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Rebuilding Kosovo: Overcoming Challenges to Institutional Reform

Muhamet Mustafa
President, Riinvest Institute for Development Research

Article at a glance

- Reformers and donors in Kosovo must re-focus their efforts on institutional development.
- Kosovo's local economy needs a better small- and medium-sized enterprise development strategy.
 - 37 percent of citizens live on less than \$2 per day
 - Kosovo has 40 percent unemployment
 - Kosovo needs to create 20,000 to 30,000 new jobs per year
- For democracy to take root, government functions and authority must be transferred to Kosovo's citizens.

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1155 Fifteenth Street NW · Suite 700 · Washington, DC 20005 · USA
ph: (202) 721-9200 · web: www.cipe.org · e-mail: cipe@cipe.org

Introduction

In 1995, a group of economists in Prishtina established the Riinvest Institute for Development Research with the mission to promote the modern economic development of Kosovo based on a philosophy of entrepreneurship. Over time, Riinvest became the region's recognized leader in economic research and policy advocacy. In the late 1990s, Riinvest conducted a comprehensive study of Kosovo's political economy environment – “Economic Activities and Democratic Development of Kosova” – in cooperation with the Center for International Private Enterprise (CIPE). Later, working with think tanks the Balkan region, Riinvest identified constraints to doing business; it continues to make specific policy recommendations to spur growth and development.

Following the conflict in Kosovo in 1999, this study on Kosovo's economic and political realities provided a blueprint for development and was the only comprehensive analysis of Kosovo's private sector. It should have been an invaluable resource for the local governance structures seeking to accommodate the returning refugees, create jobs, and provide public services. Yet, while much of effort in Kosovo's post-conflict reconstruction was focused on resolving immediate needs, Riinvest's emphasis on combining aid with longer-term institutional reform to build economic and democratic governance mechanisms went mainly unnoticed.

Although not immediately included in policy decisions, Riinvest continued to promote the institutional approach to rebuilding Kosovo, slowly becoming a key policy partner in international reconstruction efforts. Emerging as one of the only reliable sources of policy input on the local level, Riinvest engaged Kosovo's business community in a constructive dialogue with policymakers, providing key information on barriers to doing business as well as policy solutions. Seeking to jump-start the economy and build functional democratic governance in Kosovo, Riinvest has also attempted to build a civil society that can survive without donor funding and become the key to growth and prosperity. While Kosovo continues to face numerous challenges to

recovery and progress in reconstruction has been slow, Riinvest remains committed to engaging local groups in reform and building local capacity to sustain growth and development.

The War and its Aftermath

The effects of the war were devastating. Seventy percent of Kosovo's citizens were displaced, and much private property, including homes and businesses, was destroyed. After the war, Kosovo experienced rapid post-war recovery, thanks to NATO intervention and the involvement of the international community. Citizens were able to return to their homes and work began very shortly to promote economic growth and reconstruction efforts. The success of those efforts has been mixed – in the early stages, immediate needs were often effectively addressed by the donor community with the proactive approach and commitment of Kosovo's citizens; yet longer-term economic development has proved to be more challenging.

Immediately following the conflict, massive amounts of aid were made available for rebuilding key infrastructure and capacity in Kosovo. Basic public services and utilities were restored as peace was maintained by the commitment of the international community and the majority of the population. The roles of the United Nations Interim Administration Mission in Kosovo (UNMIK) and NATO in maintaining security and providing governance were essential in the early stages of Kosovo's reconstruction. Ninety percent of citizens rated NATO's presence in Kosovo very positively in a series of Riinvest public opinion surveys.

Kosovo was able to avoid many of the problems that plague most post-conflict countries, such as high numbers of permanently internally displaced persons (though nearly 70,000 Serb minority citizens have not yet returned to their homes). Reconstruction efforts were reinforced by experiences elsewhere – in addition to addressing immediate humanitarian needs, it was equally important in the early stages of the reconstruction process to begin building political stability and security as well as inter-ethnic communications and good relations with neighboring

countries. Without these efforts and institutions, development efforts could have been thrown off course, frustrating citizens and undermining the legitimacy of reconstruction efforts.

However, this extremely positive progress slowed after two years. As Kosovo's economic growth and post-conflict recovery stalled, larger issues pertaining to governance and local ownership of reform began to emerge.

The key difficulty in sustaining early success has been ensuring local ownership in the institution-building process. After initial positive steps were taken, Kosovo experienced deficiencies in democratic governance and the management of economic policy, prompting the business community and other stakeholders to express their dissatisfaction with UNMIK and the nascent institutions. As the local governance structures established by the international community were not accountable to local citizens, frustration and complaints grew. The economy stagnated. Many of these issues remain unaddressed; many of the problems that Kosovo faced in 2002 persist.

