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November 10, 2000

To: Members of the Executive Board

From: The Secretary

Subject: **Kosovo—Macroeconomic Issues and Fiscal Sustainability**

Attached for the information of Executive Directors is a paper on macroeconomic issues and fiscal sustainability in Kosovo. Conclusions appear on pages 22 and 24.

If no objections are received by noon on Friday, November 17, 2000, the paper will be posted to the Fund's external website.

Questions may be referred to Mr. Corker (ext. 37304), Ms. Rehm (ext. 37492), and Ms. Kostial (ext. 35349).

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INTERNATIONAL MONETARY FUND

KOSOVO[1]

Macroeconomic Issues and Fiscal Sustainability

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Approved by Michael Deppler and Shigeo Kashiwagi

November 9, 2000

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[1] Kosovo is a province of the Federal Republic of Yugoslavia (Serbia/Montenegro), a non-member of the IMF.

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I. INTRODUCTION

1. **This paper analyzes the size and structure of the Kosovo budget and looks at the prospects for the budget to be self-financing in the medium term.** [2] To date, fiscal policy has focused on activating essential services and building up capacity to tax and administer budget funds. Capital expenditures for the large reconstruction program have been kept separate from the current expenditure budget and treated as a stand-alone component of donor support. The initial goals of fiscal policy have been achieved in quick time: budget systems are in place, revenue is being collected, there is a clearer understanding of expenditure needs, and the reconstruction program is in high gear. The challenge now is to develop tax and expenditure policies to ensure that public services are comprehensive, efficiently provided, and financed largely from locally generated resources.

2. **Forward looking exercises are fraught with uncertainties, even more so in this case**. In particular, the way in which the question of Kosovo's sovereignty is resolved will have an important bearing on the structure of the tax system and the extent to which public expenditures remain devolved from the rest of the Federal Republic of Yugoslavia (FRY). Recent political change in the FRY opens up possibilities for moving forward on sovereignty issues, but there are as yet no firm clues as to direction.

II. ECONOMIC AND POLITICAL BACKGROUND

3. **The UN has been in charge of administering Kosovo since the end of the conflict that took place in March-June 1999.** The UN's mandate comes from Security Council Resolution 1244 (SC1244) which gives the provisional authorities (the UN Mission in Kosovo, or UNMIK) powers to pass regulations that override Yugoslav law. While local Kosovars are consulted closely in the decision making process, there is no recognized indigenous government—although municipal elections in October have provided a democratic foundation for local administrative structures.

4. **Policy decisions are guided by the assumption that Kosovo will continue to enjoy considerable autonomy in the future regardless of the resolution of the sovereignty issue.** Nonetheless, lack of clarity about Kosovo's political future complicates the

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[2] Kosovo is a province of the Federal Republic of Yugoslavia (Serbia/Montenegro), a non-member of the IMF. Since the end of the conflict in June 1999, IMF staff has been providing technical assistance to Kosovo to help the province rebuild its economy. The assistance has been channeled toward setting up taxation and budgetary institutions (led by FAD), a payments and banking system (MAE), and, more recently, a statistical framework (STA). The staff has also provided general macroeconomic policy advice, especially in the realm of budget formulation. All the staff's work has been carefully coordinated with the World Bank and donor agencies. The legal basis for the provision of IMF technical assistance to Kosovo is discussed in EBD/99/80.

establishment of property rights and narrows policy and institutional options. Economic development is necessarily adversely affected.

5. **While pre-war statistics on the economy are incomplete and unreliable, they paint a picture of an economy that was already in serious decline.** Per capita GDP was estimated to be low even by Southeast European standards and unemployment was very high, particularly among the disenfranchised ethnic-Albanian majority. Low-productivity agriculture accounted for about 30 percent of output and the dominant means of employment. Mining and metals processing were other important activities, but were starved of investment and production techniques were outdated. More generally, the province's infrastructure was showing the signs of serious neglect and underinvestment.

6. **The economy had also yet to embark on transition to a market economy.** While agricultural land was largely privately owned, industry was state or socially owned (the Yugoslav form of worker-ownership). Banks tended to direct lending according to political considerations as opposed to profit motives and were essentially insolvent. Jobs in the public sector, including key jobs in the industrial sector, were typically reserved for the ethnic-Serbian minority, which made up only about one tenth of the population of roughly 2 million. The majority ethnic-Albanians, meanwhile, engaged in extensive gray economy activities and operated separate health, education, and social benefit systems funded through parallel taxes and remittances from the diaspora.

7. **The war provided a further setback to output and the quality and capacity of the infrastructure.** Damage to the housing stock was particularly extensive, but the main utilities (power, telecommunications) also suffered considerable damage as did some of the already dubiously-viable industrial concerns. Massive, but for the most part temporary, population flight during the conflict led to the missing of planting seasons in 1999 and the disruption of commerce. The subsequent departure of a large proportion of the ethnic-Serbian population left the province with a severe shortage of qualified or experienced workers.

8. **Recovery is well underway, led by a donor-financed reconstruction boom.** Shortly after the end of the conflict, donor funds were mobilized to help reactivate the agricultural sector, begin the repair of housing and the utilities, and support incomes through humanitarian assistance. These efforts went hand-in-hand with assistance to set up a rudimentary payments system (Box 1) and establish budgetary functions and controls. An early decision to legalize the use of the deutsche mark, which quickly became the currency of choice, helped ensure price stability. So far, disbursements for reconstruction are estimated to have amounted to about US$½ billion and there is at least the same in the pipeline established at a donor conference in November 1999.

9. **How far the economy has recovered is hard to gauge at this stage.** By the second half of 2000, agricultural production was estimated to have reached about three-fourths of its pre-conflict level, construction activity was at a very high level, and some trade-related private services (hotels, restaurants, and retail) were blossoming on the back of aid flows and private remittances from abroad. Industry, however, remained depressed.

Box 1: The Banking and Payments System

After the conflict, commercial banking operations in Kosovo effectively ceased and transactions through the local payment bureau system dwindled to a negligible level. To facilitate the modernization and development of payment services and a commercial banking system, two UNMIK regulations were passed in November 1999, establishing the **Banking and Payments Authority of Kosovo** (BPK) and legislation for bank licensing, regulation, and supervision. The BPK was assigned responsibility for fostering (a) an efficient and safe system for domestic payments; and (b) the liquidity, solvency, and efficient functioning of a stable market-based banking system. In keeping with this, the BPK licenses and supervises all banks and nonbank financial institutions operating in Kosovo; maintains a stock of DM and Yugoslav dinar (YUD) banknotes and coins; and provides depository and payment services in DM until sufficient capacity has been developed within the commercial banking system. The overall plan calls for commercial banks in Kosovo to eventually provide payment services cleared through a local clearing house and settled on the books of the BPK (DM transactions) and the National Bank of Yugoslavia (YUD transactions). As soon as sufficient capacity exists within the banking system, teller operations currently performed by the BPK for the government of Kosovo will be shifted to commercial banks and BPK branches and sub-branches closed.

For now, as the government's bank, the BPK accepts deposits from UNMIK and other government agencies and makes payments on instructions from the CFA and other depositors. All deposits in the BPK have been in the form of cash. Other than holding some cash for safekeeping, the BPK has not at this stage been offering deposit and payment services to enterprises in order to prevent the BPK from competing with or undercutting the development of the nascent banking sector.

Licensing procedures cover three types of **commercial banks**: banks with a minimum capital of DM 1 million are allowed to take in deposits in a single currency and provide collection and payment services; banks wishing to make commercial or consumer loans are required to have minimum capital of DM 3 million; banks engaged in underwriting, dealing in debt or equity securities, or providing portfolio management services are required to have at least DM 5 million in capital.

The banking system nevertheless remains extremely thin. At end-October 2000, the commercial banking system consisted of only one institution (Micro Enterprise Bank), which is partly capitalized by the EBRD. It operates five branches and has taken in about DM 105 million in deposits. So far, most of these deposits have been invested abroad with lending in Kosovo amounting to about DM 4 million. License applications have been received from five other would-be banks. However, these institutions have encountered major problems in raising the necessary capital and in some cases, the owners do not satisfy background requirements laid out under the licensing regulation.

10. **Preliminary staff estimates put the level of per capita GDP in 2000 in the range US$650–850 (see Appendix I).** The structure of expenditure is highly distorted with consumption (public plus private) estimated at about 145 percent of GDP and imports over 80 percent of GDP (Table 1). Total investment is also sizable—about 40 percent of GDP—reflecting mainly donor-financed reconstruction. Exports are, to a first approximation, zero. The estimated per capita GDP is below the level in other regional post-conflict countries: in Albania, per capita GDP is about US$1,000 and in Bosnia and Herzegovina it is about US$1,100. And Kosovo per capita GDP would be only about half the level in Bulgaria, FYR Macedonia, and Romania and well below levels in the more advanced transition economies of central and eastern Europe. The level of national income in Kosovo would greatly exceed GDP because of the sizable official transfers and private remittances. These transfers bridge the wide trade deficit.

11. **Macroeconomic policy instruments and options are extremely limited.** As a result of the decision to legitimize the use of the deutsche mark and other foreign currencies, there is no independent monetary or exchange rate policy. The dinar remains legal tender and is accepted for paying taxes, customs duties, utility charges, and other compulsory payments. But in practice it has all but vanished as a medium for transactions. A prohibition on public borrowing ensures that the budget has to be balanced.

III. Fiscal Structure and the 2000 Budget

12. **Given Kosovo's unique circumstances, fiscal policy currently takes a rather rudimentary form.** UNMIK had to start from scratch in designing a tax system, developing a budget, and creating the institutions to implement its policies (Box 2 describes the administrative structures). At present, Kosovo has a fairly basic tax system that relies mostly on tax collection at the border (sales tax as well as customs and excises), while the structure of expenditure has yet to become fully comprehensive. In the absence of domestic financing instruments, donor grants are financing about half of the recurrent budget, as well as all capital outlays.

