



**UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT**

**KOSOVO ECONOMIC DEVELOPMENT INITIATIVE**

**FINAL PROJECT REPORT**

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Matthew Smith

Chief of Party

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## **1. CHIEF OF PARTY'S REPORT**

I am pleased to submit the End of Project Report on the progress of the Kosovo Economic Development Initiative. Generally, all benchmarks were met, many exceeded. Outstanding achievements have been made across the broad spectrum of the project:

- in privatization, over half of the socially owned enterprises have been privatized and stunning results are being seen from the investments being undertaken by their new owners;
- in the energy sector, the world's leading energy firms have formed consortia and been short listed to bid on 2 billion Kosovo C project;
- in the institutions, the capacity of the Kosovo Savings Pensions Trust has been fully developed and technical assistance has now been withdrawn;
- similarly, in the Ministry of Finance and Economy and Central Banking Authority, local staff are now firmly entrenched in management roles and undertaking all functions independently;
- in the legal sector a vast array of laws are now firmly in place underpinning the operation of the Kosovo economy and the process for future development, costing and review of legislation is up and running; and,
- finally, the success of the Professional Development Program has exceeded our expectations. The combination of leadership/management training alongside the traditional technical skill development has led to better outcomes in capacity and sustainability of institutions. The American University of Kosovo has taken over the ongoing PDP delivery, in itself a major outcome.

Outstanding issues for the future include the continuation of building the capacity of the Kosovo counterparts. In some areas, capacity remains thin and needs to be deepened. The intake of graduates from this year from the AUK into the MFE will make a considerable difference to the quality of personnel a new project will deal with – however, finding a solution to the ongoing salary issue within Government, such as the Super Grade for well educated professionals, will be key to ensuring the legacy of USAID in all supported institutions is long lived. A major effort also needs to be implemented across the supported institutions to improve the performance management and accountability process. Individuals must be held to account in order for performance of individuals and therefore institutions can be vastly improved.

Individual team reports follow.

## **2a. MINISTRY OF ECONOMY AND FINANCE - BUDGET AND MUNICIPAL BUDGET**

The last three years have seen a dramatic improvement in the capacity, initiative and ability of the MFE Budget department. All aspects of budget management are undertaken by capable Kosovo staff – led by a highly skilled and experienced Manager. At the end of this project, the Budget department was split into two departments to create a separate Municipal Budget department. The following is a summary of activities and accomplishments against the task order requirements.

### **Accomplishments**

**Budget development and execution process.** Over the past three years the strategic framework for a multi-year budget process has been advanced from a simple medium term budget framework underpinning the 2005 Budget to a fully articulated Medium Term Expenditure Framework which provides policy context for the budget formulation. In particular, it addresses the economic and social development needs of Kosovo over the next years by expressing a set of major policy spending priorities agreed to by the Government within a medium-term macroeconomic and fiscal framework. The first MTEF prepared by Budget Department provided the policy foundation and document for the donor event in April 2006, which resulted in 56 million euro donor pledges for budget support. The 2008-2010 MTEF has been developed to assess the alternative possibilities for financing a number of the most important priorities identified in the Kosovo Development Strategy and Plan (KDSP). The intention is that this MTEF will provide the basis for a donor conference immediately following the resolution of the status of Kosovo.

Building on the budget reforms introduced through 2005, a number of improvements to the transparency and accountability framework for budget decision-making as well as a more streamlined and systematic budget development process have been implemented. The improvements have been made with a view to building institutional capacity and self-sustainability in budget development and management both at the central and municipal levels of government.

Gradually, the budget process practice underwent considerable improvements in terms of increased compliance with legal requirements for supporting Budget documentation, timely transmittal to the Assembly and Budget promulgation, and increased detail in budget circulars, including instructions, planning targets, and Government priorities. For example, compared with prior years, the 2007 Budget was approved by the Kosovo Assembly with the advantage of greater back-up documentation prepared and provided by Budget Department. A draft of the 2007 budget book was provided to the Assembly prior to the completion of its work. Usually, in the past, the budget book had been prepared for the general public and not for use of the Assembly.

Budget preparation and planning have been fully devolved to the staff of the MFE. Increasingly, the advisors “worked themselves out of their jobs”, while the local Senior Managers undertook full responsibility for the design and development of budget instructions and documents. This marks milestone improvement in the institutionalization of budget process under the MFE direction.

**Analytical support for budget decisions.** Budget Analysts received substantial training in budget analysis. These skills have been gradually applied in their daily activities. Examples of the major analytical efforts include: preparation of budget hearings, mid-year budget reviews, and recently the 2006 budget underspending report, which was led by the budget staff. Analysts led

discussions with 15 budget organizations, and with the procurement agency, regarding reasons for underspending on over 100 individual capital projects. The results were integrated in a report describing major reasons for underspending in 2006 and concluding with a set of recommendations for reducing future underspending through improved planning and execution. This large analytical effort and report establishes an important precedent for the Budget Department, showing that it can produce analysis of high quality and value on major budget issues. The recommendations informed by this work were endorsed by the MFE Permanent Secretary and presented to all Permanent Secretaries by him, to strengthen capital planning and improve execution of budgets for capital and for goods and services.

Budget Analysts participated in MTEF's development. Analysts participated in working group meetings held to support priority setting and the drafting of sectoral analyses for the MTEFs. Analysts who participated in these meetings were able to serve as a source of budget information for the group and to gain insight into the MTEF analyses and process that will enrich their approach to annual budget development.

Bearingpoint advisors also assisted and supported counterparts in the preparation of information on budget support by donors and incorporation of this information in the budget process; worked especially closely with MFE donor support staff and the OPM donor coordination unit; assisted in the incorporation of the Government spending priorities, MTEF, and anticipated outcomes of donor conferences in applicable budget instructions, including instructions pertaining to status settlement.

**Budget process for municipalities.** In line with overall budget process reform several modifications have been introduced into municipal budget development in order to strengthen budget process transparency, accountability, devolution, and to assist municipalities in targeting their expenditure to the highest priority areas. The following procedures are now embodied in the municipal budget process: basics of multi-year budgeting within municipal medium term budget frameworks, implementation of the first stages of program budgeting, introduction and application of the Public Investment Program at the municipal level. Municipal Budget Analysts understand budget process elements and requirements and are capable to assist Municipal officials.

Comprehensive training/consultation program consisting of a series of sessions and supporting template materials for Municipal officials was delivered. Training paralleled the timetable and stages of the 2007-2009 budget process. It was designed and implemented in close cooperation with the MFE, USAID LGI, and OSCE. A total of around 250 leaders and budget officers from all Kosovo Municipalities participated in several training sessions, which addressed the main aspects of municipal budget reform: (a) establishment of Municipal Medium Term Budget Framework; (b) program budgeting; (c) integration of Public Investment Program; and (d) public budget meetings and public participation in the budget process.

The Grants Commission plays now its statutory role in the municipal budget development and execution process. Local staff gradually took over the responsibility for the preparation and technical support for Grants Commission meetings. BearingPoint advisors also worked with Budget Department and World Bank on a joint project to support improvement of the existing system of intergovernmental transfers and address post-status settlement challenges in fiscal decentralization.

**Training.** In 2005-2007 several training sessions in budget concepts and best practices was provided to all budget analysts, including Central and Municipal Budget departments. In the first

half of 2007, working with BearingPoint's training specialist and in consultation with the Budget Director, the Advisors developed a sequence of analytical exercises for budget staff and delivered these to analysts. These are intended to build analytical and writing skills of the analysts through practice and the production of products that they can use directly in the 2008 budget process. This is part of a larger BearingPoint training plan that is being coordinated with the World Bank PENTAG project among others, to ensure an integrated effort to build and sustain capacity in the Budget Department here in MFE.

### **Outstanding issues**

- Timeliness of the annual Budget Book considerably improved during the contract period. However, its publication and dissemination to a wider public still faces considerable delay. Among the reasons are limited in-house translation capacity and the need to procure outside services.
- As identified through the PEFA process, incorporation of a three-year perspective, Public Investment Program, and donor assistance into the regular annual budget process remain outstanding issues which require further improvements.
- Development of the 2008 Budget will be extraordinarily difficult. The challenge is complicated by the anticipated addition of Government responsibilities with transition to permanent status, both the timing and cost of which will be difficult to estimate. Budget planning must reflect a variety of new financial commitments – new ministries, decentralization (with attendant costs), and debt service. The agreement with the IMF on a fiscal rule will require establishing tighter fiscal discipline.
- As attrition continues within the Budget Department, redeployment and careful management of existing staff to make maximum use of current capabilities will be essential. The Advisors will work with Budget Director to prepare to supplement such staff movement with training, as appropriate.
- Analysts in the Budget Department will need new skills in assessing the relationship between spending plans and performance and in assessing current programs on the basis of their results to date.
- Fiscal decentralization and implementation of the status settlement requirements will create numerous challenges for the annual budget planning process in 2008 and 2009.
- In the transition period, the large number of donor-funded projects in the MFE focused on budget capacity building and training will require close coordination by the Budget Department and among the donors and their project leaders to avoid duplication and maximize their combined effectiveness.

