machinery, and this shift is attributed to the increased investment in public infrastructure. The ratio of exports compared to imports decreased to 12.1% in July 2010, and is still extremely low. However, Kosovo does not have a balance of payment deficit due to its large surplus in capital and financial accounts.

Kosovo's state budget recorded a deficit equivalent to 2.2% of GDP as a consequence of a high increase in expenditures. Expenditures increased by 29.7% compared to a revenue increase of 21.7%. Kosovo's budget revenues consist mainly of border taxes (55.3% of total revenues), rendering the budget dependent on imports and external factors. Budgeted expenditures for 2010 are €2.124 billion. Budget revenues increased to some extent due to dividends from the state-owned Post and Telecom of Kosovo (PTK).

The financial sector expanded by 24.3% in 2009. Its total assets amounted to 72% of GDP. The banking sector has supported an increase in loans. Interest rates have declined modestly but still remain higher than in neighboring or European countries.

12 | Sustainability

Environmental policies in Kosovo have been put under pressure by the effects of urbanization, industrialization, agriculture and general economic development. Kosovo has adopted several environmental laws and policies and established government environmental institutions. However, politicians' and the public's attention is focused more on other priorities. In 2010, Kosovo took several legislative steps toward establishing environmental impact assessments, strategic environmental assessments and implementing rules on public participation in environmental impact assessments. There is good cooperation between civil society and government in implementing environment programs, and around 20% of the projects in the environmental action plan have been completed.

Environmental
policy
5

Kosovo adopted a law on protection from air pollution and monitors discharges from mobile sources. The new law on waste is aligned with EU rules but lacks implementation, and no integrated waste management system exists. There is only one waste water treatment plant in Kosovo. Only 70% of the population has a connection to potable drinking water and only a third to adequate sewage systems. Government institutions lack the ability to prevent or manage the extraction of stone and gravel from rivers and forest land. Kosovo continues to lack resources and staff to deal with environmental issues. Kosovo is not part of the U.N. convention on climate change or the Kyoto protocol, and has no climate change strategy of moderating established greenhouse gases.

Kosovo's education sector remains fraught with problems and delivers insufficient results. The state budget for education is not enough to accommodate the growing numbers of youth and the overall quality of teaching is poor. The country spends only 4.6% of GDP on education, which when analyzed by expenditure per student, shows this investment is minimal.

Education policy /
R&D
5

Kosovo lags far behind other countries in the region regarding higher education. An increase in private universities has resulted in more enrolled students over the past three years. Enrollment in primary education totals 95%. The dropout rate from secondary schooling is worrying and is usually a result of financial hardship. Most schools operate on a shift schedule, due to a lack of adequate space especially in rural schools. School infrastructure and the general conditions of facilities are not adequate and offer little space for recreational or didactic activities, although there has been some progress in the last few years.

The government has carried out reforms to align Kosovo's educational standards with European standards. The academic structure of universities has been changed in accordance with Bologna standards, and a new public university was opened in Prizren. Consultations have taken place with a view to modernize both the law on

pre-university education and the law on higher education. A National Qualifications Authority (NQA) has been established and manages the process of accreditation for all public and private higher education institutions.

Yet importantly the educational sector in Kosovo is still not in line with the needs of the labor market, and Kosovo's graduates are less prepared to compete in regional and European markets.

Transformation Management

I. Level of Difficulty

Since declaring its independence, Kosovo has continued to face challenges in state-building. Kosovo is still governed by a dual state structure, with the lead structure Kosovo institutions while the International Civilian Office supervises Kosovo's independence, the European Union Special Representative oversees Kosovo's path to EU integration and the European Union Rule of Law Mission in Kosovo (EULEX) mentors, monitors and advises Kosovo institutions over rule of law issues while assisting the executive in the investigation and prosecution of organized crime activities, corruption and war crimes. This complex governance structure has continued to hamper general governance and accountability.

Structural
constraints

6

Socioeconomic challenges continue to affect Kosovo's growth and development, such as poverty, low employment rates, minimal foreign direct investments, the effects of corruption and organized crime, a weak rule of law, ethnic divisions (in particular in the north) and a poor education system. Labor strikes have been planned for 2011 if governmental salary increases that were promised in 2010 are not realized.