13. **Kosovo's first budgets for the final four months of 1999 and for 2000 focused on essentials such as re-establishing the provision of basic goods and services, a minimal welfare net, and the rehabilitation of utilities.** With the help of World Bank technical assistance, expenditures were drawn up on the basis of a needs assessment, although due regard was also given to resource constraints in the design of the key programs in the areas of education, health, and welfare. At the same time, with the help of EU and IMF technical assistance, UNMIK moved rapidly to establish border tax collection. However, it was recognized at the outset that it would take time to establish revenue streams given limitations in administrative capacity and the many gaps between border posts. In the meantime, donor grants were to supplement local revenues for financing recurrent expenditures with the explicit assumption that such grants would be on a declining path as the local tax base was developed. The budgets focused only on recurrent spending. The capital budget was drawn up separately, based on reconstruction needs, and financed in full by donors.

Box 2. Administrative Structures

The removal of Kosovo's autonomy and centralization of public administration in Belgrade during the last decade created an institutional vacuum in Kosovo. Essential functions, such as the management of public resources, either did not exist or existed in a rudimentary form. A parallel budget system financed by voluntary contributions of the Kosovar diaspora was created in these years to ensure the provision of basic public services for the ethnic-Albanian majority. However, by summer 1999, neither the official nor the parallel system could serve as a substitute for formal budgeting.

While initial spending had to be organized in an ad hoc fashion, UNMIK adopted at end-1999 an IMF technical assistance blueprint for the Central Fiscal Authority (CFA), which assumed the functions of a Ministry of Finance. Fiscal operations are also performed by municipalities and public utilities.

Central Fiscal Authority

The CFA is responsible for the financial management of the Kosovo Consolidated Budget (KCB) which consists of general government activities, municipal services and public enterprises, but excludes the UNMIK budget. The CFA formulates the overall fiscal strategy by executing its main functions:

- budget preparation and monitoring;
- execution of budgetary transactions through the treasury single account and their financial control, including procurement procedures;
- design of tax policy;
- control of tax and customs administration—the latter executed by the EU Customs Assistance Mission in Kosovo (CAM-K); and
- internal audit.

Municipalities

Kosovo has 30 municipalities which are currently financed by transfers from the central government (about DM 20 million in 2000), but also by illegally levied taxes, including from the exploitation of natural resources (in particular quarries). A recent regulation laying the groundwork for future local self-government envisages the devolution of major services such as health and education. However, while explicit in assigning expenditures, the regulation limits municipal revenue to few instruments which are insufficient to cover the envisaged expenditure devolution.

Public utilities

Kosovo's Electricity Company (KEK) is currently a huge drain on public finances due to net operating losses (reflecting non-payment of electricity bills, but also overemployment) and the need to complement domestic electricity production by imports to offset outages caused by the rehabilitation of the power stations. Budgetary subsidies are expected to reach DM 38 million in 2000 and are supplemented by additional off-budget donor support for imports of about DM 50 million. With the rehabilitation work expected to be completed in the course of next year, subsidies and import support are expected to decline to about DM 70 million in 2001.

14. **After initial teething problems, the execution of the recurrent budget has been commendable.** At first, UNMIK encountered problems in both establishing the flow of tax revenue and in carrying out planned expenditures. On balance, spending shortfalls predominated and the budget generated a cash surplus in the final months of 1999, which was used to supplement donor pledges in 2000. As holes in the border were plugged (mostly by establishing border posts with Montenegro) and experience with payments and procurement procedures improved, tax and spending were brought up to planned levels during the course of 2000 (Table 2 and tabulation below). The composition of revenues and expenditures has, however, diverged in places from budget plans. On the tax side, revenues have been boosted by windfall gains in car imports that have offset generally weak tariffs and excises at the beginning of the year and the postponed introduction of some domestic taxes, including income tax. On expenditures, utility subsidies have been much larger than planned because of bill collection difficulties as well as problems of over-staffing in the electricity company. There have also been problems in reducing staffing to budgeted levels in the education and health sectors. Expenditure overruns have been offset by shortfalls in procurement—in some cases compensated for by off-budget provision of goods in kind from donors, notably for pharmaceuticals and education equipment.[3] Overall, required donor support will be close to the requested amount.

2000 Budget Summary[4]

(In millions of DM)

	2000 Budget	2000 Budget amended March	Expected outturn
Revenues	223.2	210.0	230.0
Of which: from imports	163.0	144.0	210.0
Expenditures	423.2	429.3	430.7
Of which: wages	165.6	171.6	163.4
Balance	200.0	219.3	-200.7
Financed by:			
Donor grants	170.4	189.7	191.0
Use of cash surplus	29.6	29.6	9.7

[3] Sizable off-budget grants (detailed in Table 2) were also received for electricity imports to compensate for technical problems in electricity generation.

[4] The initial budget was revised in March to reflect new costs associated with the implementation of the Joint Interim Administrative Structure (JIAS) and a more pessimistic outlook for local revenues.

15. **On a consolidated basis, total government expenditure levels are temporarily quite high because of the large foreign-financed reconstruction program.** Data on off-budget spending are less reliable than those on the spending controlled by the CFA. Nonetheless, the IMF staff estimates that capital spending in 2000 is currently about twice as high as the recurrent budget (see tabulation below). Adding in some identified off-budget spending items, notably a temporary subsidy for the payment of electricity imports, pushes spending up to about 42 percent of GDP. The consolidation does not include the accrued costs of servicing potentially large liabilities for existing pensions and debt service. Nor does it factor in the cost of humanitarian aid (which should be largely exhausted by end-2000), defense (provided by NATO), or foreign assistance in running the civil administration.[5]

Consolidated Budget for 2000

(In percent of GDP)

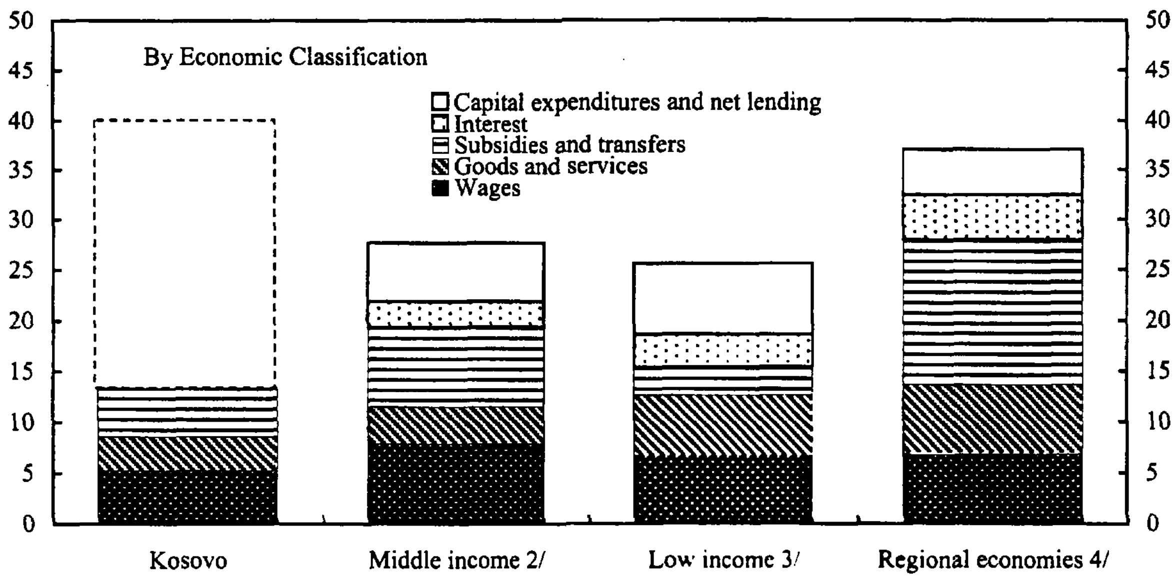
Revenue	7.7
Expenditure	42.2
Current	17.0
Kosovo budget	14.4
Off-budget items	2.6
Capital spending	25.2
Balance	-34.5
Financed by:	
Donor reconstruction grants	25.2
Budget support grants [1]	6.7
Off-budget contributions	2.6

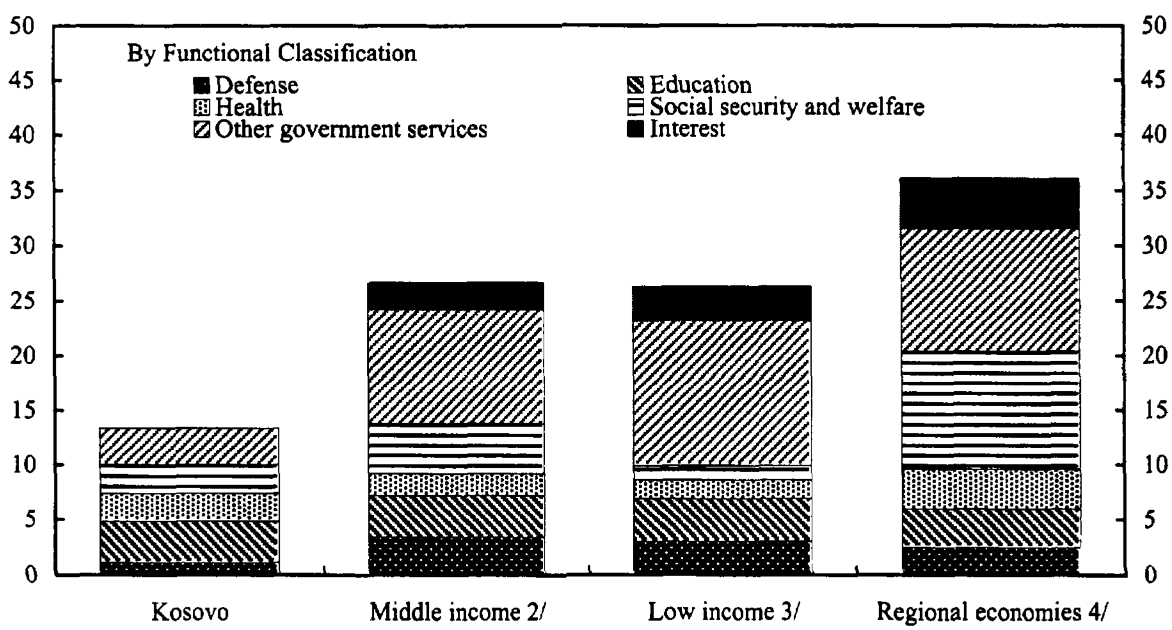
[1] Includes use of cash reserves.