### **Lessons Learned**

- Limited staffing will require emphasis on improving the productivity of staff through better organization, skilled management, and additional professional training.
- Analytical capacity is highly variable and dependent on a small number of staff with advanced training.
- MFE structure and communications problems can hamper effective mobilization of analysis in support of the budget process – especially translation of the MTEF into guidance to budget organizations for the annual budget preparation.
- Additional progress in strengthening the municipal budget process will require more emphasis on further development of capacity in the municipalities, in particular new entities established in accordance with status settlement.
- There will be a continuing need for professional development and training to counteract the continuing drain of talented staff and support further improvement of the budget process.

## **2b. MINISTRY OF ECONOMY AND FINANCE - TREASURY**

The overall objective for the technical assistance to the Treasury was to achieve the following:

- Treasury Department is fully operational including cash management and debt management modules, and
- Treasury staff is fully capable of professionally operating all Treasury functions and modules.
- To develop a Debt Management Unit in anticipation that Kosovo may incur debt in the near future.

### **Accomplishments**

**Structure of the Treasury Department** - In June 2005, a local Director of Treasury was appointed by the SRSG, following USAID advisors who had previously held the position. The terms of reference for the position, established in the Law for Public Financial Management and Accountability (LPFMA), guarantee its independence from political influence. The Treasury Director took an active role in implementing financial controls, and prepared a strategic plan 2006-2009 and annual business plans for Treasury. His Deputy is successfully leading the daily Treasury operations and accounting functions, including the preparation of the 2004, 2005 and 2006 financial statements. Heads of division started to prepare job descriptions for all staff, containing performance measures and linking staff duties to treasury procedures.

**Financial reporting** – The 2006 financial statements were prepared in full compliance with IPSAS standards and format by the Treasury staff under the direction of the Deputy Director. Recommendations of the Office of the Auditor General with regard to 2005 and 2006 led to a number of improvements in reconciliation. The 2006 financial statements showed practically no reconciliation differences (versus EUR 72,000 in 2005).

**Treasury Single Account** - Institutional and banking arrangements were reviewed. Hundreds of bank accounts in commercial banks, where public funds were initially held, have been closed in 2007 and the concept of a Single Account was realized. Currently, a small number of accounts are all held in the Central Banking Authority of Kosovo (CBAK) and swept to the Single Account on a daily basis.

**Cash Management** – In 2006, a Cash and Debt Management Division was newly established within the Treasury department. Its mission is to monitor budget execution and to maintain budget liquidity. The Cash Management Unit prepares consolidated cash flow forecasts based on the cash flow plans submitted by all budget organizations. This has resulted in improved control over budget allocation with no overspending at the end of 2006. A Joint Liquidity committee by Treasury and the CBAK was established in 1<sup>st</sup> quarter 2007 and started preparing transactions for optimizing the returns on investment of liquid public funds.

**Kosovo Financial Management Information System (KFMIS)** – Decentralization of Freebalance was completed in 2006 through implementation of the system in 60 central budget organizations. The Purchase module was newly implemented in all central budget organizations and municipalities, and significantly contributed to gaining control over the commitment process associated with procurement. All budget organizations are now using the system to manage their expenditure commitments, to carry out procurement and to manage their assets.

**Policy reform** - Treasury has developed and enforced secondary legislation to the LPFMA, the most prominent being sublegal acts on Expenditure Management and on a standardized reference number system for revenue collection. A new chart of accounts, aimed at program oriented budgeting (versus the previous organization based budgeting) and project oriented allocation was implemented. Benefits include improved control; the reporting of capital expenses in accordance with the Public Investment Program (PIP); and the possibility to implement individual budgets for municipal sub-units such as schools. Implementation of a sustainable strategy for mitigating problems in recording and reconciliation of revenue and expenditure was started in 2007 through introduction of a standardized invoice reference number system, supported by bar codes, for all revenue collecting bodies.

### **Capacity building**

*Management training* – 26 senior and middle management staff of the Treasury have completed the USAID funded PDP training, with 10 participants also completing LDP training. In 1<sup>st</sup> quarter 2007, the International Advisors conducted training workshops on risk management for 20 middle management staff in the Treasury Department and on cash management (cash flow preparation) for 250 financial staff of all central and local budget organizations. Treasury senior management attended a USAID funded training on cash and debt management in 2007 at the Center for Excellence in Finance in Slovenia.

*Technical Training* – In 2005 and 2006, technical training was delivered by the local staff, coached by the International Advisors, to about 500 employees in all budget organizations on the use of Freebalance in general, and to about 200 employees on the newly implemented Purchase module in particular. Additional training was delivered to the CFOs of budget organizations on the preparation of financial statements

### **Outstanding Issues**

- Although initial preparations for the procurement of a debt management IT system have started, the Debt Management function was not yet fully developed. In accordance with instructions received from USAID Office in Pristina, the issue was not further addressed as it is planned that assistance in establishing a debt management function will be provided later in 2007 by the US Treasury.
- Initial studies for decentralization of payment controls to individual budget organizations have been made, but the process remains to be completed once the budget organizations have all necessary internal controls in place. Also, decentralization of control shall be synchronized with future fiscal decentralization.

### **Lessons Learned**

- Reducing the involvement of advisors in daily operations to a minimum, in order to strengthen development of local senior and middle management
- Increasing the involvement of local officials in legal drafting in order to create more ownership

## 2c. MINISTRY OF FINANCE AND ECONOMY - TAX ADMINISTRATION

### Objectives

- Further the capacity of the tax administration division to efficiently and professionally collect taxes. This will, in particular, require improvements in the areas of compliance, audit and appeals (Policy Reform and Institutionalization/Capacity Building)
- Assure accurate, efficient and streamlined data flows that are necessary for accurate and timely administration and reporting. This will require coordination with tax administration and Ministry of Public Services
- In TAK, significant training is still needed to establish a cadre of professional tax inspectors, with the skills to perform sophisticated audits and to collect the proper amount of taxes. To accomplish these tasks and this level of capacity, the contractor will continue its work with this ministry.

### Accomplishments

**Policy Reform:** Corporation Income Tax Law, Personal Income Tax Law, and Law on Tax Administration and Procedures were implemented; the first two laws effective 1 January 2005 and the latter was effective 1 May 2005. These laws essentially eliminated the previous presumptive tax regime, increased the individual income tax obligations to include self-employed individuals, and replaced the profit tax law. They are recognized as meeting international standards, as noted by both the IMF and World Bank. The VAT law largely meets the EU Sixth Directive.

**Institutionalization/Capacity Building.** All current TAK employees were trained in the new tax laws in late 2004. Additional technical training was conducted in December 2006 for identified inspectors from the LTU and the two Pristina regions. Starting in February 2007, 75 inspectors from the two Pristina regions and the LTU have been trained in communications and conflict management skills. Early in the contract period, evidence was gathered regarding possible corruption in the highest levels of the tax administration, largely involving hiring practices. As a result, the Director and his deputies were all replaced. New deputies were selected about two years ago, and they have completed the Professional Development Program. The new Director (named in January 2006) is currently a participant in that program. Advisors have worked closely with the senior staff members to assist them in developing managerial skills necessary for a tax administration.

Beginning with a planning session in December 2006, TAK developed a strategic plan with the advice and assistance of BearingPoint and CAFAO advisors, which was formally signed in early February 2007. The strategic plan covers the years 2007 – 2010. In addition, TAK developed a 2007 Annual Business Plan which includes actions needed to achieve the goals of the strategic plan. Included in the business plan is an audit plan for each region.

An IMF visit recognized that TAK has a fully-functioning Large Taxpayer Unit (LTU), whose businesses account for nearly 70% of the TAK revenue. Significant work has been done in the LTU to improve management practices and develop risk-based selection criteria for audit. It is expected that work done in the LTU will be spread through the other regions once a risk assessment process has been fully developed and tested in the LTU. Within the LTU, specialization by industry has been implemented (banking, insurance, construction, and internet-related business), with audits of most banks having been completed. TAK audit results each year have improved: 2004 – 2808 audits, €24.8 Million additional tax; 2005 – 2956 audits, €36.1 Million additional tax; and 2006 – 2667 audits, €2.8 Million additional tax. With the additional

assistance of CAFAO, enforced collection activity has increased: 2004 – €9.4 Million; 2005 - €8.6 Million; and 2006 - €17.6 Million.

Information exchange between TAK and KPST is working smoothly with the expectation that KPST will be able to issue pension statements covering the period through 31 December 2006. Two taxpayers have been prosecuted for tax evasion and another two prosecuted for brandishing weapons to intimidate tax officials; news releases have been published relative to these convictions. Additional tax evasion cases are pending. The SRSG, Minister of Finance, and Prime Minister have all noted the success of the tax administration in collecting the revenue; annual tax revenue has increased from €110 Million in 2004 to €168.5 Million in 2006.

