Assessment of Economic Conditions and Possible Development Projects in Northern Kosovo

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EXECUTIVE SUMMARY

PURPOSE: USAID/Kosovo requested this assessment to identify opportunities to support economic development and income generation through technical assistance in northern Kosovo with a focus on northern Mitrovica. A two-person team, Michael B. Dan and Lindsey Wellons, visited Kosovo September 10 - 24, 2006 to conduct the assessment. Its two main purposes are to analyze constraints to private sector development, and to identify broad conceptual ideas for USAID to consider as possible projects in the short, medium and long-term.

FINDINGS

The economy of northern Kosovo can be described as a "kiosk economy" with high unemployment, dependent on state subsidies, and supplemented by subsistence agriculture. Unemployment in the four municipalities of northern Kosovo is between 70 to 80 percent. Most residents depend on social transfer payments from Serbia and/or PISG. The public sector accounts for 73 percent of all jobs in northern Mitrovica and Zvecan, while the private sector generates only about 1,600 jobs. In Leposavic, the job situation is similar. Zubin Potok is more agricultural, but the public sector remains the dominant employer. Estimated income per capita was EUR 102 per person in Mitrovica and Zvecan in 2003.

Social and public enterprises are unlikely to add much to employment in the northern Municipalities in the short term. The Kosovo Trust Agency has not completed privatization of any of its 43 enterprises, as municipalities are uncooperative. The Trepca mining complex, effectively closed since the late 1990s, still requires clarification of its legal status and would need to be extensively recapitalized, rebuilt and cleaned-up before it could be productive. Even if partly rehabilitated, as a modern complex it would have far fewer employees than previously. As rehabilitation is not likely to occur within the next 3 – 5 years, Trepca is relevant to this assessment mainly in providing opportunities for assisting in site clean up.

The private sector comprises about 800 registered companies, with 85 percent engaged in trade only, about 10-13 percent in services, and only 1 – 2 percent in productive manufacturing. Of total registered companies, an estimated 400 – 500 are operational, with many small family firms not actually functioning. Many firms are branches of Serbian companies serving the Kosovo market. Employment is often part time or seasonal especially for construction, road-building and agricultural companies. As such, many of the private companies listed by the OSCE and other authorities provide only minimal and sporadic employment.

Government and donor support to private business is limited. There is no significant and coordinated support to businesses by the Serbian Government or the PISG (Provisional Institutions of Self Government). Donor activities include the Danish Refugee Council's (now PISG) vocational training school; a World Relief microfinance institution, and USAID's KCBS project and new IOM and Mercy Corps public works projects. The EU plans a EUR 4 million job grant and TA project.

Northern Kosovo ranks low in economic development and competitiveness, due mainly to a lack of basic economic foundations that are pre-requisites for growth: inadequate infrastructure; weak technology institutional structures; lack of skills and opportunities to acquire them; limited use of capital for productive investment; and regional insularity.

Additional constraints to competitiveness specific to northern Kosovo include: restricted market access to south Kosovo; widespread corruption; extensive smuggling, double taxation and delayed VAT reimbursements for registered companies following the rules; lack of entrepreneurial initiative; economic distortions due to Serbian subsidies and the UNMIK presence; lack of skilled labor in productive age groups; wait and see attitude to productive investment; political uncertainty.

CONCLUSIONS

Northern Kosovo's limited economy is not likely to provide an adequate base at this time for firm-level assistance projects that can generate significant new jobs in the short-term. Relatively few private companies are registered, many are not operational, the great majority engages only in trade, and only about 20 to 25 productive operational private companies actually exist. Improving basic economic foundations remains a pre-requisite for private sector development and attracting productive investment.

Certain opportunities exist for supporting selected trade and investment initiatives, despite the region's relatively low level of development and competitiveness, including:

- Retail trade within northern Mitrovica; trade among the four neighboring municipalities; expanded north-south linkages
- Investment in selected agribusiness (horticulture, fisheries, dairy); wood processing; metal working; scrap metal recycling; small-scale mining; car battery recycling plant.

An appropriate strategy for providing technical assistance in northern Kosovo, given constraints, is to start with small-to-medium scale projects, phasing in assistance as conditions permit:

- In the short-term, until status is defined, focus on job creation programs (public works infrastructure improvement, agricultural and environmental support) and facilitating north-south trade linkages
- In the medium-term, as political and economic conditions improve, consider more support to improving economic foundations (technical and management training, business development services, university linkages);
- In the longer-term, support industry cluster development in sectors with the strongest potential for growth and eventual export-readiness.

RECOMMENDATIONS FOR PROJECT OPTIONS

Assumptions and risks include the assessment that major conflict seems unlikely without major provocation from extremists. Economic risks include a possible decline in subsidies from Belgrade following status, with a sudden drop likely to have an immediate and severe economic impact.