16. **Excluding capital spending, expenditure levels in Kosovo are not high by international standards.** On-budget recurrent spending in Kosovo amounts to about 14 percent of GDP compared to 20-23 percent of GDP on average in low- and middle-income countries with which Kosovo might reasonably be compared (Table 3 and Figure 1). However, most of the difference can be accounted for by the exclusion from the Kosovo budget of defense and debt service—which make up about 6 percent of GDP in typical low- or medium-income countries. Expenditure-to-GDP levels are much higher in typical transition economies, including the economies in the region, but it is well known that such economies have bloated public sectors.

[5] The extra cost of replacing foreign administrators with locals at Kosovo budget wage levels would, however, be modest.

Figure 1. Government Expenditure for Selected Countries
(Simple averages in percent of GDP) 1/





Source: "FYR Macedonia Technical Assistance Report: Some Options for Restructuring Government Expenditures," Fiscal Affairs Department, 1998; and staff estimates.

1/ Middle- and low-income countries based on Government Finance Statistics Yearbook (1995).

2/ Barbados, Botswana, Chile, Colombia, Costa Rica, Cyprus, Dominican Republic, Egypt, El Salvador, Fiji, Hungary, Iran, Jordan, Malta, Mauritius, Morocco, Panama, Paraguay, Peru, Romania, Swaziland, Thailand, Tunisia, Turkey, Uruguay, and Zimbabwe.

3/ Burkina Faso, Cameroon, Ghana, Kenya, Lesotho, Malawi, Mali, Sierra Leone, Sri Lanka, Zaire, and Zambia.

4/ Albania, Bulgaria, FYR Macedonia, and Romania.

17. **Of the main economic categories of expenditure, social transfers and the wage bill are on the low side by international standards.** Welfare and social security spending is noticeably below that in transition countries and somewhat below that in middle-income countries reflecting primarily the absence of payment of public pensions—the counterpart to the lack of collection of social security contributions. Instead, Kosovo's welfare system focuses on the provision of means-tested social assistance to the neediest families.[6] Until now, such assistance has been augmented by sizable off-budget humanitarian assistance. The overall budget sector wage bill is low by international standards because employment levels are for the most part lean—there are some exceptions, including in health and education—and some functions (for example military personnel, police, judges) are not fully developed. Nonetheless, wage rates for government workers are high in comparison with those in a broad range of transition economies when they are corrected for average productivity levels in the economy (Figure 2).[7] On a functional basis, spending on health and education is broadly in line with that in other countries.

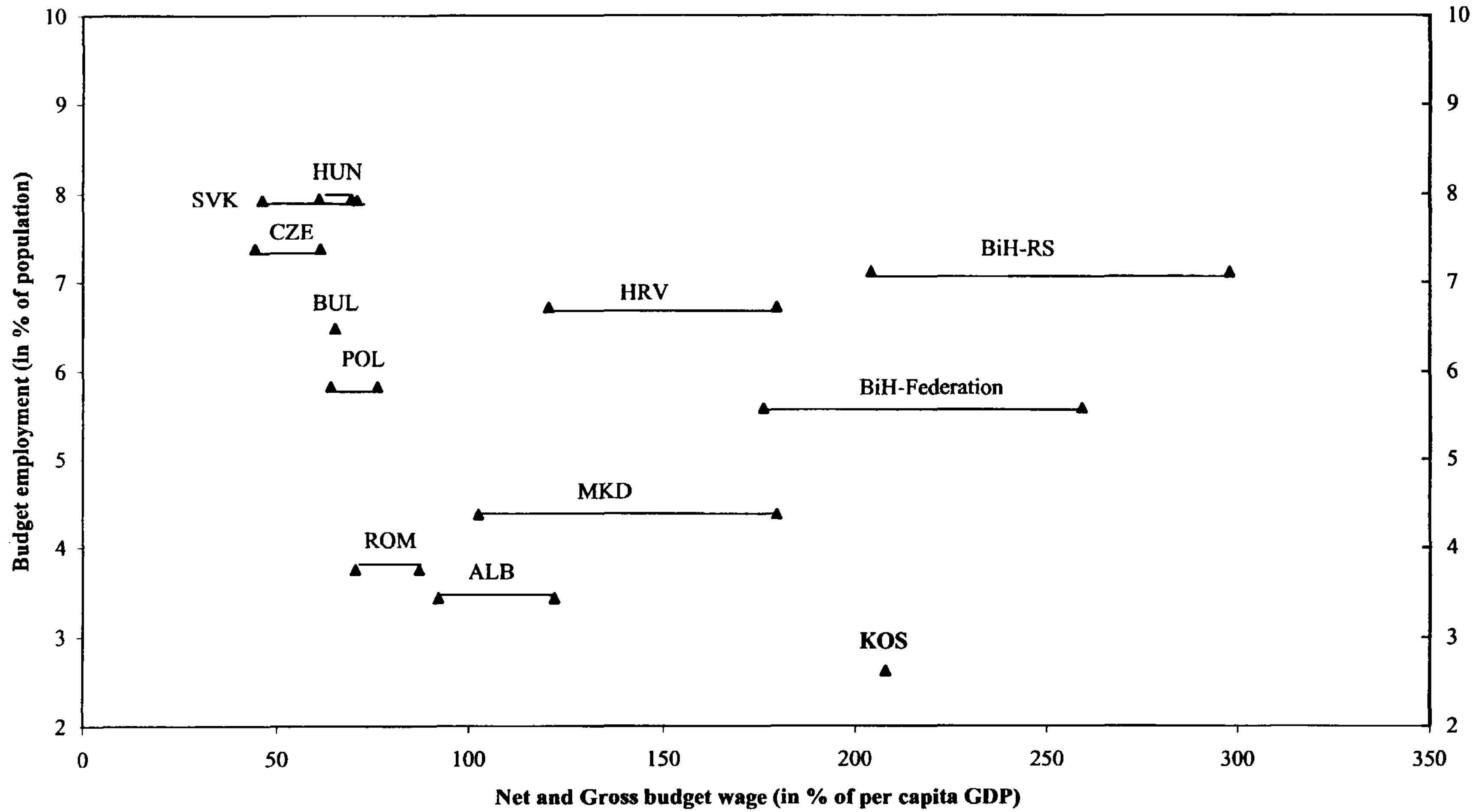
18. **At this stage, Kosovo's tax base is very small by regional standards.** While the revenue-to-GDP ratio varies considerably across countries in the region, Kosovo's ratio at under 8 percent is only 40 percent of that in Albania, which stands out as a low revenue raiser (Table 4). Kosovo's revenue base compares even more unfavorably with states of the former Socialist Republic of Yugoslavia, which would have shared with Kosovo a similar tax system before the break up of Yugoslavia began in the early 1990s. For example, Bosnia and Herzegovina—which endured a much longer conflict than Kosovo—has, at 47 percent, one of the highest revenue ratios in the region. Other transition countries raise between 30 and 45 percent of GDP in revenues—roughly 4–6 times more than Kosovo.

19. **Kosovo's weak revenue performance is to a large extent due to its rather basic tax instruments.** Almost all revenues in Kosovo stem from imports which are subject to a uniform tariff, a sales tax, and excises while the domestic economy escapes virtually untaxed (Box 3). Tax rates are not low, but substantial exemptions on basic consumption goods depress collections. Conspicuously absent in Kosovo are taxes on incomes, including social security contributions. The latter are a substantial source of revenue to fund programs such as pensions in the former-Yugoslav republics where surviving payments systems from the old regime play an important role in forcing collections: social security contributions amount to about 15 percent of GDP in Bosnia and Herzegovina, for example. In Kosovo, however, the breakdown of the payments system (which had been centralized in Belgrade) and the widespread collapse of the state sector made the collection of income tax and social security contributions initially infeasible after the conflict. Efforts to collect revenues on incomes have only restarted tentatively with some limited presumptive taxes on businesses. Official business and income taxes have to compete with illegal "parallel" taxes collected by local

[6] See World Bank, "Kosovo: Building Peace Through Sustained Growth," November 1999.

[7] Wage rates are also reportedly much higher in Kosovo than in the rest of the FRY.

Figure 2. Selected Transition Economies: Budget Employment and Net and Gross Budget Wages 1/



Sources: Staff estimates.

1/ The two observations for each entry denote net and gross budget wages.

administrations and extortionists. In some cases, such taxes exert a substantial burden on local businesses and their elimination is a major challenge.

Box 3. Tax Policy: Status and Outlook

Current tax structure

Kosovo has a basic tax system which collects revenues mainly from imports. Imports are subject to a 10 percent uniform tariff (with the exception of agricultural and medical products and humanitarian goods), a 15 percent sales tax (same exceptions apply), and excises on alcohol, tobacco and petroleum goods as well as soft drinks and some electronic goods. To begin taxing the domestic economy, UNMIK introduced a 10 percent hotel, food, and beverage tax on the gross receipts of hotels and restaurants, and a presumptive tax on businesses (with a flat-rate and a second-tier tax on turnover for larger enterprises).

Tax Policy in the Future

While taking into account the practical limitations of the economic situation, Kosovo should lay the groundwork for a coherent long-term tax policy as the economy recovers and administrative capabilities increase. The following is based on FAD technical assistance and describes the main issues and next steps for improving the current system and further extending it to the domestic economy while taking into account the tax systems of neighboring countries.

Customs duties: The major issue relating to customs duties is the treatment of trade with FYR Macedonia (exempt under a free trade agreement) and Montenegro (exempt as this trade is considered internal trade within the Federal Republic of Yugoslavia). The best option to deal with this trade would be to levy a uniform tariff for goods regardless of origin. However, if this option is politically not feasible, the status quo should be maintained, but customs would need to further develop its capabilities in determining the origin of imports. Alternatively, tariffs could be abolished and sales tax rates adjusted to compensate. As the food exemption (from the customs duty and sales tax) has lost its justification with the resumption of trade after the emergency situation, CFA has drafted a resolution to eliminate this exemption by mid-2001.

