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**Working Paper**

## Financial and Technical Assistance in the Reconstruction and Development of Post-Conflict Kosova

wiiw Balkan Observatory Working Papers, No. 072

**Provided in Cooperation with:**

The Vienna Institute for International Economic Studies (wiiw) - Wiener Institut für Internationale Wirtschaftsvergleiche (wiiw)

*Suggested Citation:* Demukaj, Venera; Kotorri, Mrika; Mustafa, Isa (2006) : Financial and Technical Assistance in the Reconstruction and Development of Post-Conflict Kosova, wiiw Balkan Observatory Working Papers, No. 072, The Vienna Institute for International Economic Studies (wiiw), Vienna

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The wiiw Balkan Observatory

Working Papers | 072 | August  
2006

*Isa Mustafa, Venera Demukaj and Mrika Kotorri*

Financial and Technical Assistance  
in the Reconstruction and Development  
of Post-Conflict Kosova





# The wiiw Balkan Observatory

[www.balkan-observatory.net](http://www.balkan-observatory.net)

## *About*

Shortly after the end of the Kosovo war, the last of the Yugoslav dissolution wars, the Balkan Reconstruction Observatory was set up jointly by the Hellenic Observatory, the Centre for the Study of Global Governance, both institutes at the London School of Economics (LSE), and the Vienna Institute for International Economic Studies (wiiw). A brainstorming meeting on Reconstruction and Regional Co-operation in the Balkans was held in Vouliagmeni on 8-10 July 1999, covering the issues of security, democratisation, economic reconstruction and the role of civil society. It was attended by academics and policy makers from all the countries in the region, from a number of EU countries, from the European Commission, the USA and Russia. Based on ideas and discussions generated at this meeting, a policy paper on Balkan Reconstruction and European Integration was the product of a collaborative effort by the two LSE institutes and the wiiw. The paper was presented at a follow-up meeting on Reconstruction and Integration in Southeast Europe in Vienna on 12-13 November 1999, which focused on the economic aspects of the process of reconstruction in the Balkans. It is this policy paper that became the very first Working Paper of the wiiw Balkan Observatory Working Papers series. The Working Papers are published online at [www.balkan-observatory.net](http://www.balkan-observatory.net), the internet portal of the wiiw Balkan Observatory. It is a portal for research and communication in relation to economic developments in Southeast Europe maintained by the wiiw since 1999. Since 2000 it also serves as a forum for the Global Development Network Southeast Europe (GDN-SEE) project, which is based on an initiative by The World Bank with financial support from the Austrian Ministry of Finance and the Oesterreichische Nationalbank. The purpose of the GDN-SEE project is the creation of research networks throughout Southeast Europe in order to enhance the economic research capacity in Southeast Europe, to build new research capacities by mobilising young researchers, to promote knowledge transfer into the region, to facilitate networking between researchers within the region, and to assist in securing knowledge transfer from researchers to policy makers. The wiiw Balkan Observatory Working Papers series is one way to achieve these objectives.



# The wiiw Balkan Observatory

## Global Development Network Southeast Europe

*This study has been developed in the framework of research networks initiated and monitored by wiiw under the premises of the GDN–SEE partnership.*

The Global Development Network, initiated by The World Bank, is a global network of research and policy institutes working together to address the problems of national and regional development. It promotes the generation of local knowledge in developing and transition countries and aims at building research capacities in the different regions.

The Vienna Institute for International Economic Studies is a GDN Partner Institute and acts as a hub for Southeast Europe. The GDN–wiiw partnership aims to support the enhancement of economic research capacity in Southeast Europe, to promote knowledge transfer to SEE, to facilitate networking among researchers within SEE and to assist in securing knowledge transfer from researchers to policy makers.

The GDN–SEE programme is financed by the Global Development Network, the Austrian Ministry of Finance and the Jubiläumsfonds der Oesterreichischen Nationalbank.

For additional information see [www.balkan-observatory.net](http://www.balkan-observatory.net), [www.wiiw.ac.at](http://www.wiiw.ac.at) and [www.gdnet.org](http://www.gdnet.org)



*Project title:* **Financial and Technical Assistance in the  
Reconstruction and Development of the Post-Conflict  
Kosova**

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## ***ACRONYMS AND ABBREVIATIONS***

ABU- Agro Business Unit

DEG – Deutsche Investition und Entwicklungsgesellschaft

EAR – European Agency for Reconstruction

EU – European Union

EWS – Early Warning System

FDI – Foreign Direct Investment

FYROM- Foreign Yugoslav Republic of Macedonia

GDP – Gross Domestic Product

GORED – The German Office for Reconstruction and Development

GTZ - Deutsche Gesellschaft für Technische Zusammenarbeit

HDI – Human Development Index

KFOR – Kosovo Forces

KfW – Kreditanstalt fuer Wiederaufbau

MAFRD – Ministry of Agriculture, Forestry and Rural Development

MEF – Ministry of Economy and Finance

NGO – Non-Governmental Organizations

POE – Publicly Owned Enterprises

RIMS – Reconstruction Monitoring System

SEE – South East Europe

SME – Small and Medium Enterprises

SOE – Socially Owned Enterprises

UN – United Nations

UNMIK- United Nations Interim Mission in Kosovo

USAID – United States Agency for International Development

WB – World Bank

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## ***1. INTRODUCTION***

This paper is prepared within the Global Development Network Southeast Europe research competition of the Vienna Institute for International Economic Studies. The purpose of the paper is to assess the impact of foreign assistance in different sectors and in a macroeconomic framework, with a special focus on poverty reduction during the post-war period. Furthermore, the paper aims at suggesting recommendations for a more efficient allocation of financial and technical assistance of the donor community in Kosova.

The working methodology consists of describing aid patterns by year and sector, estimating achievements by sectors and assessing the aid impact on promoting economic growth, investments and exports and thus indirectly inferring the aid impact on poverty reduction. The paper uses data on donor activities gathered by local institutions (Banking and Payment Authority, Ministry of Economy and Finance, Statistical Office etc.) and international institutions (World Bank, IMF, UNMIK). An additional source of information was the Riinvest research database, such as quarterly household surveys and annual surveys with small and medium enterprises.

The general picture of foreign aid in Kosova during 1999-2005 shows that about 9,092 projects have been implemented amounting for app. €2.29 billion. The main findings of the analysis are that foreign aid has contributed to improvements in different economic sectors, to economic growth and to poverty alleviation. Positive effects are visible mainly in the sector of housing and infrastructure. The reconstruction in the housing sector is partly due to the Kosovar efforts. Improvements in the electricity supply are not satisfactory, despite the use of many funds from donors and the Kosova Consolidated Budget. Elementary health service is available everywhere and the development of a legal framework is considered as an important achievement where technical assistance provided by donors played a crucial role. Nevertheless, a comprehensive legal framework to enable and promote sustainable economic development has not been completed yet. The economic growth rate in the first two post-war years was aid-driven and slowed down to a more sustainable level after 2002. The effectiveness of foreign in reducing poverty, inferred from the analysis of its effectiveness by sector and by macroeconomic indicators, is considered satisfactory. This is supported by the increase in the Human Development Index (HDI) as well. Yet, based on WB assessments, the

average living standard is still low<sup>1</sup> and the Kosova Consolidated Budget is not capable of covering all capital investment needs, while foreign aid is gradually scaling down. To meet the Government priorities additional investments are needed. These should be covered through mobilizing the economic potential of Kosova and securing alternative sources of financing, such as foreign aid and international bilateral and multilateral development finance programs.

## **2. METHODOLOGY**

This paper is based on donor activity data collected by the Ministry of Economy and Finance through the RIMS database, data collected by the Banking and Payment Authority, as well as by the Statistical Office of Kosova. Moreover, use has been made of data about different macroeconomic indicators published by international institutions, such as the World Bank, IMF, UNMIK and UNDP. An additional source of information was the Riinvest research database such as quarterly household surveys and annual surveys with small and medium enterprises.

The working methodology involves first of all the describing of the general picture of foreign aid disbursement by year and sector in Kosova during 1999 – 2005. For this purpose the economy was divided into eight sectors: public utilities, housing, trade and industry, education and science, infrastructure, agriculture, environment and others (see section three). Henceforth, each sector was analyzed in terms of the annual flow and share of foreign aid received using the RIMS database. Furthermore, each sector was divided into sub-sectors and the same description methodology was used. The paper continues with the assessment of the aid effectiveness by sector. In this regard, achievement indicators, which have been defined by World Bank in cooperation with MEF, are used in order to trace the contribution of foreign aid. Again, the indicators for each sector are analyzed separately and by year. Improvements as recorded through these indicators are translated into evidence in support of the effectiveness of foreign aid. In the fifth section, the impact of foreign aid is traced through its impact on four macroeconomic indicators, i.e. the economic growth rate, exports, investments and consumption. For this purpose the IMF analytical framework of estimating the direct contribution of foreign aid to the abovementioned indicators is used. Thus, the

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<sup>1</sup> World Bank, Report no. 32378-XK, Kosovo Poverty Assessment, June 16, 2005

annual flow is given and positive trends are translated into evidence supporting the effectiveness of foreign aid on the Kosovar economy. In order to derive a relationship between foreign aid and poverty reduction, the methodology used by Le and Winters (2001) is followed. The effectiveness of foreign aid in alleviating poverty is traced via its achievements in the different sectors (see section 4) and via its impact on the macroeconomic indicators (see section five). In addition, improvements in the Human Development Index (HDI) are also analyzed when assessing the aid impact on poverty reduction. In the last section the paper concludes by giving the main shortcomings and achievements and gives recommendations for the future allocation of donor funds.