SHORT TERM OPTIONS

1. **Public works / job creation projects:** Subsidized public works (roads, schools, hospitals, health clinics, utilities public transport); Agricultural support (land reclamation, improved irrigation); Environmental support (river pollution clean-up, Trepca tailings clean-up, other site clean ups; Trepca metal recycling)

2. **Provide more support in the short-term to SMEs**: Increase support through KCBS especially to expand north-south business contacts and sales in agribusiness (horticulture, processed foods, dairy, cattle, fish farming) and in construction (road building, building materials)

3. **Support a Multi-Ethnic Business Council and thus promote north-south trade and joint ventures:** Promote matchmaking deals between northern and southern Kosovo, building on the current UNMIK sponsored multi-ethnic group, encouraging sales and purchases of products and services between both northern and southern Mitrovica, and

northern and southern Kosovo generally. Encourage joint multi-ethnic consortia to bid on donor projects.

MEDIUM- TERM OPTIONS

4. **Promote public – private outreach:** Inform the public about realistic political/ economic scenarios and instruct new enterprises on “how to do business.” Activities could include: An initial “Roundtable Conference” among private & public sector leaders; a second conference on drafting a private sector strategy; Cooperation with the proposed OSCE Regional Economic Development Agency; Study groups on experience in re-industrialization e.g., the Ruhr Valley, Russia; Overview conferences on strategies as conditions evolve.

5. **Micro-finance support:** With more stability, there should be more motivation to start productive businesses and higher demand for micro credit; USAID could focus on agro processing, and productive lending in general.

6. **Business start-up incubators:** As the environment improves, USAID could consider putting together a fully-fledged business incubator with start up services for new enterprises. Incubators work well to get business ideas off the ground & reduce costs and there is some experience in the region, e.g. Bulgaria.

7. **University linkages:** This is a very flexible project option in terms of costs: at one end, USAID can support student exchanges, support to selected departments of the local university or twinning with an American university; at the other end, USAID can help bring into being a new university, as was done in Tetovo, Macedonia.

8. **Business associations’ support:** Private sector associations are a relatively new phenomenon to northern Kosovo following socialism; recent start-ups have little understanding of appropriate association concepts. USAID should focus on assisting those that best demonstrate commitment to providing practical business services to members. Support might extend beyond current associations to the establishment of, e.g., a local Young Businesspersons’ Association and a local IT/software association. USAID can best support multi-ethnic cooperation through the “Multi-ethnic Business Council” described above

LONGER - TERM OPTIONS

9. Additional, longer-term SME sector support: As more private companies start operating and producing, support through KCBS or new projects should include:

- Business development services to SMEs, both directly through a project, and support for developing private sector BDS providers. BDS services should include business start-up procedures, accounting, credit, management training, marketing, advertising, and export readiness.
- Sectors with potential include: Wood processing / furniture; metalworking, scrap metal recycling; small-scale mining;

10. Long-term industry cluster development: Following status and stability, consider major projects on Cluster competitiveness in key sectors focusing on improving competitiveness in areas where N. Kosovo is not competitive at the firm and industry-levels. Also, consider comprehensive competitiveness projects to improve specific WEF rankings of the business environment, e.g., certification, taxation, customs, and standards and metrology projects that can help northern Kosovo businesses implement regional and EU standards.

I. INTRODUCTION

USAID has been assisting the municipalities of northern Kosovo since 1999. Increasingly, these majority Serb municipalities are facing unique challenges particularly in view of the possibility that the status issues of Kosovo will be resolved by the end of 2006 or shortly thereafter. The economic climate in these municipalities is difficult, with widespread unemployment and low incomes. To better assess how to meet its strategic plan objectives SO1.2 Improved policy and institutional climate for productive investment and SO 1.3 Accelerated growth of the private sector, USAID has requested this review to assess opportunities for USAID to support accelerated economic development and income generation in northern Kosovo with a particular focus on northern Mitrovica.

To review the possibilities for accelerated economic development and income generation in northern Mitrovica, the consultants first reviewed available documents on Mitrovica (see literature listing in Attachment B) and secondly have interviewed a wide range of key public and private sector community leaders in Pristina, northern Mitrovica and the other three northern municipalities (see interview list in attachment A),

Following the scope of work, we have divided this report up into the following four sections:

(i) Assessment of economic conditions in northern Kosovo.
(ii) Competitiveness assessment.[1]
(iii) Identification of possible economic development projects.
(iv) Prioritization and timing of USAID interventions.

Michael B. Dan, Team Leader, and R. Lindsey Wellons, Private Sector Specialist, undertook this assessment during September 2006 under the direction of Jeff Wuorinen and Jorge Segura, Project Directors. Messrs. Dan and Wellons were in Kosovo from September 10 to 24, 2006.

[1] In the SOW, the first two sections were combined. Following our interim discussions with the mission, we decided to break out the competitiveness discussion separately.

II. ASSESSMENT OF ECONOMIC CONDITIONS IN NORTH KOSOVO

II.1 POPULATION AND PHYSICAL CHARACTERISTICS OF THE FOUR NORTHERN MUNICIPALITIES

The four municipalities comprise 1,539 km^2 and 231 communities, and they all have a solid Serbian majority population, cf. table 1.