Excises: To improve compliance for excise taxes, the major excises on petroleum products, alcoholic beverages, and tobacco products will be converted from ad valorem to specific levies. Once the stock of cars is registered (expected to be completed by end-2000), UNMIK could consider an annual tax on cars as it would be easy to administer and could yield substantial revenues.

Wage tax: A draft of a 15 percent wage tax is under review.[1] This tax will ensure greater equity between employees receiving wage income (and not currently taxed) and those entrepreneurs, such as repairmen, professionals, and various service providers, who pay (or should pay) the presumptive tax and whose income is primarily labor or earned income.

Manufacturers' VAT: The CFA has started drafting the legislative framework for a 15 percent valued-added tax to expand the sales tax to domestic goods with a view of its implementation on July 1, 2001. A major impetus to extending the sales tax to the domestic economy is to ensure that exports are not burdened by VAT charged on imports used to produce the exports. The VAT will replace the sales tax currently paid by importers and will apply to a limited number of domestic taxpayers in order to not exceed administrative capacities.

Profit tax: As the last pillar of Kosovo's tax system, a profit tax should be imposed on business profits, measured by taking into account all legitimate costs of producing income. As many Kosovar enterprises are crippled by years of under-investment and the recent war, the profit tax is not likely to be a major revenue raiser in the early years. Its introduction should thus have lower priority than introducing a VAT or wage tax.

[1] Its implementation has been delayed, in part, because it appears that local employees of international organizations would be exempt from this tax pursuant to the UN Convention on Privileges and Immunities. The current draft excludes UN local hires thus raising political problems of fairness of treatment.

IV. THE PATH TOWARD SELF-SUSTAINABILITY

20. **Kosovo needs to make budget decisions with a clear view to achieving a sustainable fiscal position.** The objective should be to avoid the need for sharp expenditure adjustments in the future when external financing sources are likely to dry up. While donor support for reconstruction might continue for several years, as it has in Bosnia and Herzegovina, donors have repeatedly stressed the need for support for recurrent expenditure to decline substantially in the next few years. In the short term, this will constrain spending options as increases in tax revenue replace declining donor grants. In the longer term, a fully sustainable fiscal position would require all expenditures—including the three big off-budget items, investment, defense, and debt service—to be mainly financed out of local revenues and perhaps a modest level of borrowing. Moving along a path that prepares for such an eventuality is entirely consistent with the "considerable autonomy" principle underlying SC1244.[8]

21. **The priorities for ensuring that budgets are on a sustainable path are thus to diversify the tax system and contain expenditure growth through careful review of spending needs.** In this context, the low tax-GDP ratio indicates considerable potential for raising revenues in the future; but at the same time, there will be pressures to expand social spending, including to cover payment of pensions.

22. **On tax policy**, IMF technical assistance has outlined a sequenced plan for improving existing tax instruments and introducing new ones (see Box 3). The main steps are:

- In the immediate term, to strengthen customs and excise collections by raising duty rates (particularly for petroleum products) and converting them into specific duties, reducing exemptions from import and sales taxes, and further improving border administration.

- In the coming year, to introduce a VAT and income tax. To capture domestic sales, it is proposed for initial administrative purposes that the VAT be levied only on large manufacturers. The VAT would also replace the sales tax levied currently on imports. The proposed initial rate is 15 percent and, allowing for tax payer education, the VAT could be in place by mid-2001. An income tax could in principle be introduced before then, although UN unwillingness to tax its local hires has become a stumbling block because it raises political questions of fair treatment.

- Beyond 2001, to extend the tax system to incorporate taxation of profits.

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[8] Sustainability analysis is necessarily complicated by the uncertain political future of Kosovo. In what follows, it is assumed that Kosovo remains an autonomous economic entity.

23. **On expenditure policy**, the key issues are:

- To maintain a lean public sector and avoid pay increases that could undermine Kosovo's competitive position.

- To prevent the budget becoming a magnet for industrial subsidies—a mistake made in other transition economies, which have found it difficult to keep state enterprises at arms length, with a resulting high and inefficient resource cost. The main subsidies on Kosovo's budget at present go to the electricity company, KEK. These subsidies, which are sizable, should be phased out quickly (which will require KEK to be restructured) in order to accommodate new demands for public spending.

- To avoid commitments on public pensions that cannot be honored in the future. As broad entitlements for the aged are unlikely to be affordable until tax or social security systems are more developed, the best approach for now appears to be to continue alleviating poverty for all segments of the population through a targeted, and perhaps enhanced, social assistance program. Before pension entitlements from the old system are paid, financial responsibility (which has a political dimension) needs to be established, claimants identified, and ongoing financing secured.

- To ensure that integrated planning takes place for financing the rising maintenance cost of the public investment under the foreign-financed reconstruction program. Maintaining the revitalized public infrastructure will require shifting budget priorities.

24. **At the same time, Kosovo will need to continue building an efficient intergovernmental structure**. Whereas a recent UNMIK regulation has set out the broad structure of municipal government, detailed expenditure responsibilities and the associated financing through a system of transfers and taxes (shared as well as local) have yet to be spelled out. Given the small size of Kosovo, and its further fragmentation into some 30 municipalities, there is a case for keeping decentralized taxing powers to a minimum, although an early start could be made in introducing local property taxes, a typical staple of local government. Ensuring that there are sufficient controls and incentives in place to prevent fiscal indiscipline at lower levels of government will be a major challenge. At the central level, the formal integration of current and capital budgets would help with budget planning. Current good practices of transparent fiscal accounting for recurrent expenditures (up-to-date information is posted to the CFA website) should continue and be extended to the consolidated budget and to the budgets of the municipalities.

2001 Budget[9]

25. **The 2001 budget will aim to make progress toward self-sustainability by focusing on revenue raising and containing overall expenditure growth.** Assuming tax administration improves further, and planned taxes are introduced, revenue is expected to increase by about 45 percent to DM 330 million. Assuming a wage freeze, and reductions in employment to the originally budgeted levels for 2000, on-budget expenditures are estimated at about DM 480 million or some DM 50 million above the expected 2000 outturn. Much of the increase reflects higher personnel costs from expanded public services, one-time costs of setting up the municipal government structures, some expansion in the welfare budget to make up for a withdrawal of humanitarian aid and to pay invalidity pensions to veterans, and additional allocations for capital maintenance. Donors are being asked to provide about DM 150 million in financial support as well as DM 40 million for electricity imports. They would nevertheless be financing about one third of recurrent expenditures compared with over a half in 2000.

26. **There are, however, considerable risks that could require downward flexibility in expenditures if sufficient donor financing is not forthcoming.** In particular, the projections assume the introduction of a VAT by mid-2001, which is ambitious given the need for taxpayer education.[10] The VAT is penciled in to raise DM 30 million on domestic value-added in 2001. The tax projections also assume continuation of the strong underlying performance of border collections seen since the first quarter of this year. And while the assumptions do not build in undue optimism—suggesting there may be upside potential as well—collections have been buoyed this year by special factors (car imports) and have slowed recently. All this suggests that, in order to provide maneuverability on expenditures, it will be important to enforce the intended wage freeze and carry out reductions in employment in some budget sectors. Strong efforts will also be needed to contain subsidies to the utilities by eliminating overstaffing and improving bill collection.

Beyond 2001

27. **An examination of fiscal sustainability requires looking beyond the near term, an exercise that is necessarily highly uncertain in the case of Kosovo.** Accordingly, this section looks at longer-term scenarios for the fiscal accounts. The main scenario assumes real GDP growth of 10 percent a year, inflation of 2 percent a year, the full implementation of the Fund staff's tax policy proposals, and the ending of donor support for the recurrent budget in 2003. At that point, foreign-financed reconstruction would also begin a sharp decline.

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[9] Figures in this section are based on CFA estimates that are expected to form the basis of the draft budget.

[10] Plans to introduce an income tax in 2001 are currently suspended. However, the income tax would not be expected to raise much revenue in 2001.

Alternative scenarios examine the sensitivity of the fiscal accounts to lower growth and to delays in introducing tax instruments. More details can be found in Appendix II.

28. **The main scenario suggests that an early exit of donor budget support would impose tight limits on spending.** On the back of the assumed strong recovery in GDP and the broadening of tax instruments, revenue growth is projected to average about 25 percent a year in 2001–06, bringing the revenue-to-GDP ratio up to about 14 percent. Even so, the arithmetic straight jacket of eliminating donor recurrent budget support implies that underlying recurrent expenditures would grow by little more than 5 percent a year up to 2003, or about 3 percent a year in real terms (Figure 3 and Table 5).[11] This would imply fairly tight restraint in view of likely new demands on the budget for capital maintenance, more comprehensive social benefits, and the effects of demographic trends.[12] After 2003, continuing revenue growth would not be offset by declining donor support, implying scope for more rapid growth in spending that, for illustrative purposes, is assumed to be partly allocated to topping up declining externally-financed capital spending. On a consolidated basis, current spending would level off by mid-decade at about 11–12 percent of GDP and capital expenditure at about 7 percent of GDP.[13] It is assumed that more than half of capital spending would continue to be financed by foreign donors.