### ***3. ANNUAL DONOR AID INFLOW BY SECTOR***

Since the end of the 1999 war, following the NATO intervention, Kosova has been administered by UNMIK under the UN Resolution 1244. Since then reconstruction started from a very low base given the economic rundown and extensive war damages. Thus, during the emergency phase (1999-2002) the international community, in cooperation with local institutions, has provided substantial support to move Kosova forward on the path to recovery and sustainable development. The reconstruction program was largely successful, a dynamic economic recovery was initiated and economic activity especially in the services, trade and construction sectors were revitalized rapidly contributing to high annual GDP growth rates (10-16%).

The cumulative portfolio of donor funds spent in Kosova from 1999 until 2005 amounts to €2.29 billion. In what follows, the share and flow of donor assistance will be shown for the following sectors: infrastructure, housing, public utilities, trade and industry, agriculture, health, social welfare and education, environment, technical assistance, capacity building and others. The amount of donor aid disbursed in Kosova achieved its peak in 2000 and 2001<sup>2</sup>, spent mainly on the reconstruction and rehabilitation of the economy.

Looking at the dynamics and the composition of foreign aid flows during the post-war period in Kosova, a shift of donors' emphasis from emergency to development projects can be noticed. Thus, immediately after the war, the donor community was focused on meeting emergency needs of the population i.e., humanitarian aid, whereas from 2002 donor projects started to rather cover components of a developmental nature. Therefore, during 2000, the housing sector received around €155.5 mn, i.e. 25 percent of the cumulative aid, falling

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<sup>2</sup> 53% of the total aid given during the period 1999-2004, was spent in these two years in 2000 and 2001

drastically to €6,020.48 in 2005. This reflects the emergent need of the population to rebuild their largely devastated and burned houses in the immediate aftermath of the war. After 2002, more than 40% of donor assistance was offered in the form of technical assistance, whereas some intervention areas lost their importance (e.g. supply of equipment and running costs).<sup>3</sup> Moreover, rehabilitation and reconstruction activities continue to take in a considerable portion of external funding, mainly in the public utilities sector. As shown in the table below, this sector received the largest amount of external financing during the 1999-2005 period.

*Table 1. Annual foreign aid inflow and share of total by sector, 1999-2005* (amounts are in thousands of euros)

| Sectors                      | Spent-‘99         | Spent-‘00         | Spent-‘01         | Spent-‘02         | Spent-‘03         | Spent-‘04         | Spent-‘05        | Total spent ‘99-‘05 | Share of Total (%) |
|------------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|------------------|---------------------|--------------------|
| <b>Public utilities</b>      | 16,854.00         | 127,693.60        | 193,210.40        | 94,099.70         | 91,703.30         | 54,029.10         | 3,618.23         | 590,391.94          | 25.68              |
| <b>Housing</b>               | 26,895.00         | 155,530.70        | 90,831.70         | 67,572.90         | 14,107.00         | 6,888.30          | 6,020.48         | 380,769.08          | 16.56              |
| <b>Trade and Industry</b>    | 124.44            | 56,570.50         | 42,263.50         | 27,061.90         | 29,189.80         | 21,034.10         | 11,044.00        | 187,352.37          | 8.15               |
| <b>Education and Science</b> | 43,256.00         | 74,503.00         | 65,671.80         | 49,493.00         | 31,092.80         | 19,908.20         | 7,400.41         | 291,325.21          | 12.67              |
| <b>Infrastructure</b>        | 202.00            | 50,183.70         | 48,295.00         | 20,968.20         | 12,807.00         | 1,955.70          | 312.00           | 134,723.60          | 5.86               |
| <b>Agriculture</b>           | 125.05            | 17,736.80         | 34,377.40         | 17,565.30         | 15,880.40         | 4,514.90          | 878.23           | 91,077.56           | 3.96               |
| <b>Environment</b>           | 85.00             | 184.64            | 633.62            | 1,097.20          | 3,471.40          | 1,063.80          | 958.65           | 7,494.31            | 0.33               |
| <b>Others</b>                | 89,976.00         | 124,979.10        | 117,917.60        | 120,758.50        | 90,113.40         | 54,035.80         | 18,562.74        | 616,343.14          | 26.8               |
| <b>Total</b>                 | <b>177,517.49</b> | <b>607,382.04</b> | <b>593,201.02</b> | <b>398,616.70</b> | <b>288,365.10</b> | <b>163,429.90</b> | <b>48,794.74</b> | <b>2,299,477.73</b> | <b>100.00</b>      |

Source: MEF - RIMS Database, April 2006

### **3.1.1. Infrastructure**

The total amount of funds allocated to this sector, from 1999 until 2005, was about €134.724 mn. This makes up around 6% of the total amount spent thereby making it to be a modest contribution compared to the other sectors.

*Table 2. Annual aid inflow and share of total in the infrastructure sector, 1999-2005* (amounts are in thousands of euros)

| <b>Infrastructure</b>        | <b>Spent-‘99</b> | <b>Spent-‘00</b> | <b>Spent-‘01</b> | <b>Spent-‘02</b> | <b>Spent-‘03</b> | <b>Spent-‘04</b> | <b>Spent-‘05</b> | <b>Total</b>      | <b>Share of total</b> |
|------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|-------------------|-----------------------|
| Sub-sector                   |                  |                  |                  |                  |                  |                  |                  |                   |                       |
| Transport and infrastructure | 174.39           | 47,702.92        | 43,014.59        | 20,953.41        | 12,159.99        | 1,955.74         | n/a              | 125,961.04        | 93.50                 |
| Post and telecommunication   | 27.61            | 2,480.81         | 5,280.42         | 14.74            | 647.01           | n/a              | 312              | 8,762.59          | 6.50                  |
| <b>Total</b>                 | <b>202</b>       | <b>50,183.73</b> | <b>48,295.01</b> | <b>20,968.15</b> | <b>12,807.00</b> | <b>1,955.74</b>  | <b>312</b>       | <b>134,723.63</b> | <b>100.00</b>         |

<sup>3</sup> MEF, Monthly Macroeconomic Monitor Kosovo, 2005

Source: MEF - RIMS Database, April 2006

The table above shows the annual inflow trend of donor assistance provided for this sector. Immediately after the war, the amount of donor funds spent in this sector was about €0.2 millions, while the years 2000 and 2001 absorbed the highest amounts, i.e. some €50 million each. In the following years it decreased again amounting to 1.96 million in 2004, while in 2005 it recorded another drastic fall. The story behind this donor funds' oscillation lies in the fact that in the first year of the post-war period the donor community focused more on distributing humanitarian aid, returning refugees, establishing peace and order and securing residents. Hence, the restoring of infrastructure, in particular local infrastructure rehabilitation and rehabilitation of the infrastructure needed for economic recovery started in the next two years, where the amount of funds donated to this sector was much higher compared to the first post-war year. Beyond this phase, a certain level of improvements was reached, consequently donor assistance, provided for this sector, started to decrease.

Infrastructure consists of two sub-sectors: transport and infrastructure (transport, railways and roads) and post and telecommunications. They have a similar annual flow of donor assistance, since their flows shape that of the whole sector.

Except for telecommunications, this sector suffered relatively little damage during the war. The damage resulted mainly from lack of maintenance and departure of qualified staff during the pre-war decade. However, compared to post and telecommunications, the former sub-sector received the largest amount of donor assistance, i.e. 93.5% of total funds spent in this sector. Given that their restoring is a prerequisite for economic recovery and limited budget capacities to cover capital investments, the continuation of donor injections into this sector are considered to be more than necessary.

### 3.1.2. *Public Utilities*

Public utilities, notably energy, is the sector, which received the largest amount of external financing, during the 1999-2005 period. The total amount spent in this sector makes up 25.52% of the cumulative portfolio of donor funds received.

