EUROPEAN UNION

UNMIK

European Union Pillar

The 10 Key Achievements

End of Mission Report
1999-2008

September 2008

"Job Done!"

This report marks the closing of Pillar IV of UNMIK, also known as the EU Pillar. After nine years of intensive work, the Pillar has ceased operations on 30 June 2008. According to United Nations Security Council Resolution 1244 of 10 June 1999, the task of the Pillar was to support the "reconstruction of key infrastructure and other economic reconstruction", but also – in line with the overall imperative for UNMIK – to establish provisional institutions for self-government in the economic field and to transfer its administrative responsibilities to these institutions, while overseeing and supporting their consolidation.

Economic reconstruction and setting the foundations of a stable market economy were a considerable challenge, but I know that the Pillar has done its job. The Pillar's ten key achievements support this statement. Today Kosovo has the legal framework that a modern market economy needs: laws favourable to business creation, an investor friendly tax system, and rules and regulations that protect the entrepreneur as well as the consumer. Banking and insurance supervision has been established. The private sector has received a boost from a successful privatisation process. Market regulators are in place and public utilities are on the sometimes painful path of modernisation. Kosovo can be proud of one of the most modern and efficient Customs services in South East Europe. And a number of agreements have integrated Kosovo's economy into the region's, thus paving the way for a common European future.

Moreover, the Pillar led the establishment and development of local economic institutions by assisting in the drafting of required legislation, developing organisational structures, and following through with on-the-job mentoring, and functional engagement in the substantive tasks.

Work remains to be done, but I am sure that the Kosovo authorities, together with the business community and international support, will continue to create conditions that will allow for increasing economic growth and much needed job creation. Further progress depends on firm local ownership and its capacity to preserve and further develop the achievements of the past eight years.

I would like to express my gratitude to the partners who supported us in these years. First, without the European Commission's readiness to provide the funding and invaluable partnership and guidance on EU matters, the Pillar would have never come into being. And the Pillar's work greatly benefited from the financial, technical and political assistance of the European Agency for Reconstruction, the European Union member states and their donor agencies, the US Government and USAID, the World Bank, the International Monetary Fund, and other important bilateral donors.

Last but not least, I would like to commend all EU Pillar staff, who throughout the years has made this organisation a success. Some 450 international and local colleagues worked closely together in a spirit of trust and mutual support, and with many of them continuing their work in the institutions of Kosovo the EU Pillar is proud of its sustainable legacy.

Paul Acda
DSRSG EU PILLAR

Achievement 1:
Bringing Innovation to Institution Building

On 10 June 1999, the United Nations Security Council passed Resolution 1244 establishing the United Nations Interim Administration Mission in Kosovo (UNMIK). In comparison to 'traditional' peacekeeping operations, UNMIK was mandated to exercise an unprecedented scale of administrative functions "where and as long as required". These included the support to the reconstruction of key infrastructure and other economic reconstruction, the development of provisional institutions for democratic and autonomous self-government and the transfer of administrative responsibilities to these institutions.

In this context, the UN entrusted the European Union with the task of economic reconstruction. To this end, the EU decided to establish and finance the "European Union Pillar" (officially: UNMIK Pillar IV for Economic Reconstruction). For the first time in history, the EU, as a regional player, took the lead for a policy area of a UN mission.

From Shared Powers to Transferred Competencies

Following its establishment in 1999, the Pillar engaged in four economic departments of the Joint Interim Administrative Structure that UNMIK had introduced in Kosovo, the Department of Reconstruction (DoR), the Central Fiscal Authority (CFA), the Department for Trade and Industry (DTI), and the Public Utilities Department (PUD). Each department was co-headed by an international and a Kosovar expert.

In May 2001, the "Constitutional Framework for Provisional Self-Government in Kosovo" laid the foundation for a new system of power separation and sharing between UNMIK and the new "Provisional Institutions of Self-Government" (PISG).

The Constitutional Framework "transferred" most administrative powers to the Government and the Assembly of Kosovo that arose from elections, while "reserving" specific powers to the SRSG. The latter encompassed in the economic area the administration and regulation of all publicly and socially owned enterprises, monetary policy, and the final authority to set the financial and policy parameters for the

UNMIK Pillar IV premises in the Central Government Building

Sparkling lights – Pristina at night

Kosovo Consolidated Budget (KCB) and its final approval. The transfer of economic competencies, in particular in the budget sphere, had already been largely completed at the beginning of 2003. This was in line with the explicit desire of the large majority in the international community to have the PISG take over substantial responsibilities in economic policy making and implementation.

Consequently, the Government became responsible for a wide range of economic competencies, and the following Ministries are today operative:

- The Ministry of Finance and Economy (MFE), which develops and executes the Budget and the Medium-Term Expenditure Framework (MTEF), oversees tax collection, tax administration and tax policy initiatives; coordinates with donors; and monitors compliance with rules and procedures for public expenditure.
- The Ministry of Trade and Industry (MTI), which develops policies, legislation and programmes to promote industrial and commercial enterprises; facilitates external trade and investment promotion; and runs the Business Register.
- The Ministry of Transport and Communications (MTC), which develops policies and legislation in the sectors of road transport, information technology, post and telecommunications; establishes and supervises standards for service providers and infrastructure; develops infrastructure maintenance and construction programmes and carries out respective procurement activities.
- The Ministry of Energy and Mining (MEM), which is responsible for the development of policies and legislation in the energy and mining sectors and – importantly – coordinates the project to build a new lignite-fired power plant in Kosovo.

The years after 2003, when the Government and key donors were initially very eager to see UNMIK let go of economic competencies as quickly as possible, also saw an increasing interest of the donor community and the Government in joint economic initiatives between UNMIK and the PISG. The EU Pillar actively promoted and moderated such initiatives, in particular the following:

- The Trade Policy Working Group, which advised relevant institutions on trade policy, prepared negotiations on Free Trade Agreements, and identified trade-related technical assistance needs. The group worked out a comprehensive policy paper in 2004, which served as a basis for trade policy in the years thereafter.

- The Economic Strategy and Project Identification Group (ESPIG), on the other hand, initiated work on a comprehensive economic strategy.

Bringing Innovation to the UN Interim Administration

The task to create sound foundations for a market economy required UNMIK to explore new ways to carry out its mandate. A UN peacekeeping mission has never before been so deeply involved in economic development. It was the EU Pillar that introduced crucial innovations. The most prominent of them were the promotion of Kosovo's regional and European integration, as well as the launching of a privatisation process.

Going out – UNMIK Pillar IV press briefing

While the 'traditional' approach to mission policy focussed on the interim character of UNMIK's mandate and cautioned to engage into new areas alien to past UN peacekeeping activities, the EU Pillar pointed out the necessity to create viable, competitive economic institutions, and the costs of non-action in terms of development and stability foregone. This seemed even more important as UNMIK's mandate, while being interim, was de facto open-ended and therefore threatened to leave Kosovo in a limbo at a time when the rest of the region was making substantial progress in restructuring its societies and economies and moving towards closer European integration.

Consequently, the EU Pillar's policies to promote economic development went beyond narrow reconstruction tasks and were driven by the goals of fostering the sustainable development of a market economy in Kosovo. The regional initiatives of the Stability Pact for South Eastern Europe and the EU's Stabilisation and Association process (SAp) were the most important European 'policy anchors' in this respect. The Pillar took the lead in convincing the key international stakeholders that openness to institutional innovations aimed at integrating Kosovo in the wider European structures was the right way ahead.

Regional and European Integration

After the Kosovo conflict in 1999, the international community created the Stability Pact for South Eastern Europe to promote cooperation in the region and its further integration in Europe. In December 2002, the Regional Table in Thessalonica explicitly mandated the Pact to "actively consider ways in which Kosovo, in accordance with UNSC Res. 1244, could be more integrated into the neighbouring region by fostering greater cross border/ boundary cooperation."
On this basis, the EU Pillar, with strong support from the European Commission, focussed on making headway on the substance of regional integration:

- Bilateral Free Trade Agreements were negotiated with Kosovo's neighbours, thus integrating Kosovo into the network of bilateral FTAs under the auspices of the Stability Pact's Working

Group on Trade Liberalisation and Facilitation. These activities culminated in 2006 with the inclusion of Kosovo in the enlarged Central European Free Trade Agreement (CEFTA).