29. **The extra room for spending in the medium term could easily be eaten up by the need to incorporate some potentially big ticket items into the budget such as defense, debt service, or pensions.** For example, even a small defense force might cost on the order of 2 percent of GDP a year and debt service, assuming debts were not repudiated, could add 1 to 2 percent of GDP.[14] On pensions, old liabilities might have to be serviced and there could be considerable pressure for a new, more comprehensive pension scheme. The latter could become a substantial burden on the budget if coverage were broad and conditions for re-establishing social security contributions remained difficult. For example, paying a pension equal to only 30 percent of the average budget wages (currently, DM 275 per month)

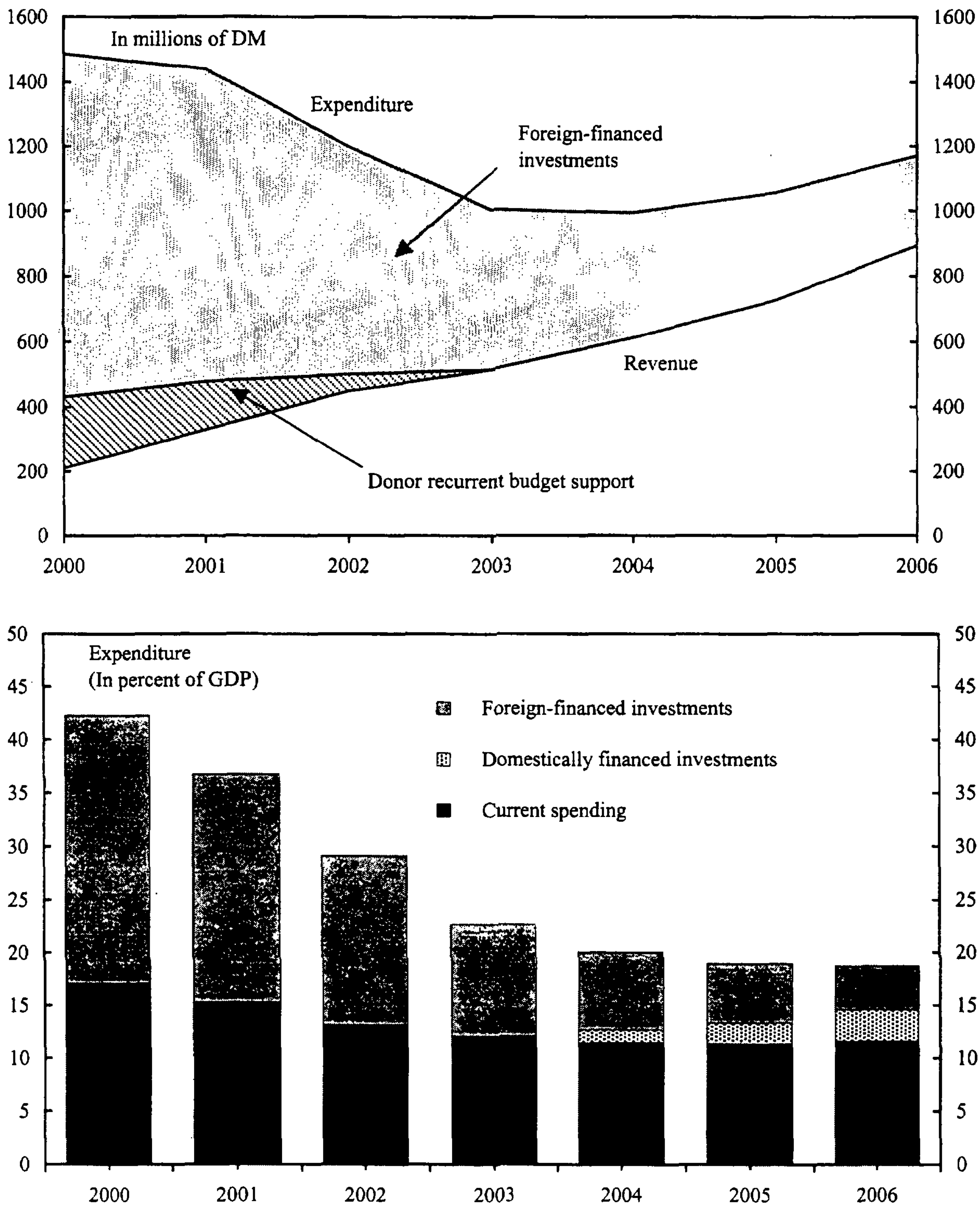
[11] Underlying recurrent expenditures exclude temporary electricity imports. Adding them back in, current expenditure in 2003 would be only slightly higher in nominal terms than its level in 2000.

[12] Demographic analysis is rather speculative, but a bulge of school children is expected in coming years. Emigration could also raise the dependency rate and put pressure on the fiscal accounts in the absence of an ability to tax remittances from overseas workers and to properly means test dependents.

[13] Note that budget wages are not grossed up for income taxes in the consolidated presentation. If this were done, gross expenditure levels would be about ¾ percentage point of GDP higher, although the overall budget constraint would be unchanged.

[14] Based on the order of magnitude that Bosnia and Herzegovia is paying.

Figure 3. Kosovo: Medium-Term Scenario



Source: Staff estimates.

to 12 percent of the population would amount to a transfer cost of about 5 percent of GDP in the medium term. While this would be modest by the standards of many public pension schemes, and there would likely be some offsetting savings on social assistance, the cost would put a heavy strain on contribution rates (or more likely would require substantial subsidization from the budget) if it were introduced before there was a recovery of taxable employment.[15] A pay-as-you-go scheme could also build up problems for future generations.

30. **While the parallels should not be drawn too closely, comparison with the post-war experience in Bosnia and Herzegovina provides a benchmark for the scenario.** Three main points arise.

- First, the growth path assumed in the scenario is not out of line with what happened in Bosnia and Herzegovina after 1995 (Figure 4). In keeping with its much weaker starting point, Bosnia's economy enjoyed a somewhat larger post-war "bounce" than is expected in Kosovo, but thereafter the growth rates in the Kosovo scenario are similar to Bosnia's in the late 1990s. While it could be argued that, under UN administration, Kosovo has the potential to implement reforms in a more coherent fashion and hence enjoy a faster pace of catch-up to pre-war levels—Bosnia's per capita GDP is still estimated to be only about a half what it was in 1990—the complexities of Kosovo's political situation provide a counter-weight to optimism.[16] Indeed, it could be argued instead that Kosovo's growth will not gain from as large and sustained reconstruction effort as is taking place in Bosnia.

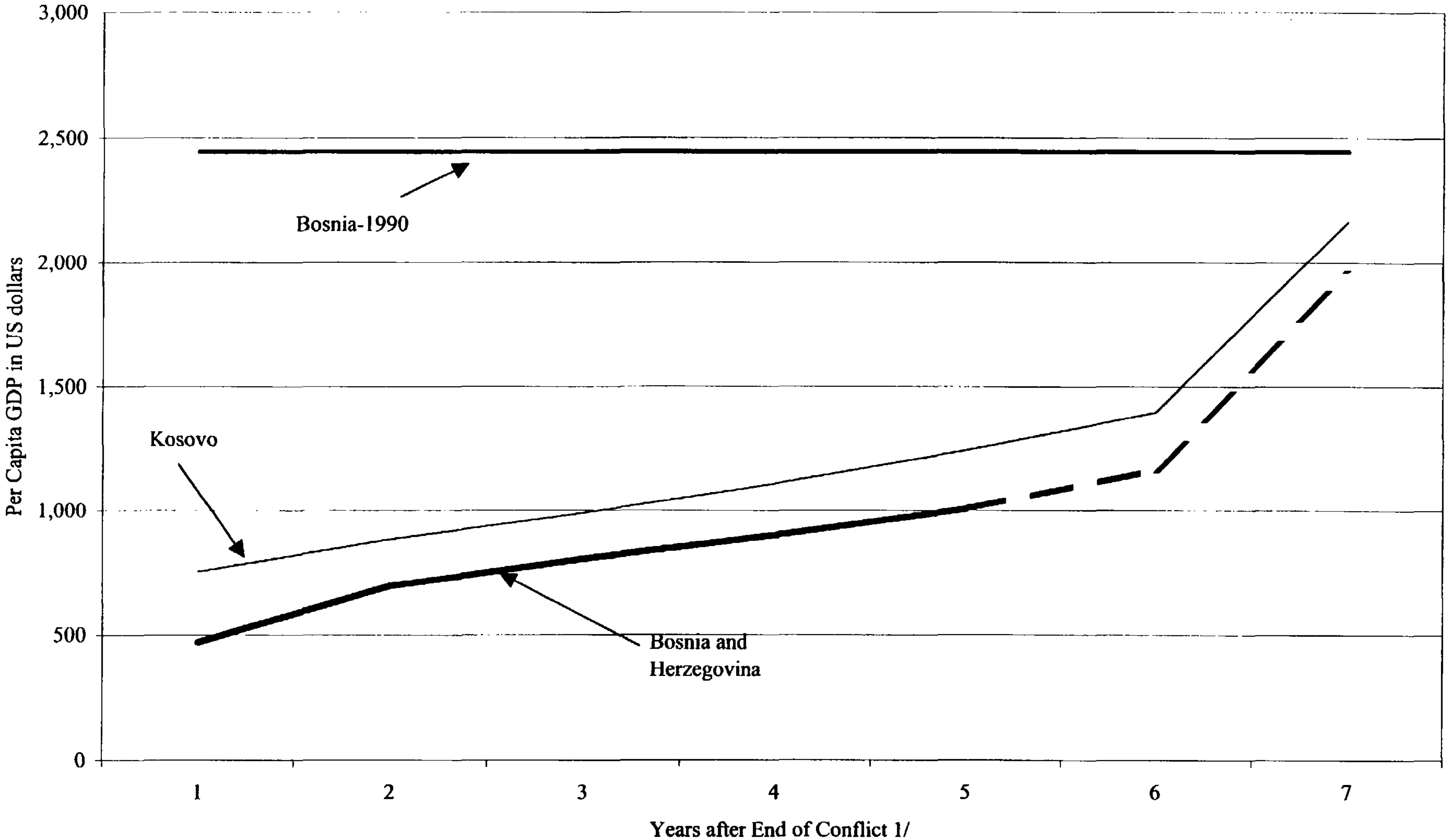
- Second, donor budget support (including soft loans) was initially lower as a percent of GDP in Bosnia and Herzegovina than in Kosovo, but has persisted beyond the horizon allowed in the Kosovo scenario (Figure 5).

- Third, donor support is proportionally much more important to Kosovo than it is to Bosnia and Herzegovina where it has hovered around 5 percent of total revenues. This reflects the much stronger tax base in Bosnia made possible by the survival of institutions such as the payments system and, at least for now, by more clearly defined borders for collecting taxes on imports than is the case in Kosovo. By implication, the elimination of budget support would impose a proportionately

[15] Note the scenario described in Table 5 does not incorporate social security contributions.