*Table 3. Annual aid inflow and share of total in the public utilities sector, 1999-2005*  
(amounts are in thousands of euros)

| Public utilities                          | Spent-'99 | Spent-'00  | Spent-'01  | Spent-'02 | Spent-'03 | Spent-'04 | Spent-'05 | Total      | Share of total |
|---|-----------|------------|------------|-----------|-----------|-----------|-----------|------------|----------------|
| Sub-sector                                |           |            |            |           |           |           |           |            |                |
| Rehabilitation of Electricity sub-sectors | 16,006.20 | 111,245.80 | 133,374.20 | 59,434.90 | 85,687.00 | 48,144.00 | 1,068.03  | 454,960.13 | 77.06          |

|                                     |                  |                   |                   |                  |                   |                  |                 |                   |               |
|-------------------------------------|------------------|-------------------|-------------------|------------------|-------------------|------------------|-----------------|-------------------|---------------|
| Solid waste disposal rehabilitation | 164.69           | 9,180.23          | 7,073.95          | 11,271.59        | 65,329.00         | 580.00           | 383.00          | 93,982.46         | 15.92         |
| Water sub-sector rehabilitation     | 683.36           | 7,267.58          | 6,684.06          | 13,471.41        | 6,038.00          | 5,138.00         | 2,167.20        | 41,449.61         | 7.02          |
| <b>Total</b>                        | <b>16,854.25</b> | <b>127,693.61</b> | <b>147,132.21</b> | <b>84,177.90</b> | <b>157,054.00</b> | <b>53,862.00</b> | <b>3,618.23</b> | <b>590,392.20</b> | <b>100.00</b> |

Source: MEF - RIMS Database, April 2006

During the first post-war year the public utilities received €16.85 million. The donor assistance increased in the two following years, 2000 and 2001, where the total annual amount was €127.70 million and €193.21 million respectively. Later on, it started to fall, amounting to €3.62 million in 2005. The reason for these oscillations is the same as that given for the sector of infrastructure.

Within the sector of public utilities, rehabilitation of electricity sub-sectors received the highest portion of donor assistance, i.e. around 77.06%. This is about half a billion euros, which makes up around 20% of the cumulative portfolio of funds disbursed during the 1999-2005 period. Compared to the energy sub-sector, solid waste disposal rehabilitation and water sub-sector rehabilitation, received negligible portions, around 16% and 7% respectively. The main projects implemented in the first sub-sector aimed at repairing “Kosova A” and “Kosova B” power plants, coalmines for electricity supply as well as importing electricity and consultancies. In the other sub-sector funds were mainly allocated for the improvement of the management of solid wastes and securing collection equipment. Among others, the aim in the third sub-sector was to repair water supply and sewage systems, improve water quality and build new pumping stations.

### ***3.1.3. Housing***

As of the end of 2005, the housing sector (housing reconstruction and social housing) received €380,767.84 million, some 16.56% of total donor funds spent.

The pattern of annual donor funds provided for this sector is similar to that of infrastructure – there is an increase amounting to €26.89 million in 2000, followed by a decrease in the next years, where the years 2000 and 2001 make up the largest part of the total, i.e. about 68%. Here too, the reason for this pattern is similar to that given for the other two sectors. Consequently, Kosovars carried out significant repairs during the summer of 1999, without donor assistance. In 2002, a significant progress was made; over 40,000 houses were

rehabilitated or rebuilt with donor assistance. Later on, donor dependency of this sector started to decrease.

*Table 4. Annual aid inflow and share of total in the Housing sector, 1999-2005* (amounts are in thousands of euros)

Source: MEF - RIMS Database, April 2006

The table above gives an overview of funds provided for the housing sectors, split between housing reconstruction and social housing, the two sub-sectors of housing. Due to lack of data for social housing for the period 1999-2001, reconstruction housing mainly shapes the pattern of donor funds, so that its pattern is similar to that of the whole sector.

| <b>Housing</b>         | <b>Spent-'99</b> | <b>Spent-'00</b>  | <b>Spent-'01</b> | <b>Spent-'02</b> | <b>Spent-'03</b> | <b>Spent-'04</b> | <b>Spent-'05</b> | <b>Total</b>      | <b>Share of total (%)</b> |
|------------------------|------------------|-------------------|------------------|------------------|------------------|------------------|------------------|-------------------|---------------------------|
| Sub-sectors            |                  |                   |                  |                  |                  |                  |                  |                   |                           |
| Housing reconstruction | 26,894.52        | 155,530.66        | 90,831.33        | 67,572.85        | 14,107           | 4,588            | 3,570.48         | 363,094.84        | 95.36                     |
| Social Housing         | n/a              | n/a               | n/a              | n/a              | 12,923           | 2,300            | 2,450.00         | 17,673.00         | 4.64                      |
| <b>Total</b>           | <b>26,894.52</b> | <b>155,530.66</b> | <b>90,831.33</b> | <b>67,572.85</b> | <b>27,030.00</b> | <b>6,888.00</b>  | <b>6,020.48</b>  | <b>380,767.84</b> | <b>100.00</b>             |

### **3.1.4. Trade and Industry**

During 1999-2005, donors gave €187,352 mn for the trade and industry sector, which makes up around 8% of the total aid. The table below indicates that the major part of this aid went for the private sector development. The donor funds were mainly given as credit lines to commercial banks and micro financial institutions in order to provide loans to the SME sector (DEG, KFW, EAR, WB) or through the technical assistance and training to SMEs (USAID, Swiss Contact). The aim of the funds flowing to this sector was to support the revitalisation of the businesses in order to generate income and employment.

During the reporting period, more than €11 mn went for the Trepça Complex<sup>4</sup> and for the environmental, safety and asset preservation activities in Mitrovica<sup>5</sup>. In 2004, more than 20% of the aid given to the trade and industry sector was allocated for economic development namely, promotion of the balanced economic and social development; institutional strengthening of the commercial banking sector; compilation of the Kosovo Development Plan; and business advisory services to the potentially viable enterprises at the pre and post privatization phase; all of it financed by the EAR.

*Table 5. Annual aid inflow and share of total in the trade and industry sector, 1999-2005 (amounts are in thousands of euros)*

| <b>Trade &amp; Industry</b>       | <b>Spent-'99</b> | <b>Spent-'00</b> | <b>Spent-'01</b> | <b>Spent-'02</b> | <b>Spent-'03</b> | <b>Spent-'04</b> | <b>Spent-'05</b> | <b>Total</b>      | <b>Share of total</b> |
|-----------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|-------------------|-----------------------|
| Sub-sectors                       |                  |                  |                  |                  |                  |                  |                  |                   |                       |
| Private sector development        | 124.44           | 53,084.70        | 29,921.70        | 19,876.00        | 22,468.00        | 16,067.00        | 10,250.00        | 151,791.84        | 81,02                 |
| Economic development              | n/a              | n/a              | n/a              | n/a              | 1,582.00         | 4,632.00         | n/a              | 6,214.00          | 3,32                  |
| Planning, management and finances | n/a              | n/a              | 6,150.60         | 3,582.03         | 1,486.00         | 335.00           | n/a              | 11,553.63         | 6,17                  |
| Trepça Complex                    | n/a              | 3,485.80         | 6,191.11         | 1,700.00         | 1,968.00         | n/a              | 794.00           | 14,138.91         | 7,55                  |
| Others                            | n/a              | n/a              | n/a              | 1,968.00         | 1,685.83         | n/a              | n/a              | 3,653.83          | 1,95                  |
| <b>Total</b>                      | <b>124.44</b>    | <b>56,570.55</b> | <b>42,263.47</b> | <b>27,126,03</b> | <b>29,189.83</b> | <b>21,034.09</b> | <b>11,044.00</b> | <b>187,352.26</b> | <b>100,00</b>         |

Source: MEF - RIMS Database, April 2006

### **3.1.5. Agriculture**

The agriculture sector is estimated to comprise some 25% of GDP<sup>6</sup>, representing thus an important pillar of the whole economy, in particular for the food security at the household levels. During the last decade, productivity in the agriculture sector declined drastically due to the years of underinvestment in this sector. This situation worsened further during the war in 1999 causing considerable damages to the livestock herd and the agricultural production. Given the worsened conditions in the aftermath of the war, a part of donor funds has been committed to the agriculture sector support and reactivation. During 1999-2005, donors spent €91.07 mn in this sector, which makes up some 4.0% of the total aid. The table below shows that foreign assistance provided to the agriculture sector was rather minor with variations during the reporting period.

<sup>4</sup> The main public enterprise in mining and processing lead and zinc, located in the Mitrovica region.