### **Outstanding Issues**

**Policy Reform.** A Memorandum of Understanding between KTA and MFE has provided some relief for POE's regarding penalties and interest incurred if they revise their accounts and report based on amounts billed, rather than amounts earned. Advice has been sought from OLA as to whether this MOU has valid legal standing. A revision to Corporate Income Tax Law to clarify the definition of Permanent Establishment has been submitted to the EFC and a working group is now reviewing and re-drafting as appropriate. The working group is also considering revisions to withholding on payments to non-residents in respect of Kosovo-sourced income.

**Institutionalization/Capacity Building.** Businesses have expressed their reluctance to request VAT refunds based on experience of some businesses that refund requests result in lengthy audits and loss of access to books and records. This has resulted in a significant amount of VAT credits being carried forward from year to year. While TAK is taking a number of actions to address the concerns raised by the amount of VAT credits carried forward, this will continue to be a concern raised by the IMF.

**Management Practices.** An IMF Technical Assistance visit and EU Blueprint study identified significant gaps in the tax administration's management practices. The strategic plan for 2007 – 2010 includes goals and actions to address those gaps. Much work will be needed to address the IMF and EU Blueprint gaps through the strategic plan. The TAK headquarters was specifically identified as needing to improve its planning and oversight capabilities, as well as needing to establish new units to accomplish those and other tasks. Improved pay scales and performance management practices are also needed. Additional management information capability is needed for proper management oversight and control, in addition to needing increased IT capacity to further develop a risk-based audit selection process.

### **Lessons Learned**

Experience during the course of this contract has shown the benefits of a cooperative effort with other donors, particularly CAFAO. Through continual contact and cooperation with CAFAO, BearingPoint advisors were able to identify additional staffing needs. Flexibility in work under the contract is necessary to deal with needs which become identified during the course of the contract, such as the initiation of the communication and conflict management training now underway as a response to concerns raised by international business. Reform of a tax administration is a long process given the need to establish the appropriate management culture and climate, which in western tax administrations has taken decades and are still evolving.

## **2d. MINISTRY OF FINANCE AND ECONOMY - PROPERTY TAXATION**

During the past three years, the USAID Economic Development Initiative established the property tax system in Kosovo and built the capacity of the municipal property tax administration to ensure that the property tax continues to play a more significant role in municipal finance. Property taxation accounts for approximately 30% of municipal own-source revenue. On average, revenue from property taxation accounted for 5% of total municipal revenue in 2006 and as high as 10% in some municipalities such as Pristina and Obiliq.

### **Accomplishments**

The establishment of property taxation in Kosovo and the registration of nearly 370,000 properties is a major achievement. Though the amount collected is still small in what are still the first years of this major reform, it is a significant amount and in some municipalities totals 10% of all municipal revenues. The USAID Economic Development Initiative has institutionalized the property tax to the point where it will continue to grow and provide a stable and significant own-revenue source. Collection procedures are more vigorously enforced and valuation continues to improve with greater attention paid to market analysis. Property tax registers were established and a simple, easy to understand IT solution was implemented at the municipal level. Work has begun to replace this system with a more sophisticated database since local counterparts have become more skilled at their jobs through significant capacity building efforts.

The growth of revenues has been significant with growth exceeding the previous year by 58% in 2004, 21% in 2005 and 14% in 2006, where a total of 7.6 million euro was collected. On current estimates in 2007 collections are due to exceed 2006 by some 20%. The development and implementation of a sophisticated property tax incentive program in 2005, as part of the general grant distribution process from central to municipal governments, together with the capacity that has been built over the course of this contract, is credited with the continued increase in revenues.

### **Outstanding Issues**

The major technical challenge that remains is aligning the IT system that supports property tax administration with the processes and operations of the municipal property tax offices. Efforts are currently underway to migrate the existing property tax registers to a new database platform, house them on a central server, and develop a web application for the user interface. The first phase of this project will be complete by the end of 2007. The second phase which involves aligning the property tax IT system to other system development efforts within the Kosovo Cadastre Agency (KCA), will begin next year.

The collection of additional property characteristics is needed before valuation in Kosovo can be in line with international best practices. The KCA is proceeding with a survey of all parcels in Kosovo, though this is tedious work that will take several years. A law to establish a certifying body for Kosovar survey companies is in development and should be promulgated later this year. Once a few survey companies are certified by this body to perform official surveys, municipalities or the MFE may contract with them to collect these additional property characteristics (including GPS coordinates, building quality, material of construction, etc.) for the purpose of estimating market values.

## **Lessons Learned**

Kosovo is one of the first of the former socialist/communist countries of Eastern Europe to implement a market value-based property tax. USAID has played a pivotal role in this reform. The major lessons learned are:

- Ad valorem property tax reform need not await the full development of the cadastre
- A strong commitment from the local government implementing the property tax and support from the central level is essential
- All relevant property characteristics must be collected during the initial survey
- Development of the IT system supporting property taxation is an organic process that will grow in terms of functionality and sophistication as other reforms progress, notably the development of the real estate cadastre and the recording of payments through the Treasury system
- An incentive framework connected to the grant process is instrumental in focusing (and rewarding) municipalities to take initiative and set realistic rates and focus heavily on collections.

## **2e. MINISTRY OF FINANCE AND ECONOMY - MACROECONOMIC UNIT**

### **Objectives:**

- Conduct an internal assessment of MFE and develop a Strategic Management Plan so the MFE functions more efficiently, so that MFE goals and actions are based on strategic plans and so that the MFE functions as the lead ministry in providing strategic economic development for Kosovo
- Establish a functioning tax policy unit in MFE that will develop the capacity and processes for legal interpretation of tax laws.
- Assist the Macroeconomic Analysis Department to strengthen its data analysis and forecasting abilities in order to improve policy formulation. In addition, the Contractor will assist this department to strengthen cooperation and collaboration with the Statistical Office of Kosovo.
- To greatly increase the capacity of counterparts and staff in Kosovar economic and legal institutions to understand and perform tasks related to economic development and implementation of legislation.
- Establish an internship program whereby the Contractor will hire four to five recent university graduates for a one-year internship to gain exposure to economic and legal policy and practice. These interns will be drawn from study areas such as economics, finance, law and public administration.

### **Accomplishments:**

Strategic Management Plan completed. Vision and Mission statements are publicly posted and available to all, and well-understood, as are the Ministry functions and corporate culture. A tax policy department in MFE, which focuses on the legal interpretation of tax law, is in existence, but its capacity is not well developed.

A very strong macroeconomic analysis department exists. It is widely acknowledged to be an important and integral part of the MFE. The department uses a small but sophisticated macroeconomic model to perform regular forecasts of the Kosovo economy and analysis of specific issues. The model is regularly adjusted and updated as new data becomes available and new developments occur. The Kosovars who staff the department are well educated and motivated.

This department has been given the extremely demanding tasks of finalizing the Kosovo Development Strategy and Plan (KDSP) and producing the Medium-Term Expenditure Framework (MTEF) by the Minister, which implies enormous confidence being placed in the unit. A first draft of the MTEF has been produced. The Macro department takes the lead in discussion with IMF and EC/WB missions.

A graduate recruitment was initiated with scholarships with the American University of Kosovo. The first graduate intake will be in 2007. A plan is underway to develop a graduate training program, linking these young professionals with international advisors to ensure their education program continues and to ensure integration into the MFE system.

### **Outstanding Issues:**

- Attention has been focused on the macroeconomic department, and as a result the tax policy department seems at times to be adrift. The tax policy department appears to lack strong economic analysis capacity, and therefore does not seem to engage in debate regarding the best, and least distortionary, tax mix, the competitiveness of tax systems in the region and so on. More attention should be devoted to this unit in future.
- The effects of increased capacity in Kosovar staff can be very fragile. As capacity increases, the individuals become more marketable, and there must be greater flexibility in government to attract and retain top-performing staff, without those benefits becoming subject to nepotism, favouritism or political interference. An earlier attempt to pass legislation to create a “supergrade” pay scale failed. This attempt will have to be repeated, in a more deft way, at an appropriate time.
- An internship program has not yet been implemented. The IMF imposed hiring freeze makes this difficult to gain significant support for since the hiring implies terminating the contracts of more employees. However, it is important to maintain a flow of bright and motivated young professionals into the Ministry, and this would be the best way to do that. Efforts to implement such a program should be redoubled.

**Lessons Learned:**

In order to build a department, considerable support is necessary. First, it is important to ensure that the key people have sufficient education. Second, they must receive continuing support from advisors, to ensure a continuing sense of purpose and direction, and to be well connected to the Minister and the most senior officers in the MFE. Third, they must receive sufficient financial compensation to retain the best. Forth, they must have an important and challenging workplan to maintain and build their motivation and team cohesion.

