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KOSOVO ECONOMIC REFORM PROGRAM (ERP) 2017 - 2019

December 2016
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4. Structural reform priorities for 2017-2019

4.1. Identification of key obstacles to competitiveness and inclusive growth

Over recent years, Kosovo recorded economic growth rates among the highest in the region, but the growth was based on a specific development model consisting of two pillars. The first pillar are large remittances and FDI inflows from diaspora that boost domestic demand through household consumption, while the core of the second pillar is a high level of public investment. The resulting economic structure is characterized by high levels of consumption and investment in non-productive sectors (mainly construction) and, on the other hand, one of the least diverse export baskets in the region, comprising almost solely of low value added goods. The combination of high consumption and low exports has resulted in very high trade deficits. Given the risks associated with such a development model, the main challenge for Kosovo is to establish conditions conducive to self-sustained growth based on increased domestic productivity and export competitiveness, and aimed at reducing high unemployment and poverty.

To support selection of priority measures for addressing this challenge, two growth diagnostics studies were conducted during preparation of Kosovo's ERPs and identified binding constraints to economic growth. This section reports on developments with respect to the identified growth constraints since last ERP submission.

Figure XX: Obstacles to growth in Kosovo *

* The constraints in bold are considered to be binding, while others are important and may become binding in future. The figure is based on the OECD growth diagnostics for Kosovo (2015) and a study prepared by the EU technical assistance for ERP (2014). The MCC's compact development team prepared another growth constraints analysis in 2016 and their findings are also used in the text of this section.

Access to finance for SME. This obstacle was directly addressed by a credit guarantee scheme established in 2016 that will be expanded further through the Kosovo Fund for Credit Guarantee (measure #12). Recent data show that this obstacle was somewhat reduced. Nominal interest rates
for commercial loans declined from over 10% in 2014 to around 7% in 2016 and, in the same period, the annual growth rate of loans to non-financial corporations picked up from around 2% to around 6%. These favourable developments led the recent MCC study to consider the obstacle as not binding anymore for medium and large companies. Nevertheless, with the banking sector remaining highly concentrated and thus recording high profit rates, it is not assured that current trends in interest rates will continue. The ERP measure #12, focused on SMEs, thus remains pertinent.

**Weak contract enforcement.** Introduction of a private bailiff system considerably improved enforcement of contracts, with Kosovo now ranking 44th in this Doing Business indicator (up from rank 138 in 2014). The time for resolving a claim shrunk from 420 to 330 days, but the cost of enforcement remains at a third of the claim's value. On the other hand, no improvement has been recorded in resolving insolvencies or in corruption perceptions among businesses. Weak contract enforcement, which also has a negative impact on access to finance, remains a binding constraint and is being addressed by reform measures aiming to strengthen the property rights system (measure #10) and increasing judicial efficiency (measure #11), the latter specifically focusing on the economic department and the fiscal division of the Pristina basic court.

Growth diagnostic studies found the overall **business environment** to be challenging, stressing the issues of burdensome regulation, large informal economy (estimated at 39% of GDP), and coordination externalities constraining FDI and exports. Some progress in this area was noted by Kosovo's continued improvement in the overall Ease of Doing Business indicator (now ranking 60th compared to 75th two years ago), but the situation with respect to obtaining construction permits has not yet improved.

With the recent European Reform Agenda, the government committed to reduce the costs of construction permits and to fully implement the strategy for the fight against informal economy, including the merger of tax and customs authorities (measure #13) and addressing informality in the immovable property sector (measure #10). Business environment will be further improved by introducing better regulation principles and evidence based policy making (measure #9), increasing cost-effectiveness of international trade transactions (measure #15) and electronic public procurement (measure #1). Development of industrial clusters (measure #7), quality infrastructure (measure #16), ICT infrastructure (measure #4) and improving innovation policies and capacities (measure #14) will help reduce the coordination failures.

**Insufficient and unreliable electricity supply.** The new power transmission line to Albania built in 2016 improved security of supply and connected the country with regional electricity markets, but will only become operational after Kosovo is admitted to the European Network of Transmission System Operators. Investing in new power generation capacity (measure #3) and improving energy efficiency (measure #2) remain among key priorities for action.

Compared to electricity supply, underdeveloped **transport links** are considered a less binding constraint at the moment. They are nevertheless important for facilitating trade flows and labour mobility and will be further improved by continued ongoing investment in road and railway infrastructure.

**Skills gap between education and labour market needs.** Based on evidence of higher employment rates among persons with tertiary and vocational secondary education, and survey results where businesses cited inadequate skills as an important obstacle, both growth diagnostics studies concluded that skills gap is a binding or potentially binding constraint on growth. The skills gap
may not only relate to the level of education, but also to specific competencies and skills that are lacking in the labour force, or to the **quality of education** in general. Results of the 2015 PISA study, where knowledge of Kosovar secondary school students was ranked among the bottom three countries, confirm that quality of education needs urgent improvement.

As pointed out by the recent MCC growth diagnostics study, the demand side of the labour market is part of the problem. Although education does increase employment opportunities, unemployment rates are high also among the better educated. This means that the current economic structure, largely based on unsophisticated and lower value added products and services, is not able to create a sufficient number of high-skilled jobs. On the positive side, labour force surveys in the first two quarters of 2016 recorded a decline in unemployment rates of persons with tertiary and both vocational and general secondary education. To a large extent these improvements may be purely cyclical, following an increase in unemployment and emigration during the economic slowdown of 2014 and 2015.

The mismatch between the skills structure and needs of the labour market is addressed in ERP by improving public employment services and active labour market policy (measure #19), actions to improve the quality of education by modernising curricula, developing professional standards and improving the teacher career system (measures #17 and #18). Other ERP measures that are aimed at supporting innovations (measure #14) and competitiveness in general will contribute to higher demand for skilled labour force in the labour market.

4.2. **Summary of reform priorities**

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<tr>
<th>I. Public Financial Management</th>
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<tbody>
<tr>
<td><strong>Measure #1:</strong> Improvement of public procurement through application of electronic procurement** - addresses development and promotes wider use of electronic public procurement by central and local authorities through an adequate system of information and communication technology, in order to increase efficiency and transparency.</td>
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<th>II. Energy markets, infrastructure and telecommunications</th>
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<td><strong>Measure #2:</strong> Reduce energy consumption through energy efficiency measures** – It aims to achieve the energy saving target of 9% by 2018, through the implementation of EE measures and renewable energy sources in public central and local level buildings.</td>
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<tr>
<td><strong>Measure #3:</strong> Further development of energy generation capacities** - Main objective of the measure is to address the energy security through establishment of new generation capacities, rehabilitation of Kosovo B, and investments in RES.</td>
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<th>II. Energy markets, infrastructure and telecommunications</th>
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<tr>
<td><strong>Measure #4:</strong> Extending relevant ICT network infrastructure for socio-economic development** - The reform measure aims to extend the ICT broadband network infrastructure to 98% of households by 2021.</td>
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<th>III. Sectoral developments – agriculture, industry and services</th>
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<td><strong>Measure #5:</strong> Investments in the agricultural and agro-processing infrastructure** - Addresses the challenges related to agricultural infrastructure, diversification of products, coverage of the irrigation system, with a focus on supporting investment projects in priority sectors.</td>
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Measure #6: Regulation and consolidation of agricultural lands - By applying the regulation and voluntary consolidation of agricultural land, the aim is to increase the average farm size, facilitate access to cadastral parcels, and rational use of agricultural land in general.

Measure #7: Support development of industrial clusters - This reform addresses SME development in Kosovo through group development (industrial group) in priority sectors of industrial policy.

Measure #8: Development of tourism products in Kosovo touristic regions - The purpose of this measure is to promote development of tourism products with the aim of increasing economic value of tourism, focusing on the identification of local products and products of regional potential.

IV. Doing business environment and reduction of informal economy

Measure #9: Developing data-based policies - The purpose of the measure is to simplify the legislation and the regulatory system, including creation of the possibility to reduce administrative burdens for businesses.

Measure #10: ensuring property rights by addressing informalities in the real-estate sector – the main objective is to strengthen the system of property rights, by addressing informality in the real estate sector, in order to ensure citizens' access to efficient and financially affordable administrative processes.

Measure #11: Increase judicial efficiency through reduction of court case backlog - This measure aims to improve the judiciary’s efficiency in order to reduce the case backlog by increasing human capacities and improving case management system.

Measure #12: Improving access to funding for SMEs through the Kosovo Credit Guarantee Fund (KCGF) - This measure attempts to expand credit guarantees and improve information on the credit history of individuals and businesses through further functionalizing KCGF, which would allow many other businesses to have access to finance and lower interest rates.

Measure #13: Establishing a single revenue collection agency - The purpose of the measure is to address the informal economy by reducing the "tax gap" through institutional simplified and effective revenue collection structures.

V. Innovation and research

Measure #14: Improving the policy and strategic framework and capacity building for research and innovation - aims to establish a policy framework, the legal basis and build internal capacities for research and innovation, as well as increase the level of participation by local scientific institutions into European and regional projects and programs.

VI. Foreign trade and facilitation of investment

Measure #15: Increasing cost efficiency of international commercial transactions - Aims to increase cost effectiveness of international trade transactions by simplifying and standardizing all border formalities and procedures, with a view of harmonizing practices in accordance with multilateral agreements.

Measure #16: Improvement of Quality Infrastructure - addresses the modernization of quality infrastructure for businesses, such as standardization of legal infrastructure, metrology, accreditation and conformity assessment bodies.

VII. Education and skills

Measure #17: Harmonization of supply and demand by developing occupational standards and reviewing the curricula - This measure aims to harmonize educational programs with
labour market demands by developing skills, occupational standards, reviewing existing curricula and developing a new curricula based on priority areas, and teacher training.

**Measure #18: Applying and improving the teachers’ career system** - The objective of this measure is to implement a system for professional development and evaluation of teachers’ performance via the licensing scheme for teachers’ career advancement, and implementation of the strategic framework for teacher development.

### VIII. Labour market and employment

**Measure #19: Improvement of employment services through the establishment of the Agency for Employment and the active labour market measures** - The measure focuses on the reform and modernization of the Public Employment Service through the establishment of the Employment Agency and its capacities as well as by planning, design, implementing and effectively monitoring the active labour market measures.

### XI. Social inclusion, reduction of poverty and equal opportunities

**Measure #20: Improvement of social and healthcare services** - aims to strengthen the social protection system and healthcare services through the establishment of a sustainable system for funding social services and establishing a health insurance fund.

### 4.3. Analysis by area and the structural reform priorities

#### 4.3.1 Public Financial Management (PFM)

**a. Analysis of main obstacles**

**State of play:** Although, Public Financial Management is not identified as a major obstacle to economic growth, external assessments (PEFA -2016 and SIGMA / OECD) have pointed out the need for further improvements in the field of PFM for increasing the government's chances to budged policy priorities, and ensure the implementation of transparency and efficiency of budgetary allocations.

Public procurement in Kosovo represents a wide range of public funds expenditures. Only in 2015, around 10895 contracts were awarded, and this amounted to EUR 401 million (about 75 of the GDP). Out of these contracts, 76% have been granted through open procedures, marking a 3% increase compared to 2014. The high-value contracts represent about 57% of all contracts, whereby the average number of total tenders has decreased from 6.1 in 2014 to 5.8 in 2015\(^1\). Given that the public procurement system is facing numerous problems, recent reforms have addressed some fundamental shortcomings with the aim of increasing transparency and ensuring competitiveness.

Reforms in the implementation of electronic procurement and promotion of centralized procurement have already commenced, however further efforts are required in these fields. European Commission Report for 2016 concludes that continuous efforts must be done in order to improve transparency in all stages of public procurement, particularly by systematically monitoring the implementation of public procurement tenders by strengthening the system and ensuring the proper functioning of e-procurement.

**Structural obstacles:** Public procurement is an area which is particularly vulnerable to corruption, given the government’s high expenditures and the relatively small private sector, followed by the low level of transparency and accountability. Particularly, the lack of transparency at all levels of

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\(^1\) Raporti i Progresit i Komisionit Evropian për vitin 2016.
public procurement, and the lack of a systematic monitoring of renderers and proper compensation system, remain the challenges that are constantly mentioned. Moreover, it is considered that there is a lack of capacity among responsible public procurement bodies, which disables efficiency and transparency.

**The impact of barriers on competitiveness:** Lack of transparency and application of advanced public procurement procedures, increases the misuses and causes increased social exclusion since small businesses and poor households cannot overcome the differences caused by the presence of corruption. On the other hand, corruption in public procurement has a significant impact on competition, consequently in the optimal allocation of resources in economy. Furthermore, public finances are economic losses due to corruption and as a result, the fiscal space which would otherwise be available for other priorities.

**b. Priority reform plans**

| Measure of reform #1: Improvement of public procurement through application of electronic procurement |
| Description of the measure: As a continuity of reforms from ERP 2016, the main focus of the measure is to increase efficiency and transparency of public procurement procedures, ensure the best use of public funds, reduce procedural costs and encourage economic operators to participate in public procurement procedures. Based on the decision of the Government, since 01 September 2016, has commenced the application of e-tendering module for central authorities. Also, in 2016 were developed a number of operational manuals, and several trainings were held for procurement officials in both levels of government (central and local level). This measure is in line with the National Development Strategy and the Public Finance Management Reform Strategy 2016-2020, namely Pillar 3 "Operational Efficiency", Priority 7 "Public Procurement". |
| Arrangements for implementation of the measure: During 2017, activities will focus on the effective implementation of e-procurement legislation and relevant operational guidelines. Alongside launching and implementation of the remaining modules (e-contracting), the expansion of the application of mandatory procurement in all budgetary organizations will continue. In order to ensure the implementation of the system, it is necessary to address the capacity at all levels, focusing on increasing administrative capacities - recruitment of six officials - and delivering basic training to procurement officials, including training of trainers. During 2018, will be conducted the assessment of electronic procurement systems, and advanced trainings and e-procurement trainings will be provided, by ensuring effective implementation of legislation and operational guidelines. Monitoring procurement activities is another important activity that includes monitoring of procurement activities as requested, monitoring reports and contract award notices, monitoring contract management processes in 30 contracting authorities. Similarly, during 2019 the compulsory implementation of e-procurement in all budgetary organizations will continue, as well as system maintenance and monitoring of public procurement activities. |
| Costing and budgetary impact: Implementation of electronic procurement implies additional costs for the next medium-term period, which includes system maintenance and capacity building. Initial capacity building activities are covered through the existing World Bank project. According |
to the PFM Reform Strategy 2016-2020, the expenditures in public procurements for a three year period (2016-2018) are estimated to be in a mil Euro. The budget presented throughout years in the 2017 Budget, is the one planned for 2017-2019 for PPRC, this includes €430.052 for 2017, €431.583 for 2018, and €434.669 for 2019. The implementation of this measure will have a positive impact on the budget, since increased transparency, through electronic procurement, will attract foreign contractors and investments.