Kosovo civil society continues to be limited in its engagement. Stemming from a tradition of active citizenry during the 1990s, the non-governmental sector has been its most active since independence during the period under review. Often criticized as donor-driven, the sector has actually managed to develop its initiatives as responses to crucial issues of societal importance, such as democratic governance and the rule of law. Most NGOs however continue to be donor-dependent.

Civil society
traditions

4

A few civic movements, such as the Movement for Self-Determination (Vetevendosje), expressed its political ambitions by registering as a political party in the 2010 national elections.

In general, civil society remains inactive with a limited culture of participation in daily life. In 2010, only 44% of the population participated in the national elections. Public trust in institutions continues to be low.

Socioeconomic tensions remain high, with a number of labor strikes in health services and education. Ethnic tensions still exist between the Albanian and Serbian population, especially in the northern municipalities. In southern municipalities, the Serbian population has continued a process of institutional integration, by participating in local and national elections in 2009 and 2010.

Conflict intensity
5

II. Management Performance

14 | Steering Capability

Question
Score

Government priorities were set from the start of the ruling party's electoral mandate yet have changed continuously since. Overall governance has been based more on ad-hoc decisions rather than on development strategies. Most work has been prioritized to attract voters to support the political parties in power and not on the overall development of the country. The allocation of budgetary resources has been determined more by political considerations and the relative strength of respective ministers than by declared policy priorities.

Prioritization
6

Kosovo made some progress in implementing structural reforms and macroeconomic and microeconomic policies. However, current rates of economic growth are not sufficient to effectively reduce the high level of unemployment. The government has been heavily influenced by a macro-political agenda and by policies that were drafted by foreign countries that supported Kosovo's independence. A lack of capacity coupled with weak administrative performance remains one of the largest hindering factors of state success. Inter-ministerial cooperation has been weak.

Implementation
6

In many segments, government decisions are made on an ad-hoc basis and are mainly reactions to current problems. The role of the international community, including the International Civilian Office (ICO), the OSCE, the European Community and members of the "Quint" (the United States, the United Kingdom, Germany, France and Italy) in drafting policies remains very high. The political leadership has perpetually been involved in a process of policy-learning through such direct assistance. This has kept the dependency level of state officials high.

Policy learning
5

Laws are not even drafted on the basis of policy deliberations, nor do they reflect specific needs or reality on the ground. Officials essentially copy and paste legislation from other countries, often from different legal and social traditions. In certain cases, the government has been forced to defend policies it has not created from criticism from the opposition, civil society and the media.

15 | Resource Efficiency

Public administration continues to be among one of the main sources of employment in Kosovo. An estimated 70,000 employees work as civil servants in Kosovo's public administration. The post-independence government initiated an in-depth review of the public administration, trying in addition to trim its budgetary expenses on salaries. Civil servants continued to be underpaid, with an average monthly salary ranging from €170 to €250. Staff with expertise is thus not interested in such poorly paid work, or cannot even find a post because of a lack of connections. Many skilled workers instead seek employment in international missions/organizations or with local NGOs. None of the recommendations for a functional review of government had been implemented by January 2011.

Efficient use of assets

4

In 2010, the Assembly adopted laws on civil servants and their salaries as well as a law on an Independent Oversight Board for appointments of senior officials. However, the government did not decrease the number of civil servants in accordance with public administration reform, in order to retain the votes of this group in the 2010 elections.

Public administration continues to be heavily politicized, and main managerial positions, such as permanent secretaries of ministries, are appointed based on their particular political affiliations with governing parties. Nepotism-related connections continue to dominate the recruitment of public administration staff, rather than professional criteria. Senior public appointments have not been made in accordance with U.N. regulations, actions which were justified by a lack of legal provisions and their delayed promulgation by the Assembly, which in turn was directly influenced by the government. Such a situation has severely affected the use and management of human resources and budgetary expenditures.

The drafting of the state budget is relatively transparent, and there are regular external audits by the office of the auditor general for each public spending agency. However in most cases, irregularities observed do not lead to legal sanctions. There is still no debt management unit, as the government was not allowed to borrow money (both domestically and in the international capital market). The international community in Kosovo had impressed the philosophy of an annually balanced budget, which led to continual surpluses as many spending agencies lacked the required procurement capacities for the efficient implementation of allocated funds.