### 3. CENTRAL BANKING AUTHORITY OF KOSOVO (CBAK)

The objective of this project component, as stated in the task order scope of work, is a sound expanding financial system supervised by professional financial sector regulatory institutions. The primary focus, as specified, was placed on banking regulation, with limited short-term assistance to BPK insurance and pension departments. The Sub-objectives established to fulfill the SOW, as developed in the annual work plans during this phase, were: (a) to institutionalize supervisory policies and processes; (b) to build capacity of management, staff, and systems within CBAK; and (c) to initiate/implement policy reforms;

#### **Accomplishment**

**Supervisory Policies and Processes.** The DMD position was transferred in February 2006, with the incumbent reverting to an advisory role. All supervision management positions are now held by Kosovars. A successor position to the DMD, the Chief Supervision Officer, was re-established and filled to enable continuity at the executive level. Management positions within CBAK supervision reflect no gender bias; all appointments have been on merit.

**Capacity Building.** Capacity building was paramount and is ongoing. Supervision Directorates have been reorganized along functional lines. Position descriptions have been written for each position within each organizational unit. Training needs are identified via the annual performance appraisal process, requirements specified in position descriptions, and the CBAK's strategic vision of the financial system and how it will be supervised. Training needs are quantified annually for each staff member in the Individual Training Profile required by the CBAK Training Policy. Needed training is timed in accordance with the Supervision Training and Development Policy to correspond to the appropriate career level of the staff member. Funding is then allocated via the annual performance planning and budgeting process, and training is provided in accordance with the annual training schedule that is incorporated into each Directorate's performance plan.

The technical assistance for training, provided by multiple donors, has been coordinated for maximum benefit. This training, plus that funded directly from the CBAK budget, has encompassed all areas specified in the TOR – and beyond, as evidenced in the quarterly reports' attachments that showed training attended by CBAK staff and management. In addition, all management positions from team leader upward are accorded opportunity to participate in the USAID-Bearing Point Professional Development and Executive Development Programs.

**Policy Reform and Institutionalization.** CBAK issued a new anti-money laundering Rule concurrently with implementing strengthened examination procedures. A broader and stronger Regulation was drafted by the FIC in consultation with CBAK, but the OLA opted not to approve the proposed legislation. CBAK entered into an interagency MOU with the FIC concerning sharing of information and personnel for purposes of upgrading AML-CFT efforts and to develop staff experience. One senior CBAK examiner is seconded to FIC; another secondment is planned. Additionally, a Compliance Team has been established within the Banking Supervision Directorate whose primary function is to assess compliance with AML-CFT rules and the regulation in all financial institutions. The team examines all financial institutions; reports are shared with FIC. Several individuals have been earmarked to develop expertise in this specialized area and have been sent to courses and workshops on the subject. CBAK staff members have

participated in joint actions with FIC and police that have resulted in arrests and prosecutorial actions.

Several “assisted” BCP assessments have been performed. The results formed the basis of work plans to improve the legal-regulatory-policy framework to upgrade compliance. More importantly, those components of the work plan dealing with capacity building and operational supervision were designed to overcome implementation weaknesses. The CBAK website contains many new rules and regulations, which reflect efforts to upgrade BCP compliance. Risk-based supervision policies and methodologies were developed and implemented. The work of the CBAK Supervision Committee was upgraded to policy and issues reviews and decisions to guide and evaluate supervisory activity. Cross-border cooperative agreements have been signed with banking and insurance supervisors in other countries. Examination procedures for, inter alia, the areas of lending, insider activities, governance have been upgraded. Risk rating processes have been refined. Institutional supervisory strategies have been established. Offsite reporting forms have been redesigned (but not yet put into place).

Much of the institutionalization and policy reform was done in an adverse environment. Significant turnover in banking supervision occurred in mid-2005 at senior levels, necessitating reorganization of staff and organizational work flows. One bank had to be closed in early 2006; its liquidation is ongoing and diverts focus as well as resources. Five of the seven banks were placed under some form administrative or enforcement actions, which involved removal/suspension of shareholders, directors, and managers, and prompted major restructuring of their internal processes. Two buyouts and a merger were negotiated with a foreign bank. Several applications were processed for new banks and other types of financial institutions, thus increasing the potential for competition. The legal-regulatory framework for MFI and non-bank financial institutions was revised to sponsor further growth in this segment of the market and to remove defects in market structure.

Similar rehabilitation of the insurance and pension sectors involved changes in capital requirements and solvency determination, rationalization of distribution points, liquidation of SOE defined benefit pension plans and conversion to modern, viable plans, and approval of new entries and products into the marketplace.

In practice, CBAK meets regularly with the CEOs of insurance companies and banks, each as a group, and consults with industry groups, such as KBA, AMIK, and SCAAK on issues affecting their areas such as changes in legislation, training, and donor coordination efforts. The Managing Director of CBAK is a member of the Pillar IV Core Team that meets daily to raise and resolve issues on the UNMIK-EU side. For institution-specific issues, of which there are many, the dialogue is continuous. CBAK holds press conferences and issues press releases whenever deemed appropriate. The MD and DMD for supervision subject themselves to periodic interviews with the media.

### **Outstanding Issues**

- Continued mentoring will be needed for all management positions, particularly if the Deputy Managing Director for Supervision is appointed, as anticipated, to the Managing Director position during the next 6-8 months.
- The Certification Program that was developed by the BearingPoint team, although designed, has not yet been fully implemented. The intent is to implement this phase in concert with a new supervision compensation and position management plan (also designed by the

BearingPoint team) to be approved by the CBAK Supervision Committee. The plan should resolve transparency issues related to promotion and salary actions that have been sources of dissatisfaction.

- A planned attachment of the Corporate Team Leader to an applications/licensing unit of a more advanced regulator was not obtained. Training in offsite analysis has been limited thus far and remains an important need, which is expected to be met, in part, through scheduled training by the First Initiative advisor in forthcoming months.
- Further legal-regulatory reform is needed for the banking, insurance and pension sectors. Several prudential Banking Rules need revision to bring closer to Basel II and EU harmonization and BCP compliance. A framework for life insurance (rules, supervisory procedures) must be developed. Risk-based solvency requirements, prerequisite to TPL insurance premium de-regulation are not yet fully implemented. Certain institutions are in process of implementing reforms or must be resolved via enforcement actions by CBAK. The licensing and supervision framework for branches of foreign banks and the framework for consolidated supervision of financial institutions must be further developed.

### **Lessons Learned**

A strategic vision and plan for the financial sector and its supervision should have been adopted early and then implemented consistently. Priorities should have been established and sequenced in a building block manner. Looking back, it seems that too many projects and tasks were given equal priority and undertaken simultaneously, thus diluting focus on essentials and straining absorption capacity.

Licensing of institutions would have benefited from better “fit and proper” screening of owners and managers, although there may not have been any option in the early years of Kosovo’s financial system. The urgency to establish a banking system, together with the lack of interest by internationally reputable banks, left little alternative. Local businessmen were given ownership, and ownership lacked a single strong shareholder. Management expertise was lacking. Owners proved self-serving and clever at concealing their activity; managers, often family members, were simply tools of the owners. In retrospect, twinning arrangements and management appointees from large institutions abroad, with a gradual dilution of initially donor-held capital would have been better.

#### 4. COMMERCIAL LAW

The amended Task Order for Kosovo V contains a number of requirements with respect to the development and implementation of Kosovo's economic/commercial legislative environment. These requirements fall broadly into four basic categories: (1) *Substantive Legislative* requirements, principally aimed at ensuring the enactment of important, substantively sound, economic/commercial legislation; (2) *Procedural* requirements, aimed at ensuring that the process governing the development of legislation is more policy-based, quality-oriented, systematic, and inclusive; (3) *Drafting* requirements, aimed at improving the technical form, i.e. drafting, of legislation; and (4) *Implementation* requirements, aimed at ensuring the improved implementation/enforcement of economic/commercial legislation.

##### **Accomplishments**

**Substantive Legislative Requirements.** Nearly all core and commercial legislation needed to support the proper functioning of a market economy has now been promulgated. This includes laws on collateral (pledges and mortgages), bankruptcy and commercial arbitration. The laws on real property and obligations (contracts and torts), which were previously adopted by the Assembly but returned to it by UNMIK for additional revisions, are expected to be re-adopted and promulgated in the Summer of 2007. A modern company law, which has been very positively received by the Assembly, is expected to be adopted by mid-July of 2007. Beginning in 2005, substantial assistance was provided to the Government in connection with the development of a draft Law on Courts; however, owing to the creation of the new MOJ in 2006, which took over sponsorship of the draft law and disagreed with or did not understand the fundamental policy choices reflected in the draft law, it is still under development within the MOJ.

In addition to the above-mentioned pieces of legislation, and as required by the amended Task Order, the Contractor provided substantial advice in connection with the development of numerous other pieces of important economic/commercial legislation, which were enacted during the contract period. These include laws on Competition, Foreign Investment, Trade Marks, Copyright, Patents, Industrial Designs, Mining, Energy, the Energy Regulator, Electricity, Procurement (substantial amendments), Public Financial Management (substantial amendments), Internal Audit, Financial Reporting, International Financial Agreements, Concessions, Expropriation, Personal Income Tax, Profit Tax, Tax Administration, Consumer Protection, Product Safety, the General Safety of Goods, Standardization, Construction, Construction Products, Market Inspection, Small and Medium Enterprises, Internal Trade, the Chamber of Commerce, Precious Metals, Petroleum, and Money Laundering.