[16] It should be stressed that statistics on GDP in Bosnia and Herzegovina, both pre- and post-war, are extremely imprecise. Reliable estimates of pre-war per capita GDP in Kosovo are not available. However, before the break up of the former Yugoslavia, Kosovo was considered poorer than the republics of Bosnia and Herzegovina, FYR Macedonia, and Montenegro.

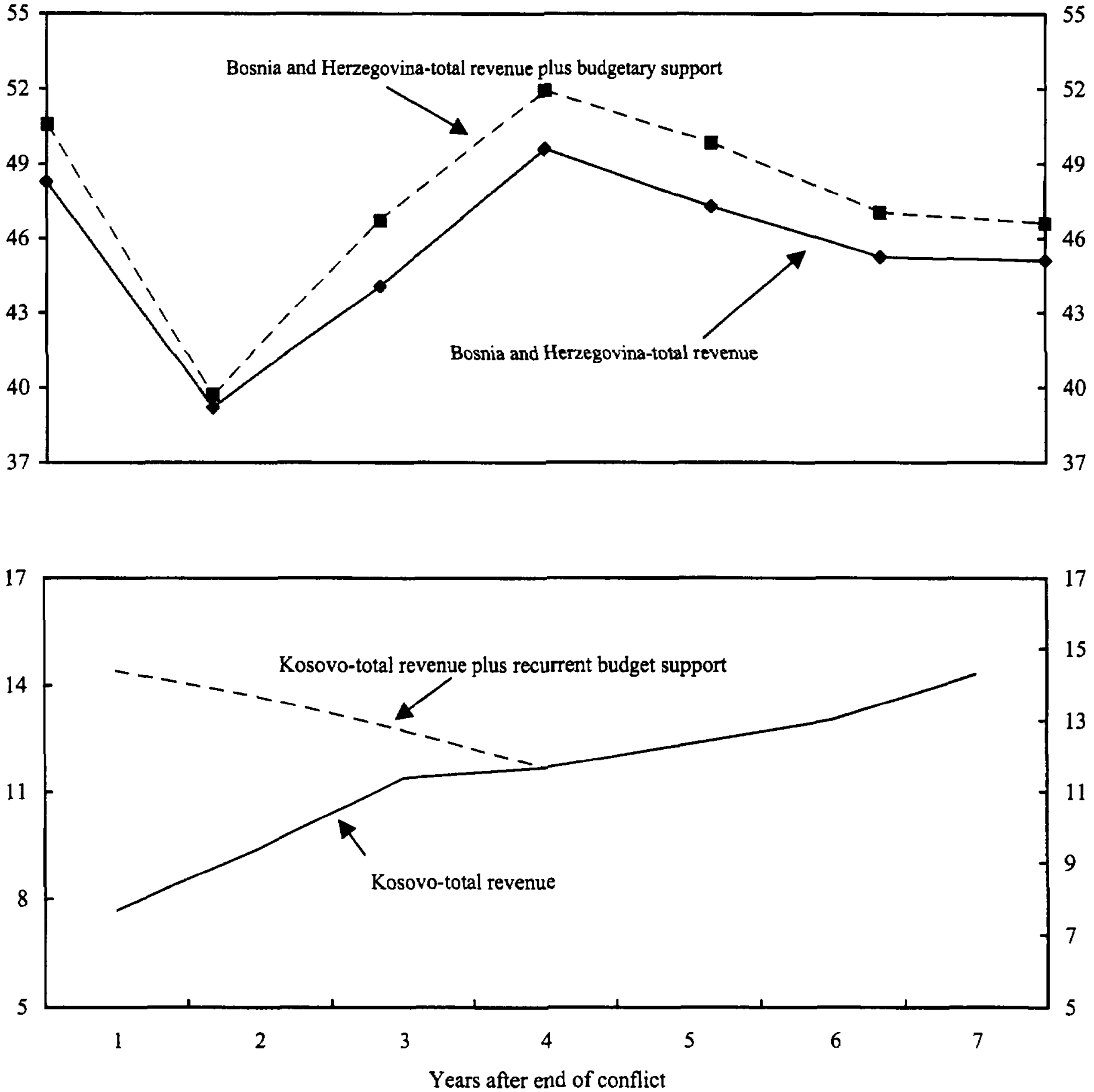
Figure 4 . Kosovo and Bosnia and Herzegovina: Post-conflict GDP Per Capita



Sources: Central Fiscal Authority; and staff estimates.

1/ Covers the first seven years after the end of the war in Bosnia and Herzegovina (BiH, 1995) and the Kosovo conflict (1999). Projections for Kosovo cover 2000-06. The seven year period for BiH includes staff estimates for 1996-99, and projections for 2000-02.

Figure 5. Kosovo and Bosnia and Herzegovina: Revenue and Budgetary Support 1/
(In percent of GDP)



Source: Kosovo Central Fiscal Authority; and staff estimates.

1/ Chart covers the first seven years following the end of the war in Bosnia and Herzegovina (BiH, 1995) and the conflict in Kosovo (1999), respectively. For Kosovo, projections cover 2000-06. The seven year period for BiH includes staff estimates for 1996-99 and projections for 2000-02.

much bigger strain on Kosovo's expenditure than it would in Bosnia and Herzegovina.

31. **Kosovo's expenditure constraints would be more severe if the economy were to grow less strongly in the medium term or there were delays in implementing tax measures**. For example, if real GDP growth were limited to 5 percent a year—not a disaster scenario—there would be no room for an increase in underlying recurrent expenditures in real terms in 2001-03 if donors insisted on removing budget support by 2003. Nor would the pick up in expenditure growth after 2003 be as strong as in the higher growth scenario, implying that the squeeze to accommodate new programs or to pay for off-budget items would be much tighter. The constraints on expenditure would also be much tighter if there were delays in introducing new taxes, given that it takes time for revenue from new taxes to build up (Figure 6). For example, if the VAT and income tax were postponed by 12 months from their planned implementation dates, the revenue- and expenditure-to-GDP ratios could be as much as 1 percentage point lower by mid-decade. There would, of course, also be a tight squeeze in 2001.

32. **At the same time, there is potential for more positive outcomes that could alleviate some of the constraints on expenditure**. First, tax revenues could prove to be more buoyant in the future, taking into account their low starting level and factoring in the potential for improving tax administration. Assumptions about the success of the income tax in particular err on the conservative side and under the main scenario the tax-to-GDP ratio would, by mid-decade, still be below the current level in Albania. There would also be some scope to further broaden tax instruments and raise marginal rates. Second, in the medium term Kosovo will likely have alternative financing sources, including domestic borrowing. A sustainable borrowing level could in principle alleviate the spending constraint by a few percent of GDP. Third, donors may be more generous to Kosovo than assumed.

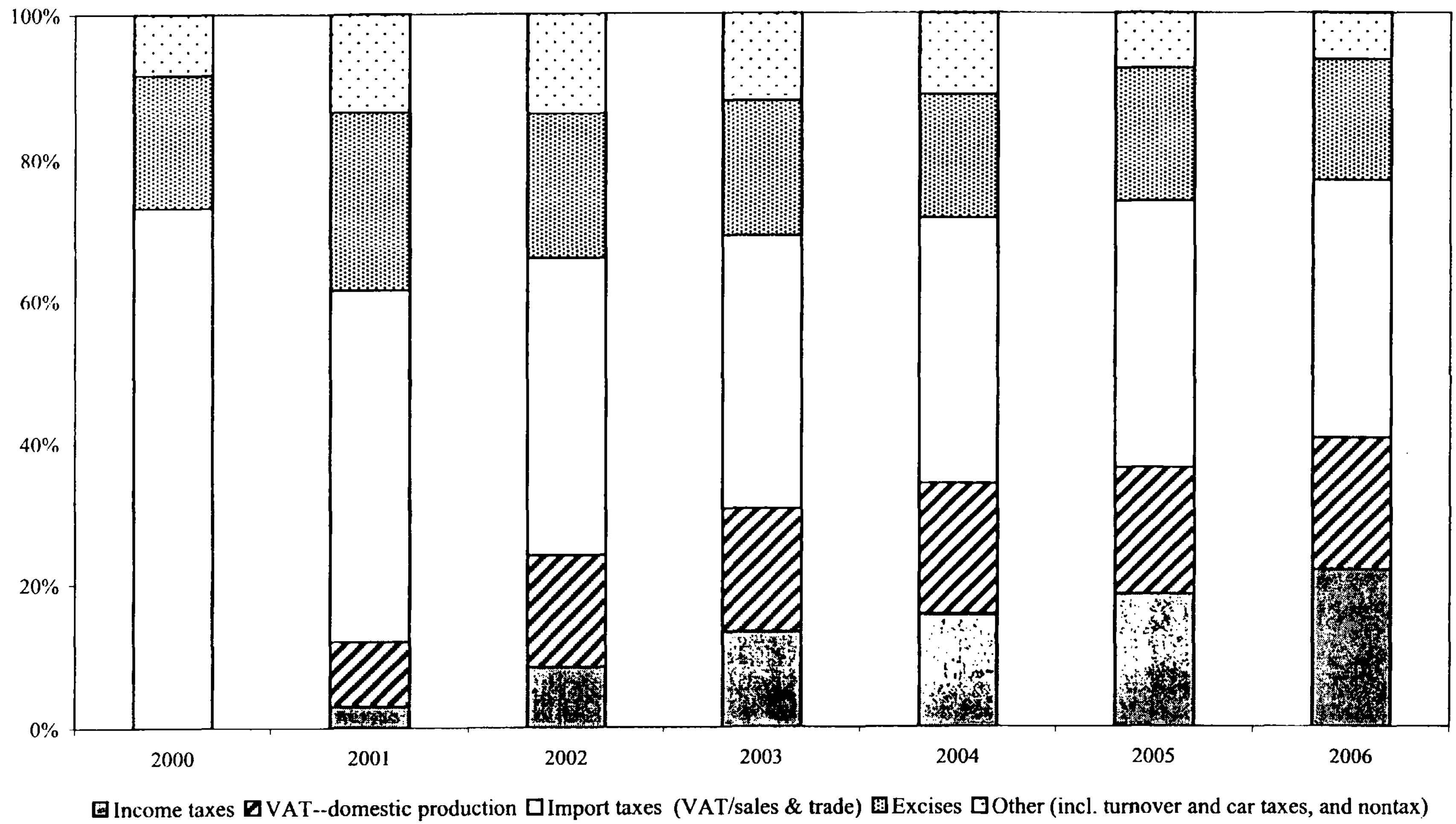
V. Conclusions

33. **A number of conclusions emerge from the analysis**:

- **The UN has made a good start in budget implementation and an important step toward budget self-sustainability appears to be in train for 2001.** However a small tax base and the expectation of rapidly diminishing donor support for recurrent spending implies a very tight constraint on expenditure, especially in light of pressures to expand the scope of the budget and, eventually, shoulder some large off-budget items.