- Energy became a major focus for regional integration. The EU Pillar ensured that UNMIK signed the so-called Athens Memoranda in 2002 and 2003, as well as the Energy Community Treaty in October 2005, with a view to creating a single energy market that enhances energy security in Europe and conditions to attract foreign direct investment. The latter is particularly important for Kosovo, which has the chance to develop the electricity sector as a source of economic growth and public welfare due to vast lignite reserves.

- Transport integration was mainly promoted through a Memorandum on the South East Europe Core Regional Transport Network in 2004, which also set up the South East Europe Transport Observatory (SEETO) as a regional secretariat

- Bilateral operational mutual cooperation agreements were signed with Customs Administrations and Services of neighbouring countries, and with Serbia. These allowed for the exchange of information and intelligence as well as mutual assistance, all of which are vital in dealing with cross border crime, ensuring that compliance is at a high level and maintaining revenue flow and trade facilitation.

- Finally, UNMIK integrated Kosovo into the 2006 European Common Aviation Area comprising South East Europe, the EU Member States, as well as Iceland and Norway.

The Pillar followed an approach of 'functional engagement', which allowed Kosovars to increasingly determine the respective policies for Kosovo. In line with this approach, the Pillar always included representatives of Kosovo's institutions in the delegations that negotiated these agreements, and ensured that they were increasingly involved in the formulation of negotiation positions and implementation strategies.

Towering tall – Coal processing facility at the Kosovo Energy Corporation power plant in Obiliq/Obilic

Creativity was also required in the development of direct relations between Kosovo and the European Union. Following requests from the EU Pillar, the European Commission decided to establish a Tracking Mechanism (STM), which allowed Kosovo to participate in the Stabilisation and Association process (SAp) for the Western Balkans.

Transforming Social Ownership into Private Property


After hours – Wine settling at the privatised Rahovec/Orahovac processing plant

A domestic economic policy area where the traditional approach to interim missions soon reached its limits was the fate of some 500 socially owned enterprises (SOEs). The EU Pillar and the largest donors favoured a quick privatisation of these enterprises. This was not met by unanimous support. Especially within the UN caution of such a radical intervention that had been alien to former UN missions was expressed. A change in property rights, it was initially suspected, would go far beyond an interim administration mandate and should therefore not be part of UNMIK's activities. However, private sector interest in a "commercialisation" scheme (under which enterprises were given into several year leases) remained low.

Soon, conflicts around management appointments and industrial action emerged in these enterprises, and weak governance structures led to the stripping and further deterioration of assets. In order to prevent the situation from further deteriorating, the SOEs were therefore brought under the trusteeship of a new Kosovo Trust Agency (KTA). The KTA's mandate for SOEs combined well-known privatisation elements with an almost unique trusteeship concept, where potential owners and creditors were encouraged to file claims in parallel to the ongoing privatisation. While the first privatisations in 2003 soon revealed some shortcomings in the initial legislation, the process gained full speed in 2005.

This approach brought important assets into legal productive use, while keeping the proceeds in trust for potential owners and creditors. Moreover, it created a stratum of new private owners of companies in Kosovo, who now have an interest in further development of the Kosovo economy and its relations to neighbouring ones.

Achievement 2:
Sound Foundations of a Market Economy

An undisputed success of the engagement of the EU Pillar has been the creation of the foundations of a modern market economy from scratch. Kosovo today boasts a stable macroeconomic environment anchored on the use of the Euro and prudent fiscal management, a very modern and business-friendly legal framework and a stable and growing financial sector. The establishment of a modern tax regime with a broad base and low, uniform rates; as well as a light regulatory regime for private enterprises have created fertile ground for private sector growth.

On site – DSRSG Joachim Rücker talking to workers of the mining combinate "Trepça"

This is in large parts due to the Pillar's adoption of a development strategy that took into account the lesson that economies with relatively weak or nascent governance structures should refrain from a sophisticated industrial policy and rather concentrate on

(i) macroeconomic fundamentals,

(ii) a generally favourable environment for private sector development, and

(iii) basic infrastructure supporting business activities.

On the basis of these three fundamentals, the strategy concentrated on the following four basic objectives:

(i) *Stable macro-economic framework.* Macro-economic stability has been achieved mainly through the introduction of the Euro as the currency in use, and the impossibility for the Kosovo Budget to run a deficit. In 2002, a first Medium-Term Expenditure Framework was introduced, allowing for budget expenditure prioritising and planning. In this exercise it also became obvious that planned projects dramatically exceed public financing capacities, and that Kosovo's economic development will only be successful if private capital can be increasingly mobilised.


Spinning the yam – Privatised company "Trepca Confection"

(ii) *Implementation of institutional and legal reforms.* The process started in 1999 and now Kosovo has, by and large, the necessary legal instruments that regulate the operations of a market economy. This legislation is almost fully compatible with EU standards. They govern company registration and operations, property rights, internal and external trade activities, external investment, transportation, procurement, regulation of telecommunications, public broadcasting, and energy markets, as well as other areas of economic activity. Importantly, in 2006 an independent survey rated Kosovo's legal and regulatory infrastructure the most business friendly environment in the region.

(iii) *Rehabilitation of key infrastructure.* Reconstruction, thanks to the support of many donors, has been a major success, both in social (housing, education and health care facilities) and general infrastructure (roads, railways, water, waste, energy). Reconstruction of transport infrastructure has focused on the rehabilitation and upgrading of the existing major road and rail networks, through which Kosovo can now be adequately linked to its neighbours and the trans-European transport corridors. Pristina airport has not only developed its passenger, but also cargo facilities. And even though energy supply still remains a major infrastructure bottleneck, heavy investment and capacity building helped to almost double electricity production since the conflict.

Moreover, the Pillar launched the process for the construction of a new power plant (Kosovo C) combined with the development of new mines. This major initiative aims to overcome Kosovo's energy deficit and to contribute addressing the regional generation deficit alike, in line with the conclusions of the World Bank's regional Generation Investment Study. In March 2006, a Project Steering Committee (PSC) comprising all relevant stakeholders was established under the chairmanship of the Minister of Energy and Mining. As a result of a pre-qualification process carried out by the PSC, four international consortia qualified as prospective bidders. In the second half of 2007, the project entered into its next phase with the help of World Bank funded technical advisory teams.

(iv) *Creation of an effective financial sector.* Effective banking supervision through the establishment of the Banking and Payments Authority of Kosovo (BPK, later transformed into the Central Banking Authority of Kosovo, CBAK) has allowed for the sound development of the emerging financial sector.

(v) *Effective tax regime.* The tax system (VAT, profit tax, wage tax, municipal property tax) is simple, transparent and does not put a heavy burden on enterprises. Exports are duty free, the average import tariff of 10 % is low, and measures promoting investment have been introduced.

Achievement 3:

A Self-Sustaining Budget for Kosovo

Since 1999, international donors have invested some €3 billion in Kosovo. Initially, this assistance focused on budget support, emergency relief, housing reconstruction, basic services and security. Increasingly, donor attention turned to reconstructing the physical infrastructure and to creating and enabling a legal and institutional environment for economic reconstruction, shifting away from direct budget support.

Relations with Donors and International Financial Institutions

In order to practically fulfil the EU's reconstruction mandate in Kosovo, the Administrative Department of Reconstruction (DoR) was established by the EU Pillar in March 2000, and continued its work until 2003 when its competencies were transferred to the newly established Ministry of Finance and Economy.

Kosovo is a passive member of the Eurozone

From June 2000 to March 2003, the DoR launched a Public Reconstruction Investment Programme (PRIP) and developed a database to monitor the reconstruction process (Reconstruction Intervention Monitoring System, RIMS). With analytical input to donor conferences and the donors' Working Level Steering Group, which was regularly meeting under the auspices of the European Commission and the World Bank, DoR helped to attract and channel around €2 billion donor assistance towards reconstruction priorities. The European Agency for Reconstruction and USAID were the lead donors for Kosovo, greatly supported by grants of other bilateral donors and the World Bank.