<sup>5</sup> During 1999-2002, Government of the Netherlands spent €1.7 millions for environment protection in Mitrovica

<sup>6</sup> Beilock, Richard, 'Agriculture, Rural Development and Prosperity in Kosova: An alternative view', in Rural Development in Kosova, Riinvest July 2004



Table 6. Annual aid inflow and share of total in the agriculture sector, 1999-2005 (amounts are in thousands of euros)

| <b>Agriculture</b>                    | <b>Spent-</b> | <b>Spent-'00</b> | <b>Spent-'01</b> | <b>Spent-'02</b> | <b>Spent-'03</b> | <b>Spent-'04</b> | <b>Spent-'05</b> | <b>Total</b>     | <b>Share</b>    |
|---------------------------------------|---------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|-----------------|
| <b>Sub-sectors</b>                    | <b>'99</b>    |                  |                  |                  |                  |                  |                  |                  | <b>of total</b> |
| Agribusiness Development              | 125           | 1,446.25         | 8,427.29         | 3,210.07         | 8,318.00         | 1,418.00         | 175.63           | 23120.24         | 25.39           |
| Institutional Capacity Building       | n/a           | 2,295.00         | 77.09            | n/a              | 7.00             | 296.00           | n/a              | 9485.19          | 10.41           |
| Irrigation Rehabilitation Programme I | n/a           | 8,875.80         | 15,831.26        | 2,956.00         | 1,018.00         | 700.00           | n/a              | 14570.17         | 16.00           |
| Other Agriculture (Non PRIP)          | n/a           | 4,158.40         | 2,782.93         | 834.86           | 728.00           | 981.00           | n/a              | 11143.21         | 12.23           |
| Input and Farm development            | n/a           | 102.00           | 5,989.32         | 2,483.85         | 5,395.00         | 600.00           | n/a              | 29381.06         | 32.26           |
| Forestry                              | n/a           | 859.35           | 1,269.53         | 8,080.03         | 414.36           | 519.94           | 702.60           | 3377.69          | 3.71            |
| <b>Total</b>                          | <b>125.05</b> | <b>17,736.8</b>  | <b>34,377.4</b>  | <b>17,565</b>    | <b>15,880.4</b>  | <b>4,514.9</b>   | <b>878.23</b>    | <b>91,077.56</b> | <b>100.00</b>   |

Source: MEF - RIMS Database, April 2006

Initially, donors provided emergent aid based on grants, such as farm inputs development, which helped mitigating of the damages caused in this sector and supporting of the agricultural production to a rather subsistence level. Thus, in 2000 and 2001 about half of the foreign aid focused on providing and repairing of farm machineries; providing cattle, seeds and fertilizers on a grant basis; and developing rural micro finance projects. Later on (from 2002) foreign aid was disbursed for the creation of a more sustainable development of the agriculture sector, mainly focused on the establishing of the agricultural policies, capacity building within the MAFRD, transfer of the knowledge to the local farmers, in order to pave the way to the commercial agricultural production.

Hence, in 2003 more than 50% of the aid was allocated for agribusiness development aiming at the strengthening and expanding of the private agribusiness sector, development of the business planning, access to credit, technological transfer, and access to supplies. In order to lead reforms in the rural sector of the economy, EAR committed €1.5 million<sup>7</sup> to institutional capacity building efforts, through strengthening of the MAFRD institutional capacities in planning and implementation of agriculture policies and strategies.

Yet, the small share of donor funds allocated to the agriculture sector regardless of its huge share to GDP reflects the lack of development aid in the first years of the post-war Kosovo.

### ***3.1.6. Education, Health and Social Welfare***

During the 1999-2005 period, the cumulative portfolio of donations spent in the sector of Education, Health and Social Welfare amounted to €291,325 mn. This makes up 12.6% of the

<sup>7</sup> Note: there is no match between the committed and spent funds within the RIMS database, since usually an amount of the committed money in the respective year is spent in the following year(s).

total aid disbursed, ranking it among the first three sectors in terms of absorbing donor funds.<sup>8</sup>

*Table 7. Annual aid inflow and share of total in the Education, Health and Social Welfare, 1999-2005 (amounts are in thousands of euros)*

| <b>Social Welfare, Health and Education</b> | <b>Spent-'99</b> | <b>Spent-'00</b> | <b>Spent-'01</b> | <b>Spent-'02</b> | <b>Spent-'03</b> | <b>Spent-'04</b> | <b>Spent-'05</b> | <b>Total</b>      | <b>Share of total</b> |
|---|------------------|------------------|------------------|------------------|------------------|------------------|------------------|-------------------|-----------------------|
| Sub-sectors                                 |                  |                  |                  |                  |                  |                  |                  |                   |                       |
| Social Welfare                              | 36,032.50        | 9,243.18         | 5,290.53         | 5,126.67         | 3,941.53         | 2,498.02         | 2,336.20         | 64,468.63         | 22.13                 |
| Education and Science                       | 5,632.36         | 40,614.14        | 26,626.89        | 24,558.83        | 10,191.84        | 9,139.70         | 1,191.46         | 117,955.22        | 40.49                 |
| Health                                      | 1,336.39         | 20,397.32        | 28,217.46        | 16,150.14        | 15,395.08        | 7,120.18         | 2,706.68         | 91,323.25         | 31.35                 |
| Culture                                     | 151.57           | 2,142.27         | 3,845.46         | 1,339.20         | 1,180.89         | 573.31           | 1,166.07         | 10,398.77         | 3.57                  |
| Sport                                       | 73.44            | 100.73           | 650.26           | 1,149.87         | 290.75           | n/a              | n/a              | 2,265.05          | 0.78                  |
| Youth                                       | 29.58            | 2,005.36         | 1,041.27         | 1,168.29         | 92.75            | 576.98           | n/a              | 4,914.23          | 1.69                  |
| <b>Total</b>                                | <b>43,255.84</b> | <b>74,503.00</b> | <b>65,671.87</b> | <b>49,493.00</b> | <b>31,092.84</b> | <b>19,908.19</b> | <b>7,400.41</b>  | <b>291,325.15</b> | <b>100.00</b>         |

Source: MEF - RIMS Database, April 2006

The table above shows that the annual flow of donor funds allocated to this sector increased by €31,247 mn, from 1999 to 2000, and then decreased gradually in the following years. The sub-sectors social welfare, education and science, and health absorbed the major part of donations allocated to this sector, i.e. 94.21%.

### 3.1.7. Environment Protection

During the 1999-2005 period, aid allocated to this sector amounted to some € 7.5 mn, making up 0.33 % of the total donor funds spent. Immediately after the war, the amount of donor funds spent in this sector was about € 0.085 mn, while the year 2003 absorbed the highest amounts of funds dedicated for environment protection, i.e. € 3.5 mn. The donations fluctuated from year to year and the sub-sectors that received the largest amount were the 'Institutional Capacity Building', 'Quality of Urban Areas', 'Obiliq Pollution Impact' and the 'General Environment Protection and Planning'. The situation in this sector was very poor due to the lack of investments and neglect for more than 10 years prior to the war, as well as destructions caused during the war. Given this fact, any investment in this sector could be considered as an improvement in itself.

<sup>8</sup> The RIMS database, under the headline of this sector have included: 1) social welfare, 2) education and science, 3) health, 4) culture, 5) sport and 6) youth

### 3.8. Others

Table 8. Annual aid inflow and share of total in the others sector, 1999-2005 (amounts are in thousands of euros)

| Others                                    | Spent-'99        | Spent-'00        | Spent-'01         | Spent-'02        | Spent-'03        | Spent-'04       | Spent-'05        | Total            | Share of total |
|---|------------------|------------------|-------------------|------------------|------------------|-----------------|------------------|------------------|----------------|
| Sub-sectors                               |                  |                  |                   |                  |                  |                 |                  |                  |                |
| Central Fiscal Authority                  | 3,044.70         | 7,425.56         | 28,693.46         | 25,893.64        | 19,781.56        | 11,229.83       | 367.69           | 96,436.44        | 13.16          |
| Local Administration                      | 166.04           | 6,551.32         | 12,388.86         | 8,864.41         | 17,824.96        | 3,025.66        | 180.72           | 49,001.97        | 6.69           |
| Public Services                           | -                | 19,631.48        | 8,114.93          | 5,151.87         | 8,207.81         | 1,249.06        | 423.06           | 42,778.21        | 5.84           |
| Democratic Governance and Civil Society   | 974.65           | 10,291.54        | 21,298.15         | 31,718.56        | 20,669.75        | 22,108.97       | 5,429.63         | 112,491.25       | 15.35          |
| Civil Security and Emergency Preparedness | n/a              | 13,269.98        | 8,166.14          | 4,551.99         | n/a              | 375.00          | 442.10           | 26,805.21        | 3.66           |
| Kosovo Police Service                     | 2,167.50         | 27,718.50        | 5,405.66          | 23,430.88        | 5,612.97         | 1,780.53        | 1,153.00         | 67,269.04        | 9.18           |
| Mine Action Co-ordination Center          | 17,170.76        | 10,603.51        | 10,424.79         | n/a              | 223.93           | n/a             | 500.00           | 38,922.99        | 5.31           |
| Justice                                   | n/a              | 8,269.14         | 12,572.81         | 10,412.84        | 9,140.62         | 10,353.23       | 640.58           | 51,389.22        | 7.01           |
| Labor and Employment                      | 114.75           | 1,081.20         | 6,973.34          | 4,067.43         | 2,222.92         | 602.31          | 3,039.96         | 18,101.91        | 2.47           |
| Non-Residential Affairs                   | n/a              | n/a              | 2.56              | 4,760.67         | n/a              | n/a             | n/a              | 4,763.23         | 0.65           |
| Other Sectors                             | 66,337.55        | 20,136.84        | 3,877.00          | 1,906.18         | 6,428.81         | 3,311.20        | 122,664.65       | 224,662.23       | 30.67          |
| <b>TOTAL:</b>                             | <b>89,975.95</b> | <b>124,979.0</b> | <b>117,917.70</b> | <b>120,758.5</b> | <b>90,113.33</b> | <b>54,035.8</b> | <b>134,841.4</b> | <b>732,621.7</b> | <b>100.00</b>  |

Source: MEF - RIMS Database, April 2006

Under the headline “others” different sectors are included (see table above). These are mainly related to institutional building. Among them, the sectors Democratic Governance and Civil Society and the Central Fiscal Authority received the largest amounts of donor funds spent in this sector, while the sector Kosova Police Service, Justice and Local Administration absorbed, on average, €50 million each.