The Contractor also provided advice and assistance with respect to other pieces of economic/commercial legislation still under development. Most notably, beginning in the fourth quarter of 2006 and continuing through the end of the contract period, the Contractor provided substantial and on-going advice and support to several UNMIK-PISG working groups charged with reviewing the entire body of UNMIK Regulations for the purpose of modifying these as needed to transfer UNMIK's competencies to the PISG. Of particular importance, in the first half of 2007, the Legal Team provided assistance with respect to the review and modification of the KTA Regulation and the initial development of a proposed new law on Publicly Owned enterprises.

As a necessary aspect of its advisory role on substantive legislation, the Contractor routinely worked with Government officials and lawyers, Assembly members, other donors and interested stakeholders from Kosovo society (NGO's, private lawyers and private businesses) to improve

their understanding of the policy issues, subject matter, meaning and intent of each piece of the afore-mentioned pieces of legislation.

**Procedural Requirements.** The Contractor also enjoyed great success, through its work with the Government and the Assembly Committees in greatly improving, as required by the amended Task Order, the process of legislative development to ensure the prioritization of draft legislation needed to support market-based economic development, and to generally ensure that the drafting of laws is more policy-based, quality-oriented, systematic and inclusive.

As a consequence of the Contractor's active assistance in this area, the Government adopted, in 2005, a set of standardized, substantive and procedural rules to govern the drafting of legislation in the Government. These rules now impose a strict procedural and substantive requirements on the drafting of legislation and ensure that all draft legislation is necessary (clearly related to a public policy objective). The rules require stringent quality control and EU compliance checks before a draft law may be transmitted to the Assembly. The rules also reinforced the authority of the OLSS to enable it to better fulfill its central role in the legislative drafting process. The rules require that all draft laws be reviewed and approved by an OLSS working group that includes representatives of outside stakeholders and interested parties. (Prior to the adoption of these rules, the legislative drafting process of the Government was clearly out of control as purely political considerations and agendas caused a massive "rush to legislate" that overwhelmed the available drafting capacity and resulted in a large amount of poorly written draft legislation.).

After the adoption of the new procedural rules the Contractor then provided on-going training and assistance to the OLSS lawyers with the implementation of those rules. The achievement of this objective has been one of the major successes of the legal team working in the Government, and has been chiefly responsible for greatly reducing the flow of draft legislation from the Government to the Assembly and substantially increasing the quality of that draft legislation.

Furthermore, as a salutary consequence of the fewer, generally better-drafted, pieces of legislation submitted to the Assembly by the Government, the members of the Assembly charged with reviewing that legislation have been able, often with the Contractor's active assistance, to focus greater attention on understanding and critiquing a given piece of legislation more thoroughly, including the underlying policy choices, the specific provisions, the operational mechanisms and the costs and benefits. The Assembly Committees, also with the active assistance of the Contractor, are now holding far more meaningful public hearings to solicit and consider the views of the donor community, private sector actors, the NGO community and outside experts. Furthermore, the Assembly members, most notably those of the Budget Committee and the Trade and Industry Committee, now have more time and experience to focus on other valuable tasks, e.g., reviewing how well existing pieces of legislation are being implemented in practice.

**Drafting Requirements.** As required by the amended Task Order, the Contractor achieved a very high degree of success in improving not just the process governing the development of legislation, but also the technical drafting skills of Government lawyers. This improvement is partly a direct result of the new drafting rules adopted by the Government in 2005. The adoption of the new rules and the resultant slowing of the flow of legislation permitted the Contractor to work more intensively with Government lawyers (particularly OLSS lawyers) and officials on producing more professionally written draft legislation. The improvement in drafting skills is also attributable to the increasing experience being gained by these local counterparts with legal writing and to the recent creation of a significant number of well-written pieces of legislation in the local languages that are now being used by local counterparts as models. By the end of the

Contract period, the Contractor was only rarely called upon to produce the first drafts or to completely re-write proposed legislation, but instead was able to focus on assisting our counterparts with reviewing and improving their own work-product and to help them draft amendments to existing legislation. This represents a major advance from the situation that prevailed at the beginning of the Contract.

Our approach to achieving better capacity in the area of legislative drafting and review has been to conduct day-to-day on-the-job training of local counterparts on a law by law basis. Because of its immediate relevance, this methodology seems to have been very effective, as a significant number of Assembly members and Government lawyers are now demonstrating a substantially improved ability to review, analyze, understand and even develop amendments for draft laws.

**Implementation Requirements.** Implementation requirements and benchmarks constitute a very substantial component of the amended Task Order, and, as required by that Task Order, the Contractor provided a substantial amount of training and education to judges, Government and private lawyers and law students on the new and developing economic/commercial legislative regime.

In particular, the Contractor provided, throughout 2006 and in the first quarter of 2007, a commercial law training program to commercial court and other judges and a significant number of private and public sector lawyers. This training program included courses on each of the following legal subject areas: the law of obligations (contracts and torts), real rights law (immovable property), collateral law (pledges and mortgages), company law, competition law, foreign investment law, commercial arbitration law, and bankruptcy law. This training program also provided information to the attendees on how to access local language versions of the new commercial/economic legislation on-line. As a consequence of these training efforts: (i) the broader legal community is far more aware of where and how to obtain the new legislation, (ii) a large number of judges are far more aware of the existence and basic substance of the new economic/commercial law framework, which can be expected to result in greater judicial observance and enforcement of that framework; and (iii) private lawyers representing the investor community are increasingly referring to, using, relying on and demanding the observance of the new legislation.

Prior to 2006, the Contractor provided training to judges, lawyers, government officials and other interested parties, both in Pristina and in the regions, in a series of targeted subject-matter specific seminars dealing with the laws on procurement, bankruptcy and collateral (mortgages, and pledges). Written commentaries and/or explanatory notes on the procurement, bankruptcy and mortgage laws were prepared and distributed to the participants.

In an effort to positively enhance the skills of the next generation of legal and business professionals, the Contractor also delivered, in the first year of the Contract period, a course “Advanced Contemporary Business Law and Commercial Transactions” to law and business students at the University of Prishtina.

With respect to a number of existing laws, the Contractor provided on-going issue-specific implementation training and assistance to Government bodies, administrative agencies and POE’s charged with the implementation or observance of those laws. This implementation assistance was regularly provided to the MFE, the Treasury, the Public Procurement Regulatory Commission, the Public Procurement Agency, the OPM, the OLSS, the MTI, the Business Registry, the ICMM and KEK.

In all of these training and education activities, the Contractor routinely provided the attendees with explanations regarding the policy bases of the concerned legislation, especially with respect to how the new commercial/economic legislation promotes the development of a well-functioning market economy. The result has been a demonstrable growth in the public's knowledge of and support for the new commercial/economic legislation.

### **Outstanding Issues**

Outstanding issues include: (1) finalization and promulgation of the Law on Courts, which was delayed because of the creation in 2006 of a new MOJ, which took over sponsorship of that law; (2) introduction of mandatory continuing legal education requirements by the Chamber of Advocates and the Judges Association requiring attorneys/judges to obtain annual certification of training in commercial laws; (3) establishment of a certification procedure for bankruptcy trustees and the training of an appropriate number of trustees; (4) provide implementation assistance to the Kosovo Competition Commission, which will only be appointed, at the earliest, in June 2007; (5) assist with the amendments to the Competition Law that are now required due to recent changes in the applicable EU requirements.

### **Lessons Learned**

To ensure the proper and uniform implementation and observance of the new economic/commercial legislation, several critical things are still required: (i) detailed explanatory material/annotations must be developed and disseminated to help the professional user properly understand the intent and meaning of the various detailed provisions of the law concerned; such secondary material is conspicuously absent in Kosovo; (ii) with respect to the issuance of sub-normative acts (regulations) under the authority of a public law (a law that a public authority is mandated to actively implement), there is a critical need for a law on subnormative acts that would impose – as in the US Administrative Procedure Act – detailed rule-making procedures that the public authority must observe when issuing sub-normative acts under that public law; this would provide for greater public consultation and help constrain the public authorities' demonstrated tendency to issue sub-normative acts that are at odds with or not authorized by the law concerned; and (iii) finally, a law specifying the fundamental and customary rules of statutory interpretation is needed to help reduce the potential that laws will be subject to unusual interpretations that are at odds with the law's purpose and wording.

## **5. KOSOVO TRUST AGENCY**

In April 2005 the Kosovo privatization program was stalled, no companies were being privatized and intense discussions about the legal basis for privatization were taking place. Only 2 waves of privatization had been completed, the KTA Board had not met for more than a year, and, Kosovo's population was depressed about the lack of positive activity in the economic development arena. Our team fought an often bruising encounter against the debilitating climate of fear and inaction that held sway over the privatization program, and with great USAID support and courage, today we can claim that we won that battle, and have successfully transformed much of the socially owned property into a private sector which is starting to thrive.