With the funds attained, 50,000 houses damaged or destroyed during the conflict were reconstructed. In the education sector, 57 new schools were built and around 130 others refurbished. This made possible the return of over 462,000 pupils to the school system and of around 20,000 students to university. In the health sector, 30 family health centres throughout Kosovo were renovated and important investments were made in hospitals. 500 kilometres of road were repaired and 6 bridges rehabilitated. Intensive efforts were also made in the energy, agriculture, and water supply sectors, as well as in private sector development.

Pillar IV has also been instrumental in bringing about important economic accords with key International Financial Institutions (IFIs) that have enforced fiscal discipline and assisted economic development in Kosovo.

In March 2005, UNMIK signed a Memorandum of Understanding (MoU) with the European Bank for Reconstruction and Development (EBRD), which greatly facilitated this institution's operations in Kosovo. Based on this memorandum, the EBRD has lent considerable amounts to Kosovar commercial banks such as Kasabank and the New Bank of Kosovo.

In May 2005, UNMIK concluded a Framework Agreement that the Pillar had negotiated with the European Investment Bank (EIB) – the European Union's long-term financing institution. The EIB in 2007 extended a €10 million loan for a SME facility to Raiffeisen Bank in Kosovo, and in 2008 expressed the intention to make a €100 million loan to the benefit of the second mobile phone network in Kosovo.

In October 2005, the International Monetary Fund (IMF) agreed with the authorities of Kosovo on a fiscal framework for the remainder of 2005 and for 2006. As a result, the Special Representative of the Secretary-General of UNMIK and the Prime Minister signed a Letter of Intent and a Memorandum of Economic and Financial Policies with the IMF in November 2005, thus giving Kosovo's public expenditure control policy international credibility.

Fiscal Affairs

At the initial stages of its mission, in order to set up a budget for Kosovo, the Pillar established a Central Fiscal Authority (CFA) responsible for the overall financial management of the Kosovo Consolidated Budget (KCB). The main focus of the CFA was to put in place a budget system and build capacity to collect taxes and administer domestic revenues.

By 2002, some 330 Kosovars had been hired and trained in the areas of macroeconomic forecasting, budget development and implementation, treasury functions, internal audit, revenue analysis, tax collection, and customs administration. In line with UNMIK's transfer of responsibilities, the Government of Kosovo took over the functions and staff of the CFA at the end of 2002, and those of the Tax Administration in 2003.

From the outset, Pillar IV also assisted in designing a tax system and rapidly established tax collection at the borders. In a relatively short period after 1999, a simple tax structure was put in place comprising of customs duties, excise tax, sales tax and later VAT on imports. As the tax base grew and the economy expanded, the fiscal system became stronger and revenue streams increased. As mentioned, donor

Institution building – The refurbished government premise in Pristina grants to the budget were a major source of financing in 1999 and 2000, but by 2003 covered less than 5% of total expenditures and further decreased since then.

Domestic revenues have performed impressively. General budget revenues in nominal terms grew from €128.5 million in 2000 to €891.4 million in 2007. Although domestic revenue performance has improved drastically, revenue collection is still very dependent on taxes collected by Customs, which constitute around 60% of the total tax revenue. At the end of 2007, Kosovo's public finances were characterised by buoyant tax revenue coupled with conservative expenditure planning and weak capital expenditure execution leading to a budget surplus in the magnitude of 7% of GDP.

The outlook for tax revenue in 2008 remains positive, underpinned by projections for continued economic growth and improved tax collection. Domestic revenues are expected for the first time to break the €200 million threshold. The KCB envisages a substantial increase of budget expenditure mostly driven by investment need priorities in a Public Investment Programme.

Following the transfer in 2003, the Pillar's fiscal competencies were bundled in the newly created Fiscal Affairs Office (FAO), which advised the SRSG in respect of his overall responsibility to set the parameters for and approve the KCB. Moreover, FAO also provided advice and assistance to the Ministry of Finance and Economy regarding budget development, budget management, the Medium Term Expenditure Framework, revenue forecasts, and the operation of the Tax Administration. FAO staff also contributed to improving the management of public finances through membership in various Boards and committees such as the Central Banking Authority of Kosovo (CBAK) Governing Board, and the Governing Board of the Kosovo Pension Savings Trust.

Considering the starting point, the progress achieved in this area of fiscal affairs is impressive. However, some challenges remain. The audit reports on the KCB reveal many weaknesses and inefficiencies in the management of public money. The implementation of public investment projects remains weak, as demonstrated by substantial under-spending in capital investments. There are deficiencies in the administration of domestic taxes that need to be tackled in order to improve the business climate, without, however, eroding the budget revenue base.

Office of the Auditor General

In 2002, UNMIK established the Office of the Auditor General (OAG) as an independent public institution. The EU Pillar set up the organisation from scratch by hiring the relevant expertise, and providing full administrative support. The OAG started operations in 2004. Pillar IV has continued to fund international experts in the organisation, and a number of support staff until the end of its mandate.
Since then the OAG has made significant progress in fulfilling its mandate. Local trainee auditors have been hired and given an intensive training programme. As a result, in 2007, the OAG completed 52 audit reports covering the Kosovo Consolidated Financial Statements, the Kosovo Trust Fund from privatisation receipts, 20 Ministries, and 30 Municipalities. This intensive work has continued in 2008.

The OAG can still be considered a developing organisation. The ultimate goal is to enable local OAG staff to audit KCB with minimum international assistance. It is standard practice for a fully operational Supreme Audit Institution to take up to ten years to establish. And as there is no tradition in external auditing in Kosovo, international expertise is necessary to provide sufficient audit support, and to carry out the required capacity building in all elements of audit practice.

Achievement 4:

A Modern Customs Service

Soon after its inception, UNMIK recognised the necessity to form a Customs Service, as a way to provide revenue for public expenditure. Contributing to this endeavour, the European Commission deployed a Customs Assistance Mission in Kosovo (CAM-K) to help with the technical and advisory aspects of building a customs service using the European Union Customs Blueprint as the model. In September 1999, the UNMIK Customs Service was formed by CAM-K with 38 local customs staff. The United Kingdom agreed to fund an international professional to head the service, and later what became a small team of international customs professionals in his support. Pillar IV took over the funding requirement for this international team from 2004 onwards.

Now Kosovo boasts a simple and effective customs regime based on a 10% duty on imports and an extended list of duty exemptions for raw materials, production inputs, and capital equipment. It also includes incentives for efficient inward processing and re-exporting. These instruments make Kosovo's customs regime conducive to private sector development.

Freight Watching – UNMIK Customs at work

A new Customs Code was introduced in March 2004. Based on the EU Customs Code, it introduced the same legal, human rights, and economic standards, making an important contribution to the modernisation of the economic legislation.

UNMIK Customs has grown to a current establishment of 567 staff with all the facets of a modern customs service, and is still the mainstay of Kosovo budget revenue. The international staff members in executive authority were phased out during 2006, and from 1 April 2007, the service was wholly Kosovarised with the appointment of a local Director General.

The only area where the Pillar continued to employ international staff has been in the activities of the Customs Compliance Unit (CCU) based on the so-called "North Plan". A main focus of the Plan was to assist in the strengthening UNMIK Customs risk management and law enforcement countering corruption and organised criminal activities as manifested north of the Ibar. It particularly focused on mutual assistance under relevant protocols concluded between UNMIK and Serbian authorities. The Plan had a major effect and revolves around a combined approach with police and KFOR and mutual assistance within regional structures and neighbouring administrations, especially Serbian authorities. The CCU activity will need to be carried forward by the customs component of the EULEX mission.

The establishment and maintenance of UNMIK Customs is a major success story. Assessment in the context of regional initiatives and bench marking exercises suggest it is the most effective in the region; demonstrating that the model adopted for its development, as detailed above, has been very effective. The Service's continuing success will depend on its capacity to adhere and adapt to the evolving requirements regarding Customs coming from the European Union.

Achievement 5:
A Stable Banking and Insurance Sector

One of the first decisions made by UNMIK at the beginning of its mandate was to set up the Banking and Payments Authority of Kosovo (BPK). This institution was transformed into the Central Banking Authority of Kosovo (CBAK) in 2006, in order to enlarge its capacities and strengthen its independence.