- **Policies to foster growth in the economy are essential for ensuring that the constraints on expenditure are not unbearable**. As growth will hinge on private sector development picking up the running as the construction boom eases off, an appropriate enabling environment is crucial. This means placing immediate priority on finding workable, albeit perhaps temporary, solutions to property rights problems and putting in place—and enforcing—modern commercial codes

Figure 6. Kosovo. Medium-term Revenue Composition, 2000-06
(In percent of total revenue)



Source: Central Fiscal Authority; and staff estimates.

and regulations.[17] Private sector development will go hand in hand with a deepening of the banking system. Maintenance of law and order and a lessening of ethnic tensions are also essential ingredients.

- **Delays in diversifying the tax system should be avoided.** Revenues from new taxes build up over time and the authorities need to get a jump start on administrative problems.
- **Caution should be exercised as regards the introduction of spending programs that carry long-term commitments.** Ensuring there will be a sound base of social security contributions to fund social programs such as public pensions is an obvious example.
- **Phasing out donor budget support by an early date would be quite stringent.**

[17] UNMIK has in this regard drawn up a White Paper on private sector development and draft commercial regulations are awaiting approval.

Estimating GDP

34. While technical assistance from the IMF's Statistics Department is helping to define a program to regularize the collection and reporting of statistics, reliable estimates will depend on data from surveys scheduled for late 2000 and 2001. Until then, estimates of the size of the economy are based on partial information, potentially unreliable observations, and some educated guesswork.

35. The IMF staff's estimate of GDP presented in Table 1 is based on the expenditure approach. The main data sources and assumptions underlying the estimate are:

- ***Private consumption*** is based on an August 1999 survey of 500 households conducted by RIINVEST, which estimated daily average consumption at US$2.57. For 2000, this estimate is rounded up to US$2.75. As well as humanitarian aid, private remittances from abroad provide significant support for consumption. Informal estimates put the number of remitters at about 200,000 making an average monthly remittance of DM 500–1,000 per month. Taking the low end of this range, total private remittances would amount to some US$570 million in 2000, or roughly US$1,500 a year per family living in Kosovo.

- ***Public consumption*** is estimated from information on the execution of the central budget for 2000. No estimate is factored in for the value of services provided by the parallel system that continues to function at the local level, although this is partly picked up in the estimate of private consumption.

- Donor-financed capital projects account for most ***investment***. Based on information from the UNMIK Department of Reconstruction, *foreign-financed reconstruction* inflows for 2000 are estimated to be US$360 million (DM 750 million), of which about $250 million is for rehabilitation of housing and other buildings. *Private sector investment* is estimated at about half this amount on the assumption that housing reconstruction is matched by a large local effort—although this is largely guess-work as there are no systematic surveys. Private investment would amount to about 30 percent of private remittances, consistent with anecdotal evidence that a significant part of money sent home from abroad is used for house construction.

- ***Imports*** are estimated from a variety of sources. First, import duty receipts are consistent with US$390 million in dutiable declared imports for 2000. To correct for under invoicing, smuggling, and delays in establishing border points, this number is augmented by 45 percent, a factor based on experiences from other economies in the region—particularly Bosnia and Herzegovina—bringing total dutiable imports to US$710 million. Second, based on discussions with the Department of Reconstruction, donor-financed reconstruction inflows are assumed to have a 90 percent (non-dutiable) import content. Third, electricity imports are expected to amount to US$26 million in 2000. Fourth, based on information from FAO and donor groups, imports of humanitarian assistance for 2000 are estimated at about US$150 million. Such assistance comprises: food aid (wheat and wheat flour) of US$60 million; agricultural assistance and supplies of US$15 million; emergency social welfare of US$50 million;[18] donations of equipment (US$10 million), medical supplies and essential drugs (US$10 million), and education materials (US$5 million). Total imports add up to US$1.2 billion.

- Based on customs data, ***exports*** are expected to amount to less than US$1 million 2000, reflecting limited on-line productive capacity. There is, however, reportedly some unrecorded two-way trade taking place with the rest of the FRY.

36. Taken together, the above information implies GDP for 2000 equal to US$1.4 billion, or DM 3 billion. With the population of Kosovo estimated to be currently 1.9 million, per capita GDP is thus about US$750. This would be about twice as high as a much-quoted pre-conflict estimate based on official FRY data by the independent research group RIINVEST. However, the earlier estimate probably grossly undervalued GDP. Among other things, it was based on the concept of Gross Social Product, which neglected value added from services, and likely undervalued the contribution of the ethnic-Albanian majority. Taking into account the size of private remittances and official funding for reconstruction, budgetary support, and humanitarian aid, national income would amount to DM 4.5 billion, equivalent to US$1,130 per capita.[19]

37. The estimate of GDP is subject to a sizable degree of uncertainty. Given its large relative size (146 percent of GDP), the estimate is particularly sensitive to different assumptions about private consumption. For example, should daily consumption be US$3, instead of US$2.75 (i.e., only about 10 percent greater), per capita GDP would rise to about US$825, assuming no offsetting upward revision to imports. Such a higher figure might plausibly go with a higher estimate of private remittances, which in turn might argue for a somewhat higher level of private investment. However, there is also significant likelihood that GDP is overestimated through either an underestimation of unrecorded imports or perhaps an unwarranted rounding up of daily consumption levels.

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[18] Includes monthly food baskets valued at DM 80. With the introduction of means testing, the share of families receiving emergency assistance declined from about 60 percent at the beginning of the year to about 20 percent by July 2000.

[19] No allowance is made for debt service, which in principle is accruing and would lower this estimate somewhat.

Medium-Term Fiscal Scenarios

38. The main medium-term scenario summarized in Table 5 depends on assumptions about macroeconomic developments and policies on taxes and expenditures. The scenario treats Kosovo as a continuing autonomous economic entity.

Macroeconomic assumptions

39. Under the main scenario, real GDP is projected to grow by 10 percent a year on average through 2006. Such growth would be a little above the rate seen in Albania following episodes of internal conflict, but a little below the rate seen in Bosnia and Herzegovina, which suffered a longer and more devastating war than Kosovo. Annual inflation is projected to be about 2 percent, assuming that Kosovo continues to use the DM/euro. Implicit in the growth projection is a strong private sector performance that would return agricultural production rapidly to at least pre-conflict levels and allow the industrial sector of the economy to recover much of its lost share in output. The importance of the construction sector would decline as the reconstruction boom eases.

40. Consistent with this broad pattern of growth, domestic savings would have to rise as a share of GDP to assume more of the burden of financing investment in the medium term. Specifically, the scenario assumes that private consumption growth is 2 percentage points below that of incomes, which in turn would be growing slower than GDP because: (1) income support from humanitarian aid drops off; (2) remittances from abroad are assumed to grow in line with more slowly-growing foreign income levels; and (3) income growth from rapidly rising employment is attenuated by relatively modest real wage growth (3 percent a year).[20] As a result, private consumption declines in the scenario from 136 percent of GDP in 2000 to 100 percent of GDP by 2006 (see tabulation below). Total investment also declines as a share of GDP as private sector investment does not compensate for the drop off in foreign-financed reconstruction investment in the medium term.[21] The reduction in domestic expenditure as a share of GDP is compensated by an improvement in the trade balance: exports begin to emerge with the recovery of private sector industry and agriculture, reaching 7 percent of GDP by 2006, while the share of imports is sharply reduced. The projection for net exports is cross-checked with the assumed financing from remittances, donor support, and a small amount of inward foreign direct investment.

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[20] Taxable employment income, however, would grow much more rapidly as workers are integrated into the formal economy.

[21] The scenario assumes the current pipeline of reconstruction support is refreshed but at a lower level than before.

Main Scenario: Expenditure as a Percent of GDP

	2000	2001	2002	2003	2004	2005	2006
Consumption	146	132	125	119	116	112	109
Public	10	9	9	8	8	8	9
Private	136	123	116	111	108	104	100
Investment	39	34	29	25	23	24	24
Public	25	22	17	12	9	8	7
Private	14	13	12	13	14	16	17
Net exports	-85	-67	-54	-44	-39	-36	-33
Financed by:							
Reconstruction aid	25	22	17	12	9	7	5
Budget support	9	5	2	0	0	0	0
Humanitarian aid	10	3	0	0	0	0	0
Remittances	40	36	34	32	30	28	26
FDI	0	0	1	1	1	2	2

41. Under the alternative lower-growth scenario, Kosovo's real GDP is assumed to expand at about 5 percent a year. Behind the scenario is an assumed slower pace of private sector development and less buoyant employment growth. As a result, GDP is about 21 percent lower than in the main scenario by 2006. However, for the same absolute levels of remittances and external donor support, the drop off in consumption, investment, and imports relative to the main scenario would be less than this.