### **Accomplishments**

An overview of the privatization program during the project period shows that total Spin off revenues paid and banked to date are €288.1 million, Total revenues paid or pending are €332.9 million. This includes the total Special Spin off revenues paid or pending of €91.6 million. Investment commitments from Special Spin offs total €121.8 million which is an additional boost to the economy, and employment commitments total over 6,000 jobs. If all Sales commitments are honored (tender proceeds, liquidation sales, and investments), €427.2 million Euros will have been raised through privatization and liquidation tenders in the privatization program. 445 NewCos have been tendered from the assets of 276 SOEs.

In addition to the measured commitments of the larger Special Spin offs, a recent survey of 50 of the smaller and medium sized enterprises privatized during the project indicates that revenues have increased by a factor of 7, paid employment has increased by 10%, and planned capital investments into the businesses is greater than 300 thousand Euro per new company. On a macro level, exports from Kosovo have increased from circa 14 million per year in 2004 to nearly 70 million a year in 2006. much of this is due to the SOE sector and the privatization of enterprises.

The KTA launched its first liquidations in August 2005. The total number of Board-approved liquidations now stands at 90. Over 85% of the SOEs in liquidation have already had their core assets sold via spin-off tenders. However, 57 enterprises (63%) still have remaining assets for sale, and eleven (11) SOEs are in the process of being privatized via the liquidation route rather than the spin-off method. The BearingPoint advisor led the work of developing the sealed bid auction rules for asset sales and provided both training as well as broad-based technical advice to the KTA regional staff on all liquidation sale related matters and procedures. To date, the KTA has conducted 15 liquidation sales, which included over 30 properties – mostly factory premises, offices, retail outlets and warehouses, land and buildings – and the combined value of the winning bids exceeded €4.3 million.

In preparing for status and handover, we have twinned Kosovo nationals with our international advisors in all privatization departments. At the start of this program we had 6 advisors in leading roles. Today, all departments are led by Kosovars, except liquidation which still has an EU funded head. Six of our leading staff have completed the professional development program, and most staff members have been thoroughly trained. The organization now operates professionally and efficiently.

### **Outstanding Issues**

The Brezovica ski resort privatization program suffered a severe set back when political pressure from Belgrade resulted in some considerable nervousness from UN NY concerning proceeding

with the tender during the final status negotiations. This tender has been postponed until further notice.

Four meetings of the Trepca Administrator bid evaluation committee have been held. In the final meeting of this committee, held on 19<sup>th</sup> September 2006, the PISGs position crystallized, and they reported themselves unable to support continuation of the Administrator appointment under the applicable law. The fact that they have been granted a veto right by the KTA board means that the process has become frozen. Options moving forward:

- To withdraw the application and put Trepca into voluntary liquidation. We understand from previous legal advice that it would be possible for the KTA to run Special Spin Off tenders through liquidation, and this would meet the preference of the PISG. However, the KTA is severely limited in resource to undertake such a program, and, would need to consider this need very carefully.
- To appoint a special project team to act as administrator and submit this for consideration to the special chamber.
- The Special Chamber to unilaterally appoint an administrator.

Substantial effort has been given to the largest SOE in Kosovo, this being Sharrprodhimi, in the Dragash municipality of the Prizren region. Some 22,000 hectares of mainly pasture land are managed by this SOE and the team has developed a strategy for its reform and privatization. This is indeed an exciting venture and one which will shape the future of this stunningly beautiful areas of Kosovo.

The Sharcem cement factory which was commercialized 7 years ago, is now being prepared for privatization. Concerns over the commercial negotiations required to buy out the remainder of the lease and the right of first refusal of the grantee have slowed the process. However, the policy has been put in place, and we confidently expect an offer from the grantee that will enable this enterprise to be privatized in the next 6 months.

The future funding of the KTA staff remains a blank page from end of September 2007. The central question – who covers the cost of KTA staff and other EU related expenses has not been covered. One undesirable outcome is the loss of key local staff members.

### **Lesson Learned**

Initiating a privatization program requires huge energy to overcome institutional inertia. Once the process has been started and routines established, it is essential that the momentum is retained.

Speed and energy are essential in completing such tender programs, because it is only by transferring social assets into the private sector, that investment and sustainable activity can be created. Our program is a shining example of what can be achieved in stimulating the economy.

## **6. MINISTRY OF ENERGY AND MINES**

The objectives for providing assistance in the energy sector were added to the project in late 2005. They included providing assistance to the (then) newly-established Ministry of Energy and Mining (MEM) in the areas of developing policy expertise and facilitating the introduction of private-sector participation into the sector.

Two main objectives included; Assist MEM in developing a sound understanding of energy policy that comports with the best international standards; and, assist MEM to appropriately lead efforts to attract private investment in the energy sector.

By far the main accomplishment was the design, development and release of an Expression of Interest (EOI) for the development of a new power station and lignite mine to the value of around 3 billion USD. Through this process BearingPoint was instrumental in facilitating the achievement of consensus with the World Bank on its support for the development of Project C through the Lignite Power Technical Assistance Project (LPTAP) and the Government's execution of the Financing Agreement and related formal project implementation agreements. The result of the EOI was the short listing of four key consortia of the world's most reputable energy firms. The World Bank funded Transaction Advisor will now take this project forward to the Request for Proposal stage.

Other accomplishments include:

- Assisted MEM to implement the key provisions contained in the Government's Energy Strategy for Kosovo 2005-2015.
- Applied financial modelling techniques to support the analysis of Kosova's power sector, including KEK's operations and finances and implications for retail revenue requirements and future tariff levels.
- Facilitated coordination between MEM and other Government fiscal institutions toward a better understanding of the financial and retail price impacts of the application by the Energy Regulatory Office (ERO) of its newly-adopted tariff methodologies for establishing 2007 tariff levels.
- Assisted in the development of the Government Policy Paper on KEK, and continued to advise the Ministry on appropriate mechanisms for ensuring proper oversight of Government policy objectives for KEK.
- Assisted MEM in its response to politically-sensitive ERO tariff decisions and MEM's consistent public position to support the role of ERO as the independent regulator of the energy sector.
- Assisted on the development of MEM positions on key lignite mining licensing issues that are designed to protect strategic coal assets from any impairment that might impact Project C (below).

### **Outstanding Issues**

- For the remainder of 2007 and extending into early 2008, the continuing need to assist both the PSC and the PO in facilitating the Kosovo C project, helping the PO to properly manage the work of the LPTAP Advisors, bridging gaps which are

anticipated to arise across different grant-funded advisor teams, and coordinating their activities for maximum effectiveness.

- Development of increased/improved public outreach regarding the Kosovo C project, as well as future projects (or policy efforts).
- Assistance to MEM in the implementation of appropriate structures and approaches to attract private-sector capital into the sector for the effective exploitation of other potential opportunities to benefit Kosovo, including, for example, KEK privatization, mini-hydro development and/or initiatives in the mining sector. Development of MEM's mining sector policy and strategy. This should include addressing issues of fiscal regime, approach to license awards (e.g., "first-come-first-served" (current approach) vs. tendering)
- Continued improvement in clarity between policy-making activities and policy-implementation activities, further defining the respective roles and interaction of ERO, ICMM, and MEM
- Further articulation of MEM's policies and approaches in areas of energy efficiency, renewables, future participation in the European carbon emissions trading scheme, implementation of Athens Treaty requirements, and participation in the Athens process.

### **Lessons Learned**

- There is a diversity of energy policy experience at the MEM staff level. Some focus on capacity building (possibly by taking advantage of AUK programs) would be useful.
- There is a need to proactively plan and manage several policy matters, particularly those related to "external" processes (e.g., Athens process) which have exogenous timetables.
- Significant experience was gained in the implementation and management of the Bank grant programme. This will probably lead to more realistic understandings of pre-programme timetables, objectives, etc.
- As with the policy objectives, there is a diversity of experience and capabilities at the MEM staff level with regard to the multiple, complex requirements of large-scale development projects. Some focus on capacity building, particularly in the non-technical areas (such as economics / finance) would be useful.

## 7. PRIME MINISTER'S OFFICE

The Adviser's summary brief has been to provide economic policy advice and support to the Prime Minister and his Office

*One cannot over emphasize that over the whole reporting period and at this level, the factor that has exerted a clear dominance over everything has been the expected resolution of the status of Kosovo. At the highest level in Government, short-term political influences have tended to divert attention and take priority over structural policy issues.*

This is the essential background against which the Adviser has had to try and raise the profile of economic policy and to develop a capacity within the OPM to engage in such issues. The post itself has been very active with constant daily engagement involving meetings, informal discussions and production of many short policy driven memos on issues that span the whole range of economic policy. The Adviser meets with the PM every morning at the 'cabinet' meeting. *Because of this, the post by its nature serves to develop the capacity of the Prime Minister himself to engage in economic policy debate and enhance the quality of decision making.*

Outside of the typical administrative functions of any Ministerial Office, the majority of central policy functions of the OPM are concentrated around the Adviser Group or 'Cabinet' which includes the Permanent Secretary.