The CBAK is an independent authority that supervises all financial and insurance institutions operating in Kosovo, and simultaneously performs central banking operations with the exception of any issuance of money since in Kosovo the Euro is the *de facto* legal tender. Having in mind that due to the 1999 conflict all financial institutions previously operating in Kosovo had virtually disappeared; the BPK, and then the CBAK, have come a long way in facing the enormous challenges that this situation posed.

A major achievement was the restoration of public confidence in the banking sector and in the currency in use, after years of chaos, neglect, inflation, and financial crises. In this respect, the use in Kosovo of the Deutsche Mark and then of the Euro were crucial. Monetary stability has prevailed since early 2002, despite an unexpected inflation peak in 2007 (4.5% in retail prices) due to a boost in prices of some imported raw material and agricultural goods. Deposits in commercial banks have continuously increased from €93 million to over €1.1 billion from 2000 to 2007, and the loans-to-deposits ratio has gone up from 3.6% to 78% during the same period.

The CBAK has promoted and implemented a modern legal and regulatory framework of the financial sector. The great majority of the provisions of the applicable legislation are compatible with EU Directives or international best practices. On the basis of this framework, the CBAK was able to take strong enforcement measures – including the closure of one bank in 2006 – in order to keep the stability of the financial system and to protect depositors.

Regarding the financial institutions themselves, a good variety of actors now operate in Kosovo. In particular, the banking sector is close to an ideal structure with a combination of three types of banks: international, regional and domestic. Indeed, not only has the CBAK continuously promoted or directly taken actions to strengthen existing financial institutions, but it has also tried to attract new players able to enlarge the scope of financial services supplied to the local market in sound and safe conditions. In the

In the heart of the capital – The Central Banking Authority in Pristina insurance industry, while basic insurance products are supplied by a large number of institutions, the consolidation of the market is still ongoing with an increasing involvement of foreign owned companies, and an expected extension of supply towards non-compulsory products such as life insurances.

As a consequence of the internationalisation of Kosovo's financial sector, the CBAK has signed several Memoranda of Understanding with supervisory authorities from the countries of origin of some actors operating in Kosovo. These memoranda make possible an exchange of confidential information on a legal basis and foster international cooperation between authorities.

CBAK has also successfully applied for membership in the main specialised associations of supervisors: as of June 2005, it is a member of the International Association of Insurance Supervisors (IAIS), and as of September 2005, a member of the International Organization of Pension Supervisors (IOPS). On February 2007, it became member of the Institute for Internal Auditors (IIA). CBAK is an observer member of the Group of Banking Supervisors for Central and Eastern Europe, and is listed by the General Secretary of the Basle Committee as the Banking Supervisor in Kosovo. Moreover, the CBAK has embarked in different bilateral cooperation with other supervisory agencies in the Balkans on technical matters such as on site inspection, payments systems, and statistics.

Managing Director Hashim Rexhepi (left) talking to Kosovo President Fatmir Sejdiu (right)

Amongst other useful services created by the CBAK in the last years, is the creation of an efficient inter-bank payment system, and a modern Credit Registry. In addition, the CBAK regularly publishes a wide range of statistical data on economic trends as well as developments in the financial sector, and since 2006 these include Balance of Payments statistics.

Intensive capacity building conducted with the generous assistance of many international partners has allowed a gradual transfer of competencies from international experts to local staff. In fact, with the appointment of a Kosovar Managing Director in March 2008, the CBAK is a fully Kosovarised institution. The international community, however, will continue to provide support through both long term and short term technical assistance.

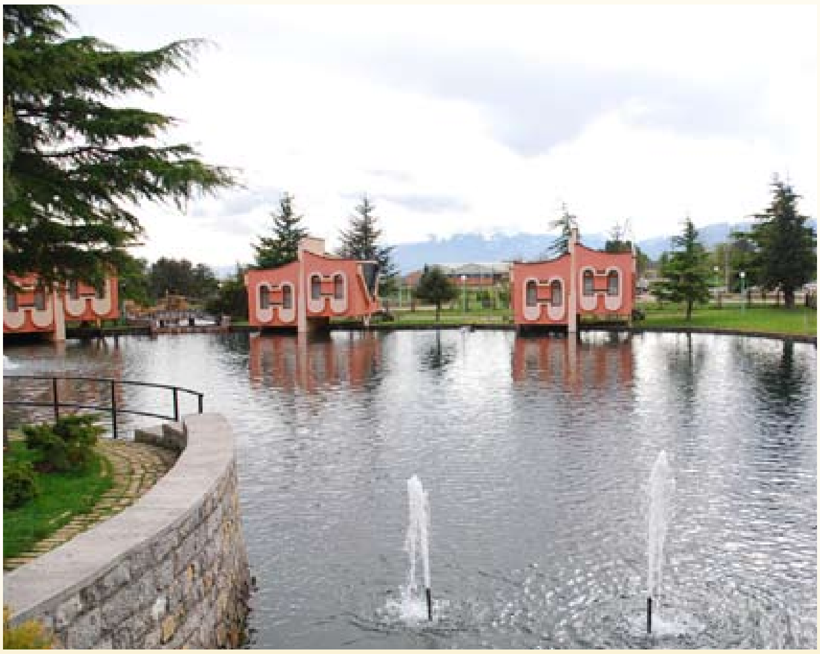
Achievement 6:
A Successful Privatisation Process

The EU Pillar and the Kosovo Trust Agency (KTA) have successfully carried through one of the most rapid privatisation programmes in Europe. The Pillar's role was three-fold: the preparation with support of donors of the privatisation legislation, the establishment and financing of the KTA's operations and representation of UNMIK on the KTA's board of directors.

Kosovo's socially owned enterprises (SOEs) operated in all sectors of the economy, and it is estimated that they represented 90% of Kosovo's industrial assets. A significant lack of investment in plant and equipment, combined with a lack of modern corporate governance, and frequent changes in entire managements and workforces due to the political conflict in the 1990s, caused the SOEs to become, by the time of UNMIK's inception, ineffective business organisations. The loss of market share for SOE products had also made the majority of SOEs effectively bankrupt.

The first set of legislation for the privatisation of these SOEs was passed in mid-2002. Subsequently, the Kosovo Trust Agency (KTA) was established to act as a trustee for any potential owner of socially or publicly owned enterprises. The KTA's mandate combined well-known privatisation elements with an almost unique trusteeship concept. SOE land titles were given into 99-years leaseholds.

However, in the first two and half years following the establishment of the KTA only a handful of SOEs were privatised and in 2003/4 the privatisation process came to an almost standstill. This was because the KTA considered the legislation setting out the KTA's mandate had failed to address fundamental legal issues of social ownership that undermined the KTA's ability to proceed with the privatisation process. The legislation was amended in April 2005 and since this date the KTA launched 30 waves of privatisation.



Salmon pink – Garden of privatised "Trofta Fish Farm"

Privatisation took place in two steps. First, in a procedure called "spin-off", assets of an SOE were transferred to one or more new subsidiary companies and it was the new subsidiary company that was then slated for privatisation through a public auction. The privatisation proceeds have since been held in trust accounts to the benefit of the potential owners and creditors of the old SOE until such time that ownership and creditor claims against this old SOE could be

Tidied up – Privatised and refurbished Ferronikeli mining plant

properly established through a liquidation procedure. Therefore, whoever had ownership or creditor claims to an SOE was invited to file their respective cases with the KTA.

In order to ensure a speedy privatisation of as many enterprises as possible, with the limited administrative resources available, the ordinary spin-off procedures foresaw a sale in public auction to the bidder offering the highest price. However, in a limited number of cases where enterprises were considered to have a strategic value for Kosovo, the KTA introduced “special spin-offs”, under which investors had to make firm commitments on investment and employment figures.

As of 30 June 2008, 551 New Companies (NewCos) had been tendered for sale (deriving from the assets of 313 SOEs), 417 sales contracts were signed, and 78 contracts were still pending signature. Important ordinary spin-offs include the “StoneCastle” Winery in Rahovac/ Rahovec, the “Silosi” flour mill and pasta factory, the “Silcapor” construction material company, the seeds factory “Agroelita” in Klina, the “Trofta” trout farm, the Trepca confection subsidiary “Europtex”, and the Motel “Nora”.