There is considerable evidence on developments in the institutional building process. The Provisional Institutions of Self-Government, Kosova Police Service, the Tax and Customs Administration, the Central Fiscal Authority, the Banking and Payments Authority, the legal infrastructure have been established.

## 4. ASSESSMENT OF AID EFFECTIVENESS BY SECTOR

Due to the mixed outcomes of aid effectiveness, it is not easy to see how much has been achieved since June 1999. On one hand, notable success is evident in the physical infrastructure of Kosova where within three years over 30% of families whose homes were partly or completely destroyed are now in decent permanent housing; over 50% of roads have been repaired; the SME sector flourished; elementary healthcare as well as education at all

levels is now available almost everywhere. Most of these achievements can also be attributed to the strong efforts of the people of Kosova. However, it is worth stressing that most of the reconstruction process absorbed imported materials, which in turn did not give impulses to the domestic economy. Furthermore, the situation in the energy sector, despite huge donor support, has remained critical with frequent system collapses and continuing imports.

In the infrastructure sector, donor assistance covered the major part in repairing of main and rural roads, supply of maintenance equipment, rebuilding bridges and restoring public transport in cities by importing buses.

Until 1999, the road network consisted of about 1,700 km of roads, including 623 km of main roads<sup>9</sup>. It was estimated that about 450 km of road sections, mostly located on the main network and around 400 km of gravel and earth roads, needed to be rehabilitated. With the support of the donor community a total of 435 km of roads was repaired until 2003, 1040 km was maintained, while 5 bridges were repaired (see Annex).

Another priority was the repair of the railway network and civil aviation. Regarding the railway network, the main objective was to rehabilitate and equip the sector with the needed tools, since traffic on most of the lines ceased before and some lines were damaged during the war. The railway network consisted of 330 km of single track, non-electrified standard gauge route length. KFOR re-established traffic between Prishtina and the border with FYROM, which was transferred to civilian operations in 2000. Since then, around 9 km of railways were repaired and the rail transport of goods and passengers started (see Annex). The rail transport of goods increased by three times from 2001 to 2002, and then incurred a slight decrease in 2004, while the latter underwent no significant changes. The effectiveness of donations allocated to this sector was particularly significant in the Prishtina Airport, which is acknowledged as being one of the best run airports in the region. On a daily basis, the average number of flights during 2000-2003 was 10, while the average number of passengers flying in and out of Kosova was 340.874 and 365.162 respectively (see Annex).

The donor aid was effective also in the rehabilitation of the irrigation system. Within four years (2000-2003) 258 km of the irrigation system have been rehabilitated<sup>10</sup>, providing better conditions for agriculture development.

In the public utilities sector, with the exception of the water system in the rural areas, where half of the rural boreholes and wells were deliberately polluted, the water, energy and waste system in urban areas suffered little direct war-related damages. However, mainly due to the

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<sup>9</sup> Kosova 2001-2003: From Reconstruction to Development, Preliminary Evaluation by the Department of Reconstruction, 2001.

<sup>10</sup> MFE, The Impact of the Donor Activities on the Economic Development of Kosova (2004)

lack of investments, maintenance and mismanagement, the situation in the post-war period was critical. The overall objective in this sector was to reactivate these three systems, i.e. reactivation of power plants for energy production and of the lignite mines, improvement of the water supply and waste removal systems. During 1999-2002, electricity production increased continually, with exception of the year 2003, from 564,410 MWh in 2000 to 3,481,054 MWh in 2004. Coal production had a similar pattern to energy production. Progress is recorded also in the length of restored lines for transport and distribution of electrical energy (km) and number of new installed transformers. Given that this sub-sector has absorbed around 25.6% of the cumulative portfolio of funds disbursed during 1999-2005, the high imports of electrical energy and the frequent black outs in power supply, one can conclude that the effectiveness of donor assistance to this sector is questionable and not satisfactory.<sup>11</sup>

The overall damage in the sector of housing was estimated to be 120,000 out of a total housing stock of 250,000. The objective of donor assistance in this sector was to satisfy the needs of the population by ensuring that sufficient housing of a reasonable standard is available. Until 2000, the reconstruction of houses for 20,000 families was carried out, based on minimal standards. Thus, the major part of the planned donor-assisted rehabilitation of dwellings was completed within 2000. Later on, the reconstruction of the rest of the houses followed, amounting to 40,251 houses, i.e. 1/3 of the total stock. Private efforts contributed to the process of reconstruction as well, resulting in enormous improvements. Considering the overall outcomes in the housing sector, one concludes that donor assistance in this sector has been satisfactory.

Data from the Statistical Office of Kosova show that during the post-war period a rapid increase in the number of newly established and registered businesses was recorded. Thus, SMEs in the trade and service sector flourished where during the 2000-2004 period the number of the registered businesses increased from 14,656 to 37,776. Moreover, the donor community provided funds and technical assistance to commercial banks and financial institutions for on-lending of the SME sector. This boosted their lending activities and

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<sup>11</sup> Ex President of the KEK Board Joe Trutschler, have been accused for stealing millions of Euros from KEK. He was sentenced by a court in Bochum, Germany, for three and a half years, while the money was returned to KEK. Such theft was the first case found of UNMIK officials abusing.  
See: [http://www.eciks.org/english/lajme.php?action=total\\_news&main\\_id=364](http://www.eciks.org/english/lajme.php?action=total_news&main_id=364)

increased their importance in financing private sector investments.<sup>12</sup> Micro credit schemes financed by the donor sector facilitated an easier access to rural finance. In the initial post-war period, the huge demand for loans in the agriculture sector was mainly covered by micro financial institutions rather than by the Kosovar commercial banks. The Agro Business Unit (ABU), which was financed by EAR, presented one of the main credit sources for the farmers. ABU credited agro producers and farmers (conditions: 7-10% interest, for five years with 6 months grace period). Since 2001, ABU provided 52 loans (totalling €14mn) and technical assistance to agri-business enterprises, farmers' associations, SOEs and a rural micro-finance institution.<sup>13</sup> These credit schemes supported mainly the transformation of the SOEs, and later on the SME sector development as well. Shortcomings of this credit scheme lay on the fact that there was a limited number of farmers benefiting from the scheme, and that there was a high determined minimum level of credit €100,000. Moreover, a considerable number of borrowers were recorded to be in default of payment, damaging thus the efficiency of the credit scheme.<sup>14</sup>

The objectives of the donor community in the education sector were the rehabilitation of the physical infrastructure, including construction and reconstruction, and modernizing of the education system in line with the needs of the market economy and with the Bologna Declaration. Accordingly, out of a total of 750 damaged schools during the war 461 were constructed and/or reconstructed by the end of 2003, and the student center of the University of Prishtina was repaired. Moreover, with the exception of 2001, the number of pupils enrolled in primary and secondary schools increased continuously, amounting to 166,027 and 22,548 respectively, in 2003. By the end of 2003, the donor community financed different training programs for a total of 11,302 education staff, thus supporting the education system reform. Conclusively, the figures indicate that the effectiveness of the donor assistance in this sector could be considered as satisfactory.

In the health sector, the donor community focused mainly on restoring a minimum level of service health centers and hospitals by funding physical reconstruction, medical supplies and equipment<sup>15</sup>, improving of medical skills and practices as well as offering technical assistance. Thus, a total of 278 health centers and hospitals were constructed and/or

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<sup>12</sup> Riinvest survey data show that the share of the local bank credits in financing investments of the SMEs has increased from 13.8% 2002 to 18.5% in 2003.

<sup>13</sup> EAR in Kosovo, internet source: <http://www.ear.eu.int/kosovo/kosovo.html>

<sup>14</sup> In 2002, of total borrows 46% of them were in default payment (see: Green Book, MAFRD 2003, pp. 58-60)

<sup>15</sup> During the 1999-2002 period, EAR spent around €13 million for the health sector. A considerable part of this amount was allocated to modernizing the department of blood transfusion and providing essential equipment for hospitals.

reconstructed until the end of 2003. During the same period, the number of trained staff amounted to 458. In addition, training is provided also through “telemedicine” sessions, i.e., internet or live teleconferences. Consequently, the outcomes of the donor aid in this sector could be rated as satisfactory. Yet, based on the Riivnest opinion poll (Septemeber, 2005) around 50% of the respondents are very dissatisfied and/or dissatisfied with the situation in the health system.