### **Accomplishments**

The Prime Minister Mr. Agim Ceku has been in office now for fifteen months. He continues to keep most of the central policy functions concentrated in his Adviser Group or 'Cabinet'. Although the Prime Minister and the OPM have little real experience of economic policy issues, as a result of the presence of an independent economic policy Adviser within the OPM the following has taken place and/or is very much in evidence.

- There has developed a widespread recognition that in the post-status environment, economic performance will be of central importance for the future place of Kosovo in the international community.
- In order to speed up the development process, the PM transferred the Kosovo Development Strategy to his Office. The Report was delivered successfully to the Government in December 2006.
- Supported by the Adviser, the Prime Minister himself is engaging more and more in discussions with the international financial institutions (IMF/World Bank/EU). This is particularly true of negotiations involving IMF Letters of Intent, Energy policy and medium term development policy
- The Prime Minister is now fully installed and active in his position as Chairman of the Fiscal Policy Committee. This position was formerly held by a Reserved Powers representative.
- There is now accepted willingness on the part of the PM to be engaged directly in presentations of economic policy issues e.g. Investors Conference on Energy, Central European Free Trade Association issues, the Government's record on the economy to the Assembly, defending the Budget before the Assembly and so on.
- Engaging directly in policy discussions with a wide range of representations from the business community and other private sector bodies. There have been a number of formal presentations by the PM concerning the economic issues that such bodies face – taxation, investment incentives, allegations of foreign trade discrimination and so on.

- Donor co-ordination has been centralized within the OPM.
- Kosovo is now a formal partner in the EU Pre-Accession process and as such becomes eligible for direct financial support under the financial instrument of pre-Accession (IPA).

All of the above have started from very thin and fragile positions. Moreover, the timescale of development in Kosovo is really very short. A great deal has been demanded of Kosovo by the international community and in many respects, the response has been credible.

### **Assessment**

It must be understood that even today, 'collective' government decisions are not much in evidence. Although much administrative and legal infrastructure is in place, the state apparatus is still in a formative stage. Given the nature of political coalitions in Kosovo, the Prime Minister is more a Chairman than a political leader. Post-status, this probably will change.

Even so, the above score as tangible successes in that only two years ago, the OPM had virtually no competence or even involvement in economic policy issues. The whole rested with the Ministry of Finance.

Today and as a result of there being an economic Adviser in the OPM:-

- there is daily contact between the PM and the Minister of Finance and between the two offices.
- there is an excellent relationship between the OPM, the SRSG, Pillar IV and the Office of fiscal Affairs.
- directly as a result of the facilitating role of the Adviser, there is regular contact between the OPM and the IMF, World Bank and EU.

As a result, the expectation is that more economic policy issues will begin to appear on the Government Agenda. Indeed, this is happening now with the Budget, the KDSP, the Medium Term Expenditure Framework, energy investment policy all being subjects for discussion and decision.

The above serves as a credible foundation for the policy process on Kosovo to develop so as to support a liberal market based economy.

## **8. KOSOVO PENSIONS SAVINGS TRUST (KPST)**

The KPST is a Kosovo success story. The Objective was for a modern pension system that will provide adequate income to pensioners (in addition to the Tier I basic pension). Our advisors assisted the KPST in implementing systems, processes and procedures while building the capacity of local staff. In 2006, BearingPoint concluded its technical assistance to the KPST. The institution is now fully operational, managing over 230 million euros in contributions from over 200,000 workers, and is recognized as an example of successful USAID support for institutional development in Kosovo.

Bearing Point advisors at KPST and CBAK worked together to resolve remaining legal-regulatory issues. A new Pension Regulation (2005/20 dated 29 April 2005) was issued to replace the intended interim regulation in effect from 2001. This regulation is comprehensive for the entire pension fund industry covering all pensions, including the Tier II system. This regulation incorporated many aspects covered in interim Rules issued by CBAK. Those Rules were revoked or amended during the current phase of the project using Bearing Point technical assistance. A reasonably comprehensive framework for the pension system in Kosovo now exists.

There may be a need to continue to review and update the framework, and possibly carve out the body of rules and portions of the current regulation that are specific to KPST, although the existing framework is adequate for administering Tier II. The “carve out” would be to protect the KPST framework in the event that portions of the existing Regulation applicable to other components/entities in the pension sector would need to be revised later. This would be a strategy to insulate the KPST funds from political aspirations.

Additional supplementary pension fund providers (Tier III) have entered the market, which is slowly increasing in competitiveness. Whether the income to be derived from these funds will prove adequate is not clear due to the relative youth of the funds, and the policy of fund managers/directors to opt initially toward safety rather than income. But the opportunities for income beyond work years now are available.

The Benchmark: Assure accurate, efficient and streamlined data flows that are necessary for accurate and timely administration and reporting. This will require coordination with tax administration and Ministry of Public Services.

Information exchange between TAK and KPST is working smoothly with the expectation that KPST will be able to issue pension statements covering the period through 31 December 2006 by end of May or early June from now on.

The Benchmark: Identify and promote policies and procedures that will assure that KPST is well-managed and operates efficiently in accordance with the law

KPST continues to be licensed and supervised by CBAK. By law, the Managing Director of CBAK Chairs the Selection Committee for directors of CBAK. Also by law, the Selection Committee sets guidelines for the candidates' qualifications. During the last round of nominations/selection, the CBAK and KPST advisors provided by Bearing Point assisted the Selection Committee in its activities. CBAK also vets any key management nominations, applying “fit and proper” analyses of financial and biographical data, and requesting background checks through local and international police/criminal authorities.

The Benchmark: CBAK's Insurance and Pension Supervision examiners regularly examine KPST to identify risks associated with its activities as well as compliance with Regulations and Rules. Refine and support policies that ensure sound investment decisions for the pension fund.

The Pension Regulation in Section III sets forth the framework of requirements for the operation of KPPST. CBAK Rules have been issued where permitted by this Regulation to implement the requirements. In practice, CBAK reviews in advance any proposed KPST Board decisions involving changes in investment strategies, policies and asset managers.

The Benchmark: Assure that the public is adequately informed about Tier II, including its purpose and functions, so that the public will understand and support sound investment decisions for the pension fund

The KPST has been very diligent in working on public relations (see public relations report for further information). From a regulator point of view, this aspect has been well managed. Although increasing political pressure through the media has been brought upon KPST (and CBAK) arguing for investment locally of the contributions/fund, the KPST Board and the CBAK have remained unmoved by the arguments to date, in light of a lack of suitable instruments. Both CBAK and KPST have consulted on possible options that might be introduced for certain lower risk local instruments for investment, but to date, nothing has been satisfactory.

## 9. PUBLIC INFORMATION & EDUCATION

Support provided by the Project's resident Public Information and Education (PI&E) Advisor over the three year span of the task order included strengthening of skills and human capacity, institutionalization of processes and practices, and information dissemination. This support was provided separately and at times in parallel at the Ministry of Economy and Finance (MEF), the Kosovo Pension Savings Trust (KPST) and the Ministry of Energy and Mining (for the past 9 months).

Significant, demonstrable progress has been made in the areas of programming, planning and budgeting among counterparts at MEF and KPST. By the end of Year Two, the KPST counterpart required very little technical support from the Advisor, while MEF counterparts only managed similar results at the start of Year Three. Counterparts at the Ministry of Energy and Mining (MEM) are somewhat familiar with planning and budgeting processes.

The main factor contributing to the successful development of counterparts lay in the daily interactions with the Advisor—for example, back and forth discussions on how to approach problems and find solutions and also through template materials developed by the Advisor for counterpart use (*Outlines for Annual Work Plans, Press Releases, structuring of Q&As, Fact Sheets, talking points, etc.*). The pairing up of internationals with local staff, working in the same office environment, proved valuable in delivering the results set out by USAID and the Project management. This is, perhaps, the most significant and long lasting contribution that USAID, through the Economic Development Initiative Project, has made to the field of public outreach and information within select Kosovo's government institutions.

### Accomplishments

*Strengthening of skills and capacity*—Information counterparts at MEF, KPST and, to a lesser degree, MEM have proven capacity to adequately confront their communications challenges. Two separate training sessions were offered to counterparts: 1). On Communications and Planning, and Developing Presentation Skills, held Spring 2004, in coordination with the USAID/Advocacy Training Resource Center. The training targeted press and information staff from several institutions including MEF, the Tax Administration, the Office of the Prime Minister, the Banking and Payments Authority, KPST and UNMIK Customs; 2). Crisis Communications, organized in consultation with USAID/World Learning.

*Institutionalization*—Processes for developing Annual Work Plans and accompanying Budgets have been instituted across MEF, KPST and MEM. In addition, media policies spelling out how the institution should interact with the media, establishing clearance procedures for issuing news and other information items, and identifying authorized spokespersons have been adopted by MEF (2005) and the KPST (2006).