The largest single privatisation case was completed in April 2006 when an international investor bought the mining company “Ferronikeli” under a “special spin-off”. The price received amounted to more than €30 million and the investor gave a €20 million investment commitment and a 1,000-person employment guarantee.

Fresh air – Privatised Motel Nora

Other important special spin-offs included the “Kllokoti” mineral water plant, the “Perparimi” brick factory, the “Peja” brewery and the “M&Craft” tobacco factory in Gjilane.

In 2007, the European Agency for Reconstruction (EAR) published a survey including 55 of the privatised enterprises, which assessed the effects of privatisation. The survey showed that on average, revenues in the new companies had multiplied by seven since their privatisation, planned investment into the capital infrastructure of the companies was more than €450,000 per company, and a considerable number of jobs had been created or secured.

Little progress was made on privatising

SOEs that are fully or partly located in Serbian community areas (such as the Brezovica ski resort or the Trepca mining complex), where local leaders supported by Belgrade continued to oppose the process as such. Due to the inter-ethnic sensitivities, KTA was advised by the United Nations to refrain from pushing privatisation forward without local consent, which had the negative side-effect to deprive these areas from a major opportunity to boost employment and incomes.

Total privatisation proceeds (received and banked) amounted to €383 million per end of June 2008. Furthermore, as of 30 April 2008, the KTA Board had approved a total of 114 liquidations with total proceeds amounting to €10.5million. The privatisation funds for each single enterprise have been kept in individual trust accounts to the benefit of potential claimants and owners, to be determined in the liquidation process.

It should be noted that since 2005, the Auditor General carried through a number of audits of the financial statements of KTA. For both the years 2006 and 2007, the Auditor General issued positive and unqualified opinions on the financial statements, and KTA was also complimented on the standard of its accounting as part of the 2007 audit of the Kosovo Consolidated Budget.

Flour for Kosovo – Privatised Silosi flour mill

A separate audit on the administration and management of the Trust Funds was commissioned by the Auditor General and executed by independent auditors of the firm Grant Thornton in the fourth quarter of 2007. Grant Thornton issued an unqualified positive opinion also and a positive assessment of the internal controls implemented by KTA with regard to the administration of the Trust Fund. Another audit by an independent audit firm looking at the process of privatisation made a number of valid recommendations to improve some internal procedures of KTA, all of which were accepted and implemented. This audit also complimented KTA on the success of the process in the light of the difficult circumstances in which the Agency was operating.

As part of the Pillar, the Kosovo Trust Agency ceased operations on 30. June. All responsibilities were passed to UNMIK. On 29 July, the Special Representative of the Secretary-General issued an Executive Decision to temporarily suspend all activities relating to the KTA.

Achievement 7:

Modernisation and Incorporation of Public Utilities

The Kosovo Trust Agency (KTA) also received the responsibility to administer and restructure 25 publicly owned enterprises (POEs): the public utilities providing energy, water, waste and irrigation services; as well as Post and Telecommunications, Pristina International Airport, district heating companies, and the railways.

Like many other former socialist enterprises, the POEs had an unclear legal status and internal structures unfamiliar to investors, banks, suppliers, consultants and auditors. Furthermore, following the conflict they were generally in a non-functional, dilapidated state caused by severe under-investment throughout the 1990s. As in the case of SOEs, the POEs had seen frequent changes in entire management teams and workforce due to the political conflict between 1989 and 1999. These proved particularly challenging in the big POEs.

In order to revitalise these enterprises the KTA brought in experts to oversee the restart of operations and launched into a process of capacity building, and corporate governance development through incorporation. At the same time, the KTA followed the political intention to ensure that Kosovar managers were enabled to run these companies.


Night talk – Antenna on a house in Pristina

In January 2006, assisted by funds from the European Agency for Reconstruction (EAR), the KTA completed the incorporation of the Kosovo Energy Corporation (KEK), UNMIK Railways, and the two district heating enterprises in Pristina and Gjakove/Djakovica, thus finalising the incorporation of all major POEs in Kosovo. Pristina International Airport and Post and Telecommunications of Kosovo had already been incorporated in June 2005. The incorporation of water, waste, and irrigation enterprises was completed by the end of 2007.

Incorporation has given the POEs clear legal status by turning them into Joint Stock Companies under the Law on Business Organisations in Kosovo. It has also improved corporate governance structures, financial transparency, and accounting procedures, with a view to increase the efficiency of the POEs, and to equip them to operate in a modern market economy.
The following is just a flashlight on the progress achieved in the three largest POEs:

Post and Telecommunications of Kosovo (PTK)

PTK has evolved from being an enterprise extremely damaged from the conflict, and hardly providing any services, to being a profitable POE with a modern corporate governance structure.

Following its incorporation in 2005, the PTK drafted an ambitious five-year business plan with a foreseen investment of €550 million. Planned investments have started on a new phase of mobile telephony development that includes extending the coverage of the mobile network to 99% of Kosovo's territory; developing GPRS (internet through Mobile Telephony), and MMS (Multimedia Messaging System). Additionally, PTK has signed a contract with UNMIK Railways in order to be able to lay optic fibre cables along railway lines in Kosovo.

Given its successes, PTK has given itself, in its vision statement, the lofty goal "To become internationally recognised as a first choice provider of the most preferred telecommunication services in the region by fulfilling customer needs and meeting standards of excellence".

Kosovo Energy Corporation (KEK)

Keep digging – Excavator at Bardh coal mine

The Kosovo Energy Corporation is Kosovo's electrical utility – and admittedly the most difficult Kosovo utility to modernise. In 1999, KEK was in an extremely poor condition as a result of decades of under investment, de-capitalisation, mismanagement, the lack of adequate maintenance and low environmental, health and safety standards. The conflict had a further deteriorating effect on KEK, as almost all Albanian staff had been dismissed in the early 1990s, and almost all Serbian staff left in 1999. Following their spontaneous return, and new uncontrolled recruitment, the enterprise soon had some 8,000 staff on its payroll, who had to re-learn how to operate of a complex, vertically integrated electricity utility.

International donors moved immediately to cover the cost of emergency electricity imports, provide assistance to KEK for the rehabilitation of the power plants, and give managerial support to the company. Significant donations, first and foremost by the European Agency for Reconstruction (EAR), assisted KEK develop its capacity and improve operational efficiency.

Since 1999, approximately €500 million were mobilised from donors, and about the same amount from the Kosovo Consolidated Budget (KCB), to improve KEK's performance. Although this is a considerable amount of funds, only a small part went into the rehabilitation of the power plants. After deduction of expenditure for electricity imports and the repairs of the large damage caused by a lightning strike in the Kosovo B power plant in 2003, only some €350 million were invested, i.e. some €50 million per year. Experts have advised that European utilities of comparable size and age to KEK would normally invest at least five times this amount on capital expenditure in the same time period.

Nevertheless, against this background KEK has been increasing its annual electricity generation capacity since the end of the conflict with an annual average increase of just over 12%. However, revenue collection remained the Achille's heel of KEK. During 2006, only some 39% of energy available for sale was actually paid for by customers. The remaining 61% was either billed and unpaid or stolen by customers who illegally connected themselves to the network – despite KEK's determined efforts to send out disconnection teams.

In an effort to leapfrog the state of affairs, the EU Pillar agreed with the Government to bring in a temporary external professional Turn Around Management team in 2004. The team from the Irish Electricity Supply Board International (ESBI) introduced better management procedures and structures, and had the task to create sufficient local expertise to run the company after their departure. In line with what was agreed with the Government, management functions were handed over to a trained local KEK management team in October 2006.

In parallel, with the view of promoting the necessary external support to KEK by large customers and law enforcement authorities, the EU Pillar pushed for a Joint Task Force (JTF) with the Government, which was launched in November 2005. This contributed to an increase in revenue collection to 53.5% of energy available for sale in 2007, a considerable improvement but still far short of a sustainable level. Unfortunately, the Task Force became dormant before fully reaping its benefits.