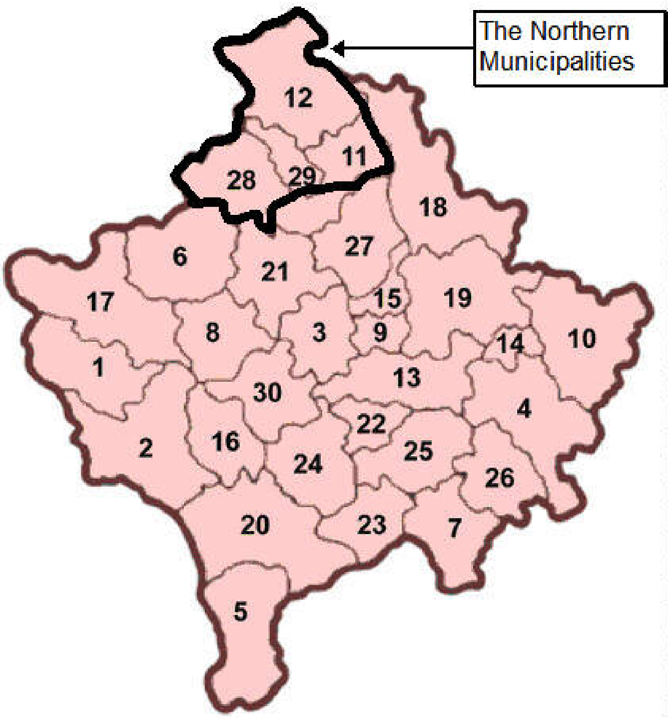
Table 1
Physical Size, Settlements and Population in the Four Northern Municipalities

Municipality	Size (km^2)	Villages/ Settlements	Serbs (Persons/Pct)	Others (Persons/Pct)	Total Population (Persons/Pct)
Leposavic	750	72	18,000/97	500/3	18,500/100
North Mitrovica	350	50	17,000/85	3000/15	20,000/100
Zubin Potok	335	64	14,000/94	900/6	14,900/100
Zvecan	104	45	12,050/73	4,550/27	16,600/100
Total	1539	231	61,050/87	8,950/13	70,000/100

Source: OSCE – Municipal Profiles, 2006

The geographical location of the four northern municipalities is shown in Figure 1. The municipalities border directly on Serbia.

Figure 2[2]
The Northern Municipalities



	ALBANIAN	SERBIAN
1	Deçan	Decani
2	Gjakovë	Đakovica
3	Gllogovc	Glogovac
4	Gjilan	Gnjilane
5	Dragash	Dragaš
6	Istog	Istok
7	Kaçanik	Kacanik
8	Klinë	Klina
9	Fushë Kosovë	Kosovo Polje
10	Kamenicë	Kamenica
11	Mitrovicë	Mitrovica
12	Leposaviq	Leposavic
13	Lipjan	Lipljan
14	Novobërdë	Novo Brdo
15	Obiliq	Obilic
16	Rahovec	Orahovac
17	Pejë	Pec
18	Podujevë	Podujevo
19	Prishtinë	Priština
20	Prizren	Prizren
21	Skenderaj	Srbica
22	Shtime	Stimlje
23	Shtërpcë	Štrpce
24	Suharekë	Suva Reka
25	Ferizaj	Uroševac
26	Viti	Vitina
27	Vushtrri	Vucitrn
28	Zubin Potok	Zubin Potok
29	Zveçan	Zvecan
30	Melishevë	Mališevo

2 Tables and figures are numbered as one category.

Note: The Municipality of Mitrovica is divided between a de-facto northern (Serb-Kosovar) and de-facto southern (Albanian-Kosovar) part.
Source: UNMIK, Report Writers' Analysis

II.2 POLITICAL STRUCTURE

UNMIK administers northern Kosovo including northern Mitrovica. In general, the PISG (the Provisional Institutions of Government) have little influence, and since June 2006, the municipalities north of the Ibar River have refused to cooperate with the PISG in Pristina. PISG has never had any significant influence on policies in the northern municipalities, including economic policy. In northern Mitrovica, UNMIK works with an appointed committee of citizens, which act principally as unelected caretakers. In the remaining municipalities, UNMIK interacts with an elected municipal body.

The so-called parallel institutions of the Serbian Government in Belgrade appear to provide most of the political guidance and the bulk of the funding for the municipalities of northern Kosovo. In terms of governance and most day-to-day matters, the four northern municipalities are de-facto separated from the rest of Kosovo and are de-facto in most matters integrated with Serbia. Moreover, mobility and communications between the northern municipalities and the remainder of Kosovo are limited.

Finally, the four northern municipalities are subject to minimum law enforcement from both the Serbian and PISG side. Taxes are routinely not paid. Moreover, smuggling, excise tax and VAT evasion (both Serb & PISG) are wide spread and commonplace.

II.3 ECONOMIC BACKGROUND

II.3.1 Employment

Today, unemployment in northern Kosovo is between 70 and 80 percent[3] and most of the population depends on social transfer payments from Serbia and/or PISG, see table 1 below. A high rate of unemployment is quite common throughout the region. Kosovo has an unemployment rate of 60 to 70 percent[4], Serbia 30 to 35 percent and Macedonia 35 to 40 percent.[5]

Data from the European Stability Initiative suggest that private sector employment accounts for 1,600 jobs in north Mitrovica and Zvecan. While these numbers were collected in 2003, according to most people they have not changed much since then. The public sector accounts for the vast majority of jobs in north Mitrovica and Zvecan. Excluding recipients of pensions and social payments, public sector jobs account for 73 percent of all jobs.