The Economic Picture

An economic snapshot of Kosovo shows early reconstruction success side-by-side with profound structural challenges. Despite massive inflows of aid, Kosovo remains relatively poor – its per capita GDP is \$1,550 – yet more prosperous than many other states emerging from conflict. Unequal distribution of wealth is of key concern; 37 percent of the population lives on \$2 or less per day.

Inflation is low and the budget share of GDP is moderate. However, a moderate level of credit demonstrates a lack of proper investment activity: the ratio of investment to GDP is around 20-25 percent. While this number is respectable in any developed country, for a developing country looking to rebuild infrastructure, attract foreign investment, and spur economic activity – especially in the small- and medium-sized enterprise (SME) sector, the ratio should be much higher.

Kosovo suffers from macroeconomic imbalances that can be solved only by rapid and sustained economic growth. Unfortunately, Kosovo has not experienced notable economic growth since 2002, and worse, estimates from 2003-2005 indicate that there has been negative growth..

The initial problem was that the infusion of international funds dropped sharply between 2003 and 2007. The local capacity for income generation had not yet developed to a level that would make up for the difference in lost of funding. More importantly, appropriate policies to encourage business development and economic growth were not yet in place.

Before the war, Kosovo exported more than 220 million euros of products outside of Yugoslavia. Combined with its exports to other Yugoslav Republics, Kosovo's yearly exports totaled nearly 700 million euros. Today Kosovo exports a fraction of this (about 70-100 million euros). Bringing exports to their previous level would give Kosovo funding to resolve many of the problems it faces, but reliance on the government is a poor strategy for building the private sector.

In contrast, Kosovo's consolidated budget is largely successful due to a concerted government effort following the war. In 1990, Kosovo's autonomous budget was 430 million euros; immediately following the conflict, it dropped to 100 million euros, 50 percent of which was serviced by the international community. Today, Kosovo's budget is 770 million euros, coming exclusively from domestic taxes. While the budget is an undeniable achievement, it still cannot provide the funds needed for investment in public utilities, education, and infrastructure. No serious funds have been put into these vital public goods and services for 15 years, and Kosovo is in dire need of investment to rebuild and modernize them.

Kosovo's labor market imbalance is an increasingly pressing problem. While approximately 33 percent of the population is out of the labor market because of age, among the working age population, unemployment is high – nearly 40 percent. In other words, only one in every four citizens in Kosovo is generating

income. Among those employed, nearly 30 percent are employed in public service companies and by the government.

The labor problem goes far beyond a bloated public sector. Young people face a stagnating economy unable to supply enough jobs. Sixty-three percent of Kosovo's population is under the age of 30. These young people are the future of Kosovo's economic growth and political development, but they need a solid education before they can take on that role. Additionally, to absorb these new entrants to the labor market, 25,000 to 30,000 jobs must be created each year. Currently, Kosovo is at best creating approximately 7,000 new jobs per year. If new jobs are not created, Kosovo's young people will seek opportunities abroad, depleting the country of educated specialists.

Challenging the Status Quo

Economic growth will not take place just because the government, citizens, or the private sector desire it. In addition to identifying the barriers to growth, there must be a concerted and strategic approach to reform the institutional environment and replace existing barriers with business-friendly regulations. Something is needed to develop domestic capacity rather than relying on donor funds. Kosovo's ineffective governance and still weak institutions – manifested in weak rule of law, unfair business practices, and an increasing trend of corruption – must be addressed by local actors. Something must be done to reverse declining living standards and boost investment in Albania, Serbia, and Kosovo.

While the presence of NATO and activity of the UN have been key to maintaining peace and increasing regional cooperation, the current governance arrangement – the duality of power comprising UNMIK and the Provisional Institutions of Self Governance – has led to a debate over responsibility, accountability and competency. Frequent turnover of UNMIK staff – drawn from almost all UN member countries – has ensured a weak strategy and vague targets for improvement, highlighting the fact that further development and reconstruction must be locally owned.

Furthermore, Kosovo's final status must be determined before Kosovo can fully recover from its economic torpor. Clarification of Kosovo's final status will determine the nature of the future political process. If the status remains ambiguous, there will be a negative impact on the investment climate and governance as well as on integration and cooperation with the southwest Balkan states and the EU.

Final status is not just a political question – it is dependent on Kosovo's economic viability as an independent state. It is questioned by some if Kosovo is able to produce long-term economic growth and share the benefits of that growth with the population as a whole.

Kosovo's Economic Viability

Kosovo does have the potential to own and direct its growth and development. The country has many natural resources – including coal, minerals, and good soil – and a well-educated, entrepreneurial youth population. With these resources, evidence from other countries shows that growth is possible. One group that shows real possibility is Kosovo's SME sector. Much of the growth experienced thus far has been the result of successful SMEs. To support SMEs, Kosovo must create favorable conditions for strategic investment and value-added services.