Expected impact on competitiveness: The expected impact is the increase of transparency in public procurement process, increase of contracting authorities accountability, increase professional independence of procurement officials, improved control of corruption, and consequently the reforms will enable a larger number of companies, including SMEs, to compete for public contracts on an equal basis.

Possible risks: The main risk is related to the need for further support at political and expert level in order to continue with the implementation of public procurement reforms, including the introduction of electronic procurement practices. There is the need for a coordinated approach with regard to the allocation of financial resources for the implementation of these reforms. Last but not least, another risk related to these reforms is the need to establish a reliable system of information technology that will enable the performance of procurement procedures.

4.3.2 Energy, transport and telecommunications market
a. Analysis of the main obstacles

State of play: Despite constant improvements, the unstable supply with electricity continues to be present in Kosovo. High losses in the distribution network and the low level of energy efficiency still aggravate the security of electricity supply. Average duration of unplanned interruptions in the distribution network of electricity in 2015 was 81.74 hours per customer per year, while the quality standard is 30 hours per customer per year. Local manufacturing capacities of electricity cover around 90% of demand for electricity, while 10% is covered by imports. Production of electricity from RES accounts for only 3%. Prices of electricity in the household sector in 2015 were 61 Eurocent/kWh, while in the industrial sector 81 Eurocent/KWh.

Production capacities of PP Kosova A are outdated and should be replaced, while PP Kosovo B has entered the fourth decade of its operation and should be rehabilitated. The electricity distribution network is very old. Due to significant investments in electricity transmission, the situation in this system is very good and the capacities are sufficient to meet the system’s needs. Heating is done mostly with firewood. The heating from the District Heating covers only 3-5% of the amount needed to cover all premises. Also, electricity is significantly used for heating premises (estimated about 800GWh).

Regarding transportation, Kosovo’s geographical position underlines the importance of developing an efficient road network, and fully integrating it with neighbouring countries and the region. Roads represent more than 90% of the transport infrastructure in length, and 98% in terms of providing services (WB, PFR, 2014). Kosovo has a “high density of road transport”, but when measured as “average length of road for thousands of people”, Kosovo’s road density is at an average level (WB, PFR, 2014).

In the railway sector, SEETO has defined the main railway corridors for South-East Europe, and Kosovo is part of these corridors with railway route 10 (Leshak - Hani i Elezit) which belongs to
the comprehensive network of SEETO and connects Kosovo with Serbia and Macedonia. Kosovo railways extend throughout Kosovo, with a length of 335 km of open railway line, with a length of 105 km with stations and 103 km of industrial lines. Kosovo has the Law on railway which is in accordance with EU legislation and enables opening of the rail market for providing transport services for passengers and goods.

**Regarding air transport**, Kosovo has no special law on transportation of goods, but this type of transportation is provided along with the transport of passengers, and in 2015, based on Cargo statistics, 1,017,132 kg were transported. The development of air transport is done under the agreement for joint use of European space. Kosovo has no airlines yet. The legislation that regulates the field of air transport is harmonized with EU legislation; therefore, this legislation enables competitiveness and market liberalization without obstacles.

**Regarding telecommunications**, landline networks are widespread in urban areas. Landline telephony penetration per capita has fallen below 4%, as new technologies make this technology useless. Mobile phone penetration has now reached 97% of the population, whereas it is estimated that 48% of the population are Internet users through 3G and 4G, and internet penetration with landline access is estimated to be in over 75% of households. Investments made by the operator's ownership structure in 2015 are: public operator 56% and private operators 44%. Landline telecommunications networks are widespread in urban areas. Mobile phone penetration has reached 97% of the population. Broadband internet penetration (landline access) at the state's level is 13%, while 75% of households have internet access; penetration of broadband internet (mobile access with 3G and 4G) is 61%.

**Structural obstacles:** Instability of supply with electricity is as the result of: (i) insufficient and outdated electricity generating capacities; (ii) outdated and limited capacity distribution electricity network (iii) low diversity of energy sources that cause the aggravation of the electricity burden to meet the needs for space heating and other needs; (iv) non-functioning of open energy market and the tariff subsidies made to the detriment of the business sector, although not to the extent of the previous years; (vi) lack of incentives for efficient electricity use by businesses and households.

Compared to electricity supply, underdeveloped transport lines are considered as a less important obstacle for the time being. However, they are important for facilitating trade flows and movement of labour force and will be further improved by continuous investments in road and railway infrastructure. Nevertheless, in the future the matter of sustainability can represent an obstacle as a result of inadequate investments in existing road networks maintenance.

Poor status of railway lines and the lack of railway rolling stock have as a consequence the stagnation of the development of railway transport of passengers and goods. Another obstacle is the lack of operational railway in the north between Kosovo and Serbia, which is a political barrier and which has a really negative impact on the development of competition in railway transport. Lack of railway network has caused an overload use of the road network, using it for transport of goods.

The above figures show that the distribution of the ICT infrastructure in Kosovo is relatively unbalanced. The rural areas, many cities’ neighbourhoods, schools, libraries, healthcare and other institutions and government agencies suffer from lack of access to broadband infrastructure and it is not expected that this gap will be covered by private investment. Research reports indicate that there are difficulties in providing new staff with the skills needed in the ICT field.
The impact on competitiveness and economic growth: Unstable energy supply negatively affects the competitiveness and creates constant uncertainty among businesses. The increase of reliability in the electricity supply represents a significant factor in the decision-making process, whether for establishing new businesses or expanding existing ones. The price of electricity is another important factor affecting competitiveness. Currently, the prices of electricity in the industry sector of Kosovo are higher compared to most countries in the region.

In the area of railway transport, inadequate international lines reduce the level of passengers and goods transport. Currently, only one international railway connection with Macedonia is operational, while there are political obstacles with Serbia which are expected to be overcome in order to have a proper development of railway transport. However, it is worth mentioning that Kosovo has established mechanisms for introducing the competition in the railway market to revive the market and increase efficiency.

Lack of broadband internet expansion impacts negatively the productivity and global competitiveness of companies in Kosovo. Existing reports indicate that policymakers should support accelerated investment in adopting technology by employers and employees and in development of human resources with a focus on productivity and utilization of technologies.

b. Report on policy guidance implementation since May 2016

For the purpose of implementing policy recommendation, the Government of Kosovo will focus on achieving energy saving targets planned by 9%, which corresponds to the reduction of consumption in the amount of approximately 92 ktoe by 2018. Also, government policies include transposing the new EE directive, which will be incorporated into respective legislation through review and adoption of the new law on EE, development of relevant financial mechanisms, such as EE fund, and institutional development and capacity building in this field.

ERO has designed the tariff structure with incentives measures for customers who save energy, whereby the categories of domestic customers and consumers through block tariffs, and costumers who consume electricity during off-peak loads save energy and pay bills with lower cost of electricity. So, the costumers get charged with higher prices when the electricity power system is congested and there is a lack of producing capacities in Kosovo, where the marginal costs of supply are significantly higher at the peak time, which is aggravated further by very high prices of import, and very low prices when the system is not congested. Therefore, this tariff structure has been set to respond to consumption needs and the offer of energy production in Kosovo.

c. Plans for priority reforms

Reform measure #2: Reduce of energy consumption through energy efficiency measures

Description of the measure: As a continuation of the ERP 2016-2018, the aim of the measure is to implement energy efficiency measures in order to reduce energy consumption, aiming at achieving the goals of energy saving based on the Action Plan of Kosovo for Energy Efficiency 2010-2018 of 9% by 2018. To implement this measure, the tender is open for implementation of EE measures in buildings of the central level funded by the loan from WB for 19 buildings, for which reason, two companies were selected for project implementation. The energy efficiency measure is related to the broader strategic context of Kosovo, including the National Development

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2 See for example, Brynjolfsson & McAfee, The second machine age: http://secondmachineage.com/
Strategy and the draft of the Energy Sector Strategy. Also, this is related to obligations under the Energy Treaty and relevant directives under this Treaty.

**Arrangements for implementing the measure:** As part of efforts to reduce consumption through energy efficiency, the EE measures will be implemented in 5 buildings financed from the budget of Kosovo during 2017, and 5 others during 2018. Through the World Bank project will be implemented efficiency measures and renewable energy sources in public buildings of central and local level, which include: 20 buildings during 2017, 15 buildings during 2018 and 15 others during 2019. Whereas, through the KfW and EU project, EE measures will be implemented at the local level in 15 public buildings (schools) for 2017 and other 15 others for 2018.

**The cost and budget impact:** Improvement of energy efficiency for the period 2017-2019 is expected to cost around €21 million during the period 2017-2019. This cost is included in the draft budget of 2017 for all the activities presented within this measure. This budget includes €2.87 million from the budget of Kosovo (+1 million from PAK) in the category of capital expenditures for Kosovo Agency for Energy Efficiency, the borrowing from the World Bank 2017-2019 (€ 3.65 million, € 5.4 million, € 6.083 million) and borrowing for the municipality of Prishtina and Gjakova from KFW (€ 1.150 million, € 1.150 million).

**Expected impact on competitiveness:** Implementation of energy efficiency measure will contribute to reducing domestic consumption. The reduction of energy consumption will serve to the reduction of energy costs. Energy efficiency can help address issues related to energy security (current deficits and reduced imports), reducing public expenditure on electricity and environmental impacts of energy use. The expected savings from EE measures in these institutions are estimated to be 8.35 ktoe per year according to the level of 50% savings from EE measures from the total energy consumption of 16.7 ktoe. Estimates show that the Government of Kosovo (GoK) spends about EUR 41 million per year on energy for its buildings and could save up to EUR 18.85 million per year through EE cost-effective measures.

**Expected impact on social matters:** Application of EE measures impacts on reducing the cost of energy in general, in particular reducing the cost of electricity, improving the quality of life (comfort), improving environmental conditions and increasing opportunities for more effective management of energy, regarding social wellbeing and orientation of electricity for economic development and job openings (especially that spent on heating).

**Potential risks:** Failure to apply this measure has a negative impact on the rational use of energy (electricity, in particular), which has numerous consequences in all sectors and substantial economic stagnation.

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**Reform measure #3: Further building of power generation capacities**

**Description of the measure:** In order to ensure stable supply of electricity as a very important factor for economic development, the building of new capacities for generating electricity remains a priority in the development of the country's economic reforms. This measure is in line with strategic priorities of the country expressed through the National Development Strategy and the
draft strategy on energy which included a comprehensive review process with internal and external stakeholders.

In the light of Government policies, the following actions were undertaken during 2016: regarding the thermal power plant "Kosova e Re", were prepared the necessary agreements such as commercial and financial agreements, as well as agreement with operators etc.; whereas regarding the rehabilitation of TPP Kosovo B, it was contracted the work and commenced the realization of the feasibility study; also at the same time were implemented the activities related to renewable energy sources, and entered into operation four small hydropower plants (SHP) with a total capacity of 26.93 MW and two new photovoltaic plants with total capacity of 0.602 MW.

**Arrangements for implementation of the measure:** Regarding new generation capacity, during 2017 are expected to be completed all agreements regarding the development of TPP Kosova e Re, so that in 2018 we can commence construction, which is expected to last until 2022. Regarding TPP Kosova B, until June 2017 it is expected to be concluded the feasibility study, and during 2018 it should be conducted the process of selecting the funding modality for its rehabilitation. Projects regarding RES that are expected to be implemented during the next three years include: two new hydropower plants projects with a capacity of 8.48 MW and three solar power plants projects with a total capacity of 9 MW in 2017; four new projects with generation capacity of 18 MW of electricity from small hydropower plants in 2018; and fourteen new projects of SHP with total capacity of 61.8 MW and two new projects of wind energy with a total capacity of 66.29 MW.

**Cost and budget impact:** The total cost of building the TPP KR is foreseen to be 1,000 million Euro. Whereas, during the period 2017-2019, are expected to be invested 400 million euro. This project will be developed by the private sector. Throughout these three years (2017-2019) the budget expenditures from BRK will be 3.6 million for consulting services. The value of € 3.65 million is budgeted within the budget for Administrative Services Program, namely under MED for consulting services, in the category of Goods and Services. There is still no estimate of the cost of rehabilitation of TPP Kosovo B but is expected to be over 300 million Euros. The projects for building RES power plants are expected to have a total cost of 250 million Euros for the period of 3 years, which are expected to be realized by private investors.

**Expected impact on competitiveness:** Uninterrupted, high-quality, reliable and affordable supply of electricity is a prerequisite for sustainable business development. From the studies conducted by USAID in 2012 on the effect of unreliable electricity supply for businesses, it turned out that the annual losses of businesses as a result of unreliable supply of electricity were 260 million euro per year and therefore there was a low competitiveness.

**Expected impact on social issues:** Although there is no special study on the social impact of the project for building TPP KR, it is estimated that this project will affect employment growth during the entire 5 year period (2018-2022) of construction. Project TPP KR is expected to have an effect in the amount of 200 million euro per year in the GDP growth (or 3% of added value of GDP only by this project). Also the development of power plants projects from RES will have an effect on employment growth and will increase annual investment for 70 million Euros.

