

ANNEX 5 THE POLITICAL AND ECONOMIC SITUATION IN KOSOVO IN BRIEF

Political developments 1999–2008

Kosovo suffered a civil war in the 1990s between the Kosovo Liberation Army and the Milosevic administration of the Federal Republic of Yugoslavia (FRY) after Milosevic abolished the political autonomy of Kosovo. The war ended when NATO bombed the FRY between March and June 1999 in order to force Serbians out of Kosovo and to enable refugees to return and international peacekeepers to enter the region. NATO started the bombings after the FRY refused to accept the Rambouillet Peace Agreement in February 1999.

The international community started providing humanitarian aid to Kosovo immediately after the NATO bombings stopped on 11 June 1999. The overall situation in Kosovo was chaotic and public administration virtually non-existent when international civilian and military organisations entered Kosovo during the second half of 1999. Serbian rule had restricted Albanians from participating in public administration since 1990, but the Albanians had maintained their own shadow administration dating from the period of autonomy (pre-1989). During the war, Kosovo Serbs were expelled from public office but Kosovo Albanians did not have experience of public administration – or if they did, they had not worked in the civil service or other public posts in ten years. It was even unclear what laws were in force in Kosovo. The legal system imposed on the country by the Yugoslav Government since 1989 was discriminatory against the majority population, the Albanians, who rejected it. On the other hand, the UN made it clear that the former Yugoslav laws were to remain in place except where they conflicted with international standards. There was no common understanding of land and real estate ownership.

The need for humanitarian and emergency aid was massive: there were more than one million refugees and most of them were provided homes or temporary shelters before the onset of winter. Over 900,000 people received regular food aid over the winter and the population was protected against significant outbreaks of disease. In the spring of 2000, many of Kosovo's farmers received at least rudimentary supplies of seeds and other materials to allow them to begin sowing and planting. There were thousands of displaced people, a large number of whom were without shelter because their homes had been destroyed during the war. According to UNMIK's estimation, 10–40 per cent of Kosovars had no personal identification document.

The situation in Kosovo was made somewhat worse due to the slow start of UNMIK. UNMIK administrators arrived later than expected due to delays in recruitment in New York, and not all of them were aware of their job descriptions. "People started arriving in UNMIK's offices and said they had been contracted by the UN. Then they asked what they were supposed to be doing", as one interviewee described.

The Serbian minority established their own parallel administration, especially in the fields of health and education services, in areas where Serbs were the majority. These parallel administrations were financed by the Serbian government and are still functioning in 2008. UNMIK did not officially recognise them but UNMIK had to engage in de facto cooperation with the parallel Serb administration, and in this way recognise them because there was no other local administration in the areas populated by ethnic Serbs. In addition, the Serbs in Kosovo received – and continue to do so – financial support from the Serbian government. The problem with parallel Serb structures is in many ways similar to the Kosovo Albanians' "shadow administration" prior to 1999.

During the first half of the decade, there were no major changes in the international status quo of Kosovo. However, soon after the introduction of UNMIK institutions it became clear that Kosovo would never return to being under Serbian rule. The security situation was more or less stabilised due to the presence of KFOR and UNMIK, although extreme Albanian nationalists continued their attacks against Serbs.

Gradually, aspirations to find a final and sustainable solution to the international status of Kosovo were accelerated. The violent riots in March 2004 alarmed the international community. It was recognised that Kosovo Albanians were losing patience with the lack of a status decision, and the violent events of 2004 also showed that KFOR, UNMIK and the PISG were not prepared to maintain control in Kosovo should there be violent mass demonstrations.

Mr Martti Ahtisaari was appointed Special Envoy of the Secretary-General of the United Nations for the future status process for Kosovo on November 14, 2005. Mr Ahtisaari together with his team and the so-called Contact Group (France, Germany, Italy, Russian Federation, the United Kingdom and the United States) held a number of meetings with Kosovo and Serbia in order to find a compromise for a final solution to the Kosovo question. A compromise acceptable to both parties was not achieved, even after several postponed deadlines. Finally, on 2nd February 2007, Mr Ahtisaari presented his Draft Comprehensive Proposal on the Kosovo Status Settlement to Belgrade and Pristina. Serbia took a strong position against Mr Ahtisaari's plan and was supported in this by Russia.

During the negotiations led by Mr Ahtisaari, it was expected that the Final Proposal would come before a vote at the UN Security Council (UNSC). However, due to resistance from Russia, the UNSC did not vote on the proposal. Russia is a permanent member of the Council with veto rights, and had Russia vetoed a vote, the whole momentum for a solution to the Kosovo question would have been lost for years. During Mr Ahtisaari's negotiations, Russia had continuously announced that it would only agree a status solution for Kosovo that would be acceptable to Serbia as well. However, it was generally expected that Russia would finally agree to the outcome of Mr Ahtisaari's negotiations and would also persuade Serbia to accept it. Despite the failure to settle the Kosovo question at the UNSC and the unilateral declaration of independence of Kosovo, the concept of Ahtisaari's plan will be followed. In its Declaration of Independence, the Assembly of Kosovo committed itself to fully implementing the Ahtisaari Plan.

After the immediate angry reaction to the declaration of independence by a relatively small number of Kosovo Serbs, the situation had already cooled down quite a bit by the end of August 2008. The impression is that a large majority of people living in Kosovo would not mind carrying a Kosovo passport, irrespective of their language or ethnicity. The main vocal opposition comes from a relatively small group of "Bridge watchers", i.e. extreme Serb nationalists who sometimes terrorise the Albanian population and those perceived as being sympathisers, but whose activities seem increasingly linked to criminal activity, not principally to ideological nationalism. After the May 2008 elections in Serbia and the August 2008 crisis in Georgia, observers have started to express slight optimism about ethnic relations in Kosovo.