3 OSCE Municipal Reports, Field Interviews.

4 According to UNMIK, the official unemployment rate is 43 percent (UNMIK: Kosovo Economic Outlook, March 2006). Generally, most estimate actual unemployment to be considerably higher.

5 Source: Economist intelligence Unit, IMF (IMF Executive Board Concludes 2006 Article IV Consultation with the former Yugoslav Republic of Macedonia)

Table 3
Employment and Income Source in north Mitrovica and Zvecan – 2003
Number of People

Income source	Individuals		Monthly Income in EUR	
	Number	Percent	Total	Percent
Non Public Sector Employment				
Private sector employment	1,600	9%	208,000	8%
SOE employment	302	2%	36,240	1%
International community jobs	215	1%	111,585	4%
Sub Total	2,117	12%	*355,825*	14%
Kosovo budget				
Public employment	1,767	10%	276,075	11%
Pensions, social assistance & Trepca stipends	7,171	41%	267,232	11%
Subtotal	8,938	51%	543,307	22%
Serbian budget				
Public employment	4,105	23%	1,391,450	56%
Social transfers	2,396	14%	193,280	8%
Sub total	6,501	37%	*1,584,730*	64%
Total	**17,556**	100%	2,483,862	100%

Source: European Stability Initiative: A Post Industrial Future – Economy and Society in Mitrovica and Zvecan, 2004.

There is little data on Leposavic and Zubin Potok. However, anecdotal evidence and discussions with UNMIK and OSCE suggest that the overall employment situation in Leposavic is similar to Mitrovica and Zvecan. Zubin Potok is more agricultural, but public sector jobs remain the dominant form of employment.

II.3.1.1 Social Enterprises, Including Trepca

The social and public enterprises are unlikely to add much to employment in the northern municipalities in the short term. The Kosovo Trust Agency (KTA) has 43 enterprises (excluding Trepca, which we will discuss below). KTA has not been able to proceed with privatization of any of the enterprises due to the uncooperative nature of the municipalities, and many bidders withdraw their bids in face of municipal resistance. KTA considers 19 of the 43 enterprises idle or non-functioning. Another 10 are utilities or other types of companies that traditionally require careful regulation before privatization. Anecdotal evidence from field interviews suggests that the public and social companies are not doing well. Those that are active are often only sporadically and intermittently so.

II.3.1.1.1 *Trepca*

All of northern Kosovo used to be dependent for employment on the Trepca mine and its nearly 100 subsidiaries. At its peak, Trepca employed more than 22,000. Currently Trepca provides only 1,000 jobs/stipends mainly for maintenance, etc. According to most observers in the region, these are really “make work” jobs.

Many Serb and Albanian Kosovars believe that following privatization, given sufficient investment, management could revive Trepca. However, we do not know of a comprehensive geological and industrial study to verify the existence of sufficient high-grade ores and the economics of industrial facilities to process them. At this point, Trepca's potential for rehabilitation is unknown.

The KTA is in the process of appointing an administrator and hopes that this will take place before the end of 2006 and this may accelerate the process of privatization.

Nevertheless, Trepca is not directly relevant to this project. Its rehabilitation is unlikely to take place within the time horizon of potential USAID projects, say five years, for the following three reasons:

(i) **Trepca must undergo extensive clean up and rebuilding before it can be productive.**
(ii) **Trepca must restructure financially and recapitalize.**
(iii) **The status of Trepca must be completely clear, and KTA or the selling agent must be able to sell the mine with a clear title.**

Even if it is possible to revive the parts of the Trepca companies, it is unlikely that they will generate as many jobs as previously. Trepca was a social enterprise and judged to be an inefficient one. A modern western complex with the same output would have far fewer employees, as it would be much more mechanized and computerized.

II.3.2 **Income**

There are few reliable statistics on income in the northern municipalities. The European Stability Initiative estimated income per capita at EUR 102 per person in Mitrovica and Zvecan in 2003, and it is likely to have changed little since then. Social pensions, stipends and public sector jobs account for roughly 86 percent of work income in the municipality, cf. table 3 above.

The Serbian government accounts for 64 percent of the income from work in north Mitrovica. Again, while there may be some more subsistence agriculture in Zubin Potok, conversations with UNMIK, OSCE indicate that this picture is roughly representative of all four municipalities in northern Kosovo. Income is likely to be somewhat higher, as these income estimates do not account for income from other sources than work. However, it is not likely that such income is significant.

The extreme dependence on public sector jobs and transfer income suggests the social and economic risks if PISG and/or, in particular, the Serbian government reduces their commitment to northern Kosovo.

II.4 PRIVATE SECTOR STRUCTURE

There is limited data on the private sector, as few collect data on the northern municipalities. Research from ESI[6] confirmed in discussions with UNMIK and private sector representatives suggests that there are 500 to 600 registered companies in Zvecan and Northern Mitrovica. Probably, there are an additional 200 to 300 companies in Leposavic and Zubin Potok.