**Potential risks:** A potential risk can be considered the delaying of the construction processes of TPP KR and rehabilitation of TPP Kosova B. The consequences of this risk can be mitigated by importing electricity.
Reform measure #4: Expansion of relevant infrastructure of ICT networks for socio-economic development

Description of the measure: As a continuation of ERP 2016-2018, this measure is aimed to enhance access and use of ICT through the extension of broadband infrastructure and strengthening its human capital and supporting digital businesses to fully participate and maximize the benefits of digital economy in a global market. Based on NDS, Digital Agenda for Kosovo 2013-2020 and Strategy on IT, through this measure is aimed to achieve the coverage (penetration) with broadband infrastructure to the extent of 98% households. Implementation of the measure "Expansion of relevant network infrastructure of ICT for socio-economic development" includes the following two components: (i) Expansion of high-speed broadband infrastructure; and (ii) Development of Human Resources for Digital Economy and Support for digital businesses.

Arrangements for implementation of the measure: In 2017, we will commence the implementation of the pilot project for the extension of broadband infrastructure that will include a rural area (some villages) in Kosovo. Efforts will be made in adapting and functionalizing the digital technology park regarding the needs of ICT businesses. Moreover, the loan agreement with WB is expected to be realized, which includes investments for the upcoming years of ICT networks expansion according to the plan described above. This will determine the implementation arrangements for the upcoming years, which generally covers the period up to 2021. In particular during the next two years, will continue the expansion of broadband infrastructure with high speed in uncovered areas with a focus on rural areas by including all schools, libraries, health institutions that are in that area.

Cost and budget impact: activities related to the 2017, are budgeted through the Draft Budget of 2017. This cost of €2.0 million is included within the Department of the Post, Telecommunications and Information Technology (MED), in the category of capital expenditures. Whereas the activities planned for the years 2018-2019 such as: 1. Extension of broadband infrastructure, are planned to be financed by the World Bank loan in the amount of €9.0 million for the years 2018-2019. This loan is expected to be negotiated during 2017 and shall begin the implementation from 2018. The loan is part of a list of loans from the Investment Clause for ERP 2017-2019, Macro-Fiscal part.

Expected impact on competitiveness: Creating suitable conditions through expansion of relevant infrastructure of networks and provision of broadband services will enable the delivery of information with lower cost, improvement of access to international markets, development of new business models, by allowing people and companies to work regardless of location and with flexible schedule, and generally speed up the procedures and processes, by increasing economic dynamism and improving the competitiveness. The study of the World Bank concludes that a penetration growth by 10% of fixed broadband will be followed by GDP growth of 1.21% in developed economies and in 1.38% of GDP growth in economies in development.

Expected impact on social policy: According to some surveys broadband infrastructure is considered as the main facilitator of flexible work, in more than three-quarters of businesses surveyed (78%) citing as a reason the speed and flexibility enabled by broadband infrastructure. It

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4 Digital Agenda for Kosova 2013-2020
5 Kosovo IT Strategy
6 Exploring the Relationship Between Broadband and Economic Growth
7 http://businessclub.bt.com/stateoffthenation.pdf
is also estimated that one third of small companies (33%) and almost half of the individual trade businesses (48%) have commenced to create a better balance work-life, by spending a great deal of their own work schedule away from the office.

**Potential risks:** As potential risks for the implementation of planned activities can be considered the potential delays in securing the funding i.e. process of approval by the Assembly of Republic of Kosovo of an aimed loan agreement from the World Bank.

### 4.3.3. Sectorial developments – agriculture, industry and services

#### a. Analysis of main obstacles

**Current state: Agriculture sector** plays an important role in economic development. Participation of agriculture sector in GDP during 2015 is estimated to be around 12%, and plays an important role in employment. Currently in agriculture are estimated to be around 26.7% of the total number of employees and the agricultural products constitute around 12% of total export value. Despite investments in the agriculture sector, Kosovo is still facing negative trade deficit of agriculture products. Imports of agricultural products remain relatively high, accounting in about 10% of all imports. Out of this amount, 30% consists of food and food products. Kosovo is one of the largest importers of food per capita in Europe.

Inadequate situation in primary production is directly reflected in the agro-food industry, and as a result the agro-food industry is quite fragmented. Structural profile of production of food, beverages, animal and crop production, hunting and related services represent one of the biggest sectors in the economy of Kosovo. Within the processing industry, food-product processing constitutes the largest part of financial turnover or 50%, whereas the processing of beverages participates with 25%. Besides processing industry, other important business activities are also the crop and animal production, hunting and related services with a turnover of 15%, production of wood, wood products and cork participates with 9% and fishing with aquaculture with 1%.

**Kosovo industry continues to face** low level of competitiveness due to internal and external factors. The relative size of the industry (mining and processing), measured through its added value in GDP, in the context of Kosovo for the period 2010-2015 was about 13%. Participation of industry in GDP is comparable to some of the regional countries, but taking into account the development needs, including the need to create jobs, this can be considered low.

Recent data indicate that the sector with the largest number of employees and enterprises and the highest turnover in 2015, but also during the previous years as well, remains the food products industry followed by the production of mineral non-metallic products sector. Only in 2015, Kosovo's economy recorded a negative trade balance of XX% of GDP, whereas the foreign direct investment oriented in industry sector, during 2015 reached the highest amount in the last four years. Unlike the previous year, when there was a decrease (reduction) of FDI in the amount of 34 million Euros in 2015, the Industry sector absorbed 20.7 million euro.

Over the recent years **development of the service sector** had a significant impact on the economy of Kosovo, mainly by closing the huge gap left from the low level of exports of goods and contributed to the reduction of other structural problems in the economy, especially unemployment. In the last decade, export of services was much higher than imports and in some years the difference was twice of the imports. Trade in services was characterized by an increase

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8 KSA, GDP by activities
of positive balance in 2015. The balance of services amounted to €354.4 million, an annual increase of 5.5 percent, which was the result of faster growth of exports of services compared to imported services. Only during the last two years, 2014 and 2015, exports of services reached the value of €767.2 mil and 796.4 mil by marking a growth of about 4%. Whereas expressed as a share of GDP, exports of services amounted in about 14%. Three major contributors to the export of services in 2015 were the sector of travelling and tourism with over €564 million, communication, including ICT with around €60 million and other business services.

Thus, revenues from international travel in 2015 rose to 564 mil from 504 as they were in 2014, contributing to around 65% of total exports of services and around 20% of total exports of goods and services in Kosovo, which is a significant percentage when compared with some developed countries in tourism. Tourism has a positive effect on the balance of payments of Kosovo. Net income from travelling are estimated to reach around 370 million Euros in 2014 and will cover approximately 18% of the country's trade deficit. It is estimated that growth in tourism business activity during the past two years was about 25%, but expectations for growth in the upcoming years will be even higher than 40%.

**Structural obstacles:** As a key sector of Kosovo economy, agriculture is full with systemic and structural challenges that will need to be addressed so that we can use its competitive potential and growth. The small size of farms and fragmentation of agricultural land is a very important limiting factor and Kosovo cannot implement what in economics is known as "economies of scale" and uncompetitive farms, where the majority of farms belong to existential farmers.

Outdated farm technologies and lack of knowledge/modern agricultural skills among farmers and agro-processors is another structural obstacle. Outdated agricultural vehicles and equipment in one hand and small parcels that make up the most productive cultivation areas on the other side are causing significant yield losses in plant production.

The main reason why there is no efficient agricultural production in Kosovo and the main stumbling factor in increasing the competitiveness of the agricultural sector is the lack of diversification of agricultural products in general. On the other hand, the lack of investment in irrigation system constitutes another structural obstacle, whereby less than 12% of the total area of land for agricultural production in 2015, which was 410,478.57 hectares, has irrigation system and irrigation possibilities.

Regarding food security, small opportunities for investment in the food industry in order to reach international standards of quality, as well as for quality and safety of food products, represent restrictions on the competitiveness of local products in the local market but also in the region and beyond.

Similar to other sectors of the economy, the **structure of enterprises in the industrial sector in Kosovo** is dominated by SMEs. Among the important problems that limit the contribution and multiplier effect of the industry in economic development of the country is still the high import, low level of DFI and linkage between production sectors in Kosovo.

In this context some of the issues identified for further strengthening of the SMEs role in the overall development of the industrial sector in Kosovo, deals with the challenges which are associated with the appearance of industrial clusters. Particularly they include weak cooperation between companies and coordination through industry associations which do not perform well as well as

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9 Banka Qendra e Kosovës, Statistikat e Tregtisë së Jashtme, 2016
the poor educational and research institutions that would have supplied the SME sector with relevant business knowledge.

As an obstacle is assessed the lack of competitive edges (due to the lack of qualified labour or lack of innovations) for integration of local groups as part of the regional or global value chain. Also, the lack of certification of products and production processes deemed to hamper efforts for integration of local groups in the SME sector in general.

Despite positive developments in the recent years, available tourism products and services are still limited. There are very few printed and electronic information about tourist sites, attractions and as well as for available products and services. There are very few tourist offers with mountain and rural tourism products, or cross border tourism. There is lack of information in community and tour operators for potential tourism products in rural and mountainous areas which can be offered for sale.

Until now, the tourism sector was not treated as a priority sector and most of the activities are supported by donors and there was no proper institutional coordination of these activities. Given the natural and cultural riches of Kosovo, the main pillars of the tourism product of Kosovo are the cultural tourism; mountain and alpine tourism; rural tourism, ecological and alternative; active tourism; cross-border travel; meetings and conferences.

The impact on competitiveness and economic growth: As a result of constraining factors mentioned above agricultural production has a low level of primary production – non consistent production, difficulties in permanent supplying of the market, lack of processing raw materials, lack of application and enforcement of standards of quality and safety of the value chain actors of food products, and lack of vertical and horizontal coordination in the food value chain.

The establishment of industrial clusters based on economic interest of businesses itself will impact use of facilities/unused opportunities by businesses and other relevant stakeholders acting lonely or as not well coordinated. Furthermore, this measure will also affect the distribution of knowledge about the opportunities and risks in the certain foreign and domestic markets, promotion of cooperation between local businesses, breaking of mental barriers prevailing in the former communist countries which have been relatively unable to produce / serve a product / service in joint way in today's free market, youth orientation in study areas which are required in today's market or tomorrow's work market.

Current development of the tourism sector is still far from its potential. In this context, the development of attractive and tourist targeted offers can create opportunities for creation of new working places, and by nature this sector requires great engagement of the workforce (intensive labour). On the other hand, considering that the potential of tourism in Kosovo is largely rural and mountainous tourism, the development of the tourism sector will boost employment and will increase wellbeing of rural population in Kosovo.

b. Priority reforms plans

Reform Measure # 5: Investment in agricultural infrastructure and agro-processing

Description of the measure: As a continuation of the measure introduced in ERP 2016-2018, this measure aims to address identified barriers related to agricultural infrastructure, diversification of products, and irrigation system coverage. The measure is in line with the local strategic framework, respectively the National Development Strategy and the Programme for Agriculture and Rural
Development 2014-2020. In particular, measure is focused on supporting the investment projects in priority sectors set out in PRDA 2014-2020 which aims increase of productivity through boosting of competitiveness and technical progress, ensuring the quality of agricultural products and increasing the farm efficiency.

**Arrangements for implementation of the measure: Investments in physical infrastructure** - adding production areas in horticulture sector (vegetable areas in greenhouses and open fields, fruit trees, vineyards, nurseries) and increasing production capacity in livestock and poultry. In this regard, the financial support will continue with expansion of production capacities for over 450 farms each year (30%, the sector of vegetables and greenhouses with 26%, the meat sector with 14%, the milk sector with 13.7%, the grape sector with 13.3% and eggs sector by 3%). The investment in infrastructure for the coming years will focus on expanding areas under irrigation by about 13.5% on annual basis. **Investments in agro-processing sector**, including investments in storage and warehousing and expanding the number of testing laboratories for verification of quality of production. For the next three years, around 55 food processing enterprises would be based on annual basis (18.2% of milk processing, 22% of meat processing, and 38.2% of processing of fruit and vegetables and wine production by about 21.6 %.). For improving/implementation of national standards and the EU on food safety/animal welfare/environment 35 companies will be supported annually. Number of modernized enterprises, with new technological equipment and introduction of new product lines and new products, will be 40 companies in each year for the next three years. Also, the number of enterprises that will treat waste and scrap in proper management will exceed 10 companies per each year.

During the next three years the focus will be on the **implementation of an integrated agriculture information system (IAIS)**, including tendering of the project for integration of the agricultural information system, testing and data analysis, staff training, data collection and updating of data, maintenance system. The project includes the following: establishment of links and integration into database for existing systems as FADN, IACS, sLIPS, REF, animal registry and register of trade statistics.

**Cost and budget impact:** The total cost for the implementation of planned measure activities is € 43.0 million in 2017, 50.6 mil in 2018 and 55.6 in 2019. The cost for implementation of this measure is budgeted in the Draft Budget for 2017 within Subsidies and Transfers category: 1. Department of Policies from € 23.0 million (2017), 25.0 million (2018), 25.0 (2019) and the Department of Rural Development Policies € 21.5 million (each year) covering a part of the activity 1 - Investments in physical infrastructure and activities 2 - Investments in agro-processing sector. For the other part of the measure 1 - Expansion of areas under irrigation is planned under Draft Budget for 2017: € 2.2 (2017), € 1.8 (2018), € 1.6 (2019) in the category of capital expenditures. For measure 3 - Implementation of Integrated Agricultural Information System within Draft budget 2017 is planned 0.2 mil for each year from 2017 to 2019 in the category of capital investments. During this period it is expected that donors are also involved mainly in irrigation projects and projects related to IT infrastructure.

**Expected impact on competitiveness:** As a result of these economic growth measures - as the net added additional gross value in supported enterprises is expected to be 15%. Increasing labour productivity, as growth (in %) of additional revenue, gross for each position, farms supported during this period are expected 15%, while increasing employment of supported farmers is expected to reach around 2%. Furthermore, by advancing food quality standards it is intended the replacement of products/imported agricultural products with local products and at the same time
increasing the agricultural products export. In this context, the growth of export for this category of the supported product is expected to be 20%, while substitution and import reduction for 10%.

**Expected impact on social policies:** The implementation of this measure contributes positively to the maintenance or stimulation of population to do farming/processing and cultivation of agricultural land, introduce specific production cultures which can be prioritized and have the potential of being competitive. These measures are expected to have a direct impact on the economic level of families dealing with the agricultural sector through the increase of their income level.