The creation of new municipalities and the transfer of power from the central level to local self-governments have progressed. This process, however, has created a new series of administrative problems, as the politicization in municipal level is now even more severe. Most personnel at the municipal level lack appropriate

qualifications and knowledge, especially those working directly in services offered to citizens.

The fragility of fiscal policies can be shown by the example of the government's decision to exceed the Medium-Term Expenditure Framework and increase the salaries of civil servants and health personnel by almost 50% at the end of 2010. This move was heavily criticized by civil society as part of the governing parties' tactics for the upcoming national elections in December 2010. The expenses were heavily criticized also by the International Monetary Fund. An ad hoc approach to fiscal policy has continued, with politicized responses remaining the major determinant of development priorities and economic performance. The feeling of disenfranchisement by citizens from such processes continues to grow.

The process of decentralization was successful in creating new Serb municipalities and a resulting high turnout of Serb voters in Kosovo municipal elections in 2009. However, full implementation depends on solid funding of new administrative structures and the international mission's ability to restore the rule of law in these northern areas. Kosovo's government has hesitated to fully support the new municipalities and postponed a provision of € million allocated for this purpose. By end of 2010, the grant was still not provided but instead given to a foreign donor for implementation.

Policy development in Kosovo continues to be fragmented among the country's national institutions and international missions/organizations. The Thaçi-led government was predominantly characterized as centralized, making most decisions in a non-transparent manner within a small group of political leaders. Non-governmental organizations in particular have critiqued decisions on major national projects as non-transparent and protecting the political interests and gains of the governing political party, including in instances such as the privatization of public companies (Post and Telecom of Kosovo (PTK) and the Kosovo Energy Corporation (KEK)) and the awarding of a Kosovo-Albania highway contract to an American-Turkish company. Policy-making and coordination has been reserved within the Office of the Prime Minister, which is often not well-connected to municipalities or line ministries.

The government has lacked a coordinated approach to accommodate the expectations of international organizations, divided between the U.S. missions/diplomatic missions or the European Union. Neither has the international donor community developed a working coordination mechanism to bridge these communications gaps. In 2009 the government formed a Ministry for European Integration, tasked with the implementation of an action plan for European integration, donor coordination and in particular communications with the European

Policy
coordination
6

Commission Liaison Office in Kosovo. The ministry has been stymied however by a lack of human and budgetary resources.

Kosovo has created a number of institutional policies and legal mechanisms to address corruption. However, the investigation and prosecution of corruption cases has lagged. During 2010 the Assembly allocated sufficient human and financial resources to the Agency Against Corruption. A number of alleged corruption reports have been processed by the agency; however, the successful prosecution of cases has been limited. In general, recommendations to the government by the Office of the Auditor General are poorly implemented. The Assembly also enacted a number of laws to increase the transparency and conduct of Kosovo public officials and of political parties. In this regard, the law on the declaration of assets and of financing of political parties has been promulgated. The laws have been criticized for their “soft” sanctions following a violation of the laws’ provisions.

The judiciary and public prosecutors continue to face structural weaknesses. The insufficient number of judges and prosecutors, inadequate office space and a considerate backlog in criminal and civil cases continues to hamper overall performance. In addition, political interference often influences the perceived independence of the judiciary and prosecutors. For example, the acting Kosovo president altered the final appointment list of judges and prosecutors. Most corruption cases of high-level officials have not been investigated or prosecuted. The EU Annual Progress Report on Kosovo stated that widespread corruption at high levels has persisted despite the publication since 2010 of asset declarations. The declared assets of high-ranking officials on declarations have often considerably exceeded the official’s income.

In addition, the Assembly failed to implement the recommendations of the EU 2010 Progress Report, requiring that the law on public procurement make senior political appointees accountable by adding them as signatories of high-value contracts. The Assembly adopted the new law in December 2010 yet without adopting this recommendation. The European Union Rule of Law Mission in Kosovo (EULEX), which is mandated to investigate and prosecute corruption cases among other cases, in 2010 delivered verdicts on only three corruption and four organized crime cases. Overall, the mission’s weak performance in prosecuting and rendering verdicts over corruption cases has contributed to Kosovo’s weak performance and lack of political will to fight corruption.

16 | Consensus-Building

Most political parties and social groups in Kosovo agree in the building of democracy and in a market economy. Most politicians believe that European Union membership is the inevitable path for the country and so does the vast majority of

Anti-corruption
policy
4

Consensus on goals
9

the population. Polls show that more than 90% of the population aspires to EU integration.