However, 80 to 85 percent of these companies engage in trade only. An additional 10 to 15 percent engage in services, including restaurants, hotels, laundry, etc. Only 1 to 2 percent of the companies in northern Kosovo engage in production. Some of the social companies still

[6] Source: ESI: A Post-Industrial Future: Economy and Society in Mitrovica & Zvecan, Brussels, 2004 and Mitrovica: Kosovo's Litmus Test, Brussels, 2006

have some limited production, but mostly they depended on Trepca and are virtually extinct. Moreover, many of the companies were branches of Serbian companies designed to serve the Kovoso market.

In attachment C, we provide a listing of the companies identified by OSCE as prominent employers. OSCE also provides an employment estimate for these companies, stressing that the work can be part time or seasonal. If you add all the private companies in the entire four northern municipalities, you arrive only at about 800 jobs.

During our interviews in the northern municipalities we repeatedly asked for names of productive companies, and usually each of our interviewees could identify only one or two – usually the same ones. Based on this, we believe that many of the companies on the OSCE's list provide only sporadic employment, and OSCE confirms this.

We can best describe the economy of northern Kosovo as a kiosk economy highly dependent on state subsidies and supplemented by subsistence agriculture.

II.5 GOVERNMENT AND DONOR SUPPORT TO BUSINESSES

There does not appear to be any significant and coordinated policy support to businesses. The Serbian government has planned a series of initiatives, but no one really knows whether they will actually be implemented. One of the only ways that Government supports business is by not taxing the business sector at all. Moreover, all utilities except telephones are effectively free.

The Danish Refugee Council opened a vocational training school to support businesses. PISG has now taken over its funding and management. The school provides training in business management, carpentry, cooking, metalworking and IT. The school has an intake of 250 students per annum, consisting of students from the four northern municipalities and the enclaves. Currently, the school can accommodate all the qualified people who wish to enroll. In addition, there is a World Relief Micro Credit operating, cf. below. Moreover, the EU plans a EUR 4 million job grant and TA project to begin soon.

There is at present no comprehensive listing of TA projects in northern Kosovo. However, many donors and NGOs are operating in the area. Up to now, donor support has been minimal and without coordination. In view of the broad based interest at this time, it is worthwhile to have a broad meeting of donors and NGOs on the northern municipalities of Kosovo to ensure coordination and to get better information on the activities of other donors. For Kosovo wide projects, it is difficult to ascertain the proportion of the assistance given to northern Kosovo.

II.6 ACCESS TO CREDIT

The two main commercial banks in Kosovo, Raiffeissen and Pro Credit are both present in the northern municipalities. Both banks seem to do quite well, having negligible losses and ample capacity to give more credit. In addition, there is the micro credit institution, Zavet. Zavet has been in operation for about a year and has given 200 loans, half of them being loans to consumers for travel and home improvement. Zavet currently has plenty of capacity to expand its lending, but cannot do so due to the lack of qualified applicants. Apart from agriculture, which accounts for about 50 loans, Zavet has only granted one loan to a production enterprise.

The Serbian banks, Bank for Kosovo and Metodia and Jugobanka, are also active, but according to interviews with OSCE they do not have licenses from Serbia or Kosovo. Farmers and farm related businesses reportedly have access to grants and interest free loans from Serbia. Recently, the Banking and Payments Authority of Kosovo licensed Komercijalna Banka of Serbia to conduct business in Kosovo. Kommercijalna Bank will focus on Mitrovica and the Serbian enclaves.

II.6 Comparisons with Comparable Economies and Lessons Learned

Northern Kosovo is not a unique development challenge, but it is a demanding one. Several factors converge to make the environment for private sector development difficult, specifically the lack of market access in Kosovo, political uncertainly and its impact on investment. Although Kosovo is not ranked separately in the World Bank's Doing Business Indicators, a Business Conditions Index comparing Kosovo to other Central European countries was prepared by KCBS in 2005 which is based on the World Bank's Doing Business Methodology[7].

The index shows, on the positive side, that Kosovo's ratings in hiring and firing workers were better than the averages for all of Central Europe, outperforming all nine countries rated except the Slovak Republic. In addition, Kosovo had relatively low barriers to business entry and exit, e.g., with the fewest number of procedures (five) and the least number of days (23) needed to open a business.

However, among more negative indicators, Kosovo had a very low rating for getting credit compared to other Southeastern European markets, and the cost of creating capital (as a percent of average per capita income) in Kosovo was three times higher than for the rest of the Balkans.

Institutionally, the Index found that the laws and tools for a transparent business-friendly environment are for the most part in place. Kosovo fell short overall in developing the institutions to support these laws such as the development of credit bureaus.

A summary review of comparable conflict and post-conflict economies, and current donor programs, indicates that no single, specific private sector assistance program exists that meets all needs. Rather, specific local conditions must dictate the content of aid programs. The choices depend on many factors, including geography, stage of development, resource constraints, special societal needs, cluster priorities, market imperfections, and local preferences.[8] Lessons learned from comparable economies and countries with post-conflict environments are also worth considering in designing possible Kosovo projects and are summarized below.