**Potential risks:** No potential risk is anticipated, except the insufficient offer by the public support.

| Reform Measure # 6: Expansion of farms through consolidation and regulation of agricultural lands |
| Description of the measure: Government of Kosovo aims to continue efforts for expansion of the agricultural farms through consolidation of agricultural land. Consolidation of agricultural land will be done by applying structural reforms including legal and institutional measures, regulation of agricultural land plots with regular geometric shape, and investments and creation of a field road network that would facilitate immediate access to the plots and rational use of agricultural land in general. This measure is based on the National Development Strategy, Program of Agriculture and Rural Development and Property Rights Strategy. |
| **Measure implementation arrangements:** Activities during 2017 will include the review of complaints of participants from the land consolidation project uncompleted by the Municipal Committee for Land Consolidation in Glogoc (with area 4,790 ha. of agricultural land) and the Municipal Commission for land consolidation in Vushtrri (with an area of 487 ha. of agricultural land). This includes data entry in the Register of Immovable Property (RDIP) from the cadastre of respective municipalities. Regarding the voluntary consolidation of agricultural land based on the FAO methodology a pilot project will be implemented, funded by FAO for voluntary consolidation, which includes 25 hectares of agricultural land in the Cadastral zone Celina, Rahovec Municipality. Continuation of the voluntary consolidation project of the agricultural land in 10 Cadastral Zones in Municipality of Viti with surface of 2,790 ha of agricultural land, including informing the owners, property dispute resolution and the review of complaints of project participants. For 2018 focus will be placed on continuation of the project of voluntary consolidation of agricultural land in 10 Cadastral Zones in Municipality of Viti with surface of 2,790 ha of agricultural land. The beginning of the consolidation project uncompleted in Municipality of Mitrovica in 4 Cadastral Zones in the area of 725 ha. Activities planned for 2019 include the introduction of data entry in the Register for Immovable Property RDIP - by officials of the Office of Cadastre in the Municipality of Mitrovica. Also, the project will start with uncompleted consolidation project in the municipality of Obiliq in 7 Cadastral Zones covering area of 2000 ha. **Cost and the budgetary impact:** MAFRD for accomplishing the planned activities, has foreseen the realization of the amount of € 500,000 from the budget of 2017, which will be allocated for realization of direct measures and rural development projects (grants) and 22% for other activities as described above in this document. This amount is planned within the category of Subsidies and Transfers: The Department of Rural Development Policies. |
Expected impact on competitiveness: Projects for volunteer consolidation of land would affect the growth of farm size, access to property, resolution of property issues, etc., which present the basis to support creation of revenues for the farmers, reduction of unit costs, increase of agricultural cultures productivity and competitiveness of agricultural products in the market. Resolving the property issues and their consolidation would help farmers in provision of land ownership security, access to loans and investments to their properties, access to investment projects of MAFRD for Rural Development, fair distribution of subsidies from the state budget for the owners and users of these properties, better control of these land properties and better monitoring of these subsidies.

Expected impact on social policies: the implementation of this measure is expected to affect the facilitation of land reform through development of land market (trading, creation of standard lease contracts), stopping further plots fragmentation, improving control of unplanned construction in areas covered by consolidation.

Potential risk: Lack of cooperation and lack of expression of the will by citizens for the voluntary land consolidation.

Reform Measure # 7: Support development of industrial clusters

Description of the measure: This priority is a continuation of measures from the ERP for 2016 and one of the key aspects of reforms to address the fragmentation and consequently poor level of coordination, and interaction of private sector with stakeholders of the other sectors is considered as industrial clustering. This measure is directly related to one of the main objectives of the National Development Strategy, Networking and development of clustered enterprises within the Competitive Industry Component. Also, it is harmonized with the final draft of the Private Sector Development Strategy 2017-2021.

Arrangements for implementation of the measure: During 2017, the Government will focus on the functioning of the Council/Forum for drafting policies for stimulation of competitiveness and entrepreneurship in industrial sectors, research on value chains for the industrial potential sectors - the definition of missing links and measures for their development. Same as in 2017 it will continue with support of the development of groups / clusters and value chains for potential industry sectors - the definition of missing links and measures for their development. In 2019 it will continue with support for development of groups / clusters.

Budget impact: For implementation of activities for Measure # 7 from the Kosovo Budget for 2017, have been allocated € 10,000, while € 293,000.00 were allocated from the European Commission ICEP Project. These expenditures are planned within the budgeted expenditure for the Department of Industry (MTI) in goods and services category (€ 50,000 each year from 2017 to 2019).

Expected impact on competitiveness: SMEs gathered in clusters are proven to mark increase and more innovative development. Consequently, regions with clusters attract more businesses related to new value chains created within clusters. Implementation of this measure will enable increase of interconnection between enterprises in value chains and larger participation of industrial sector in GDP. Cooperation between companies will create synergies, increase of innovation and will enable growth of new industries based on the activities of companies that are part of clusters. Subcontracting and specialization of companies in specific activities will enable large companies
to focus on innovation and transfer activities with higher added value, which will increase income in the economy.

**Expected impact on social issues:** Improving the private sector competitiveness level will directly affect the increase of revenues from relatively large taxes collected from the increase of activities in the economy. Indirectly, it will affect the reduction of the trade deficit, unemployment rate, providing more opportunities for the youth integration in the labour market, etc.

**Potential Risks:** Lack of understanding the benefits from acting in industrial clusters by the majority of businesses, which in fact are in desperate need for integration.

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**Reform Measure # 8: Development of tourism product in the tourist regions of Kosovo**

**Description of the measure:** The purpose of this measure is to promote development of tourism products in order to increase the economic value of tourism. The focus is on identifying local products (local) and those with regional potential which would significantly contribute to tourism development in Kosovo, growth of tourist capacity, increase of number of visitors, especially foreigners, increase income from tourism, boost the economy (increase employment, regional development, development of SMEs). Among other things, this measure requires increased institutional coordination and improvement of legal infrastructure.

**Arrangements for implementation of the measure:** For purposes of reform implementation, the activities to be undertaken during 2017 include improvement of the legal, institutional and policy framework for the tourism sector. In addition, international standards on improvement of service quality in tourism and catering. Another activity will consist of product research in the touristic regions of Prishtina and Mitrovica, focusing on identification of development priority products and information of businesses on touristic products. The Ministry of Trade will draft the guide on unification of touristic signalling in all the country and will continue supporting municipalities on establishment of Tourist Information Offices.

During 2018, we will conduct a study on the potential and needs of the accommodation sector in different regions and countries as a promising basis for catering investors and companies, as well as product research in the touristic region of Anamorava, focusing on identification of development priority products and information of businesses on touristic products.

Activities for 2019 include potential evaluation and encouragement of group approach in different regions and areas (wine and viniculture, healthcare/spas and village tourism, hiking and active tourism, etc., as well as analysis of the potential and needs related to facilities for conferences and meetings.

**Budget impact:** In order to implement activities under Measure #8, € 10,000 will be allocated from the Kosovo Budget for each of the years 2017-2019. The expected donor support during 2017-2019 is € 16,000, € 20,000 and € 16,000, respectively.

**Expected impact on competitiveness:** Identification and development of new touristic products will result in increasing the number of touristic businesses and of employees in touristic businesses selling these products, expanding the touristic offer of Kosovo as a destination and improving the quality of touristic services delivery. As a result, Kosovo is expected to become more attractive to visitors, which will result in increased income generation and have a direct impact on increasing the GDP.
**Expected impact on social issues:** Tourism capacity building contributes directly to increasing consumption of touristic services in these parts and participation in global and regional value chains providing economies an opportunity to add more value to local touristic industries and, consequently, fosters employment and wellbeing enhancement. Tourism development will expand to rural and mountainous areas aimed at employment generation and increase of family businesses providing women easy employment opportunities, particularly in culinary (offering local traditional foods) and handicrafts.

**Potential risks:** Lack of institutional human capacity in tourism may risk the full implementation of this measure. Considering that many activities are linked to municipalities and other support institutions, this may represent a risk if they do not express readiness to implement the activities fully.

4.3.4. Business environment and reduction of informal economy

a. Analysis of main obstacles

**State of play:** Over the recent years, Kosovo has marked progress in doing business indicators, such as the World Bank’s Doing Business Report and the European Commission Small Business Act. The Doing Business Report 2017 ranks Kosovo four positions higher (from the 64th to the 60th place), with progress marked in the indicators of starting a business, paying taxes and trading across borders. However, Kosovo has not marked any progress in a number of other important indicators, such as enforcing contracts, resolving insolvency, getting electricity, dealing with construction permits and protecting minority investors.

As an example, according to data presented in the World Bank Report, enforcing contracts takes 330 days and costs 34.4% of the contract value. However, it is considered that the introduction of the private execution system has facilitated the process of enforcing contracts (and helps reduce the level of problem loans). In another important indicator, which consists of procedures for resolving insolvency, Kosovo ranks in the 163rd place and, according to the Report data, insolvency procedures take approximately 2 years and cost 15% of the debtor’s assets. No progress has been made in terms of access to electricity and Kosovo ranks in the 114th place. Dealing with construction permits remains an indicator wherein Kosovo has marked regress from the 125th to the 129th place.

On the other hand, private sector crediting is improving gradually in the majority of Southeast Europe countries, whereas Kosovo has a lower crediting rate and reduced trust has affected corporate crediting in the first part of 2016. Informality and lack of financial transparency on individual profit and business income, and the low quality of financial reporting (particularly in the segment of MSMEs) has resulted in a high level of collateralized crediting instead of cash flow analysis from banks. Informal economy remains a major problem in Kosovo. Analysis of data from companies shows that the number of enterprises affected by competition of informal enterprises is the highest in the world. The level of informal economy is high in the group of countries with a similar level of development. In addition, this level is also the highest in comparison to the region.

**Structural obstacles:** The main obstacles and challenges are the poor access to financing, particularly for SMEs; slow and inconsistent law enforcement in economic contexts; low production and therefore exporting capacity; frequent, uncoordinated and costly inspections; poor
coordination of public and private institutions, especially financial institutions, in terms of collection and sharing of financial information of enterprises to reduce informal economy.

Based on OECD’s analysis of key obstacles to economic growth, financial cost is considered a major obstacle to economic growth considering the low credit compared to GDP and the highest collateral requirements in the region. The majority of small enterprises use their income or capital to finance investment and capital markets are generally underdeveloped. These obstacles include contract enforcement, inability to execute collateral value due to gaps in the property rights system (in terms of availability and credibility of documents), lack of a secondary market and costs associated with initial credits because of the high level of informality and transaction costs.

Competitive practices in the informal sector are emphasized as one of the main obstacles by companies in the Business Environment and Enterprise Performance Survey (BEEPS). Informal economy is estimated at 39% of GDP, creating unfair competition to formal businesses, with 41% of companies stating that informal competition represents a serious obstacle to doing business.

**Impact of obstacles on competitiveness:** The aforementioned obstacles reduce the competitiveness of Kosovo enterprise by affecting negatively the opportunities and capacities of SMEs in securing financing for their investment projects, increasing export and/or substituting import, inability to get involved in international value chains, unequal market competition, and lack of trust on judicial institutions and their ability to resolve economic disputes in a timely, fair and consistent manner. Simultaneously, informal economy punishes enterprises by preventing them from drawing finance and international investment and trade partners, thus continuing the cycle of poor finances, poor management, low employment and, finally, low competitiveness compared to the countries of the region, EU and global markets.

The impact of informality goes beyond the aspect of taxes, affecting competition. Compared to regional economies, informality appears to be an important issue in Kosovo. Informal economy damages the fiscal interest and the interest of Kosovo citizens and establishes unfair rules in terms of business competition.

**b. Report on policy guidance implementation since May 2016**

The Secretariat for monitoring the Strategy implementation has been reactivated this year for purposes of implementing the Action Plan for Prevention and Combating Informal Economy, Money Laundering, Financing of Terrorism and Financial Crime 2014-2018. This year the Secretariat has held two meetings and by the end of 2016, it will finalize the second report on the Strategy’s Action Plan. This secretariat has a wide structure monitoring administrative phases and up to execution of court decisions in terms of informal economy and economic crimes.

From the beginning of the Strategy’s implementation in 2014 and until now, operational outcomes of relevant authorities have marked a positive change, but there are still weaknesses that endanger efficiency and transparency. The most challenging phases of the process consist of prosecution and use of judgments for temporary sequestration and confiscation. This results from incomplete and inconsistent information on the performance of institutions.

During 2017, we will review the Action Plan and develop a Risk Assessment Plan for specific areas (NGO sector and other sectors), as well as prioritize Action Plan activities to be implemented in the first part of the year. The risk assessment in the construction sector has been completed so far.

**c. Priority reform plans**
Reform measure #9: Evidence based policy development

**Description of the measure:** As a continuation of essential reforms aimed at simplifying legislation and introducing the regulatory impact assessment system, this measure aims to improve policy and legislation development based on evidence and a genuine consultation process. In this regard, we will strengthen the current concept document system for the preparation of policy and legislation proposals, which will be replaced eventually with an impact assessment system. In addition, we will analyse the option of introducing a programme for addressing administrative loads against a 25% target. This measure is in compliance with the National Development Strategy Pillar II Measure 11, Good Governance and Rule of Law. These actions are also essential components of the amended Better Regulation Strategy 2017-2021.

**Arrangements for implementation of the measure implementation:** With the adoption of the amended Better Regulation Strategy in December 2016, implementation of activities under this measure during 2017 will focus on development and introduction of amended guidelines on ex-ante policy assessment; strengthening quality control by the Centre of Government related to ex-ante policy assessment; development and application of analytical tools focusing on competitiveness enhancement through the Standard Costing Model, the SME Test and the Regulatory Competitiveness Test; training of civil servants on application of guidelines and analytical tools to ex-ante policy assessment; and implementation of three legislative assessments.

During 2018, we will approve the Administrative Instruction on Administrative Burdens, including determination of relevant targets. We will continue further staff training on application of guidelines and analytical tools to ex-ante policy assessment, as well as finalize the database framework for impact assessment with data on further improvement of evidence-based decision-making. This year we will conduct three legislative assessments.

During 2018, the main focus will be on implementing the Government’s decision on reduction of administrative burdens. In addition to further staff training on application of guidelines and analytical means in ex-ante policy assessment, seven legislative assessments will be conducted.