However, the situation regarding a market economy and pro-European policies has changed somewhat with the most recent elections, when the Movement for Self-Determination (Vetevendosje) became a parliamentary political force. Vetevendosje advocates against the privatization of publicly owned enterprises and is against Kosovo's dialogue with Serbia, which is one of the accession conditions set by the European Union. This movement also advocates for Kosovo's unification with Albania. Vetevendosje, however, does not have wide public support on these two main issues, although public support for the idea of unification with Albania has been increasing, according to polls.

The most evident anti-democratic actors in Kosovo are Serbia's parallel institutions of security and intelligence, and the illegal intelligence agencies of political parties.

Anti-democratic
actors

7

Three years after Kosovo's declaration of independence, Serbia continues to support intelligence and security agents that operate in the territory, mostly focused but not limited to Kosovo's northern regions. These agents are under direct supervision of the Government of Serbia and are considered as illegal under Kosovo's constitutional order.

The existence of intelligence agencies of political parties remains unproven. The Kosovo Information Service (SHIK) in 2008 announced that it ceased to exist. This service is believed to have been working to protect the interest of Prime Minister Hashim Thaçi's Democratic Party of Kosovo (PDK); yet many in Kosovo, including whistleblowers and civil society activists, believe the service still continues to operate.

Both the international community and the national leadership are engaged in managing conflicts within Kosovo. During 2010, most interethnic tensions have eased, although international security agencies continue to rate the situation in some areas as peaceful but still tense. The government has shown a greater interest in engaging with the most disaffected groups.

Cleavage /
conflict
management

6

The Serb minority community south of the Ibar River has increasingly continued its process of integration with Kosovo institutions. This was also observed by a turnout of more than 65% of Serb voters in local elections in the Parteš/Partesh municipality. In January 2010, the government, supported by the International Civilian Representative (ICR), drafted a strategy on the integration of northern municipalities. The impact achieved was minimal, and the strategy was put on hold due to Kosovo's early elections in December 2010.

The government has been predominantly closed in its decisions, consulting civil society only formally. Soliciting input is on a partial basis and monopolized by the government which consults only with organizations that hold views close to its own position. Noticeably due to increased international community pressure to include NGOs in decision-making, the government in 2010 started supporting specific groups of NGOs that are kept “in control” by the government. Some NGOs continue to lack conceptual profiling and are donor-dependent. Increasingly NGOs have started to develop their profile and gather around issue-based responses. Kosovo continues to facilitate a culture of civil society, leading often to societal debates and presenting the views of civil society on various issues of public concern. Other parts of civil society, such as academics and scientists, continue to be silent on issues of public concern and rarely engage in government criticisms.

Civil society participation
6

By implementing constitutional and legal provisions derived from the Ahtisaari plan, Kosovo authorities have continued to pursue a policy of decentralization. Not only have new municipalities been formed along ethnic lines but also their legislative and executive structures have been elected and formed, and these municipalities are now functioning. The decentralization process has been rated as one of the most successful policies, not only in structuring new governance but also in reconciling Serbs and Albanians in Kosovo.

Reconciliation
5

In January 2011, the Parliamentary Assembly of the Council of Europe called for an investigation of evidence indicating the illicit trafficking of human organs by the Kosovo Liberation Army during and immediately after the war. Kosovo Albanian politicians denied these allegations, yet the report did not trigger a broader public debate over war crimes committed by Kosovo Albanians.

17 | International Cooperation

The donor community continued to be an instrumental stakeholder in the institution-building process in Kosovo. In 2009, Kosovo joined the World Bank Group and the International Monetary Fund. However, government expertise in this regard has been limited. The government continues to lack human capacities, which affect its ownership in policy and legal reforms often supported by international mission experts. Due to centralized decision-making, the government and the prime minister have failed to respond adequately to the roadmap developed by the international community. For example, by end of 2010, the government ignored the limits in the Mid-Term Expenditure Framework when it increased salaries in the civil service and health sector.