Currently, SMEs face many barriers to growth, such as unfair competition, that result from weak institutions. Tax evasion and illegal export/import practices create a great deal of unfair competition for domestic enterprises. Moreover, Kosovo has a good legal framework, but neither UNMIK nor Kosovo's administration are engaged with how these laws are implemented. While Kosovo has a good company law and bankruptcy law, the capacity and will to implement these laws are lacking for a number of reasons.

First, Parliament was unwilling to allow debate on the issues as legislation was developed. During the first years of its operation, Parliament was disinclined to allow open discussion of major institutional problems, such as why laws weren't being applied, though recently there have been calls for accountability and

open debate. Second, political parties dominate heavily over governmental structures, necessitating immediate steps toward strengthening the role of Parliament. This is not helped by the fact that initially, Parliament did not take its role seriously as an institution with the capacity to advance reform. Third, the judiciary lacks capacity to fulfill its role and obligations. There is a huge backlog of cases and Kosovo has no commercial courts whatsoever.

Another impediment to growth is foreign debt. After the war, there was \$700 million in foreign debt to be serviced, and only now is ownership of those debts being sorted out. From the beginning of the 1990s until the end of NATO intervention, Serbia had control over state-owned enterprises and publicly owned enterprises, the revenues of which should have been used to service those debts. However, Serbia repaid only \$100 million. While Kosovo should take responsibility for debts incurred before 1990 and after 1999, Serbia bears some responsibility for what happened in the 1990s.

Achieving Economic Growth and Democratic Development

To help the economy grow, Kosovo should focus on exercising rule of law, strengthening good governance, and building a friendly business environment. For democracy to take root, government functions and authority must be transferred to and owned by citizens. Currently, there are so many ruling bodies in Kosovo that it is nearly impossible to determine who is responsible for what. While an international presence is appreciated, it is time for Kosovo's citizens to govern themselves and take responsibility for their own future. Today, if a citizen criticizes the government or a ministry, officials will assert that they cannot be held accountable because international organizations, not the local government, have the authority.

Still, the importance of the international community must not be overlooked. After the war, outside assistance helped build institutions and the capacity of Kosovo's people, created a friendlier environment for doing business, protected minority rights, and provided humanitarian aid.

In addition to having held four internationally recognized elections, Kosovo has taken steps towards development and reform. The media and public have begun to demand accountability and rule of law from the government and the international governing bodies, and corruption is being exposed and condemned. In this environment, the role of civil society has also expanded. Currently, Kosovo has approximately 3,000 NGOs. While many of these are facing sustainability problems because they are dependent on international donors, a civil society that is financed locally and supported by the people it serves will grow and thrive.

The Alliance of Kosovar Businesses – an umbrella organization for business associations created with the support of USAID and CIPE – demonstrates the possibility of sustainability and advocacy capacity for local NGOs. Additionally, Kosovo's Chamber of Commerce has been transformed and membership is no longer mandatory. The chamber is now starting to improve itself, advocate on behalf of its members, and provide better services. In addition to Riinvest, there are several other notable think tanks. For example, Forum 2015 – a coalition of the Kosovo Foundation for Open Society and Riinvest that is working toward integration into the Euro-Atlantic structures – is a good vehicle for intellectuals and civil society leaders to engage in debate on democratic and economic revitalization.

Conclusion

In looking at the experience of Kosovo over the past several years, a number of important lessons learned stand out. What matters most is how reconstruction priorities are established, and that a good balance between those priorities is created. Thus far, immediate needs have taken precedence over long-term reconstruction in Kosovo. Further, reconstruction priorities were often set without full consultation with local stakeholders.

What is needed is a better balance between addressing immediate needs and building institutions for the future. More local ownership of the reconstruction process and policies that build domestic

capacity for income generation and job creation are essential. Riinvest has found that laying a foundation for the creation of a middle class is often not addressed by reform efforts – this is one of important lessons to be learned.

Dual governance powers and the resulting ambiguities over competence and responsibility have presented numerous challenges to the establishment of democracy and a market economy in Kosovo. A weak judiciary and poor parliamentary oversight of the implementation of legislation reduces the potentially positive impact of the modern pro-market legal framework developed with the assistance of donors, underscoring the importance of enforcement. The government must include all stakeholders – civil society, the private sector, and local communities – in the policymaking process.

Finally, when civil society organizations do demonstrate the potential to become sustainable and independent, donors should work with them to build their capacity to participate in the long-term reconstruction process. When local civil society groups present well-founded policy recommendations and launch quality debate in a tolerant atmosphere, they become effective and important actors in economic reform and democratic development.

Dr. Muhamet Mustafa is president of the Riinvest Institute for Development Research. He was Minister Coordinator for Development Policy and Planning in the former Yugoslavia (1986-1989), Minister for Development of Kosovo (1984-1986), and Director of the Fund for Road Construction in Kosovo (1981-1984). He is the vice president of the Association of Economists of Kosovo, and is a professor of economics at the University of Prishtina. Dr. Mustafa has authored a number of books on topics relating to economics and development.

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