Economic situation in Kosovo

Kosovo is one of the poorest countries in Europe. About 45 per cent of the population of Kosovo is poor, with another 18 per cent vulnerable to poverty. As much as 13 per cent of population is extremely poor. Extreme poverty is considerably higher (44%) among the Serbian minority than among Kosovo's Albanian.

Economic growth in Kosovo has been slow during recent years, although immediately after the end of the war, economic growth was rapid. The growth in GDP was estimated at 21 per cent in 2000. However, the average growth in real GDP in 2002–2006 is estimated to be less than one and a half per cent. The short period of growth is explained mainly by the rapid increase in foreign assistance for reconstruction.

The unemployment rate is very high. There is lack of reliable statistics but the unemployment rate has been estimated to be 44.9 per cent of the active labour force (2006). However, there may be a considerable amount of unregistered employment in the country's grey economy. Unemployment among the female population is even higher at 60 per cent, while the figure among the male population is around 30 per cent. The youth unemployment rate is also extremely high and stands at about 76 per cent. At the same time, Kosovo has the youngest population in Europe: 70 per cent of the population is aged under 30 and there is a relatively high fertility rate.

The mass unemployment among the young may have the potential to cause unrest if the situation does not get improve in the near future. Several interviewees, both foreigners and Kosovars, considered labour migration as the only possible solution for unemployment. Some European countries have recognised the situation as being one solution to their own shortage of labour. There are plenty of donors active in developing the Vocational Education and Training (VET) sector. It seems that the VET sector will not be developed entirely on the basis of the needs of Kosovo but also on the need for a labour force in the donor countries themselves. One diplomat said directly that his country will support the construction of VET schools and that graduates from these schools will get permission to work in the donor country.

The economy has been showing increasing signs of growth recently. Real GDP growth has shown a modest upward trend, reaching 4.4 per cent in 2007. The Kosovo Consolidated Budget (KCB) generated surpluses in 2006 and 2007. This was partly explained by controlling current spending, but also by the weak spending capacity. Kosovo's external trade continues to be significantly out of balance, with the recorded current account deficit (CAD) (including grants) reaching 17.4 per cent of GDP in 2007, even after large inflows of remittances (12.9 per cent of GDP) and foreign assistance (8.9 per cent of GDP). The growth in the CAD has been driven by private sector demand, with the conservative fiscal stance of the past two years having little apparent impact on external imbalances.

However, the positive trend has been accompanied by acceleration in inflation – which had previously been modest or even negative – to 14 per cent year-on-year in May 2008. Although inflation has increased mostly due to rising international food and energy prices, price pressures in the non-tradable sector have also contributed to inflation.

Economic growth in Kosovo is largely dependent either directly or indirectly on donors and international staff working in the country. For example, it is impossible to assess the impact on the economy of consumption by international staff. Salaries paid by UNMIK, KFOR and other international organisations are considerably higher than average local salaries. Furthermore, the great number of well-paid international staff and highly-paid locals employed by international organisations keeps consumer prices high for average Kosovars. This may lead, or already has to some extent, to a kind of "Dutch Disease effect". The term 'Dutch disease' originates from a crisis in the Netherlands in the 1960s that resulted from discoveries of vast natural gas deposits in the North Sea. The newfound wealth caused the Dutch guilder to rise, making exports of all non-oil products less competitive on the world market. It is an economic condition that, in its broadest sense, refers to negative consequences arising from large increases in a country's income. Dutch disease is primarily associated with the discovery of natural resources, but it can result from any large increase in foreign currency, including foreign direct investment, foreign aid or a substantial increase in prices for natural resources.

It is a paradox that the aim is to build independent and self-sufficient institutions in Kosovo, but the downsizing of the international presence may lead to a decrease in economic growth. Increased dependency on foreign aid should be avoided.

On 12 June 2008, the Government of Kosovo approved the Mid-Term Expenditure Framework (MTEF) for the years 2009–2011. The MTEF sets out the Government's development priorities and spending guidelines for the coming years. The MTEF is also one of the most important reference documents for international donors providing aid to Kosovo. The MTEF calls for a gradual reduction in donors' TA and for a shift towards direct budget support. This is justified from the perspective of increasing local ownership of the development. However, the proposals of the MTEF also include a risk that revenue performance will be weakened by the proposed reduction in tax rates. Kosovo's own budget revenues are already fairly precarious: around 70 per cent of revenues come from customs duties.

Corruption and organised crime are endemic and remain a major problem in Kosovo. The Government's measures against corruption have been relatively weak so far and corruption is undermining the proper functioning of the public administration. Foreign investments in the country are low and are unlikely to increase remarkably in the near future due to corruption and organised crime, as well as the underdeveloped state of the infrastructure and public institutions.

Migrants living abroad are an important source of income for the population in Kosovo. It is estimated that 400,000 Kosovars live abroad and that 20 per cent of the Kosovo population receives remittances from abroad. The median value of the remittances is EUR 2000 per year. It is noteworthy that only 13 per cent of the population receives social assistance. The households that receive remittances have higher consumption levels than the population in general. Money flows from migrants seem to have a direct impact on the reduction of poverty, since households with migrants abroad are less poor than the population in average.