Effective use of support
7

Tensions with Serbia have been moderated by international intervention. The International Court of Justice ruling, which found that the unilateral declaration of independence of Kosovo has not been in violation of international law, has however

Credibility
6

not eased tensions between Kosovo and Serbia. The halting process of recognition was freed by the ICJ ruling, but further recognition of the county continued at a slower pace than expected. By end of 2010, only 75 out of 192 U.N. member states had recognized Kosovo as an independent country.

The government's relatively good cooperation with the international community and the support in particular provided by the U.S. diplomatic mission in Kosovo has diminished during and after Kosovo's national elections on 12 December 2010. The process was heavily criticized as fraudulent, and violations of a free and fair vote have also been reported by observers from the European Network of Election Monitoring Organizations.

Kosovo continues not to be recognized as a state by Serbia, Bosnia, Romania and Greece, where all other regional countries have recognized Kosovo. Serbia has continued to block Kosovo's presence in EU integration processes, such as CEFTA.

Regional
cooperation
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After the positive opinion of the International Court of Justice (ICJ) on Kosovo's unilateral declaration of independence, the European Union and Serbia initiated a resolution of the U.N. General Assembly to acknowledge the ICJ ruling. The resolution calls for a dialogue between Kosovo and Serbia which will be facilitated by the European Union, which is interested in strengthening its foreign service activities in the region.

Kosovo also does not participate in regional cooperation initiatives related to security and defense issues. The five EU member states that have not recognized Kosovo's independence constrain the EU's unified position on Kosovo. In general, regional cooperation with states that have recognized Kosovo has been very good.

Strategic Outlook

The hopes and expectations that were raised following Kosovo's declaration of independence are gradually fading, while the country's political leadership has embraced European integration as its new macro-political agenda to replace the drive for independence. However, an independent Kosovo's positive example of stability in the region has exceeded even the most optimistic forecasts.

Nonetheless, regional stability heavily depends on relations between Kosovo and Serbia, a relationship which is likely to be tested in an upcoming political dialogue to be mentored by the European Union. The next three to five years are critical to overall regional stability and to the successful completion of state building and Kosovo's prospects for European integration.

In the medium term, Kosovo's government and the international presence should ensure the full implementation of the Ahtisaari Comprehensive Status Proposal. This does not only depend on internal actors but also on the behavior of Serbia and the five remaining EU states' recognition of Kosovo's independence. In the long-term, overall reforms are needed so as to strengthen the rule of law, to facilitate sound and sustainable economic development, to reconcile the skills and training of the labor force with the needs of the labor market, to fully integrate the Serb community within Kosovo's institutions, to increase investment in strategic R&D areas and to reform public administration, health and education. These much-needed reforms should not be sacrificed amid the perceived threat of instability. The political leadership should develop a more autonomous policy-making capacity and gradually free itself from its dependence on the international presence in Kosovo.

The transformation strategy should focus on the following key elements:

- **Strengthening statehood:** The Kosovo government should develop a comprehensive plan to outline and specify a realistic strategy for including northern Kosovo within a single legal and political framework. Simultaneously, this plan should also address the empowerment and development of Serb settlements in other parts of Kosovo. The international community should sincerely commit to solving these problems, and it should not undermine Kosovo's stability and development to preserve the power of the political leadership in Serbia. The International Civilian Office (ICO) and the European Union Rule of Law Mission in Kosovo (EULEX) should resolve their differences on Kosovo's status and rigorously stick to executing their mandates in support of Kosovo's statehood.
- **Rule of Law:** Kosovo should demand a better performance from EULEX in establishing the rule of law throughout the territory. EULEX has an exclusive mandate to combat war crimes, organized crime and corruption, but should also be mandated as the sole authority to establish the rule of law in northern Kosovo before local authorities will be able to take over.

- **Regional Efforts:** Kosovo authorities will enter a dialogue process with Serbia during 2011. This dialogue is expected to be focused on rather technical issues, but it should also serve as a good platform for future political reconciliation between the two countries.
- **International legitimacy:** The political leadership should utilize all of Kosovo's capacities to create and implement a credible foreign policy strategy as well as to open channels of communication with countries that have yet to recognize it. The International Steering Group (ISG) that has assisted in supervising the country's independence must adopt a comprehensive strategy to strengthen Kosovo's international legitimacy in addition to its supervision of Kosovo's authorities. The European Union should quickly reach consensus on Kosovo's tangible European integration path, which should be in line with formal association and stabilization processes and accelerate Kosovo's process of catching up with other countries in the region.