*Public Outreach and information*—From June 2006 to April 2007, the Advisor led MEM's communications strategy centering on support for the new lignite power plant initiative (*Kosovo C*), contributing the first strategic document from which all activities and deliverables stemmed. Chief among them was a public information and public relations plan for the First International Investors' Conference on Mining and Energy, and a 12 minute information video on *Kosovo C* (March 2007).

Together with counterparts of the Tax Administration of Kosovo/MEF, a major public information campaign to support the shift in tax structure from a three to two tier system—

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*Corporate Income Tax and Personal Income Tax*—was launched in December 2004, and continued throughout 2005.

The reengineering of the Property Tax Incentive Grant, signaling a major shift in policy in late 2005, also required a public information campaign. Launched together with MEF counterparts in late 2005, the campaign centered around a half-day presentation session targeting local officials from 27 municipalities, which explained the rationale for the new grant as well as the revised formula method for accessing grant funds. Packets of information materials were also prepared and presented to journalists at a briefing organized following the official presentation.

Other significant achievements include: development of an educational CD on the Law on Public Procurement (2004); development of a strategy, plan and budget for the re-launch of year-long campaign on Value Added Tax (end 2005 to 2006); briefings for journalists on budget (*several, but in 2005 coordinated with the USAID/IREX Media Development Project*), taxation and treasury issues; public discussions with stakeholders on Tier II Pensions (in 2005 in coordination with the USAID/Advocacy Training Resource Center, ATRC).

Outreach and education efforts by the resident Advisor have significantly contributed to raising awareness among government officials, the media, and the public on core areas supported by the Task Order, in particular, fiscal issues, tier II pensions, and energy. Most importantly, the Advisor has contributed to the development of a new cadre of information professionals across several institutions who can conceptualize, plan, budget and implement a communications program.

### **Outstanding Issues**

While counterparts have acquired strengthened capacity and the skills to undertake their work, minimizing the need for a full-time resident Advisor, intermittent support may be required in the near term. For example, when and if the Government decides to concession the Airport of Pristina, USAID may wish consider a short-term communications consultant to help lay out the strategy, implementation plan and development of template materials. The execution of the overall plan can be left to the local counterparts with periodic tweaks and tucks made by the consultant on subsequent visits. Similarly, circumstances at MEM may require intermittent support in the months ahead.

### **Lessons Learned**

Over the years, the Advisor has observed that many Kosovar Government officials are not fully receptive to the concept of public information and outreach. To a large degree, this stems from previous government practices prior to 1999 whereby those in positions of power closely held information. Over time, with the development of the profession this will change, but for the present those working in the field face almost daily struggles to convince their superiors of the merits of disclosing information and being transparent. Some small battles have already been “won” at MEF and the KPST.

## 10. TRAINING AND EDUCATION

The following final assessment will serve to document the Training capacity building process of work completed while assigned to the Kosovo project from June 2004, through June 30, 2007.

BearingPoint conducted an assessment of the MFE Treasury, Budget, Tax Administration, Central Administration, Central Bank (CBAK), and Kosovo Pension Savings and Trust (KPST). The assessment identified the strengths and weaknesses existing within each institution. It was decided that a large effort should not be devoted on building capacity in-house in the MFE training unit as in the first two years of the project, the Permanent Secretary was not a strong partner and, in conjunction with USAID, it was greed this effort would have been wasted.

One of the main findings on our assessments was the need to develop a comprehensive program of skill development in leadership and management expertise, to compliment the skills based training being delivered. This resulted in the Professional Development Program (PDP), specifically designed to meet the needs of those members and improve the overall capacity building making it sustainable within each institution.

### Professional Development Program

The PDP was developed by BearingPoint in September 2004 to build professional and managerial skills of a critical number of mid-level government employees. Since then, 179 people have successfully completed the program, with an ever increasing number of institutional employees in the Kosovo government and similar institutions requesting to be accommodated in the program. The course incorporates the delivery of training for four hours a week over a year-long period, accommodating the delivery of the following 12 courses:

#### Professional Development Skills:

- Writing Professional Communications, Oral Presentations, PowerPoint, Conflict Resolution, Teams, Decision Making, Goals and Priorities, Introduction to Ethics

#### Management in Government:

- Covers all aspects of Management, Planning, Leadership, Coordination, Control, Span of Control, Delegation and 54 other topics

#### Organizational Behavior:

- Expanding implementation of theories into real action
- Diversity dealing with Gray man theory and minorities.
- Sexual Harassment and ways to prevent it are covered thoroughly
- Students learn developmental leadership and examination of leadership theories and models
- Organizational structure, Developing Operational/Organizational Plan.

#### Critical Thinking and Decision Making:

- Decision Trees, mathematical and operational.
- Optimizing the Decision Process, Consequences for Actions
- Working with real world problems of Kosovo organizations

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Managerial Ethics for Today's Government Manager:

- The program expands all views of ethics and development of ethics in real world programs. Students look at views of Emmanuel Kant and Government/Business application.
- Review of controversial case that can be applied to Kosovo.

Human Resource Management for the Public Administrator:

- Covers all concepts of human resource management, staffing, work flow analysis, compensation, reward, incentive programs.

Dealing with a Changing Government:

- Covers all aspects of significant changes in organizations from an emerging economy. Focus toward end user by reviewing 21<sup>st</sup> century movement to implement quality in Government/Business.

Total Quality Management:

- Introduction to TQM through D Edward Deming, through Drucker, Peters, and how to implement quality standards in the government/organization model department/Ministry.
- Review Six Sigma, quantifiable standards, developing innovation

Budgeting:

- Covers aspects of developing a real world organizational budget and expanding through organizational budgeting
- Review and Development of Managerial Finance

Capstone:

- Re-cap on topics covered throughout the course

The format of each course includes both lecture and individual and group exercises to build a core foundation of knowledge to then be applied to real-life work situations. As well as the lecture case studies and exercises that are completed by students during class, they are also obliged to submit a personal paper and team project or paper upon completion of the program in order to graduate. Such exercises have proved to be highly successful in allowing students to put into practice their newly acquired knowledge and prepare them to use such practices in their workplace.

The success of the PDP rests highly on the structure of the classes. In order to ensure minimal disruptions to job responsibilities and departmental work flow, each block is delivered once a week over a period of five weeks. Program introduction to each class is staggered over a period of five weeks, which allows participants to make up a missed block during following cycle delivered to the next class. The mandatory attendance policy, implemented by BearingPoint and supported by the various institutions involved in the program, has been a successful approach to ensuring the success of students' learning. The following program control guideline has proved successful in aiding students to gain optimum results from the PDP:

Program Control:

- Members must be in attendance for 4 out of 5 (4 hour) blocks without a schedule make up day.

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- Training teams must meet at a different worksite once each week for at least thirty minutes.
  - They are permitted to be absent for a 2<sup>nd</sup> block, but the 2<sup>nd</sup> absence must be made up by attending one of the missing blocks in a subsequent class held at AUK.
  - A third missed block in the same course will result in the participant being eliminated from the program.
  - Failing grades in developmental assignments or generally poor attitude or uncooperative behavior with team members will result in learner termination from the program.

Since its beginning in September 2004, much progress has been made in the move to institutionalize the PDP. Although three local full time trainers for the program are under development and due to the lack of trainers available, it was necessary to cut the overall curriculum in order to complete the program by 30 June 2007.

### **Leadership School**

Held from 1 October to 31 December 2006, the Leadership school was initiated enrolling thirty five of the best rated graduates of the PDP. These students were to complete a staged 12 week program identifying real world common problems within their respective institutions. The problems were universal to an emerging economy facing common developmental issues and were broken down into a factual analysis. Modules were replaced with real situations and applications. An analysis of the staged results was examined. Students reported improving their professional skills in all areas. The program was praised by all who attended and is one the most in demand programs in Kosovo today.

USAID and BearingPoint have received requests from the Kosovo government to offer this particular school again. The school is not part of the institutionalised process at AUKI but was brought about to facilitate higher advanced development of the most empower PDP participants. This program could be offered as the Leadership School. Three students were identified with specific distinction. One student, the Director of Customs, reported that he has been asked to take over as the first local to manage his own department separate from UNMIK without international guidance or oversight as it advances toward final status.

### **Outstanding Issues**

- It is important that the PDP becomes institutionalized, the AUK have agreed to take this course over and indeed have three full paying courses underway..
- The Permanent Secretary in the MFE has changed and the new Permanent Secretary Muharrem Ibrahimmi has expressed sincere interest in developing the training unit into a progressive modern department. The director and members of the training unit have completed the PDP and are prepared to undergo modern change concepts. This should be undertaken as soon as possible utilizing the most modern infrastructure system.
- Better linkages need to be made with KIPA and SKAAK – joint delivery of training and tailored courses for government in accounting need to be explored.

### **Lessons learned**

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The linking of technical skill development with management / leadership training exceeded our expectations. Observable change can be seen in supported institutions where senior staff have undergone the PDP. These staff have a broader outlook, are more conscience of their management role and are generally more receptive to other learnings and change. This has also made them into role models for the younger generation coming through.