[7] BUSINESS CONDITIONS INDEX IN KOSOVO, 2005, Prepared by KCBS (KOSOVO CLUSTER AND BUSINESS SUPPORT) PROJECT, and Integra Consulting, for USAID/Kosovo, 2005.
[8] Creating Smart Systems: A guide to cluster strategies in less favored regions, European Union-Regional Innovation Strategies, Stuart A. Rosenfeld, Regional Technology Strategies, April 2002.

Table 4

Summary of Lessons Learned from Comparable Regional economies and Post-Conflict environments

Country/Region	Lessons Learned
Serbia, Bulgaria	• Extensive outward emigration is a risk, if a poor private sector environment persists. During the last 15 years, large numbers of young talented people have left for Australia, Canada and New Zealand.
Uzbekistan, Kyrgyzstan, Tajikistan	• Extensive outward emigration is a risk, if a poor private sector environment persists. Extensive temporary and permanent immigration to find jobs in Russia and Kazakhstan, even for rural agricultural workers.
Lebanon	• Multi-ethnic project stakeholders and cross- community beneficiaries are critical for project success; small USAID cluster development projects are working well in agribusiness, tourism, and IT
Palestinian Territories	• Expanding market access and promoting free movement of goods and people is essential for private sector development; various donor projects have failed due to lack of market access
East Timor	• Diversification beyond a single-commodity (specialty coffee) is critical for developing sustainable private enterprise; reliance by projects on a single buyer (Starbucks) is dangerous.

III COMPETITIVENESS ASSESSMENT

III.1 LEVEL OF ECONOMIC DEVELOPMENT AND COMPETITIVENESS

The major competitiveness indices have not yet ranked Kosovo separately, but it is likely to be ranked low, based on its recent economic performance compared to Serbia (1.5 % and 7 % average growth p.a., since 2003, respectively) and that of regional neighbors. North Kosovo, and within it the municipality of north Mitrovica, undoubtedly rank considerably lower due mainly to its dominant characteristics as a relatively small, isolated, de-industrialized and now increasingly rural economy, overwhelmingly dependent on government subsidies and lacking many of the basic economic foundations that are pre-requisites for growth and improved competitiveness

III.2 LACK OF BASIC ECONOMIC FOUNDATIONS

Basic foundations for development that are pre-requisites for private sector growth, as well as improved regional and global competitiveness are seriously lacking in northern Mitrovica. In summary, the lack of basic economic foundations in northern Mitrovica includes:

- **Deficits in physical infrastructur**e: Inadequate roads, public transport, sewage systems, electricity and other utilities; school buildings and hospital and health care.
- **Weak technology institutional structures:** No technical educational institutions exist other than a single vocational school (Danish Refugee Aid).
- **Regional insularity and lock-in:** The lack of freedom of movement of persons and goods limits links and familiarity with Kosovo and much of the outside world.
- **Lack of skills and opportunities to acquire them** – aging workforce, with the average age of Trepca workers at 47, and many in the productive age groups of 25 – 45 having left.
- **Uncertain political structure / stability**
- **Lack of related support foundation factors** required to attract and retain private investment and company staff: a universal basic education from early childhood through secondary school; adequate infrastructure of roads, public transportation, utilities, water, waste disposal and sanitation; health care and a wholesome environment; and adequate housing.

III.3 SPECIFIC CONSTRAINTS TO PRIVATE SECTOR DEVELOPMENT IN MITROVICA

These include at least the following:

- **Restricted market access:** Limited northern Kosovo market of less than 80,000 consumers, difficult to sell in Kosovo without connections
- **Widespread corruption:** limited access to tenders without payoffs
- **Tax burden**: For those companies in northern Mitrovica that decide to register and follow the rules, taxation is a burden and specific problems include double taxation and delayed VAT reimbursement. However, most companies decide not to follow the rules or only follow them for part of their activities. For companies that decide not to follow the rules, the tax burden is negligible, as mentioned above.
- **Inadequate infrastructure**, utilities (electricity, water)
- **Unfair competition from donors**, in providing BDS services (but there really are few companies)
- **Lack of entrepreneurial initiative**: socialist mentality, one-company town
- **Serbian subsidies and UNMIK presence distorts local economy**, but also keeps it afloat for now

- **Lack of skilled labor in productive age groups**, skewed demographic structure
- **Political uncertainty:** wait and see attitude toward local investment in productive enterprises

III.4 OPPORTUNITIES FOR TRADE AND INVESTMENT

Notwithstanding the area's relatively low level of development and competitiveness, a summary review of local economic characteristics suggests several areas where opportunities may exist in the medium to long-term for improved private sector development in both trade and investment.

III.4.1 Trade Opportunities

Opportunities for increased trade are likely to be limited to retail trade in goods and services, sourced outside of northern Kosovo, due to the near total lack of exports of goods produced in the area.[9] This reflects the large and unstable trade deficit of Kosovo as a whole, where export/ import coverage in 2005 was less than 4% of imports, an abysmally low level. Kosovo imports in 2005 amounted to 971 million Euro, while exports were only 37 million Euro. As is shown in the graph below, Kosovo exports low added-value products, mostly its unprocessed natural resources.