In 2006, under the Turnaround Management Team, KEK was incorporated as a joint stock company and has now a modern corporate governance structure. This went in hand with the establishment of a separate Transmission and Market Operator (KOSTT) in October 2006. KOSTT has since become a member of the South East European Transmission System Operator's (SEETO) Task Force, but is facing continued problems due to its Serbian counterparts' attempts to block KOSTT's full participation in its initiatives.

Airport

Pristina International Airport went through a remarkable transformation from a war-torn small military and civilian airport into a modern international airport. In June, 2006 the airport won the Airports Council International (ACI) award for the best airport in the category 'under 1 million passengers'.

Take off – Planes at Pristina International Airport, winner of Europe's Best Airport 2006 Award for smaller airports

Before 1999, Pristina Airport was a military airport also serving 250.000 passengers per year. During the NATO air strikes, terminal and runway were bombed, the air traffic control tower, radar and other technical facilities were destroyed, and equipment was stolen, removed or damaged.

After the conflict the airport had neither the equipment nor the technically educated staff to facilitate necessary aircraft services. From late 2000 until 2004, NATO and Russian forces operated the airport as a military facility with limited civilian traffic. During this time staff was trained in the technical disciplines required to run an airport. Air traffic controllers were trained in Italy, meteorological observers in the United Kingdom. Further training was provided in a variety of other tasks including forecasting and aeronautical information services.

On 1 April 2004, KFOR handed the airport over from military to civilian UNMIK control. In order to ensure aviation services that are normally reserved to sovereign states, UNMIK secured Iceland's partnership in this operation. The Icelandic Civilian Aviation Authority (ICAA) made it possible to ensure a locator code for the airport, to issue licenses to air traffic controllers, and to certify the airport according to standards of the International Civil Aviation Organization (ICAO).

Since its incorporation in 2005, the airport has invested in new passenger and cargo terminals, a new control tower and radar, runway resurfacing and intensive staff training programmes. On this basis, ICAA issued to the airport a first Interim Aerodrome Certificate according to ICAO standards in August 2007. The airport now serves over 20 airlines and welcomes almost one million passengers per year.

Kosovo Railways

After 1999, the railway infrastructure in Kosovo was integrated into UNMIK Railways, a publicly-owned enterprise which initially mainly carried out freight transports for KFOR troops. When UNMIK took over, the state of the railway sector was very poor as a result of years of neglect and underinvestment, and partly due to damage incurred during the conflict. Since 1999, with the support of donor grants, a lot of repair work was done to improve the state of tracks, signalling, communications, etc. In particular, two industrial tracks were upgraded, one of which serves the successfully privatized company Ferronickeli

Trainspotting – A locomotive donated to UNMIK Railways

In December 2005, the company was incorporated as Kosovo Railways J.S.C., and successfully concluded its Kosovarisation process with the appointment of a Kosovar Managing Director. Since then, the company has developed new business ideas, such as an airport shuttle train, and successfully concluded major freight traffic contracts, for example with the privatised Ferronikeli mining company and the M&Silosi flour mill. This has greatly boosted income for Kosovo Railways and reduced its need for budget subsidies. The "Freedom of Movement" train initiated by UNMIK has facilitated movement of Serbian community throughout Kosovo, but passenger traffic in general remains a subsidised undertaking.

In order to further improve the operating framework for Kosovo Railways, the legal infrastructure for the sector was completed in 2007, with the foreseen establishment of a railways regulator still outstanding. Pillar IV also facilitated the bid of Kosovo Railways to achieve membership in the International Railway Transport Committee and observer status in the Community of European Railways.

Achievement 8:

Independent Market Regulators

The EU Pillar has been the main driving force behind the establishment of effective market regulators in Kosovo. Independent regulators now play a key role in enforcing market rules and planning sectoral reforms. They issue licences and monitor compliance, approve tariffs and resolve disputes. Furthermore, they allocate resources and assist the investment process. Public confidence in the ability of the regulators to promote and develop sustainable markets is high, and they have received praise from international partner organisations.

In 1999, the regulatory framework for civil aviation, energy, mining, telecommunications, frequency management, railways, and the waste management sectors was non-existent. The Constitutional Framework required the establishment of independent sector regulators. Pillar IV took on the task: it initiated the development of the necessary legislative framework and went on to set up the necessary institutions. International experts were hired to work alongside the local staff that was to form the core of sustainable regulators. The Pillar initially also funded the running costs of each nascent regulator. Building local expertise was from the outset one of the main goal.

Survey from above – The Mining Regulator organised a geophysical survey over Kosovo

In mid-2007, the Pillar's financial support to the regulators terminated after a process of Kosovarisation; the last international staff members at managerial positions having handed over their positions to local management. The only exception is the Civil Aviation Regulatory Office (CARO), which is still headed by an international expert seconded by the International Civil Aviation Organization (ICAO).

Regulatory frameworks in each sector have been in place for a few years. The existing legislation is broadly aligned with the EU *acquis communautaire*. The Regulators are, for the most part, self-financing and have achieved (to various degrees) specialised technical capacity in each sector. Nevertheless, the regulators are constantly faced with the challenge of attracting and retaining qualified staff, given that salaries need to be in line with Kosovo Budget levels and at the same time competitive within the sectors in which regulators operate. Also, the regulators are at times put in situations requiring them to strongly assert their independence.

A key future challenge is for the international community to ensure that the Regulators remain independent of Government so that potential investors are assured that a free market economy remains in place.

Energy Regulatory Office (ERO)

The development and the functioning of a competitive internal electricity market in Kosovo are monitored by the Energy Regulatory Office (ERO). ERO oversees the performance of licensed energy enterprises and their compliance to relevant regulation. ERO also plays an active role in resolving disputes between ERO license holders and their customers. It fulfils its obligations under the Energy Community Treaty and contributes to the future integration of Kosovo in the regional energy market.

Independent Commission of Mines and Minerals (ICMM)

The Independent Commission of Mines and Minerals (ICMM) oversees and regulates the mining sector in Kosovo and enforces relevant legislation through the processing, approval and issuance of exploration and mining licences, the control of commercial explosives, the establishment of a functioning inspectorate, a Geological Department and a Mining Cadastre. ICMM managed to become a net revenue earning entity for the Kosovo Consolidated Fund.

Within a period of three years, ICMM managed to develop and establish a modern mining legal framework for Kosovo's mining sector. The establishment of one of Europe's most modern mining cadastres, and the incorporation of the geological data from an ICMM-initiated airborne survey, have been perceived by foreign investors as a highly useful tool for attracting foreign investment into Kosovo's mining sector in order to develop its mineral resources. As a result of the legal and regulatory foundation developed and implemented by ICMM, the mining sector will in the near future become a major source of revenue for Kosovo's economy.

During the last three years the construction minerals industry alone created approximately 5000 new jobs. The privatization of the Ferronikkeli complex resulted in the creation of an additional 1500 new jobs, and the cutting down of Kosovo's chronic trade deficit by half.

Civil Aviation Regulatory Office (CARO)

The Civil Aviation Regulatory Office (CARO) implements the applicable International Civil Aviation Organisation (ICAO) standards and recommended practices and the applicable EU Regulations and Directions on civil aviation. It also supervises the compliance of civil aviation activities with the relevant international civil aviation agreements and the subsequent worldwide standards and best practices for civil aviation. Recent assessments on Kosovo's civil aviation authorities and their procedures from the EU and ICAO came to the conclusion that the legal framework for civil aviation in Kosovo is the most advanced civil aviation legal framework in South Eastern Europe.

Water and Waste Regulatory Office (WWRO)

The Water and Waste Regulatory Office (WWRO) deals with the public utilities that provide water, wastewater, and solid waste services. WWRO's regulatory mandate includes the licensing of water and waste service providers, setting tariffs for the companies subject to its regulation, setting and enforcing service standards related to the provision of water and waste services, and regulating relationships between service providers and their customers. WWRO is fully operational and sustainable and a net revenue earner for the Kosovo Budget.