During the post-war period, Kosova has developed a new budgetary system based on the experiences of the advanced western and transition economies. The Central Fiscal Authority (CFA) administered by UNMIK operated with Kosova budget until the Ministry of Economy and Finance was established and local authorities received more competencies to administer fiscal and budgetary issues. The taxation base was broadened continuously; currently it covers the majority of direct and indirect taxes that were introduced in other economies in transition as well. A new tax administration has been established where the lack of experience was compensated with extensive trainings provided by UNMIK Pillar IV and USAID. The International Monetary Fund and the World Bank also gave an important contribution in strengthening and consolidating the budget and assisting the Ministry of Economy and Finance. Considering the achievements in building the institutional infrastructure, which was based on free elections, and given that this process started from zero, the effectiveness of donor efforts could be considered as highly satisfactory in this area.

## ***5. THE AID IMPACT IN A MACROECONOMIC FRAMERWORK***

The relationship between foreign aid and economic growth has been the subject of a considerable number of studies for more than half a century. Given differences in techniques and other characteristics of these studies, it is not surprising that neither theoretical nor empirical consensus about the nature of the relationship has been reached. Thus, the impact of foreign aid on the economy of the recipient countries is ambiguous. Some authors show that foreign aid is beneficial in terms of promoting growth and development. Others argue that aid “retards growth through reduced savings and worsens income inequalities” (Todaro and Smith, 2003).

This section tries to trace the impact of foreign aid in a macroeconomic framework in Kosova, which is characterized by critical imbalances between GDP and consumption, a very high trade deficit, a high level of unemployment, and insufficient budget to cover capital

investment needs. An econometric model for estimating the relationship between foreign aid and economic growth in Kosova could not be carried out due to the insufficient variation in the data as a result of the too short time span (2001-2007). Therefore, the paper tries to offset this shortcoming by considering IMF estimations of the direct contribution of foreign aid to economic growth, as well as to export, investment and consumption.

In what follows, the paper tries to shed light on the foreign aid impact on economic growth, investments, exports and consumption.

*Table 9. Aid and GNDI* (amounts are in thousands of euros)

|  | 2001     | 2002     | 2003     | 2004     | 2005     | 2006     | 2007     |
|--|----------|----------|----------|----------|----------|----------|----------|
|  | Est.     | Est.     | Est.     | Est.     | Est.     | Proj.    | Proj.    |
| GNDI   | 2028     | 2125     | 2161     | 2649     | 2607     | 2659     | 2714     |
| Total foreign assistance                                   | 1,175    | 912      | 737      | 572      | 554      | 547      | 425      |
| Of which:<br>Direct contribution to GNDI                   | 620      | 490      | 381      | 319      | 321      | 317      | 273      |
| Private sector disposable income                           | 1,785    | 1,742    | 1,703    | 2,233    | 2,206    | 2,229    | 2,284    |
| Private sector consumption in percent of disposable income | 92       | 97       | 101      | 81       | 83       | 81       | 81       |
| GDP growth   | 10       | 1.2      | 3.1      | 4.1      | -0.5 p   | 3.4      | 0.5      |
| GNDI per capita (in euros)                                 | 1,086    | 1,119    | 1,118    | 1,348    | 1,304    | 1,308    | 1,313    |
| FA/GNDI  | 57.93886 | 42.91765 | 34.10458 | 21.59    | 21.25048 | 20.571   | 15.65954 |
| DCGNDI/GNDI  | 30.57199 | 23.05    | 17.63073 | 12.04228 | 12.31    | 11.92178 | 10.05895 |

Source: IMF 2004 and IMF 2006

The table above shows that the post-war Kosovar economy was characterized by a foreign aid-led growth. The share of foreign aid to GNDI was as follows: 2001: 58%, 2002: 43%, 2003: 34%; decreasing by more than three times in the following years. Likewise, the share of the direct contribution of foreign aid to GNDI is very large in the beginning, and records a considerable decrease after 2003. This pattern of aid is in line with the conclusion of Collier and Hoeffler (2002; 2004) that “donors should phase in gradually during the first four years after the conflict and then gradually taper back to normal levels by the end of the first post-conflict decade.” Hence, foreign aid was more effective in generating growth in the first years after the war where the Kosova economy recorded high economic growth rates, i.e. app. 10% in 2000 and 2001. The rationale behind this lies in the fact that the low level of development after the war in Kosova served as the basis for calculating the economic growth rate. In other



words, this means that the Kosova economy made up the losses incurred during the 1990s and during the war with the support of the donor community. As the post-war recovery was relatively completed, the high growth rates scaled down to 2-3%.

*Table 10. Aid and Investment* (amounts are in thousands of euros)

|                    | 2001  | 2002  | 2003  | 2004  | 2005  | 2006  | 2007  |
|--------------------|-------|-------|-------|-------|-------|-------|-------|
|                    | Est.  | Est.  | Est.  | Est.  | Est.  | Proj. | Proj. |
| Investment         | 661   | 598   | 526   | 669   | 687   | 697   | 751   |
| Donor sector       | 245   | 180   | 126   | 94    | 83    | 69    | 108   |
| General Government | 21    | 42    | 96    | 169   | 130   | 133   | 133   |
| Private Investment | 395   | 376   | 304   | 407   | 474   | 495   | 511   |
| Housing            | 300   | 255   | 199   | 189   | 200   | 206   | 211   |
| Other              | 95    | 121   | 105   | 218   | 275   | 288   | 300   |
| Donor/Investment   | 37.07 | 30.10 | 23.95 | 14.05 | 12.08 | 9.9   | 14.38 |

Source: IMF 2004 and IMF 2006

Traditional theories on foreign aid argue that less developed countries face a shortage of either domestic savings or foreign exchange. They argue that foreign aid plays a critical role in closing those gaps in both savings to meet the investment needs and foreign exchange to finance the import of capital (Todaro and Smith, 2003)<sup>16</sup>. The table above shows that this has actually happened in the post-war Kosova, as the donor sector presents one of the main pillars of investments in the national accounts of the Kosovar economy. Hence, capital investments were chiefly donor financed through the Public Reconstruction Investments Program (PRIP)<sup>17</sup>, which was developed on the basis of the medium-term Reconstruction and Recovery Program. Spending under PRIP in 2000 and 2001 amounted for about 50 percent of GDP, whereas in 2002 it was equivalent to about 40 percent of GDP<sup>18</sup>. According to the table above, the share of donor sector investments proportionately decreases over time, recording a similar pattern to that of the share of foreign aid to GNDI. Hence, the high economic growth rates in the first post-war years can be attributed to (in addition to the argument mentioned above about the low baseline economic level) the huge amount of investments made in Kosova by the donor sector. Yet, the high rate of investment might be as hard to sustain as the high rate of growth. In this vein, the Kosova Consolidated Budget (KCB) of app. €714 million accounts for app. 28.5% of GDP. While operating/current expenditures have been capped and revenue is increasing only slowly there is an increasing need to finance essential capital investment. There is a high demand to improve transport infrastructure (in particular, in the rural areas), public infrastructure to support business development and employment, as

<sup>16</sup> Todaro, M. and Smith, S.T., *Economic Development*, 2003, pp 654-653

<sup>17</sup> Recently called PIP (Public Investment Program)

<sup>18</sup> see WB 2002, p. 29

well as investment to improve the quality of education. All this represents a serious challenge.

*Table 11. Aid and Exports* (amounts are in thousands of euros)

|   | 2001  | 2002  | 2003  | 2004  | 2005  | 2006  | 2007  |
|---|-------|-------|-------|-------|-------|-------|-------|
|   | Est.  | Est.  | Est.  | Est.  | Est.  | Proj. | Proj. |
| Exports                                     | 269   | 217   | 186   | 327   | 342   | 360   | 360   |
| Local Consumption of Expatriates (Soldiers) | 246   | 190   | 150   | 23    | 23    | 23    | 22    |
| <i>Of which reexports</i>                   | 67    | 51    | 46    | 24    | 23    | 22    | 17    |
| Other exports                               | 23    | 27    | 36    | 305   | 320   | 338   | 338   |
|   |       |       |       |       |       |       |       |
| Local consumption of expatriates/Exports    | 91.45 | 87.56 | 80.64 | 7.03  | 6.72  | 6.38  | 6.11  |
| Of which reexports/Export                   | 24.91 | 23.50 | 24.73 | 7.34  | 6.72  | 6.11  | 4.72  |
| Other exports                               | 8.55  | 12.44 | 19.35 | 93.27 | 93.57 | 93.88 | 93.88 |

Source: IMF 2004 and IMF 2006

The trade deficit in Kosova is very high with exports covering only a tiny part of imports i.e., 2000: 2.9 %, 2001: 1.2 %, and 2002: 2.7 % and 2003: 3.7 %, 2004: 5%, 2005:4.6%. Improvements in the huge trade deficit depend on the implementation of integrated policies that lead to a competitive businesses sector in both domestic and international markets. Thus, lack of a competitive export sector was to an extent compensated by donor community injections, in terms of local staff wages and benefits, international staff spending and procurement of goods and services. These injections equal income for the economy, where part of it is spent on Kosovar goods and services, by both the donor community and local employees hired by them, thus having a multiplier effect. Hence, the so called "...virtual export market..."<sup>19</sup> is one of the important dimensions of foreign assistance channelled in the domestic economy. The table above shows that in the first years of the post-war period, the role of the donor sector in covering of the trade deficit was highly significant i.e., 2001:91%, 2002: 88%, and 2003:81%. Immediately after 2003 the size of the "virtual export market" fell drastically to 6-7% of total exports. The donor support, however, radically and disproportionately decreased, before local capacities for the development of the export sector and in turn the generation of revenues and new jobs, were in place.

