

**USAID/Kosovo**

**Annual Report**

**FY 2004**

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## **Please Note:**

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## Kosovo

### Performance:

Background: International assistance and the energy and determination of the Kosovars have succeeded in improving living conditions for most of the population and in getting Kosovo back to near normal conditions. Four years after the end of the conflict, Kosovo has made significant progress in all areas of economic, social, and political development. Kosovar society is moving slowly but securely towards a modern society with economic and structural reforms that are designed according to international best practices. One major advantage Kosovo holds over its Balkan neighbors and post-transition societies of Eastern Europe and the former Soviet Union is that former elites beholden to a corrupted system have disappeared. The ponderous and change-resistant institutions have also fallen away. No entrenched bureaucracy has impeded progress for the most part, and Kosovars do not pine for anything resembling their recent past. This “cleaning-of-the-slate” offers Kosovars something unique: a virtual consensus toward reform among local political constituencies.

This clean slate means, however, that much building must be done and the process of building the elements of a democracy, the institutions for running a government, and the bases for a sound economy have just begun. Though still governed by the United Nations Mission in Kosovo (UNMIK), a Constitutional Framework is in place and a Kosovar governing structure, the Provisional Institutions of Self-Government (PISG), has been established. To date three elections have been qualified as free and fair by local and international observers. Although many powers are still retained by UNMIK, the transfer of competencies to the PISG is underway. The pace at which competencies have been transferred, however, has increasingly become a point of contention between the PISG and UNMIK. While Kosovars are expected to take responsibility for shaping their future, they lack much of the concomitant authority to do so. On the other hand, Kosovar institutions are still in the early stage of their development and are, therefore, in desperate need of capacity building. Underlying the debate on the transfer of powers is the question of Kosovo’s final status. Although the majority of the international community has tried to avoid or defer the issue, withholding a decision also carried heavy economic and social risks. As a prelude to talks on final status, UNMIK has recently introduced a set of “standards” that outline short-term objectives in eight key economic, political, and social areas. Progress towards achieving these objectives and their related set of benchmarks will be at the center of much effort and debate over the next year.

On the economic front, Kosovo has made a remarkable rebound. Domestic revenues have grown from zero in 1999 to a projected 17 percent of GDP and are projected to cover approximately 100% of Kosovo’s recurrent budget in 2003. However, there is almost no productive enterprise. Most enterprise is based on trade, which in turn is reliant on diaspora capital and the benefits of a large international presence. Unemployment, once estimated at more than 70 percent immediately after the war, now hovers in the 30 - 50 percent range. With a very young population, the youngest in Europe, unemployment if it is not reduced may very well trigger renewed conflict and certainly will not allow Kosovo to become a secure society. In 2003 assistance levels from the donor community dropped substantially while at the same time Kosovo lacks the legal status to enable it to begin tapping international capital markets or IFI loans. Its current legal status also has a significant negative impact on its ability to export and attract foreign direct investment, leaving Kosovo economically disadvantaged.

Though still in the nascent stages of development, Kosovo is a place where we have a favorable set of conditions not found in most countries. Old structures in the public and private sectors have largely been swept away, and our interlocutors are highly receptive to advice, particularly from Americans. We have a chance to “green-field” a government, a democracy, and a market economy, which can serve as important examples in a problematic region, with a primarily Muslim society. Institutions, though in their infancy, have been cleansed of the vestiges of their communist past. There are no oligarchs who control

the broadcast media at the province level. Most observers find the press to be open, free, and vibrant, though lacking basic journalism skills. Government institutions, though underpaid and under-skilled, are not yet bloated and for the most part do not exhibit signs of predatory behavior. However, this opportunity comes at a cost. It requires that we - the U.S., the EU, and other donors - stay the course and provide sufficient resources, attention, and adequate time to do the job. Kosovo's final status remains unclear, but irrespective of that eventual outcome, it must be prepared to govern with whatever autonomy it eventually gains.