Kosovo, including the north, enjoys non-reciprocal, customs-free access to the EU market as stipulated by the EU Autonomous Trade Preference (ATP) Regime. However, the northern municipalities do not have any significant products that can compete in the EU.

Given the near total lack of local production of goods for export, trade opportunities in the short- and medium-term will be limited to:

- **Retail trade within northern Mitrovica, and neighboring municipalities**, of consumer goods produced almost entirely outside the area, mainly in Serbia.

- **Expanded north-south linkages.** Trade between north and south Kosovo has potential for expansion. In spite of political obstacles and restricted market access, trade is reportedly flourishing among private enterprises on both sides. With the finalization of status and increased political stability, the region might be a significant trade intermediary between Serbia and Kosovo. Currently, according to official statistics, Serbia is a close second to Macedonia as Kosovo's largest trade partner (13% and 14% of total trade, respectively). Mitrovica's proximity to markets in Pristina offers particular opportunities, where the price structure of many consumer goods is significantly higher than in Mitrovica.

- **Export development offers little potential in the short-term.** However, although exports generally from Kosovo are very low and with relatively low value added, certain exported product groups offer further growth potential, especially horticultural and basic processed foods, such as dairy and cheese products,. Significantly, food products have a significant share in overall exports (20%), demonstrating a potential for further increases in the levels and variety of food products for both domestic and export markets. Also offering potential are products based on abundant natural resources, including metals and scrap, which account for 45% of total exports. Because production capacity is so limited, it is difficult to form an opinion as to what sectors have the greatest potential for expansion beyond agro processing and light consumer goods industries.[10]

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[9] Trade Policy for Kosovo, Joint Paper by Ministry of Trade and Industry and UNMIK European Union Pillar, June 2004

[10] *Kosovo's trade: A policy note on trade policy and measures to expand exports*, The World Bank, May 2003

III.4.2 **Investment Opportunities**

Although most former production is operating at a low level, and new productive enterprises, let alone export-oriented producers, are virtually non-existent, several areas appear to hold potential opportunities.

Opportunities in productive enterprise sectors include the following, which we will discuss further below:

- Agribusiness (horticulture, fish farms, cattle, dairy)
- Construction, building materials
- Wood processing / furniture
- Metal working
- Scrap metal recycling
- Small-scale mining

Additional productive investments and policies to consider supporting[11]:

- **Record world market prices for lead and zinc have made a limited resumption of mining feasible** but Trepca management cites very low productive capacity and morale among the Serb and Albanian work force as the main operational challenge.
- **Planning is also afoot to restart the Zvecan car battery recycling plant.** However, if the Special Chamber of the Kosovo Supreme Court upholds the claim of any of the foreign companies that worked with the Milosevic-era Serbian management in the 1990s, KTA will probably have to liquidate Trepca.
- **Donors could condition programs to support business enterprises and tenders for an array of infrastructure projects on compliance with cross-community hiring.**

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[11] Based on *Bridging Kosovo's Mitrovica Divide, Team interviews with KTA.*

IV. IDENTIFICATION OF POSSIBLE ECONOMIC DEVELOPMENT PROJECTS

IV.1 POLITICAL / ECONOMIC SCENARIOS

Based on field interviews, recent studies and available statistical data, we do not believe that the change in status will have a major impact on northern Kosovo. Most likely, the economic situation will be unchanged.

It is unlikely that the situation will change for the better, as north Kosovo is unlikely to be able to take advantage immediately of potential benefits of status, such as increased freedom of movement, less formal partition, and access to markets in south Kosovo, given the low level of current private sector development.

However, it is also unlikely that the situation will change for the worse. The key risk is that the subsidies from Belgrade and Pristina will cease. However, this is unlikely, since an EU administration will likely insist that current jobs and social payments continue, and Belgrade is unlikely to disengage immediately. As indicated in table 3, PISG and the Serbian Government account for about 86 percent of the income in northern Kosovo.

IV.2 RISKS

Among political risks, significant conflict in the area appears unlikely without significant provocation from extremist elements. Among economic risks, there is a strong possibility that economic security could worsen. First, Pristina may have higher development priorities following status than boosting assistance to minority enclaves. Second, subsidies from the government of Serbia are likely to decline over the next 2 – 4 years, as budget constraints grow in Belgrade, and the Serbian government prefers to accommodate local political constituencies rather than the Serb Kosovars.

More positively, the phasing down of state subsidies may be the catalyst needed to generate more realistic expectations among Mitrovica residents. This could help contribute to a needed change in mentality, toward less reliance on the state, and toward recognition of the need to assume more responsibility locally for investment through more entrepreneurial approaches to economic development. At such time, donors are likely to be much more successful in their efforts to promulgate private sector development.