**Budget impact:** In order to implement activities under Measure #9, € 290,000 are planned for each of the years 2017-2019. These funds will be provided by the SIDA project through direct budget assistance and expertise.

**Impact on competitiveness:** The quality of policies and legislation will be improved and unnecessary obstacles will be removed. Introduction of the standard costing model will promote understanding of the impact of legislation on businesses and citizens. The SME Test will raise the awareness of policy-makers and decision-makers about the specific needs of businesses, particularly of micro enterprises, which dominate the economic structure of Kosovo. The regulatory competitiveness test will contribute to a more competitive business environment and improved business and regulatory profile in Kosovo compared to other countries in the region.

**Expected impact on social outcomes, including employment of social groups and gender aspects in particular:** Improving the business environment will contribute to economic growth by encouraging business start-ups and formalization of business activities. Moreover, the introduction of additional tools for policy analysis focused on increasing competitiveness is associated with the integration of a gender impact assessment in the policy development process. This will contribute to a policy and regulatory framework that is focused on gender policies and in accordance with the Kosovo agenda for gender equality.
Potential risks associated with measure implementation and facilitation actions: The main risk consists of the lack of budget allocation for the development of the impact assessment database. The budget implications of the database are unclear. This issue will be monitored within the Better Regulation Strategy 2017-2021 and the Government will take appropriate actions for specific decisions in this regard.

Reform measure #12: Ensuring property rights by addressing informality in the immovable property sector

Description of the measure: As a continuation of reforms envisaged under ERP 2016-2018 on strengthening the property rights system, this measure focuses on addressing legalisation of property rights by tackling informality in the immovable property sector. It aims to provide citizens access to efficient and affordable administrative processes for the legal recognition of rights they use de facto. Legal recognition of these rights will allow citizens to register them in the cadastre, thus enabling more effective application of these rights by courts and state bodies, as well as their alienation in the assets market. The measure is based on the National Development Strategy Pillar II Good Governance and Rule of Law, Measure 13 Strengthening the Property Rights System. In order to improve the policy framework for property rights, the Government of Kosovo in December 2016 adopted the National Strategy for Property Rights, which sets out a strategic vision for ensuring these rights.

Arrangements for implementation of the measure: In order to simplify inheritance procedures to encourage citizens to legalise their property rights, we will work on improving the legal framework, including the preparation of concept documents on amending the Law on Inheritance and the Law on Notary (2017) and their adoption in the Assembly of Kosovo (2018). Regarding intervention aimed at legal recognition of de facto property rights arising from informal contracts and prevention of informality and inconsistency in the future, we will prepare concept documents on amending the Law on Property and Other Real Rights, the Law on Contested Procedure and the Law on Non-contested procedure (2017), and adopt them in the Assembly. In addition, we will draft and adopt the integrated Law on Cadastre, which would include the Law on Cadastre, the Law on THRDP and the Law on Mortgages, and would require vertical organisation of cadastre (2018).

This measure also envisages stimulation of property rights registration in the cadastre by simplifying registration procedures and removing barriers in order to complete the legalisation process. In this regard, a complete analysis of the Cadastre Agency procedures will be conducted and policies that ensure accurate registration will be developed to ensure efficiency, simplicity, affordability, transparency and predictability of the registration process. Stimulation and avoidance of barriers to promote property rights registration (2017) will also be provided. In order to simplify registration procedures and reduce the relevant cost, municipal taxes for ownership transfer will be abolished and only to fees set by AI 08/2014 on Fees for Services for Registering the Immovable. Property Rights from Municipal Cadastral Offices. (2018). Interventions within this priority will also include relevant information and capacity building activities that will extend throughout 2018 and 2019. We will also work on unification of cadastral documents with Serbian archives (2018) and the decision on the set of documents that can be taken as proof/evidence on property rights in Kosovo (2019).
Cost and budget impact: The total cost of implementing this measure is €2,661,800, out of which €84,500 is provided by the Kosovo Budget and €2,577,300 from development partners (USAID and EC). The estimated allocation by year is €1,245,850 for 2017 and €1,415,950 for 2018.

Expected impact on competitiveness: Establishing an effective property rights system creates legal certainty for investors and consequently increases investment opportunities. This in turn creates more opportunities for citizens to use property as collateral and thus improves access to finance. In general, the impact of this measure also includes improvement of World Bank’s indicators for the environment of doing business, by lowering the cost of property registration, reducing the total number of property registration procedures required by law, reducing the number of days required for property registration and improving the land management index (reliability of infrastructure, transparency of information, geographic coverage and resolution of disputes over land).

Impact on social issues: Strengthening property rights ensures economic autonomy of the individual, which translates into economic and social empowerment of the property owner. This impact is even more prominent in ensuring women property rights, contributing to their economic independence and easier access to financing.

Potential risks: No risks are envisaged in terms of implementing this measure, except unavoidable political delays that cause problems and delays in decision making.

Reform measure #11: Increased judicial efficiency in case disposition

Description of the measure: The efficiency of the judiciary is commonly measured as the speed and quality with which justice is made. However, the Kosovo’s judicial system is slow in the disposition of the cases (large number of received minor offence cases, large historical backlog, and low clearance case lead to accumulation of backlog), subsequently causing high transaction costs. The focus in improving the efficiency of judiciary should be on decreasing the caseload for minor offences through incentives and speedy court settlements, temporary increase in hiring additional manpower to sort out cases, including capacity building of the Administration Department, namely of the Fiscal Division of the Basic Court in Prishtina, including areas of taxes and customs, aimed at reduction of backlogged cases. This measure is a continuation of ERP 2016-2018 and is based on the National Development Strategy and the European Reform Agenda document.

Measure implementation arrangements: In order to achieve zero backlogs by 2020 for civil and criminal cases, 60 professional associates will be recruited during 2017 as permitted by the Kosovo Budget. These activities aim to reduce case backlog for 30% by the end of 2017. To build the capacity of the Fiscal Division, an analysis on the increase of the number of judges and professional associates will be initially conducted. At the beginning of 2017, the development of the Case Management Information System (CMIS) software will be completed and the criminal field system prototype for the general department will be developed, followed by the criminal field system for serious and juvenile crimes. In this regard, we will work on the preparation of the hardware infrastructure of the database and computer network of courts and prosecution offices. This will include capacity-building activities based on a training plan and will commence implementation at the Basic Court in Ferizaj, which is the CMIS pilot model.

Case backlog reduction by 60% is aimed by the end of 2018. Other activities this year include recruitment of judges based on needs assessment, reduction of cases in the fiscal division and
implementation of the training programs for system users and application in courts and prosecution offices.

To achieve zero backlogs by 2020, further advancement of judges in the Fiscal Division of the Basic Court in Prishtina will continue under the evaluation and full automatization of the Kosovo judiciary.

**Budget impact:** The activity of the zero backlog target costs about €7000,000 for the next two years. This relates to the payment of salaries for 50 court counsellors with a monthly salary of €550 to support the adjudication of 90 thousand backlogged civil and criminal cases within 2 years. Furthermore in the course of 2017 and 2018 net direct impact on the budget do be € 350,000, where € 330,000 Euro will have direct impact on budgetary income (salary) and 20,000 have an impact on budgetary expenditure (expenditure optional). The cost for the second activity will be done after completion of the needs assessment for the Fiscal Division, which is expected to be completed during the first quarter of 2017. The cost for the third activity is € 6,700,000. This includes software and implementation costs for the introduction of the Case Management Information. From the Kosovo budget during 2017 are available €355,000, where €205,000 are allocated for the purchase of computers and €150,000 for audio equipment.

**Impact on competitiveness:** The impact of reforms on judicial efficiency is indirect on economic growth, competitiveness and FDIs. The time spared by reducing the time of case adjudication is significant. In addition to quick access to justice and, henceforth, improved rule of law, which could attract new investments, the direct impact on reduced disposition time is valuable for those seeking justice in the courts. To determine the monetary value of time saving, the high arbitration prices were analysed. The value of one saved day is € 8.1, defined as the marginal cost of judgments/arbitration divided by marginal time saving. Using this parameter, the quick disposition of a case saves € 2.5 thousand and when we multiply this by the total number of cases, the total value of saving for the society is € 140 million.

**Potential risks:** Main risks are related to the lack of willingness of different factors inside and outside the system to implement reforms, even though this has been prioritized at all government levels.

**Reform measure #12: Improved access to finances for SMEs through the Kosovo Credit Guarantee Fund**

**Description of the measure:** This measure is a continuation of the measure envisaged in ERP 2016-2018 and aims to address one of the main obstacles to Kosovo businesses. Expansion of the credit guarantee and improvement of information on the credit history of businesses and individuals would enable many businesses access to finances and low interest rates. Considering that the Kosovo Credit Guarantee Fund (KCGF) is currently in its first year of functioning, it mainly focuses on establishment of cooperation with all commercial banks in the country for increasing credit, regardless of size, sector, demography, number of employees, growth potential, etc. of banks and SMEs.

**Measure implementation arrangements:** The activities envisaged for 2017 include the transfer of € 1,000,00 to KCGF. In order to functionalise the fund, the managing director will be selected and the operational structure will be completed. In addition, we will continue signing agreements with commercial banks in Kosovo for inclusion of their credit portfolios within the fund guarantee. During 2018 and 2019, we will work on the development and dissemination of training and
promotion programmes for SMEs and the public, and the continuation of training and promotion programmes.

**Cost and budget impact:** The contributing capital of KCGF is €22 million, of which the Government of Kosovo, namely KIESA/MTI has contributed with an initial investment of €2 million and an additional €1 million by the end of 2017. This cost is planned within the Draft Budget 2017 under expenditures envisaged for the Private Sector Promotion and Development Agency (MTI) in the category of Subsidies and Transfers. The rest of the measure is expected to be allocated as technical assistance by USAID with €6.0 million for 2017 and 2018 each.

**Expected impact on competitiveness:** More than 4,150 loans for SMEs will be supported from KCGF worth $360 million in cumulative value. Better access to finance increases opportunities for innovation and risk reduction.

**Expected impact on social outcomes:** This measure will have a direct impact on the country’s economic growth through increased productivity, added value and profitability. It is anticipated that in the first six years of operation of the fund, more than 20,000 new jobs will be created. In particular, this effect may be more prominent for businesses run by women and marginalized social groups.

**Potential risks:** Despite the fact that so far six commercial banks have signed agreements with KCGF, they may have had limited human, management, technical and operational capacities to absorb KCGF’s guarantee limits. In addition, close monitoring of banks' lending policy is required because it can increase risk appetite. Finally, as over 40% of SMEs stated that access to finance is a major challenge to their growth, their capacities and growth potential and, consequently, their absorption capacity of the marginal lending limit are not clear.

<table>
<thead>
<tr>
<th>Reform measure #13: Merging Customs and Tax Administration to establish a single Revenue Collection Agency</th>
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<td><strong>Description of the measure:</strong> One of the key aspects of reforms aimed to address informal economy consists of merging the two existing revenue collection agencies, the Customs and the Tax Administration. Establishment of a single Revenue Collection Agency is based on the need to improve services to taxpayers by reducing the “tax gap” through simplified and effective revenue collection structures. This will increase the efficiency, and reduce the cost, of revenue collection and will increase the autonomy of institutional structures that deal with revenue collection. This measure is a continuation of EPR 2016-2018 and is based on the National Development Strategy and the Public Financial Management Reform Strategy.</td>
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<td><strong>Arrangements for measure implementation:</strong> The Law on Tax and Custom Agency has been drafted during 2016 and it is expected to be adopted during 2017. This will also include inter-institutional cooperation to achieve the gradual convergence of processes and the following integration of both institutions. The legal framework will be focused on the organizational structure of the agency, paying attention to the optimization of tax collection processes by minimizing sources, eliminating loses of funds and saving time; then, the necessary legal amendment for establishment of a unified administration for revenue collection. All these will be based on a master plan of activities to be developed during 2017 in order to orient further process of merging. During 2018, the focus will be on implementing the model of good governance, implementing joint activities, harmonizing processes and developing organizational structure. The complete operationalization of the agency is expected in 2019.</td>
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Cost and budgetary impact: In the 2017 budget, €13,552,624 have been allocated for the construction of TAK – Customs building for the period 2017-2019, namely €4,052,624 for 2017, €4,500,000 for 2018 and €5,000,000 for 2019.

Expected impact on competitiveness: The purpose of merging two agencies in a single revenue collection agency is to extend the tax basis and decrease informality that would improve competition in the market, making that fairer and stimulating increase of formal and more innovative businesses. At the same time, this would create opportunities for enhancing the conditions of free competition of businesses, as well as would create better conditions for investments and economic growth.

Expected impact on social issues: Increase of budgetary incomes, which would be fostered also by institutional efficiency of a single Agency for revenues collection, would create opportunity for reallocation of revenues towards targeted social policies that would directly impact the citizens’ welfare.

Possible risks: Insufficient resources dedicated to the process of TAK – KC merging; delays in decision-making from the reform initiator.

4.3.5 Research and innovation
a. Analysis of the main obstacles

State of play: Support for the field of research and innovation in Kosovo is low, with around 4.7 million Euros allocated per year for science and research. Based on the available data, Kosovo spends 0.01% of GDP in research and innovation and the whole amount is allocated from the state budget. This is lower than the average EU-28, which is 2.2% of GDP for 2014. Based on the data of the DSC of MEST, the number of employees in R&D is 833.3 employees in one million residents.

There are four scientific research institutions involved as partners in projects of Horizon 2020. The position of Kosovo within this framework programme does not allow Kosovo institutions to be the bearers of the process, which reduces the possibility of benefiting from this programme. Enterprises and industries in general have no new orientations in the market. In 90% of cases, the approach of SMEs is oriented towards production of traditional goods and services.

According to our current data, Patent Office in MTI has approved 32 patents since 2016, whereas European Patent Office has not approved any. The only scientific infrastructure of the country is laboratories of scientific research institutions. Universities have no activities for creating incubators, start-ups, etc. STIKK has assisted in establishing 30 small enterprises (start-ups) in the field of IT; however, they may not be considered as activities related to the research.