Achievement 9:

Facilitating Technical Dialogue Pristina-Belgrade

Since its inception, the EU Pillar placed great emphasis on establishing a workable relationship with Belgrade authorities. Inter-institutional relations, dealing with issues of mutual concern, were of course the easiest to establish. In 2001, after UNMIK established a customs territory in Kosovo, the EU Pillar came to an agreement with the appropriate Serbian authorities to avoid double taxation and to recognise the authority of UNMIK Customs in Kosovo. In 2002, the Pillar negotiated a procedure allowing tax refunds in both jurisdictions, and when Serbia introduced VAT in 2005, this regime was adapted. The EU Pillar has also negotiated a regime that allows for exchange of information between UNMIK Customs and Serbian tax and customs administrations. This led to a significant increase in revenue collected by both services, as well as to prosecution of a number of cases for infractions and smuggling.

Connections - A topic of the Technical Dialogue

Under the Belgrade-Pristina Direct Dialogue, the Pillar provided since 2003 the secretariat for the two working groups which were chaired by the European Union: the Working Group on Cooperation in the Field of Energy, and the Working Group on Cooperation in Transport and Communications. While Kosovo's status issues was the biggest single obstacle for both groups in making progress towards resolving practical issues, it was nevertheless possible to bring representatives together on a regular basis.

In addition, the Pillar established a claims registration facility, so that claims towards any enterprise under KTA administration could be submitted in Belgrade as well as Kosovo. Up to its closure, this facility processed some 40,000 incoming claims and almost 20,000 other notices.

Engagement with Belgrade also covered a number of operational issues, ranging from air transport corridors to transport of explosives for mines in northern Kosovo. Cooperation was established, at times of particular importance such as mutual assistance in mining emergencies.

The Pillar further organised meetings on issues related to banking and insurance, resulting in the largest Serbian bank operating in Kosovo obtaining a proper formal license from the Central Banking Authority of Kosovo. This had important implications as it established a mechanism enabling transparent transfers from Belgrade to municipalities in the north of Kosovo, which was a major component of discussions on decentralisation and relations between Pristina and Belgrade. Following several years of working contacts, the National Bank of Serbia finally started reporting its transfers of cash to its offices in Kosovo.

Achievement 10:

European and Regional Integration

The EU has many times reiterated that the future of the Western Balkans is within the European Union and has pledged full support to that perspective. Pillar IV has played a crucial coordinating role in facilitating Kosovo's progress on the path towards European integration; and has been the key player in important regional economic integration activities.

One important element of the EU's strategy for the development of South East Europe (SEE) has been regional economic cooperation. The final objective has been to create a geographical area with increased mobility of goods, services, capital and people across borders with the view that enhanced regional cooperation and a freer movement of the factors of production will deliver concrete political and economic benefits to the region and prepare it for its European future.

Stabilisation Association Tracking Mechanism (STM)

The Stabilisation and Association process (SAp) that the EU created for the Western Balkans focussed around the conclusion of Stabilisation and Association Agreements (SAAs) designed for sovereign countries. Well aware of the respective obstacles for Kosovo at that time, the EU Pillar advocated the creation of a tailor-made instrument for Kosovo, which was introduced in the form of the SAp Tracking Mechanism (STM).

A first meeting of the Kosovo STM was held on 13 March 2003 in Pristina, and by June 2008 fourteen such meetings had been held. The process was similar to those that took place with other partners participating in the SAp, as a series of structured meetings between the European Commission and the Kosovo authorities. Since then, regular meetings have assessed progress made by Kosovo in political, economic and institutional reforms, particularly in compliance with the conditionality of the SAp. The recommendations of STM meetings have been used by the EC to assess Kosovo's assistance needs in meeting the SAp conditionality and implementing EC-compatible reforms.

Bigger picture – European vision on a student dormitory in Pristina

In 2002, the Pillar established the European Office with an UNMIK wide coordination role, in order to facilitate Kosovo's institutional relations with the European Union and its participation in the STM. The initial work of the European Office focused on three elements:

- to assist capacity building within the PISG in EU integration matters;
- to coordinate participation and representation in the STM;
- to assist the European Commission with issues relevant to Kosovo (as at the time there was no European Commission Liaison Office established).

Throughout the years, the office's role changed in order to reflect the successful capacity building of the Government, as well as the increased European Commission presence in Kosovo. In addition, as additional competencies were transferred to the Government, the need for internal UNMIK coordination decreased. As a result of these changes, but more importantly, the Government's institutional maturity, the Office was closed in March 2007. The lead in dealing with European Integration issues has since been held by the Agency for European Integration within the Office of the Prime Minister.

Regional integration

The EU Pillar, in close partnership with the relevant Kosovo institutions, helped integrating Kosovo into key economic agreements initiated by the Stability Pact for South East Europe and the European Union. The accords, briefly described below, cover essential economic fields and promote regional cooperation in key areas of Kosovo's transformation towards a more modern and dynamic market system.

Trade

Trade policy turned into a lead sector for Kosovo's external economic integration. Kosovo derives three major benefits from trade liberalisation, namely improved export opportunities, better investment conditions, and stable relations with its neighbours. There have been noticeable upward trends in the volume of trade with the neighbours with which free trade agreements were signed.

Following a Declaration of Intent in May 2003 to follow the Stability Pact Memorandum on Trade Liberalisation and Facilitation in Southeast Europe, UNMIK, through Pillar IV, started to negotiate bilateral Free Trade Agreements (FTAs) with countries in the region. From 2003 to 2006, four Free Trade Agreements were concluded with Albania, Bosnia and Herzegovina, Croatia and FYR Macedonia.

Consolidating the regional network of bilateral FTAs, the EU Pillar led and facilitated negotiations on the enlargement of the Central European Free Trade Agreement (CEFTA), which was signed in Bucharest on 19 December 2006. The 'new' CEFTA includes Albania, Bosnia and Herzegovina, Croatia, Kosovo, FYR Macedonia, Moldova, Montenegro and Serbia, creating a regional free trade area for over 25 million people.

CEFTA gives Kosovo exporters duty free access to a large regional market while creating common institutions to promote further economic development and to tackle barriers to trade in a cooperative manner. It also facilitates a cooperative resolution of trade disputes through joint institutions, such as the Joint Committee and the secretariat supporting CEFTA's work. In this way CEFTA plays an important role in preparing its members' trade related institutions for eventual accession to the European Union.

Energy Community

The trade precedent helped integrate Kosovo in other essential economic regional agreements. In November 2002, UNMIK co-signed with the countries of the region the Memorandum of Understanding (MoU) on the Regional Electricity Market in South East Europe and its integration into the European Union Internal Electricity Market, a year later replaced by an MoU including the whole energy sector (the so-called "Athens Memorandum"). Since then, UNMIK Pillar IV took an active role in the "Athens Process" and facilitated the participation of representatives of the Ministry of Energy and Mining, the Energy Regulatory Office and other local Kosovo energy institutions in its activities.

Hot wires – Transformer station and cooling tower of KEK power plant "Kosovo B"

These activities gained new momentum with the intention to conclude a treaty establishing the Energy Community to further integrate energy markets through legally binding common market rules based on the EU Acquis. Negotiations on the Treaty started in October 2004 and were successfully brought to conclusion with signature of the Treaty on 21 October 2005 in Athens.

The Energy Community Treaty creates a single energy market between the European Union and South East Europe. Its aim is to improve energy efficiency and the security of energy supply through an unimpeded trade in electricity and coordinated sector investments. To that purpose, the Treaty creates energy market institutions in line with the EU *acquis communautaire*. It therefore enhances incentives for investment in Kosovo's energy sector. Provided the enormous investment potential in the development of lignite based power generation in Kosovo, the importance of the Treaty can hardly be overestimated.

Civil Aviation

Air traffic between the EU and Southeast Europe has seen significant growth over recent years. On 9 June 2006, UNMIK signed the European Common Aviation Area (ECAA) Agreement on behalf of Kosovo, following negotiations led by the Pillar. The agreement includes the European Commission, the EU's 25 Member States, the countries of South East Europe signatories, Norway and Iceland.

The ECAA provides new opportunities for the European aviation industry by creating a single market for aviation consisting of more than 500 million people and by introducing common standards. It will gradually extend the application of EC aviation law to ECAA members, including issues such as economic regulation, aviation security, airport security, air traffic management, environmental protection, passenger protection and competition rules.