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Attachment C: Employment with Companies Identified by OSCE as Prominent Employers

Employer	**Service/Products**	**Production ongoing?**	**Size of Workforce**	**Location**	**Status**
Factory "Bar bilje" (private)	Products from mushrooms, forest fruits etc.	No (in transition)	20	Zubin Potok	Not Producing
Factory "Grade"	Screws	Not productive	50	Zubin Potok	Not Producing
Factory "VIK" (joint-stock)	Chocolates, wafers	Yes (occasionally)	60	Zubin Potok	Not Producing
Crystal	Crystal items	No	100	Leposavić	Not Producing
Trepèca	Lead & Zinc products	Yes, low capacity of alloy production and battery recycling	0	Zvecan	Social Company
Zveèan Company	Public Utilities	Yes	53	Zvecan	Social Company
Jugobanka – Zvecan	Finance	Yes	7	Zvecan	Social Company
"Ibar – Zubin Potok"	Protection of forest and wood exploitation	Yes	30	Zubin Potok	Social Company
JPK "Ibar"	Public utility	Yes	120	Zubin Potok	Social Company
Public Enterprise "PTK"	Postal Services	Yes	97	Mitrovica	Social Company
Municipal Public Enterprise "Uniteti"	Public Services - Sewage and Refusal collection	Yes	190	Mitrovica	Social Company
Municipal Public Enterprise "Regional water – supply"	Public Utilities	Yes	213	Mitrovica	Social Company
Kosovatrans	Public Transport Service	Yes	300	Mitrovica	Social Company
Trepca mines	Metals	No	800	Leposavić	Social Company
Trepca clothing	Gloves	N/A	70	Leposavić	Social Company

Employer	Service/Products	Production ongoing?	Size of Workforce	Location	Status
Jugobanka – Leposavic	Financial	Yes	5	Leposavić	Social Company
Ibar - Serbian Forest	Environment protection	Yes	88	Leposavić	Social Company
Hrast	Furniture	Poorly productive	169	Leposavić	Social Company
Prva Petoletka	Machine parts	Poorly productive	93	Leposavić	Social Company
"Univerzal" Leposavic	Department store	Poorly productive	132	Leposavić	Social Company
Plant "Elektrodistribucija" (state-owned)	Distribution of electric power	Yes	20	Zubin Potok	Social Company
24 November- Public utilities	Public Service	Yes	64	Leposavić	Social Company
Zvecan Bread Factory	Bread	Yes	10	Zvecan	Social Company
Factory "Javor" (joint-stock)	Clothes, shirts	Yes (in transition)	120	Zubin Potok	Social Company
Furniture factory "Simpo" (state-owned)	Furniture	Yes	120	Zubin Potok	Social Company
Hydro-electric power plant "Gazivode" (state-owned)	Electric power	Yes	60	Zubin Potok	Social Company
Plant "Ivo Lola Ribar" (joint-stock)	Spare parts for machinery	Yes	50	Zubin Potok	Social Company
Ivo Lola Ribar	Machines parts	Yes	217	Leposavić	Social Company
Social Enterprise "LUX"-privatised	retailer - Shops	Yes	53	Mitrovica	Private Sector Company
Brest	Civil Works	Yes	15	Zvecan	Private Sector Company
DES Komerc	Civil Works	Yes	11	Zvecan	Private Sector Company
MID Kompanija	Civil Works	Yes	24	Zvecan	Private Sector Company

Employer	Service/Products	Production ongoing?	Size of Workforce	Location	Status
Ozring	Civil Works	Yes	21	Zvecan	Private Sector Company
PP MGMB “Cole”	Civil Works / Construction	Yes	15	Zvecan	Private Sector Company
Commercial Bank	Finance	Yes	2	Zvecan	Private Sector Company
Kosovo-Metohia Bank	Finance	Yes	23	Zvecan	Private Sector Company
Cooperative “Banjska”	Agriculture	Yes	28	Zvecan	Private Sector Company
Gradina	Charcoal production/Fuel sales	Yes	10	Zvecan	Private Sector Company
“Klub Soda”	Juice production/ Poultry	Yes	12	Zvecan	Private Sector Company
Markoni	Restaurant Management	Yes	18	Zvecan	Private Sector Company
P.G.P. “Mostkolor”	Recycling	Yes	30	Zvecan	Private Sector Company
Yugo Petrol	Gas Station	Yes	15	Zvecan	Private Sector Company
Zvecan Dairy	Dairy products	Yes	14	Zvecan	Private Sector Company
Agricultural co-operative “Zubin Potok” (joint-stock)	Fish, eggs, animal food	Yes	120	Zubin Potok	Private Sector Company
Handicraft co-operative “Kolasin”	Various handicraft products	Yes	80	Zubin Potok	Private Sector Company
“Ibar-Invest” (joint-stock)	Trade, tourism, printing	Yes	30	Zubin Potok	Private Sector Company
“Kolasin Prevoz”	Transportation of	Yes	40	Zubin Potok	Private Sector

Employer	Service/Products	Production ongoing?	Size of Workforce	Location	Status
(private)	people				Company
"Stari Kolasin"	Publishing/Culture	Yes	25	Zubin Potok	Private Sector Company
Flour – bread Industry-privatised	Production	Yes	160	Mitrovica	Private Sector Company
Kosovo-Metohia Bank	Financial	Yes	10	Leposavić	Private Sector Company
Commercial Bank	Financial	Yes	5	Leposavić	Private Sector Company
Zitoproduct	Bakery	Yes	47	Leposavić	Private Sector Company
Total Employees	4,066				
Total Employees in Private Sector	808				