Structural obstacles: Current support through vouchers for innovation for individuals and SME showed that SMEs did not show any interest for absorbing these vouchers. On the other hand, there are no state grants that are allocated specifically for enterprises for purposes of R&D. MEST has grants which are allocated to scientific research institutions and which are conditioned by the element of innovation. The total amount allocated by MEST amounts up to 600000 Euro. Such an investment represents the lowest rate of investments in R&D in Europe. Currently, there is no relevant legislation for research and development (R&D), and therefore there are no tax relieves for this activity.
Projects developed so far in scientific research institutions are focused on scientific works, whereas the commercialization of the research – scientific activity showed no development. Steps taken in the field of IT for commercialization of activities of several SMEs cannot be included within the field of notion of R&D commercialization. Scientific research institutions are more oriented on basic teaching and research. This resulted in the lack of results in commercialization.

Based on the Law on Scientific – Research Activities, state of Kosovo should allocate 0.7% of the annual budget, which when converted in money would amount to 11 million Euros, which will represent the lowest level of investments for scientific researches in Europe. However, the level of 0.01% provides no chance for progress and approximation in this field.

There are no bylaws governing the field of innovation and transfer of technology and knowledge, but scientific and industry institutions, as well as scientific and business community should prepare a qualified staff as part of their duty, adopt the innovative activity of enterprises and increase competition, economic and social development.

There is no government plan to stimulate SMEs to cooperate with the Academy and towards innovation. Also, there is no cooperation between ministries and joint inter-ministerial bodies.

**Impact of obstacles on competitiveness:** Research, development and innovation is a field of activity that has a direct impact on economic and social development of all countries and this is a guarantee for our economy and industry, adapting to the conditions of regional and European competition. Also, the transfer of knowledge and technology are premises for a smart specialization and for creating a society based on knowledge as well as social and economic prosperity.

The lack of investments in this field, and especially the lack of private investments will contribute to the decrease of the ability for competitiveness of SMEs and country’s economy. On the other hand, the lack of orientation towards innovation results in an increase of employment rate of 8%, which is for 15% lower compared to the situation if SMEs would be innovative enterprises.\(^\text{10}\)

Non-participation in programmes of Horizon 2020 prevents enterprises from cooperation in the field of smart growth, aiming the innovative industries, thus causing them to lose the opportunity to be involved in the modern industrial developments regarding new goods and services.

Lack of TT results in reduction of opportunities of SMEs and economy in creating new products and services and following the market opening, it might led the SMEs to risk their chance to survive the market conditions.

### b. Plans of priority reforms

| Reform measure #14: Improvement of policy and strategic framework and building capacities for research and innovation |
| Description of measure: The purpose of this reform priority is to establish a solid strategic and legal basis and create an appropriate environment for increasing the scientific-research opportunities of the country to maintain the research as a developmental component. Based on this, the law on innovation and technology and knowledge transfer will help in creating the legal frameworks for cooperation of the academic and industrial community, while the National Science Programme will determine the methods of scientific development of the country towards European |

\(^{10}\) Seker, M.  (2013) – Background paper for the technical assistance on Western Balkans Innovation Strategy
standards. Also, we will make efforts to increase the level of participation of SIs in European and regional programmes and projects, especially in Horizon 2020. The focus will be also on funding small scientific projects, funding mobility of scientists, funding publications in magazines with IF and publications within the country, in allocating innovation vouchers and awarding the prize for scientist of the year.

**Arrangements for implementation of the measure:** For the purpose of improving the strategic and legal framework, law on innovation and knowledge and technology transfer will be approved on 2017, including the review and approval of the draft strategy. During 2018, we will work on drafting and approving the secondary legislation deriving from the new innovation law, including the establishment of the state council for innovation and inter-ministerial mechanisms in the field of innovation. During 2019, the main activity includes the operationalization of the state council for innovation and inter-ministerial mechanisms in the field of innovation. During the next three years, we will continue with the provision of the support by funding 10 small research scientific projects aimed at supporting the academic world and SMEs and 20 vouchers of innovation for medium and small enterprises; 50 short-term mobility for scientists; 20 grants for students for PhD in 500 best universities and awarding the prize for the best scientist of the year and young scientist of the year.

**Cost and budgetary impact:** For implementation of activities during 2017-2019, the planned budgetary cost is € 560,000 for each year of implementation. This cost has been planned in the Draft Budget of 2017, within the programme.

**Expected impact on competitiveness:** With the current budget and opportunities created by such a budget, the possible impact of the country on competitiveness will be very symbolic. Without a more significant budget and without competitive capacities in international programmes, we cannot wait for significant effects within this period.

**Expected impact on social issues:** As we mentioned, even in the aspect of social issues with existing capacities, the impact will be symbolic. However, in a situation where legal provisions related to the budget would apply, the measure would impact the development of the research and innovation sector in terms of increasing the ability of institutions and SME to hire new staff that would impact the increase of employment proportion for researchers compared to the total number of employees and number of employed researchers with the proportion of population (according to OECD).

**Potential risks:** The lack of budget and financial opportunities will automatically impact the stagnation and non-development of the sector and lack of the competitive ability even in the goods and service market, as well as in the international scientific and innovative competition. Another risk is the lack of budget and the failure to approve of the National Innovation Strategy.

### 4.3.6. Foreign trade and investment facilities

**a. Analysis of main obstacles**

**State of play:** During the first months of 2016, the goods market recorded an amount of 1 billion and 450 million Euros, which is an increase of 89 million Euros compared to the same period of the previous year. Goods exported in this period amounted to 152 million Euros, a decrease of 5.6%. In this period, the foreign trade of Kosovo constitutes 89% of imports and 11% of exports. The structure of partners remains mainly the same for exports and imports. During the last ten years, Kosovo has exported an average of 40 per cent of its production in EU countries. EU market
has been followed by neighbouring countries, which consists of 37 percent of total exports during 2005-2014.

Regional trade marked an increase especially following the declaration of independence in 2008, Kosovo businesses begun to move more in other market, especially EU and countries such as China and India, where the demand for natural sources is greater. Lack of diversification of product is especially acute when it comes to Kosovo exports in markets of developed countries (of EU, EFTA) with Herfindahl-Hirschman Index of 0.52 and 0.6. On the other hand, exports in CEFTA are more diversified with 0.248 HH Index. After the war, Kosovo has made important steps in liberalization of its economy, especially the trade. A major step is the membership in CEFTA. In addition, Stabilization and Association Agreement entered into force in 2016.

At the regional level, Kosovo is participating in the reforms for facilitating the trade through CEFTA mechanisms. The agenda for facilitating the trade of the latter is related to the WTO Trade Facilitation Agreement. According to the self-evaluation report of Kosovo, based on the WTO Agreement, immediate measures are required for a number of issues, including: information exchange, post-clearance control, risk management, procedures prior to arrival, electronic payment, notification procedures, consultation procedures, tariffs and charges on imports and exports, authorized operators and other fields.

Export of services constitutes a significant part of Kosovo exports and is an important determiner of future competition of Kosovo. Therefore, the removal of trade barriers for development of service sector is decisive.

Structural obstacles: Based on the indicator of the World Bank for cross-border trade, region of CEFTA has been assessed with 72.6, which is similar to the East Asia and Pacific, Latin America and Caribbean countries, and much worse than OECD, which is assessed at 86.1. For the region of CEFTA, poor results relate to the number of documents required for imports and exports, which is twice higher than the average in OECD countries. In addition to the higher import cost, the time necessary for declaration of goods through customs in CEFTA’s countries is 30 percent higher than countries with higher incomes of OECD. The overall ranging for this indicator places Kosovo in the 118th position from 189 countries. Kosovo and other countries of CEFTA with an average low performance require more documents for import and export, and cost of import and export for a simple container is higher. For instance, Kosovo and Serbia (compared to CEFTA countries) have the highest average cost for imports and exports, even though during the last two years Kosovo has significantly reduced the import cost.

In addition to the reduction in procedural costs, certification of the product quality is another obstacle of export and replacement of import. In this regard, the reduction of technical barriers to trade has the same importance for trade facilitation.

Similarly, Kosovo has identified logistical and border barriers as one of the greatest obstacles for a greater circulation of goods between regional partners, as well as for deeper integration with the other part of the world.

Impact of obstacles to the economic growth and competitiveness: Sources of unnecessary trade expenditures include: unfavourable procedures, document requirements, excessive and underdeveloped risk-based systems of inspection, underdeveloped and corrupted administration, lack of technical capacities, insufficient information flow, poor cooperation between border agencies, etc. As indicated by the World Economic Forum (2013), the most direct benefit from the
elimination of supply chain barriers is reduction in costs for commercial companies and thus low prices for consumers and businesses that import materials used in their manufacturing activities. If so, reduction of import costs is of great importance for Kosovo, as the Kosovo production sector is mainly based on the imported inputs.

b. Plans of priority reforms

| Reform measure #15: Increasing efficiency for costs of international commercial transactions |

**Description of measure:** Trade facilitation, in wider sense, may be defined as any measure or set of measures that aims to increase the cost-effectiveness of international trade transactions. Regional trade within CEFTA is still largely hampered by procedures and formalities that are time consuming and cost a lot, especially outside the borders that divide member states. Trade facilities may help to address and reduce these obstacles – specifically, trade facilities are related to the simplification and standardization of all formalities and procedures at borders, which are expected to reduce cross-border expenditures and as a result expand trade further. According to WTO, trade facilitation is important because:

**Arrangements for implementation of the measure:** Aims the reduction of trade transactions cost, the activities during 2017 include: implementation of risk management in other border agencies; operationalization of programme for Authorized Economic Operators; operationalization of Transit Agreement with Albania; drafting the legal and regulatory framework for preliminary decisions; supplementing and amending the Customs Code and its implementation; supplementing and amending the Law on Customs Measures for Protection of Intellectual Property; sustainability of the National Committee for Trade Facilitation, awareness-raising and information for private sector; and study the time of completion of customs procedures. Based on the legislative changes and other interventions, the main activities in 2018 includes the publication of tariffs and payments from the Customs and other border agencies, whereas in 2019, the development of a National Single Window.

**Cost and budgetary impact:** Funding sources will be the Kosovo budget and donations from WB, IFC and IPA (which are expected to be confirmed during the next year). From Kosovo budget, €18,000 has been budgeted for each year of the period 2017 - 2019. Out of this amount, €8,000 has been planned each year for the establishment of Single Contact Point. Also, the activity for the establishment of Single Contact Point is expected to be supported by the project funded by the European Commission during 2017-2019, with €25,000 (2017), €15,000 (2018) and €10,000 (2019).

**Expected impact on competitiveness:** Analysis shows that at the macro level, in several countries, the reduction of the time for trade for only one day may increase the trade activity for more than 5%. At the firm level, exporters in developing countries that have more efficient customs agencies produce better and more diversified products, as well as they export more. OECD has concluded that trade facilitation reforms may reduce the trade costs for 15.5%. According to OECD, Trade Facilitation is related to the easier, cost-efficient and more rapid and efficient trade transactions, thus facilitating trade flows. In addition to the easier export and import of goods and services, Trade Facilitation measures also increase the attractiveness of a country for direct foreign investments.
**Expected impact on social issues:** With this measure we aim to increase the investments in building human and institutional capacities, as well as job opening (based on studies, improvements for trade facilitation may result in global benefit with new jobs up to 21 million, where developing countries benefit more than 18 million new jobs and developed countries increase their labour force for 3 million persons).

**Potential risks:** Risks related to the implementation of measure include the cooperation between agencies, as well as the lack of professional staff. An obstacle associated with other reforms is the process of merging the tax administration and customs, which as a process may cause delays in implementing activities of this measure. The delay in approving the Protocol 5 to facilitate the trade within CEFTA will hinder the efficiency of activities related to the trade facilitation at regional level.

**Reform measure #16: Improvement of quality infrastructure**

**Description of measure:** The purpose of the measure is to further develop the quality infrastructure (*Technical Rules and Standards*), by approximating the legislation with EU acquis and its implementation as a basis for strengthening the coordinated inter-institutional system, raising awareness of businesses and other stakeholders for the role and importance of Quality Infrastructure, as well as membership to European and International Standardization Organizations. The overall objective for improving the Quality Infrastructure is the approximation and implementation of EU legislation for the framework: (NLF: 764/2008/EC, 765/2008/EC, 768/2008/EC, including directives of *New Approach and Old Approach* as well as Regulation 1025/2012/EU) for the purpose of: increasing the quality and safety of products and services provided in domestic market, integration in EU market and other countries, and elimination of technical barriers to trade.

**Arrangement for implementation of the measure:** Activities related to the changes in legislative reforms have begun in 2016, whereas in 2017 is expected the approval of the amendments of the Law on technical requirements for products and conformity assessment, as well as its supplement with other bylaws and its implementation. During 2017, other legal reforms include: approval of new Law for Construction Products and its supplement with other bylaws for certain construction products and their implementation in compliance with Regulation (EU) of the European Parliament No. 305/2011;\(^\text{11}\) approval of the Law on Standardization (new law) and approval /transposition of new European and International standards (4000 new standards for 2017-2019) giving priority to harmonized standards. During 2018, pursuant to the approved Law for Standardization, the supplement will be done with bylaws, including the structuring of the Kosovo Standardization Agency, organization and functionalization of technical controls and KPS. During three-year period, the measure activities will be focused on transposition of Regulations\(^\text{12}\) as follows: 2017 – for construction products (Regulation 305/2011/EU) and lifts (Directive 2014/33/EU); 2018 – textile names and textile fibres (1007/2011/EU) and appliances burning gaseous fuels (Regulation 2016/426/EU) and 2019 - machineries (2006/42/EC + amendments) and Personal Protective Equipment (Regulation 2016/425/EU). Within this three-year period, cooperation and information roundtables will be organized with businesses and other stakeholders for specific applicable regulations for relevant fields (*lifis, construction products, electrical infrastructure*).

\(^{11}\) This Regulation sets forth conditions for placing on the market of construction products, establishing harmonized rules for basic requirements and marking construction products.

\(^{12}\)Regulations have been listed by priority.
appliances, textile products, footwear and toy safety), increase of the number and performance of Conformity Assessment Bodies, as well as raising awareness of businesses and other stakeholders for the role and importance of applying standards.

**Cost and budgetary impact:** For implementation of measure activities, Kosovo Budget has allocated € 66,300 for each year of the period 2017-2019. This amount has been planned with the Draft Budget of 2017 within the Department of Industry (MTI), category of Goods and Services, Wages and Salaries.