Transport and Communication

Establishing adequate transport networks in Southeast Europe, linked to and compatible with the trans-European transport networks, is a joint objective in the region. It constitutes part of efforts to integrate the region into the political and economic European mainstream.

In November 2003, UNMIK and the newly created Ministry of Transport and Communications confirmed their willingness to deepen regional cooperation in this area and to sign the MoU on the South-East Europe Core Regional Transport Network, which also set up a secretariat for this initiative – the South-East Europe Transport Observatory (SEETO). The Memorandum was signed in June 2004.

Take off – Transport via air is crucial for Kosovo

The Southeast Europe Transport Observatory (SEETO) aims at coordinating transport route policies and investments in the region, and Kosovo representatives now fully participate in these activities. In 2006, Kosovo submitted its contribution for the SEETO Multi Annual Plan, which outlines regional transport infrastructure priorities and financing needs. Further progress was made in harmonising policies in the railways sector with the objective of creating some positive momentum for the development of this sector, which in the region so far fares poorly. In December 2007, UNMIK signed the Addendum on Railways to the SEETO MoU, which opened the way for increased concentration on the improvement of the regional rail network.

In June 2002, the members of the Stability Pact for South Eastern Europe developed the 'eSEE' (Electronic South East Europe) Initiative: a cooperative effort to implement an information society in South East Europe. The goal was to introduce a new legislative and policy framework, and to improve the capability in the region to apply information technologies for better governance and economic development. While not being an initial signatory, UNMIK was added to the 'eSEE Matrix' in July 2005.

The founding Memorandum of Understanding on the Broadband for South East Europe Initiative (bSEE) was signed on behalf of Kosovo by UNMIK in July 2005. The goal is to strengthen cooperation and coordination at the regional level in the domain of broadband technology, and to develop a unified broadband market under a regulatory framework in conformity with relevant EU guidelines.

Investment Promotion

On 21 June 2003, the countries of the Western Balkans and UNMIK together with the Government of Kosovo, endorsed the European Charter for Small Enterprises. The charter calls upon the European Commission, Member States and the participants to the European Charter to focus their strategic efforts on key areas in order to improve the legislative and administrative framework for small enterprises.

Recently, the Ministry of Trade and Industry with the support of the EU Pillar, engaged in the activities of the Investment Compact for Southeast Europe, a programme designed to improve the investment climate and to encourage private sector development. The programme focuses on: (i) evaluation and monitoring of progress in investment reform; (ii) support in implementation of investment reform; (iii) support in structuring the dialogue between public and private sector; and (iv) political support through an annual ministerial conference. In May 2008, the Investment Committee of the Investment Compact decided to include Kosovo in its flagship publication, the Investment Reform Index report for 2009.

Conclusion and a Short Outlook for Kosovo

The European Union Pillar had a unique chance to promote institution building beyond 'traditionalist' thinking within a UN interim administration. The innovations promoted by the EU Pillar were based on European values and the EU's overarching experience. It took time to convince the UN that some of these innovations were a vital part of the economic reconstruction of Kosovo. These have proven that institutional integration is the key to create long-term structures of cooperation and a peaceful handling of disagreement, as has happened in Europe after the Second World War. Through a successful push of this 'institutionalist' agenda, Kosovo has in a relatively short time been able to integrate its economy into wider European networks, while building the key institutions of private entrepreneurship domestically.

Ironman – Ferronikeli, nickel-ore plant in Gllogoc/Glogovac, the largest private investment in Kosovo

In late 2006, UNMIK initiated handover planning for the remaining reserved competencies of the SRSG, in anticipation of a Status Settlement proposed by the UN Secretary-General's Special Envoy Martti Ahtisaari to the Security Council. In May 2007, however, it became clear that the Security Council was in a stalemate and would not pass a new resolution on Kosovo's status. After months of fruitless international consultations and talks between Belgrade and Pristina, the Assembly of Kosovo passed a Declaration of Independence on 17 February 2008, and on 15 June a new Constitution of Kosovo entered into force.

In parallel to this process, and as the Pillar's tasks had been well accomplished, the European Commission decided that there was no reason to maintain its functions solely due to a political stalemate and decided to cease funding its operations beyond 30 June 2008. For another four months, a small liquidation team will facilitate the ultimate handover to successor institutions.

The EU Pillar's job is done. The relevant institutions and legislation in the economic field are in place. The biggest challenge for Kosovo will be to maintain these achievements and promote them further. Particularly, the external investors and donors that are needed for the next phases of Kosovo's development are looking from the sidelines and are keen to see that the Kosovo authorities credibly preserve and build upon the achievements reached so far.

UNMIK Pillar IV ORGANIGRAMME

(as of 1 January 2008)

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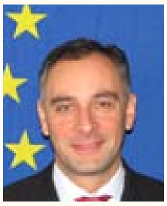
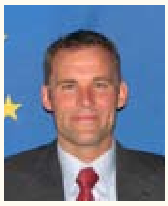
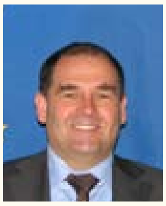
DSRSG



Shahin Lauritzen
Department of Management & Administration



Patrick Van Der Laan
Controller's Office



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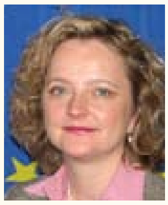
Johan Van Lamoen
Legal Office (Regulators)



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Glossary

ACI	Airports Council International
BPK	Banking and Payment Authority of Kosovo
bSEE	Broadband for South East Europe Initiative
CAM-K	Customs Assistance Mission in Kosovo
CARO	Civil Aviation Regulatory Office
CBAK	Central Banking Authority of Kosovo
CCU	Customs Compliance Unit
CFA	Central Fiscal Authority
CEFTA	Central European Free Trade Agreement
DoR	Administrative Department of Reconstruction
DTI	Department for Trade and Industry
EAR	European Agency for Reconstruction
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECAA	European Common Aviation Area Agreement
EIB	European Investment Bank
ERO	Energy Regulatory Office
ESBI	Irish Electricity Supply Board International
ESPIG	Economic Strategy and Project Identification Group
EU	European Union
EULEX	European Union Rule of Law Mission
FAO	Fiscal Affairs Office
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GPRS	Internet through Mobile Telephony
IAIS	International Association of Insurance Supervisors
ICAA	Icelandic Civilian Aviation Authority
ICAO	International Civil Aviation Organisation
ICMM	Independent Commission for Mines and Minerals
IFI	International Financial Institutions
IIA	Institute of Internal Auditors
IMF	International Monetary Fund
IOPS	International Association of Pension Supervisors
JTF	Joint Task Force
KCB	Kosovo Consolidated Budget
KEK	Kosovo Energy Corporation
KFOR	Kosovo Force
KOSTT	Transmission and Market System Operator
KTA	Kosovo Trust Agency

MEM	Ministry of Energy and Mining
MFE	Ministry of Finance and Economy
MMS	Multimedia Messaging System
MoU	Memorandum of Understanding
MTC	Ministry of Transport and Communications
MTEF	Medium Term Expenditure Framework
MTI	Ministry of Trade and Industry
NATO	North Atlantic Treaty Organisation
NewCos	New Companies
OAG	Office of the Auditor General
PIA	Pristina International Airport
PISG	Provisional Institutions for Self Government
POE	Publicly Owned Enterprise
PRIP	Public Reconstruction Investment Programme
PSC	Project Steering Committee
PTK	Post and Telecommunications of Kosovo
PUD	Public Utilities Department
RIMS	Reconstruction Intervention Monitoring System
SAp	EU Stabilisation and Association process
SEETO	South East Europe Transport Observatory
SME	Small and Medium sized Enterprises
SOE	Socially Owned Enterprise
SRSG	Special Representative of the Secretary General
STM	Stabilisation and Association Tracking Mechanism
UN	United Nations
UNMIK	United Nations Interim Administration Mission in Kosovo
UNSC Res.	United Nations Security Council Resolution
US	United States
USAID	United States Agency for International Development
VAT	Value Added Tax
WB	World Bank
WWRO	Water and Waste Regulatory Office

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