The huge inflow of foreign aid is also considered as a huge inflow of foreign exchange. This leads to an upward pressure on the exchange rate, which is expected to make the export

<sup>19</sup> IMF, Gearing policies toward growth and development, December 2004

sector less competitive.<sup>20</sup> However, this is not the case in Kosova, given the use of the Euro, which implies that European Central Bank sets the monetary policy.

## **6. *THE FOREIGN AID IMPACT ON POVERTY REDUCTION***

This section will try to trace the aid impact on poverty reduction by partially following the methodology used by Le and Winters (2001) and Feeny (2003). In this vein, given the fact that poverty is “a multifaceted problem” (Le and Winters, 2001) the aid impact on poverty reduction will be inferred from improvements in the different sectors and in the macroeconomic indicators, which have been elaborated in the previous sections.

Kosova is considered to have the highest level of income poverty in the region. Comparing the data for 2000 with those for 2002, the share of the population living below the poverty line decreased from 50.3% to 37%. However, the share of the population living below the extreme poverty line has increased by 3% points. Thus, even four years after the war extreme poverty remained a serious problem for the Kosovar society with 15% of the population living below the extreme poverty line. Analyzing other dimensions of poverty and well-being, such as life expectancy, education attainment and adjusted GDP, an indirect relationship between aid and poverty reduction can be traced via the foreign aid impact on the economic sectors. As elaborated in the fourth section, Kosova has recorded a considerable aid-driven GDP growth since the end of the war. Likewise, improvements have been recorded in the education sector where donor funding played a crucial role, mainly in reconstructing school buildings and training teachers. As a result, the education attainment index increased from 0.829 in 2001 to 0.923 in 2004 (Human Development Report, Kosovo 2004). Moreover, positive trends have been recorded also in illiteracy where the percentage of the illiterate adults fell from 6.5% in 2001 to 5.8% in 2003.

Streeten and Burki (1978) assess the aid impact on poverty through the following areas of the standard of living: nutrition, access to basic education, access to safe water, health services, sanitation, housing and related infrastructure. Areas such as sanitation, access to safe water as well as waste and sewage have been considered as sub-sectors of infrastructure, when assessing the impact of aid on this sector. Given the improvements in infrastructure (see section three), it can be concluded that in the first post-war years aid programs were strongly focused on addressing basic needs. Likewise, in the first post-war years the major part of

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<sup>20</sup> The Dutch disease.

damaged and burnt houses were reconstructed or renovated. The support of the donor community was fundamental also for improvements in the health sector, mainly in the hospital infrastructure and professional skills of the staff.

Improvements of well-being are supported also by the slight increase in the Human Development Index (HDI) between 2002 and 2004, from 0.721 to 0.734 respectively. This ranks Kosova at the medium level of HDI, and slightly below the neighboring countries (Human Development Report, Kosovo 2004).

Conclusively, from the favorable trends in human well-being, it can be inferred that aid has had a positive impact on alleviating poverty.

## **7. CONCLUSION**

The impact of foreign aid is ambiguous despite 50 years of economic research in this area. In the Kosova case, growth was aid-driven in the first years after the war. After the post-war recovery, a radical slow-down in growth was recorded, which had negative social as well as economic consequences. In this vein, the donor support radically and disproportionately decreased before a successful transition from the emergency phase of reconstruction towards a sustainable economic development was completed. A similar pattern was followed by investment.

Moreover, lack of a competitive export sector was to an extent compensated by the consumption of Kosovar goods and services by both the donor community and local employees hired by them.

During 1999-2005, under the leadership of UNMIK, the support of the donor community, namely the KFOR, UN organizations, bilaterals, and NGOs as well as major donor countries for the reconstruction and recovery of Kosova made up around 9% of the cumulative portfolio of donor funds allocated to SEE.<sup>21</sup> It is clear that, the donor commitment in eliminating war damages, notably in the housing and physical infrastructure, as well as in the institutional infrastructure, which was based on free elections, has been impressive. Only within three years, 40,000 out of 120,000 damaged houses have been rehabilitated or rebuilt. Out of 850 km of roads that needed to be rehabilitated, 435 km were repaired, whereas 1040 km were maintained. Improvements in the railway network and the repairing of 5 bridges

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<sup>21</sup> Albania, Bosnia and Herzegovina, Croatia, FYR Macedonia, Serbia and Montenegro, Kosova, Bulgaria, Romania and Moldova.

were also funded. All these accomplishments brought about the reactivation and the upgrading of the transport of goods and passengers both within Kosova and between Kosova and the neighboring countries. Moreover, 258 km of the irrigation system have been rehabilitated, providing thus better conditions for agriculture development. Micro credit schemes, through which the donor community financed the agro-producers and farmers at favorable conditions, contributed to the rural economic development. This included technical assistance as well. The donor community enabled credit lines for the on-lending of the SME sector, which increased the credit potential of the commercial banks, which in turn supported private sector investments. Financial support was provided for the privatization and incorporation process as well. On the other hand, elementary health service as well as education at all levels was made available everywhere. Another achievement is considered to be the ongoing process of developing of the legal infrastructure, which regulates the proper functioning of the economic and social life as a whole. In this regard, a substantial technical assistance was provided.

Nonetheless, shortcomings of the donor assistance are evident as well, in particular, in coordinating their activities. This is partly due to the inappropriate coordination of the donor activities, resulting sometimes even in the overlapping of projects (e.g. at the Prime Minister's Office one can find capacity building advisors from UNDP, USAID and British Office). It is also partly due to the lack of a systematic evaluation of institutional needs on which to base their funding strategy. This sheds light on the need for a national development strategy, which did not exist so far in Kosova. The donor community also failed to properly address major issues, such as economic development and job creation. A sustainable development was challenged with the sharp decline in foreign assistance and the end of the post war reconstruction boom in 2002. Starting from 2002, Kosova experienced an economic slowdown with rather slack annual rates of growth. Furthermore, projections of the international institutions such as the WB and the IMF predict that in 2005 Kosovar economy will experience negative GDP growth of 0.5%. Accordingly, this was followed by a slight increase in the economic pessimism of the Kosovars.<sup>22</sup> Consequently, the average living standard is still low. Another factor contributing to this situation was the high and increasing unemployment rate as a consequence of the manufacturing enterprises being inactive, albeit they had been privatized. Despite the efforts made for the development of the legislative framework to promote a sustainable development, it has not been completed yet. The frequent collapses of the power plants, as well as the high imports in the Kosova Energy

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<sup>22</sup> Riinvest opinion poll, September -December 2002 (EWS #2), January-April 2003 (EWS #3), and April-June (EWS #10), <http://www.kosovo.undp.org/publications/publications.asp>

Corporation, imply that improvements in the energy supply are not satisfactory, despite the huge inflow of funds from the donor community and the Kosova Consolidated Budget. Furthermore, as a result of structural weaknesses, the Kosova budget/economy will face the difficulties in financing public investment programs, which have been funded by the donor community until recently.

The overall result of donor assistance in the post-war period in Kosova could be rated as relatively satisfactory. This outcome must be credited mainly to the efforts of both the donors and the Kosovar people made in the reconstruction process. Conclusively, the positive outcomes in reconstruction seem to outweigh the less satisfactory outcomes at the sectoral level, notably in the energy sub-sector.

The experience of the donor community in Kosova should have taught them several lessons in dealing with post-conflict reconstruction and recovery. First and foremost, it is advisable that prior to the allocation of funds, there should be an effective communication between the major stakeholders on the objectives and the strategies of the donor programs, so that these be aligned with the country strategy. With the exception of the donor community as a whole, in the process of identifying of the priority needs should also be involved the ministries, different agencies and the civil society. This process should also address main issues concerning the development and implementation of programs. This would result in avoiding miss coordination, which ended up in the overlapping of activities. On the other hand, the lesson provided for the Kosovar people is that, prior to the allocation of funds they should conduct a thorough analysis of needs in order to derive priorities. So far, this has not been the practice in Kosova, because there was no national development strategy, which is a precondition for selecting relevant strategic objectives.