**Expected impact on competitiveness:** Improvement of Quality Infrastructure is a mean and the most sustainable solution for increasing competitive abilities of businesses. By implementing the technical legislation and standards, Kosovo products become more competitive against those imported as thus businesses prove that domestic products have been subject to the same security requirements and have implemented the same standards as products imported from the European market. In addition, the improvement of Quality infrastructure has a crucial impact on commercial integration as businesses which implement the Kosovo legislation that transposes that of European Union have the opportunity to export in the internal market of the European Union, without implementing additional requirements.

**Expected impact on social policies** Improvement of Quality Infrastructure in addition to the direct impact on the economy by increasing the competitiveness of businesses and consequently trade integration, is expected to have wider impact on society through the promotion of private sector investment and encouraging businesses to implement standards to achieve quality and safety of products which in turn make it possible for the Kosovar consumers a safer product consumption.

**Potential risks:** Potential risks to implementation of this measure can be of financial nature, that without the support of various projects of technical assistance, the implementation of all activities can be undermined.

**4.3.7. Education and Skills**

**a. Analysis of main obstacles**

**State of play:** During recent years it was achieved a significant progress in the development of skills, in improving quality and access to education. Inclusion in pre-primary education has been (5) 79.6%, in primary (6) 96.4%, in lower secondary 99.5%, in upper secondary education 84.5% and higher education (18-24) 49.6% is considered a challenge for some levels of education. Kosovo has started the implementation of a revised curriculum framework and based on the assessment made in the pilot schools, new curriculum framework is implemented only in 94 schools. In the academic year 2017-2018, the process will be expanded to all schools.

Education quality assurance, even though were undertaken activities in curriculum, training and salary increases for teachers, there is much to be done. Currently, two types of external tests are applied for pupils’ assessment, the achievement test in semi-matura (62.60% in 2015), and the state matura exam (54.50% in 2015). Pupil Assessment system, after the conclusion of fifth grade (5) was piloted but still expected to be implemented in a systematic way. In 2015 Kosovo participated for the first time in the Program for International Student Assessment (PISA) and was ranked 69 from the 72 countries assessed for math, science and reading for pupils from age group of 15.
Currently, about 40% of teachers do not have adequate qualifications prescribed by the relevant administrative instruction for teaching; this is reflected in the quality of education. Some positive developments were observed in the teacher re-qualification programs, but further progress is needed to ensure that all teachers meet minimum standards of teaching.

Despite the positive results in vocational education, there are still concerns about the mismatch of skills offered with the labour market needs. About 50% pupils of upper secondary education chooses a vocational education profiles, this involvement is comparable to the involvement rate in regional countries. Linking vocational education with labour market remains a challenge for around 30% of vocational schools offering profiles that are not highly demanded by the labour market. Based on Enterprise Survey (KAS, 2013), about 25% of enterprises engaged in manufacturing pointed the lack of adequate skills as a major obstacle in their business activity. The results of BEEPS Enterprises Survey (World Bank, 2013) indicate that about 76% of enterprises in Kosovo report that the skills and education of the workforce is a problem for business operations.

Recently, the enrolment in higher education has increased, and the current figures rank Kosovo among regional countries with most students per 100,000 inhabitants. The teacher/student ratio has deteriorated significantly and this is a quantitative indicator of quality in higher education in Kosovo. Current educational offer is not fully in line with labour market needs and the needs for skills in strategic sectors of government.

**Structural obstacles** regarding the fields of education and skills, it is as follows: low involvement of children in preschool education, as a result of the lack of proper funding, lack of curriculum for age group 0-3, regulation and licensing of private institutions, professional development of educators and development of national instruments for determining the quality of preschool education, are challenges that are affecting the entire education system. Development of skills for most relevant professional fields, according to the research, does not correspond to the requirements and causes negative effects on economic development.

Other obstacles include the small number of occupational standards and revision of vocational education curricula; quality assurance tools and practices are still underdeveloped; Overall quality of teaching, training of teachers at all levels and of those in vocational education.

**Impact of obstacles to the economic growth and competitiveness:** Non-inclusion of children in preschool education negatively affects their success at other levels of education, as a consequence in long-term aspects it has an impact on workforce skills. Estimates indicate that it also prevents the participation of women in the labour market. In general, the lack of connecting the education with the labour market effects the reduction of investments and hinders economic development, and in increased unemployment and poverty and unnecessary budget spending. Quality teaching is essential for preparing a skilled workforce for the labour market.

**b. Priority plans of reforms**

| Reform measure #17: Harmonization of supply and demand by drafting occupational standards and reviewing curricula |
| Description of the measure: The main objective of this measure is the harmonization of education and training with the requirements of the labour market. The measure is a continuation of ERP 2016 and is related to the National Development Strategy and the document of the European Agenda for Reform. Reforms in the framework of the priority are presented in the wider context |
and are better specified in the Kosovo Education Strategic Plan 2017-2021, which was approved in December 2016. During 2016 was revised the new Kosovo curriculum framework and the Core Curriculum for three levels of pre-university programs, 61 syllabuses have been designed and have been reviewed all textbooks regarding their contents. Also were organized two conferences and roundtables with businesses and other education stakeholders.

Arrangements for implementation: Based on the progress made so far, for the next three years will be the drafted new occupational standards and their verification – 20 standards in 2017, 10 in 2018 and 10 in 2019. Specifically, during 2017 are expected to be realized the following activities: development of VET Core curriculum based on the new curricula of Kosovo; revision of the VET curriculums and training curriculums and training of trainers and teachers based on the Core curriculum of MEST, MLSW; development of teaching materials for VET for two priority profiles by MEST and MLSW and the expansion of a new curriculum for preschool and I, VI, and X grades in all schools.

During 2018 the focus will be on expanding new curriculum for preschool and II, IV and XI grades in all schools; drafting of at least three new curricula for education and vocational training according to requirements of labour market; training of teachers for implementation of new curricula and development of teaching materials for VET priority profiles according to the needs of the economy. In 2019 we will work on expanding the new curriculum for preschool and III, VIII and XII grades in all schools; training of teachers for implementation of the new curricula and development of teaching materials for VET priority profiles according to the needs of the economy.

Cost and budget impact: To accomplish activities 1, 2, 4 and 5 for 2017 are planned 225,000 € from KCB and 112,000 from donors, for activities 1, 2, 3, 4 and 5 during 2018 are planned 275,000 € form KCB and 100,000 from donors while for activities 1, 2, 3 and 4 during 2019 are planned 225,000€ from KCB and 100,000 € from donors.

The expected impact on competitiveness: The implementation of this measure will contribute in the development of the skilled labour force and more productive labour force, will create opportunities for self-employment and employment, will foster innovation and enhance the quality and efficiency of products and companies, and also the development of the industry.

Expected impact on social policy, will be long-term and will be accompanied by increased revenue per employee and enterprises, will help in attracting the foreign investments and at the same time will increase the employment and the welfare of the citizens.

Risk - The slowdown in the implementation of the new curriculum and the slowdown of the process of developing new standards. Lack of interest of businesses to cooperate and the low economic development of the country.
implementation of the new Kosovo Curriculum Framework in 71 schools. Also 2400 teachers were trained in other programs within other natural science programs.

**Arrangements for implementation of the measure:** Based on the progress achieved so far, activities of 2017 include: completion of the legal framework for the professional development of teachers; training of 8000 teachers in implementation of the core curriculum for pre-primary grade, 1, 6, 10 in the general and vocational education; review and approval of the strategic framework for development of teachers; modification and development of database for licensing and updating the catalogue and prioritization of accredited programs by MEST. The main activities in 2018 include: implementation of the induction phase for initial teachers (Induction phase), before starting his/her career; development of the database for licensing under the new scheme of data integration system of EMIS – MEST (Education Management Information System); teachers performance evaluation (5%) that are graded by the licensing system; training of 8000 teachers in the implementation of core curriculum for grades – 2, 7, 11 in general and vocational education; and creation of mechanisms for implementation of strategic framework for development of teachers. In 2018 we will continue with the renewal of licenses and grading for teachers within the licensing process, connection with the payroll system by the funding formula, training of 8000 teachers for implementation of the core curriculum for 3, 8, 12 grades of the general and professional education and implementation of the strategic framework for the development of teachers in the school level, MEDs and MEST.

**Costing and budgetary impact:** For realization of activities for 2017 are planned 700,000 € from CBK and 150,000 from the WB program (ESIP). For activities during 2018 from the CBK budget are planned 600,000, while from the WB program (ESIP) 200,000 and for activities during 2019 from the CBK budget are planned 600,000 while from the WB program (ESIP) 550,000.

**The expected impact on competitiveness:** This measure improves and increases the pupil’s outcomes, increases the quality in the education system. It increases investments and economic development.

**Expected impact on social issues:** This measure provides a better social welfare at national level.

**Potential Risks:** The main challenge would be the connection of the payroll system with the licensing and promotion system and budgetary cost.

**4.3.8. Employment and labour markets**

**a. Analysis of the main obstacles**

Kosovo has a high rate of unemployment, which is two times higher than the regional average (26.2%) according to LFS 2016) and four times higher than the EU average, especially for women (30.3%) compared to men (25%), although the unemployment rate in Kosovo has fallen to 32.9% from 35.3% from the last year, while the overall employment rate has dropped to 25.2% from 26.3% as it was in 2014. According to LFS in 2016, the employment rate for men is 42.9%, while for women is only 12.6%. Leading indicators, according to LFS in 2016, such as the rate of labour work participation (37.8%) and employment rate (27.9%) are very low and it is only about 1/3 of the “Europe 2020” objective (75%), with the lowest indicators of usage of labour force (labour force participation and employment rates) in the Western Balkans region and much lower than the EU average. The inactivity rate is 62.2% (percentage of the population that does not participate in the labour force) with the highest rate among the women (81.9%) and 42.9% for men.
Level of employment in unstable jobs, people who are self-employed and do not have employees and those who work for free in a family business decreased from 24.9% (2014) to 22.8% in 2015. The main employment sectors are manufacturing, trade, education and construction.\textsuperscript{13}

Unemployment among the young people in 2015, dropped to 57.7%, which according to LFS in 2016, unemployment for 15-24 age group stood at 51%. Official statistics show that in 2015 has been a decrease in a long-term unemployment, with declining percentage of the unemployed who have been unemployed for more than 12 months, at 72.2%. The percentage of young people who belong to NEET category (Not in Education, Employment, or Training for responders aged 15-24 is 31.4%, while for woman is 34.9%. Unemployment is also an acute problem for the elderly unemployed, due to the limited capacity of this group to adapt to the needs of the labour market.

The unemployment rate for people with higher education was 15.6% in 2012, compared to 44.6% of those with primary education, and 28% for graduates of vocational high schools, and 38.8% for those with general secondary education.\textsuperscript{14} People with Vocational high school are more likely to be employed in the private sector than in the public sector, and the opposite is for those who have completed the higher education (34.8% of graduates from secondary vocational education are employed in public sector, compared with an average of 47.6% for those with higher education).\textsuperscript{15} Moreover, as a sign of growing importance for relevant training for the labour market, labour force participation among those with vocational education was the highest in all age groups.

**Obstacles and main structural problems:**\textsuperscript{16} In general, the high rate of inactive population is a serious obstacle for the use of potential human resources for economic growth and strengthening of competitiveness. This is due to the low demand for labour because of low economic development; mismatch of market needs with the skills offered by the formal and professional system of education; adequate non-development of vocational training system, including the integration of learning with work, discrepancy of curricula content to market need; the low rate of participation in the labour force (41.6% in 2014); participation for women is even lower (21.4%);

There is a considerable level of remittances, which according to some studies (e.g. UNDP survey on remittances) underline that they potentially discourage the participation in the labour market.

Regarding the employment services, main challenges consist in the absence of staff and capacities in the employment offices – the large number of job seekers per employment adviser that is 1200 jobseekers per adviser.

**Impact of obstacles in competitiveness:** It is important to emphasize that the existence of informality in the employment sector affects on the lack of protection of employees in general. Weak capacities of employment services prevent effective connection between job seekers and employers, as well as providing trainings and other employment facilities. Discrepancy between skills and labour market has a significant negative impact on competitiveness and economic growth, in particular due to the fact that it produces inadequate manpower that directly affects the quality and quantity of investment in economy. In addition, there may be structural unemployment if the discrepancy is high. The high level of structural unemployment (of youth) results in a burden

\begin{itemize}
\item \textsuperscript{13} Labour Force Survey in Kosovo 2015
\item \textsuperscript{14} Labour Force Survey 2012 and 2013 in Kosovo
\item \textsuperscript{15} Labour Force Survey 2012 and 2013 in Kosovo
\item \textsuperscript{16}These obstacles were identified by European Commission's assessment of Kosovo ERP 2016 -2018
\end{itemize}
on public finances, high dependency of youth in support schemes, affecting this way to the potential of long-term economic growth.

b. Report on policy guidance implementation since May 2016

Within the process of reviewing the Sectoral Strategy for employment and social policy 2015 – 2020, the Action Plan for youth employment is foreseen to be drafted in the following year, which plans specific targets for youth employment for the period 2017-2018. These targets will enable to monitor the success of active programs and projects of labour market, specifically for youth employment. Drafting of International Standard Classification of Occupations ISCO 08 was conducted in order to implement policies to facilitate the transition from school to work, which is a basis for the description of occupations, drafting of occupation standards and a basis for a new approach on drafting competency-based curricula. In this context, offices for student services in four centres were also established which imply Offices of Career Guidance. With the aim of increasing school-business cooperation were signed cooperation agreements with businesses.

EARK Employment Policy 2016-2018, which defines the policy orientations for MLSW and EARK 2016-2018 as well as specific objectives for the following three years, was drafted regarding the functioning of the Employment Agency of the Republic of Kosovo, based on the Regulation adopted for the operation of the agency.

c. Plans of priority reforms

Reform measure #19: Improvement of employment services by establishing the Agency for Employment and active measures of the labour market

Description of measure: This measure is continuation of the reforms undertaken in 2016 on improving the capacities of public employment services (PES) to enhance its services for jobseekers and employers. Steps undertaken in 2016 to implement the measure include the adoption of the regulation on internal organization of the Employment Agency as an independent body. Services of non-public providers are expected to be monitored upon the establishment of the agency. Implementation of this measure will result in a more effective planning, drafting, implementing and monitoring of active measures of the labour market, by increasing employment, better functioning of labour market and implementing the ‘grant scheme’ for vulnerable groups, especially for women and young people. This measure derives from the 2015-2020 Sectoral Strategy of the Ministry of Labour and Social Welfare (MLSW), and also is associated with MTEF 2017-2019.