**U.S. Interest and Goals:** The U.S. Government is committed to support U.N. Security Council Resolution 1244, which calls for "substantial autonomy and meaningful self-determination for Kosovo." Within this mandate, the U.S. interest is to aid in the creation of a secure, well-functioning, multi-ethnic society with an open and free market economy, a system of justice that is impartially administered, and opportunities for people to make informed choices and participate in their own social and economic recovery. As Kosovo is part of the Balkans, so is it part of Europe, and its integration into the European economy is a priority for the United States Government.

The USG foreign policy interests are directly reflected in USAID programming. USAID has been the leader in establishing the economic policy and legal framework necessary for the creation of a free market economy. Mutually supportive assistance has provided the private sector with both the skills and financing needed for the development of viable enterprises. In the democracy and governance area, USAID has worked closely with other donors in paving the way for free and fair elections, three of which have been successfully held to date. Independent media and an active civil society have been integral to these elections and to the accountable and transparent workings of the elected leaders. Most critical to the development of society and a market economy is establishing the rule of law, in which disputes can be decided in a fair and transparent way and in which decisions are enforced. Though work has started in this area, USAID, beginning in 2003, will begin a multi-year effort to train judges and prosecutors and assist UNMIK in defining a court system that meets Kosovo's needs.

**Donor Relations:** The European Commission through the European Agency for Reconstruction has been the largest donor to date, with activities in reconstruction, public administration reform, decentralization, judiciary, customs and taxation, energy, environmental management, economic development, minorities and returns, rural development, civil society, and university education. Other major donors and their principal areas of focus include: Germany (energy, water and wastewater, transport, private sector development); Canada (public administration, public health, education, media, disability); Sweden (agriculture, infrastructure, public services, environmental protection, returnees, youth, anti-trafficking, civil society); Switzerland (energy, business development, agriculture, infrastructure, public services, environmental protection, vocational education); the United Kingdom (civil society, access to justice, privatization, customs, fiscal policy, health, social policy, public administration); and the UNDP (security, job creation and minority programming, and local development).

Donor relations are for the most part very good; overall donor coordination is improving. The best donor coordination is sector, or sub-sector, specific. For example, OSCE, USAID, and the German Political Foundation Friedrich Ebert Stiftung developed the Assembly Support Initiative, a collaborative program of assistance to Kosovo's nascent legislature. USAID places a high value on working collaboratively with other donor organizations in Kosovo. Donor coordination has proven to be a valuable mechanism for leveraging our resources and informing our program. The Mission used a very participatory and collaborate approach for developing the recently-approved five-year strategic plan. Donor representatives participated in planning sessions and focus groups throughout the process, providing valuable input and insight.

**Challenges:** Accomplishments have been impressive in four short years, but a secure and stable society does not yet exist. The overriding challenge in the near-term is to ensure that there is no slippage in the reforms made to date and that momentum is maintained despite substantially decreased funding levels from the donor community. With the passing of the reconstruction and emergency phase, the three most prominent programmatic challenges are strengthening Kosovar institutions, building a sustainable and growing economy that creates jobs, and developing a harmonious multi-ethnic society. While significant

progress has been made on all fronts, these challenges require a reasonable period of time and sufficient resources to meet them. Decreasing donor resources, an inarticulate transition strategy from UNMIK to Kosovar management of government, and the unresolved final status hinder the pace and the sustainability of reform.

Donor assistance must tackle the tough job of strengthening institutions at all levels so that checks and balances exist throughout society. The reform process will deepen only when Kosovo has its own institutions in and outside government that are capable of delivering services, exposing and eradicating corruption, disseminating unbiased information, creating an environment conducive to the growth of the economy and in which the rule of law operates, maintaining civil harmony, among others. Although Kosovars are active partners in shaping their future, the capacity of the institutions and ability of the leaders to create and sustain change is still weak. High unemployment, coupled with a very high youth population, increase the intensity and the immediacy of the challenges. Unemployment is a trigger for renewed conflict if not adequately addressed and will erode any progress made in reducing ethnic tensions.