It is highly recommended that a governmental agency be established for a more effective monitoring, coordinating and evaluating of the donor funds allocation program, in order to ensure the alignment of donor activities with the relevant strategic objectives. This would serve as a regular feedback for both the Government and the donor community.<sup>23</sup>

In the future, additional investments that are needed to meet Government priorities should be achieved through mobilizing the economic potential of Kosova as well as through securing alternative sources of financing. International, bilateral and multilateral development finance programs should cover the latter. Thus, the international support should be channeled through providing financial assistance in coping with current and potential budget challenges for

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<sup>23</sup> Considering the main difficulties, i.e. lack of data and non-existence of strategic objective, faced (by the research team) in assessing the effectiveness of foreign aid, establishing of such a body is more than necessary.

public investment, especially in the medium term; this until economic growth is fostered and tax collection is improved.

New types of support should be provided for further developments in capacity building, especially in increasing capacities for law enforcement and development management and governance. Also, further support in improving education quality is needed to increase the competitiveness of the Kosovar labour force. In turn, this will increase the capacity to attract new investments. Hence, in the coming period, foreign assistance should be directed towards transferring knowledge and experiences to the Kosovar institutions, rather than towards accomplishing duties on behalf of these institutions. Furthermore, the donor community should consider the harmonization of the foreign aid flows with the continuous increase of the domestic economy capacities for development.

With progress towards resolving the political status, new capacities are expected to be established, within Governmental bodies, in order to prepare feasible bankable projects and to properly manage and implement them. In this regard, initiatives for cooperation with EBRD and EIB need to be undertaken.

Conclusively, the effectiveness could be considered as relatively satisfactory, while the main recommendation is for the Government to draft a development strategy and to establish a coordinating, monitoring and evaluating body. The donors, on the other hand, should focus more on Governmental priorities, if there are such, and to continue to channel funds to the investment projects, which would have long-term effects on the economic growth and development.

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## ANNEX

*Table 1. Annual indicators of achievements in the Transport and Infrastructure sector, 1999-2004*

| <b>Sector</b>                         | <b>Indicators of achievements in the sector</b> |             |             |                  |                  |             |              |
|---------------------------------------|---|-------------|-------------|------------------|------------------|-------------|--------------|
| <b>Transport &amp; Infrastructure</b> | <b>1999</b>                                     | <b>2000</b> | <b>2001</b> | <b>2002</b>      | <b>2003</b>      | <b>2004</b> | <b>Total</b> |
| Km of repaired (asphalted) road       | n/a   | 172         | 201         | 36               | 26               | n/a         | 435          |
| Km of maintained (asphalted) road     | n/a   | 315         | 725         | ws <sup>24</sup> | ws <sup>25</sup> | n/a         | 1040         |
| Total                                 | n/a   | 487         | 926         | n/a              | n/a              | n/a         | 1413         |
| No. of repaired bridges               | n/a   | n/a         | n/a         | n/a              | 5                | n/a         | 5            |
| Km of repaired railways               | n/a   | n/a         | 9           | n/a              | n/a              | n/a         | 9            |
| Goods transported by rail (tons)      | n/a   | n/a         | 245         | 291              | 275              | n/a         | 811          |
| No of passengers transported by train | n/a   | n/a         | 216         | 660              | 610              | n/a         | 1486         |
| No of passengers flying from Kosova   | n/a   | 232.1       | 403.408     | 441.305          | 383.836          | n/a         | 1460.649     |

Source: MEF, May 2004

*Table 2. Annual indicators of achievements in the Electrical energy and coal production sector, 1999 - 2004*

| <b>Sector</b>   | <b>Indicators of achievements in the sector</b> |             |             |             |             |             |              |
|---|---|-------------|-------------|-------------|-------------|-------------|--------------|
| <b>Electrical energy &amp; coal production</b>                                    | <b>1999</b>                                     | <b>2000</b> | <b>2001</b> | <b>2002</b> | <b>2003</b> | <b>2004</b> | <b>Total</b> |
| Produced electrical energy (MWh)  | 564,410   | 1,913,476   | 2,567,713   | 3,152,999   | 2,420,852   | 3,481,054   | 14,100,504   |
| Coal Production (tons)  | 3,639,830                                       | 3,045,758   | 4,734,778   | 5,537,892   | 4,717,833   | 5,658,333   | 27,334,424   |
| Average no. of electrical energy during the day s/1+A30                           | 4,035,978                                       | 4,592,240   | 5,137,650   | 5,613,621   | 5,463,486   | n/a         | 24,842,975   |
| Imports   | n/a   | n/a         | n/a         | n/a         | 637,275     | 650,640     | 1,287,915    |
| No of new connections and reconnections   | 602   | 5391        | 15,038      | 15,516      | 16,716      | n/a         | 53,263       |
| No of new installed transformers  | 79  | 312         | 253         | 97          | 99          | n/a         | 840          |
| Length of restored lines for transport and distribution of electrical energy (km) | 22.2  | 208.4       | 296.1       | 313.7       | 686.8       | n/a         | 1,527        |
| Collections of payments   |   | 22,720,000  | 54,693,000  | 58,893,000  | 50,622,000  | n/a         | 186,928,000  |
| Heating and gas   | n/a   | n/a         | n/a         | n/a         | n/a         | n/a         | n/a          |
| No of new houses connected  | 13,388  | 13,338      | 13,684      | n/a         | 13,684      | n/a         | 13,864       |
| Km of repaired network  | n/a   | 6           | 7           | n/a         | 1           | n/a         | 14           |

Source: MEF, May 2004 and Statistical Office of Kosova, November 2005

<sup>24</sup> Whole system

<sup>25</sup> Whole system

*Table 3. Annual indicators of achievements in the Housing sector, 1999 - 2004*

| <b>Sector</b>              | <b>Indicators of achievements in the sector</b> |             |             |             |             |             |              |
|----------------------------|---|-------------|-------------|-------------|-------------|-------------|--------------|
| <b>Housing</b>             | <b>1999</b>                                     | <b>2000</b> | <b>2001</b> | <b>2002</b> | <b>2003</b> | <b>2004</b> | <b>Total</b> |
| No of reconstructed houses | n/a   | 11,782      | 5,828       | 2,074       | n/a         | n/a         | 19,684       |
| No of renovated houses     | n/a   | 17,282      | 2,935       | 350         | n/a         | n/a         | 20,567       |
| <b>Total</b>               | n/a   | 29,064      | 8,763       | 2,424       | n/a         | n/a         | 40,251       |

Source: MEF, May 2004

*Table 4. Annual indicators of achievements in the Education sector, 1999 - 2004*

| <b>Sector</b>                             | <b>Indicators of achievements in the sector</b> |             |             |             |             |             |              |
|---|---|-------------|-------------|-------------|-------------|-------------|--------------|
| <b>Education</b>                          | <b>1999</b>                                     | <b>2000</b> | <b>2001</b> | <b>2002</b> | <b>2003</b> | <b>2004</b> | <b>Total</b> |
| No of reconstructed schools               | 72  | 61          | 74          | 43          | 60          | n/a         | 310          |
| No of constructed schools                 | 9   | 28          | 37          | 57          | 20          | n/a         | 151          |
| No of rehabilitated student centres       | n/a   | n/a         | n/a         | 1           | n/a         | n/a         | n/a          |
| No of pupils enrolled (primary schools)   | 57,171  | 130,404     | 120,887     | 137,529     | 166,027     | n/a         | 612,018      |
| No of pupils enrolled (secondary schools) | 14,935  | 27,131      | 23,858      | 24,607      | 22,548      | n/a         | 113,079      |
| No of students enrolled in university     | 22,058  | 20,277      | 13,320      | 23,175      | 22,500      | n/a         | 101,330      |
| Average class size                        | n/a   | 16.32       | 17.9        | 19.1        | 19.63       | n/a         | 15           |
| No of retrained teachers                  | n/a   | n/a         | 4,130       | 3,000       | 4,172       | n/a         | 11,302       |

Source: MEF, May 2004

*Table 5. Annual indicators of achievements in the Health sector, 1999 - 2004*

| <b>Sector</b>                               | <b>Indicators of achievements in the sector</b> |             |             |             |             |             |              |
|---|---|-------------|-------------|-------------|-------------|-------------|--------------|
| <b>Health</b>                               | <b>1999</b>                                     | <b>2000</b> | <b>2001</b> | <b>2002</b> | <b>2003</b> | <b>2004</b> | <b>Total</b> |
| No of reconstructed health centres          | 10  | 18          | 32          | 7           | 67          | n/a         | 134          |
| No of constructed health centres            | n/a   | 10          | 14          | 11          | 6           | n/a         | 41           |
| No of reconstructed hospitals               | 1   | 10          | 16          | 19          | 57          | n/a         | 103          |
| No of patients registered in hospitals      | 179,915   | 489,194     | 576,904     | 546,359     | 467,447     | n/a         | 2,258,819    |
| No of patients registered in health centres | 875,368   | 2,154,160   | 2,210,992   | 1,788,554   | 1,829,236   | n/a         | 8,858,310    |
| No of retrained health staff                | 16  | 91          | 123         | 108         | 120         | n/a         | 458          |

Source: MEF, May 2004