Arrangements for implementation of the measure: Basing on the adopted legislation, the formal establishment of EARK is expected to be established during 2017, including the transfer of existing staff and assets from MLSW. In this context, the drafting of the regulation for the advisory board should be completed, as well as the drafting of necessary sublegal acts. Other activities include: licensing of non-public employment service providers to improve the delivery of employment measures (for implementation of active measures of labour market); training of employment advisers and review of performance results; improving the integration of the Labour Market Information System (LMIS) to the Education Management Information System (EMIS); and modernization of services provided by vocational training.

The following activities will be implemented during 2018: application of an internal training system of the Agency, which includes trainings for better designing, implementing and monitoring the active measures of the labour market; implementation of a training program to strengthen the
technical monitoring capacities for EARK staff regarding the functioning and performance of non-
public employment service providers, who can be contracted for the implementation of active 
measures of labour market; implementation of the grant scheme (IPA) for the active measures of 
the labour market which will target vulnerable groups, particularly women and youth, and it is a 
direct recommendation of Joint conclusions of the Economic and Financial Dialogue. During 
2019, the focus will be on: continuation of internal training of the Agency, with increased focus 
on assessing the impact of active measures of the labour market with a view to improve the effect 
of such measures.

**Cost and budgetary impact:** For the implementation of activities related to the functioning of 
EARK, the amounts planned are: €175,000 (2017), €130,000 (2018), €130 (2019), part of the 
regular budget of the Office of Employment (salaries and wages, goods and services). For the 
Integrated Information System of the Labour Market, as part of the Draft Budget 2017, in the 
category of Capital Expenditures (MLSW) €100,000 was budgeted for 2017. As for the 
implementation of the wage subsidy scheme for the category II, the 2017 Draft Budget plans €9.0 
mil for 2017-2019 (€3.0 mil each) in the category of Subsidies and Transfers - Employment 
Department. Within this category for 2017 are also planned €600,000 for modernization of services 
provided by vocational training. On the other hand, from the IPA project are expected to be 
supported other activities of active measures of labour market with € 500,000 in 2018 and 2019.

**Expected impact on competitiveness:** Functionalization of EARK is expected to improve the 
services which will increase employment of jobseekers. This measure aims to improve 
opportunities for sustainable employment, particularly through strengthening employment 
services, which improve the employment offer, increase the employment, especially among the 
long-term unemployed. Various measures of active employment have targeted individuals and 
groups, including youth, women, people with disabilities, minority groups, but also individuals 
who aim to establish their own businesses.

**Expected impact on social issues:** This measure focuses on expanding opportunities, particularly 
for vulnerable groups, with special emphasis on the long-term unemployed, youth, women, 
minority groups and people with disabilities. There will be an expansion of grant scheme for 
implementation of active labour market measures through social enterprises, including support of 
social enterprise with a focus on women and other groups in need - costs already included in the 
funding of ALMPs above. It also aims to reduce dependency on social schemes.

**Potential risks.** Potential delays may occur regarding the formal creation of EARK. Licensing of 
non-public providers of employment services also require sufficient monitoring capacity to be 
developed within EARK to adequately supervise the contracting of public resources for non-public 
providors. Risk also remains in the failure to agree for a unified system of active employment 
measures.

**4.3.9. Social inclusion, reduction of poverty and equal opportunities**

**a. Analysis of main obstacles**

**State of play:** According to the recent report related to the Consumption Poverty of the Kosovo 
Agency of Statistics and World Bank, the poverty in Kosovo remains high, especially in rural 
zones where families headed by women are more risked from the poverty compared to the families 
headed by men (families headed by women are 4% poorer, families with more than 7 members are 
poorer). With a Gross Domestic Product of 3,000 Euro per capita, Kosovo is one of the poorest
countries in Europe and with a relatively low GINI index (World Bank 2013) and distribution of flat consumption. Around 29.3% of population lives under the poverty line of €1.72 per adult equivalent per day, whereas 10.2% still live in extreme poverty, with less than €1.20 per adult equivalent per day. Around 32.8% of children in Kosovo live in poverty compared to 29.3% of total population, whereas 10.6% in extreme poverty compared to 10.2% of total population. According to the Social Assistance Scheme (SAS), it results that from a total of 107,487 family members in SAS, 49,198 or 45.77% of them were of age-group 0-18 years old, whereas 58,289 or 54.32% of family members in SAS were over 18 years old. It results that 45.77% in this scheme consists of persons under 18 years old.

With regards to the gender issues, it is reported that the involvement of women in economy and other spheres is low: in leading positions, females constitute 19.89% at the central level and 19.7% at the local level; 14.36% in the whole public administration are females, where 12% are from minorities. Participation rate in the labour market for women is the lowest in the region (21.4%), whereas there is a significant gender gap with regards to the attendance at the higher and superior educational level. According to UNDP report on Human Development (2016), RAE communities and persons with special needs have limited access to education: only 10% of children with disabilities attend education due to the lack of physical infrastructure based on their needs, whereas 13.3% of adults in RAE communities are illiterate, compared to 1.6% among the Albanian community of Kosovo. According to the Kosovo Agency of Statistics and UNICEF, children of RAE communities have lower percentage of attendance, especially at the secondary education level (53.4% compared to 90.4% that is the average in Kosovo). Social protection system in Kosovo is based on the: benefits schemes (cash) and professional services. The system is in general funded by the State Budget for central and local level.

Programmes of benefits in Kosovo (pensions and social assistance), according to the data, cover around 15% of the population. Expenditures for Pension Schemes during 2015 amounted at €220,108,114.00, whereas expenditures for Social Assistance Schemes amounted at €25,285,403.65. Due to the population structure, pension expenditures are relatively limited compared to GDP. Pension scheme is established based on contributions, thus ensuring the fiscal sustainability. According to IMF (2016), expenditures related to the war categories comprise the largest part of social transfers.

Based on official data of MEST regarding the compulsory education, the inclusion is 47%, whereas in upper secondary education is 17.6%. Resource Centres and travelling teachers support around 166 pupils with special educational needs in the entire territory of Kosovo. Health insurance is still not applicable even though Kosovo has a Law on Health Insurance (Law No. 04-L-249) since April 2014.

**Structural obstacles:** Obstacles at the country level are related to the wide number of groups risked from poverty and social exclusion. Number of citizens and families in need for social protection, health care and other services of this nature continue to be high. Social protection system continues to face challenges due to the budgetary limitations and other limitations that infringe the efficient policy and legislation implementation. A challenge remains the maintenance and advancement of a social protection system and health care. Social support policies are not sufficiently synchronized with measures of active labour market.

A key obstacle to address the issues of social exclusion and inclusion of marginalized groups is the lack of specific grant for funding social services. Also, the system of social protection,
combined with other policies at ministry and government level, should better improve the targeting of women and girls in need, as well as disabled people, including RAE communities, long-term unemployed persons and other risked groups. Whereas obstacles in including children with special needs are: low awareness for inclusion, inadequate infrastructure in schools, and preparation of teachers for inclusion of pupils with special needs, assessment of needs and opportunities for pupils with special needs, lack of professional staff for support, as well as the lack of funds for staff employment.

Impact of obstacles: inequality in incomes, inclusion in education, health conditions and employment opportunities are important factors for economic growth and development. Based on the identified obstacles, inequalities in incomes undermine the economy performance in long-term period, and this is related to two aspects: higher level inequalities hamper the economic growth and the inequality also impacts on the education results and abilities; therefore, it may generally impact the human capital of the country. Higher level of poverty increases the receipt of welfare system, whereas the inefficient health system negatively impacts the perspective of economic growth in an indirect way through high expenditures that are not necessarily translated into expected results. b. Plans of priority reforms.

Reform measure #20: Improving the health and social services

Description of measure: The proposed measure aims to strengthen the social protection system through improved health and social services. This measure aims to define sustainable system for financing social services, and the licensing of NGOs in the provision of social and family services; further functioning of the institutional infrastructure for the establishment of the health insurance fund, including exemption of health insurance payment for the target groups in accordance with the Law on Health Insurance. This measure is based on the draft Sectoral Strategy of the Ministry of Labour and Social Welfare (MLSW), 2015-2020.

Arrangements on the implementation of the measure: Activities during 2017 include: Creating and drafting of the financing formula for social and family services (minimum 6% of the General Grant for social services); Inclusion of the "specific grant for social services" within the system for financing the municipalities by the central government, by including it in the amendment of the Law on Local Government Finances; Grants support to licensed NGOs to provide social and family services; Development, support and financing of social enterprises that provide social services; Development and promotion of Integrated Information System of social payments, which also includes statistics on gender basis; Collection of health insurance premiums from citizens; Coverage of premium cost for social categories from the Kosovo Budget (ongoing every year).

During 2018, the main activities for implementation of the measure are: Support with grants the licensed NGOs to provide social and family services; Development, support and financing of social enterprises that provide social services; Improving and maintenance of the Integrated Information System of Social Payments; Execution of payments for health insurance services of the insured (ongoing every year).

During 2019, the following activities will be implemented: Support licensed NGOs with grants to provide social and family services; Continuation of development, support and financing of social enterprises that provide social services; Continuation of the development and progress of the Integrated Information System of Social Payments; Coverage of premiums cost for social categories from the Kosovo Budget.

Costing and budgetary impact on the implementation of the measure include: Creating and drafting of the financing formula for social and family services (minimum 6% of the General Grant for social services); Inclusion of the "specific grant for social services" within the system for...
financing the municipalities by the central government, by including it in the amendment of the Law on Local Government Finances: 3,000,000 Euros in 2018; 5,000,000 Euros in 2019; Support licensed NGOs with grants to provide social and family services: 750,000 Euros in 2017 (500,000 Euros from EU and 250,000 Euros from the budget); 900,000 Euros in 2018 (700,000 Euros from EU and 200,000 Euros from the budget); 900,000 Euros in 2019 (700,000 Euros from EU and 200,000 Euros from the budget) with a total of 2,550,000 Euros. Continuation of development, support and financing of social enterprises that provide social services: 800,000 Euros in 2018 (500,000 Euros from EU and 300,000 Euros from the budget); 1,000,000 Euros in 2019 (500,000 Euros from EU and 500,000 Euros from the budget) for a total amount of 1,800,000 Euros; Development and promotion of Integrated Information System of social payments, which also includes statistics divided on gender grounds: 300,000 Euros in 2017 (200,000 Euros from donors and 100,000 Euros from the budget); Execution of payments for health insurance services for employees in the public sector in payments: 51 million Euros for the period 2017-2019 (17 million Euros budgeted in the Kosovo budget each year); Premium collection of health insurances from citizens, 60 million Euros per year, coverage of premium cost for social categories from the Kosovo Budget (amount to be determined/verified).

**Expected impact on competitiveness:** Implementation of these activities will improve the access to social services and especially enable better results of health care through improved health care. The measure is expected to have a positive impact on the welfare of different social categories, which should also be favourable in improving the performance and competitiveness of the labour market in general.

**Expected impact on social issues:** This measure aims to improve social services especially for marginalized groups and people with special needs. The measure also aims to improve health care and services by increasing the public health insurance fund.

**Potential risk:** Potential delays may occur in the approval of the amendment of the Law on Local Government Finances. There may also be delays in the collection of premiums under the Law No. 04/L-249 on Health Insurance

### 6. INSTITUTIONAL ISSUES AND STAKEHOLDER INVOLVEMENT (1 PAGE MAXIMUM)

This section presents the institutional process for the preparation and approval of Economic Reform Programme as well as the consultation of national stakeholders (national parliament, regional and local authorities, social partners and civil society) during the preparation process. As a result of the endeavours of Kosovo Government to involve a wide range of stakeholders in the process, it was achieved a very satisfactory involvement and participation of all stakeholders from all sectors in order to ensure ownership and facilitate their later involvement on the implementation of the programme. To coordinate the process, the Government of the Republic of Kosovo has adopted the decision No. 11/100, to initiate the drafting of Economic Reform Programme as part of the dialogue between the EU and Republic of Kosovo within economic governance area.

According to this decision, the Minister of Finance was appointed as the National Coordinator of ERP 2017-2019, whose work was supported by the Strategic Planning Office (SPO) within the Office of Prime Minister; the Department of Economy, Public Policies and International Financial Cooperation (DEPPIFIC) in the Ministry of Finance; and coordinators of respective fields in the line Ministries: Ministry of Finance, Ministry of Economic Development, Ministry of Trade and Industry, Ministry of Agriculture, Forestry and Rural Development, Ministry of Education,

According to the instructions of the National Coordinator, SPO invited ministries and other institutions designated by the guideline of European Commission (EC) in a meeting, in order to contribute in the drafting process of Economic Reform Programme (ERP) 2017-2019). A workshop with the OECD was held in early November, in order to review the first draft of measures. Later, the coordinators of respective fields worked on consolidation of measures, based on OECD comments/feedbacks. The first draft was introduced to EC on 22 November. Afterwards were held individual meetings with coordinators, where all CE comments/feedbacks were addressed. The National Coordinator has carried out the review of measures for prioritization.

Government of Kosovo tries to involve social partners and civil society by consulting them during the preparation of the program and ensures that their inputs are taken into account, in order to have the program reach the widest possible consensus. The public consultation as such involved two public meetings with different stakeholders. The first meeting was organized under the framework of the National Economic Development Council – a mechanism chaired by the Prime Minister, with members from key ministries and private sector representatives (business associations and chambers of commerce). The second public consultation will involve social partners, civil society and local authorities through the Association of Kosovo Municipalities. The draft of ERP 2017-2019 will be also presented to representatives of National Committee on Economic Development - permanent members of the NCED, on the meeting that will be organized with the National Council for Economic Development (NCED). After the approval of the final version by the Government of Kosovo, ERP 2016 will be presented to the National Parliament for information.