USAID has spent considerable effort over the past year developing a new strategy and adjusting its program to address the current priorities with a significantly lower budget. USAID has made a conscious shift from supporting the UNMIK pillars to building PISG institutions (i.e. government departments). Whereas in the past USAID staffed line positions within UNMIK structures, the economic restructuring program is now largely directed toward building PISG offices, ministries, and the legislative assembly - those bodies that will become permanent institutions of democracy and government. USAID will also end its large community infrastructure programs and will be focusing on creating government-community partnerships that take on greater responsibility for promoting democratic and economic change at the local level.

**Key Achievements:** USAID, with USOP political support, has provided the impetus for the deep reforms and for "Kosovarization." Significant gains have been made in establishing a macroeconomic framework, establishing a representative system of government, and in addressing the massive infrastructure rehabilitation necessitated by the war and decades of neglect. Though the work is far from complete, a solid foundation has been laid and four years of rebuilding has brought Kosovo to the threshold of a substantial turnaround. Key achievements in the three major areas of implementation include:

#### Economic Policy and Business Development:

- implementation of a liberal tax regime, including an EU-compliant value-added tax, a wage/personal income tax, a corporate income tax, and a proactive and efficient tax administration apparatus (built from scratch);
- creation of a path-breaking pension system, including a fully-financed mandatory individual retirement account component and a supplemental voluntary component;
- establishment of critical economic governance institutions, including the budget planning, macro-analysis, and municipal finance departments of the Ministry of Finance and Economy and an effectively functioning legal unit in the Office of the Prime Minister;
- development of a sound intergovernmental finance system and a functioning municipal certification program to ensure best practices of budgeting and funds management at the municipal level;
- development and adoption of core commercial law regulations, including mortgage, real property rights, business registration, and telecommunications.

#### Democracy and Governance:

- adoption of more democratic internal procedures within key political parties;
- development of a vibrant media sector, including direct assistance in the creation of a terrestrial broadcast network covering 80 percent of the population;
- increased market share and financial sustainability of the two private Kosovo-wide television stations;
- extensive support to shift the NGO community's focus from service delivery to advocacy, concentrating in numerous sectors: anti-corruption, environment, education, health, consumer protections, minority and human rights, and gender;
- development and inclusion of core "good governance" laws in the Kosovo Government's priority

legislation; adoption of the Freedom of Information Law;

- improved capacity of the 120 members and 16 committees of the Central Assembly - a multi-ethnic, multi-party democratic institution; adoption of Rules of Procedure.

Community Development:

- completion of hundreds of community-level infrastructure programs, which by involving communities in decision making encourages integration of all members of the community

- over one-third of the projects have been directed toward mixed ethnic communities, promoting ethnic harmony and creating favorable conditions for further returns.

**Country Close and Graduation:**

N/A

## Results Framework

**167-0120 Improved Policy and Institutional Climate for Productive Investment**

**167-0130 Accelerated Growth of the Private Sector**

**SO Level Indicator(s):**

Growth in real GDP

Private investment as percentage of GDP

**1.3.1** Sound fiscal policy and administration

**1.3.2** Competitive and well-regulated financial sector

**1.3.3** Market-oriented commercial law and administration

**1.3.4** Privatization of state and socially-owned enterprises

**1.3.5** Expanded formal SME sector

**167-0210 Civil Society and Government are More Effective Partners in Achieving Good Governance**

**SO Level Indicator(s):**

Increased citizen confidence in democratic institutions and degree of public trust

**2.1.1** Free and fair elections

**2.1.2** Transition to effective and impartial justice system

**2.1.3** Independent media and civil society free to operate

**167-0220 More Open and Responsive Government Acting According to the Rule of Law**

**167-0310 Restored Normalcy in Living Standards and Opportunities**

**SO Level Indicator(s):**

Number of persons directly benefiting from improved access to social services and restored livelihood opportunities

**3.1.1** Improved sustainability of social services and community infrastructure

**3.1.2** Strengthened civil institutions

**167-0410 Special Initiatives**

**167-0420 Cross-Cutting Programs**