Revenue projections

42. The revenue projections assume that the tax policy program outlined in Box 3 is fully implemented. The macroeconomic assumptions, together with some specific assumptions regarding tax compliance, combine to define the evolution of the tax base. The key specific assumptions are as follows:

Wage tax

43. The projection assumes that only 20,000 workers in the private sector will file the tax in 2001.[22] While this number might appear rather low, unemployment in Kosovo is high and experience in neighboring Albania points to major difficulties in capturing wage income accurately. Not only are there many evasion schemes, which are difficult to detect for an inexperienced administration, but the absence of a well-functioning payments system will

[22] Note that the wage bill in the scenarios is calculated net of wage tax payments.

make withholding not an option. Over the medium-term, the number of workers filing for the wage tax is projected to increase to 130,000 in 2006 due to improvements in tax administration and development of the banking system. Private sector wage levels are assumed to be the same as in the public sector: while anecdotal evidence points to monthly wages substantially above DM 1,000 for some workers, particularly in the construction sector, there are many other workers who earn less than budgetary wages—or at least are not paid regularly—for example in agriculture or factories operating at minimum capacity.

Profit tax

44. Projections for the profit tax are the most difficult given a lack of coherent information on the corporate sector. However, as many enterprises are crippled by years of under-investment and the recent war, the profit tax is not likely to be a major revenue raiser in the early years. The scenarios thus make the ad hoc assumption that revenues from the profit tax are DM 10 million in 2002—the year of its introduction—and that from then onwards are related to GDP growth with an elasticity of 1.7 in 2003 and 1.2 thereafter.

VAT

45. Projections for the VAT are based on the value of dutiable imports and calculations of the domestic VAT base on the basis of preliminary business registration data. It is assumed that the VAT, which will be limited initially to manufactures, will be extended to the retail trade sector in 2003, resulting in an increase of the tax base by 60 percent. The VAT base is projected to grow with nominal growth in the manufacturing sector until 2003 and with nominal growth in the manufacturing and trade sectors from then onward.

46. While the projection of the VAT collection from imports is straightforward, a key parameter for the calculation of the domestic VAT component is how much VAT is creditable from the import stage. With exports negligible, it is assumed that about 50 percent of the domestically produced value-added has to be credited for imports and that this amount will increase to more than 60 percent with the extension to the retail sector and an increase in exports.

Excise taxes

47. *Petroleum products*. Consumption of petroleum products is assumed to increase in line with a weighted average of real consumption growth (0.75) and real GDP growth (0.25). The specific excises are adjusted from DM 0.4 per liter of gasoline in 2001 to DM 0.45 in 2005 and from DM 0.30 per liter of heating oil and diesel in 2001 to DM 0.35 in 2005.

48. *Spirits*. The tax base grows in line with private consumption. The specific tax rate is adjusted from DM 2.0 per 100 percent of alcohol in 2001 to DM 2.3 in 2005.

49. *Beer*. The tax base grows in line with private consumption. The rate is adjusted from DM 0.30 per liter in 2001 to DM 0.35 in 2005.

50. *Cigarettes.* The tax base grows in line with private consumption. The rate is adjusted from DM 0.08 per package in 2001 to DM 0.12 in 2005.

Customs duties

51. Customs duties depend on import growth. The estimated average tariff rate (7.2 percent in 2000) is assumed to be unchanged in the medium term.

Vehicle tax

52. The stock of vehicles is estimated at 250,000 by the car registration office.

Expenditure projections

53. In the scenarios, recurrent expenditure is constrained by the projected revenue envelope to broadly eliminate donor budget support by 2003. In the main scenario, this implies about 5 percent nominal growth (3 percent real) on average for 2001-03. With declining donor support no longer a drag on resources, and tax revenues continuing to rise quickly, spending constraints ease thereafter. For the purposes of the scenario, it is assumed that about half of the increase in revenues after 2003 is allocated to recurrent spending and the remainder to capital spending. Consistent with the macroeconomic scenario, foreign-financed capital spending drops off sharply after 2003.

Table 1. Kosovo: Gross Domestic Product, National Income, and Balance of Payments, 2000

	DM million	Percent of GDP
Gross domestic product	3,000	...
Consumption	4,380	146
Private	4,078	136
Public	303	10
Investment	1,161	39
Foreign	756	25
Domestic	405	13
Exports	0	...
Imports	2,540	85
Reconstruction	680	23
Energy	54	2
Humanitarian	312	10
Food and agriculture	155	5
Equipment	21	1
Emergency assistance	136	5
Households	104	3
Health	21	1
Education	10	0
Dutiable imports	1,496	50
Declared	823	27
Other	673	22
National income	4,512	150
GDP	3,000	100
Private remittances from abroad	1,200	40
Humanitarian assistance	312	10
Balance of payments		
Current account	-1,029	-34
Trade balance	-2,540	-85
Remittances	1,200	40
Humanitarian assistance	312	10
Financed by:		
Budgetary assistance 1/	273	9
Reconstruction aid	756	25

Sources: Central Fiscal Authority, UNMIK Departments, Food and Argiculture Organization; and staff estimates.

1/ Includes off-budget financing and draw down of cash balances.

Table 2. Kosovo: Recurrent Budget 1999-2000 1/

	1999	2000		
	Sep-Dec.	Budget	Budget Revised 2/	Projection
	(Millions of DM, unless otherwise indicated)			
Total revenue	31	223	210	230
Tax revenue	30	197	180	222
Customs	9	38	35	56
Excises	2	21	18	38
Sales taxes	20	104	91	116
Payroll taxes	...	15	15	0
Other	...	19	21	12
Nontax revenue	1	27	30	8
Total expenditure	87	423	429	431
Education	32	116	116	111
Health	17	81	81	69
Defense and public order 3/	...	56	56	55
General public services	14	15	19	23
Social assistance	9	83	83	78
Other	14	73	75	95
Subsidies	...	32	32	52
Energy 4/		23	23	38
Other 4/	...	9	9	14
Municipalities	...	19	19	19
Other	...	22	24	24
Balance	-56	-200	-219	-201
Financing	56	200	219	201
Donor contributions 5/	85	170	189	191
Transfers from cash reserve	-29	30	30	10
Memorandum items:				
Total revenue, excluding grants (percent GDP)	...	7.4	7.0	7.7
Total expenditure (percent GDP)	...	14.1	14.3	14.4
Identified off-budget expenditure	...	...	56	78
Electricity imports	...	...	39	54
Equipment	...	...	5	5
University hospital	...	...	8	8
Other	...	...	4	11

Sources: United Nations Interim Administration Commission in Kosovo (UNMIK); and staff estimates.

1/ Does not include donor-financed reconstruction, which accounts for all capital spending.
2/ In April 2000 a revised budget added DM 6 million for the Joint Interim Administrative Structure, responsible for the administration of Kosovo since February 2000.
3/ Includes DM 20.7 for the Kosovo Protection Force.
4/ Subsidies to the Kosovo Electricity Company and for water/public heating increased by DM 15 million and DM 5 million, respectively. Increases reflected delays in reducing redundant staff, as well as higher oil import costs.
5/ Includes dedicated donor support of DM 17.7 million for the Kosovo Protection Corps.

Table 3. Government Expenditures for Selected Countries

(Average as percent of GDP)

	Kosovo 1/ 2000	Albania 1998	Bosnia and Herzegovina 1999	Bulgaria 1998	Croatia 1998	FYR Macedonia 1999	Romania 1999	Middle income 2/	Low income 3/
Expenditures by economic type (including net lending)	14.4	30.7	53.4	36.9	30.0	37.7	37.1	27.7	25.6
Current expenditures	14.4	25.5	46.5	34.2	25.2	35.1	34.1	21.9	18.6
Goods and services	8.9	10.2	30.9	16.5	16.4	12.4	11.8	11.5	12.6
Wages 4/	5.4	6.2	6.8	8.7	9.6	9.3	5.0	7.9	6.7
Other goods and services	3.5	4.0	24.1	7.8	7.0	3.1	6.7	3.6	5.9
Interest	0.0	7.8	2.0	4.4	1.4	1.6	5.5	2.5	3.2
Subsidies and transfers	5.5	7.5	13.7	13.3	7.4	21.1	15.4	7.9	2.8
Capital expenditures	0.0	5.2	6.9	4.0	4.8	2.6	2.9	4.7	6.0
Net lending 5/	0.0	0.0	0.0	-1.4	0.8	...	0.1	1.1	1.0
Expenditures by function 6/	14.4	30.7	...	41.3	29.9	37.7	35.7	26.7	26.3
Military and civil defense	1.8	1.2	...	2.7	5.3	2.4	3.6	3.4	3.0
Education	3.7	3.0	...	3.8	3.4	4.0	3.3	3.8	3.9
Health	2.3	1.7	...	3.6	0.6	6.1	3.0	2.0	1.7
Social security and welfare	2.6	7.4	...	11.6	5.8	13.6	10.6	4.6	1.3
Housing	0.6	1.3	...	1.7	1.9	0.0	1.7	1.1	0.7
Economic services	2.2	0.3	...	1.0	...	2.0	0.5	5.7	6.4
Other government services 7/	1.2	8.1	...	12.7	...	7.9	7.4	3.6	6.1
Interest	0.0	7.8	...	4.4	1.4	1.6	5.5	2.5	3.2
Number of countries								26	11

Sources: IMF Government Finance Statistics Yearbook (1995); and staff estimates.

1/ Budget 2000, subsidies and transfers include unallocated contingency reserves.
2/ Barbados, Botswana, Chile, Colombia, Costa Rica, Cyprus, Dominican Republic, Egypt, El Salvador, Fiji, Hungary, Iran, Jordan, Malta, Mauritius, Morocco, Panama, Paraguay, Peru, Romania, Swaziland, Thailand, Tunisia, Turkey, Uruguay, and Zimbabwe.
3/ Burkina Faso, Cameroon, Ghana, Kenya, Lesotho, Malawi, Mali, Sierra Leone, Sri Lanka, Zaire, and Zambia.
4/ Military wages included in other goods and services for Bosnia and Herzegovina in 1999.
5/ Data unavailable for FYR Macedonia.
6/ Does not include lending minus repayments.
7/ Services provided by Ministries of Agriculture, City Planning and Construction, Development, Economy, and Information, the Bureau of Statistics, and non-classified expenditures.

Table 4. Selected Transition Economies: Revenues as a Share of GDP 1/

	Total revenue	Nontax revenue	Tax revenue	Income and payroll tax	Corporate tax	Sales, turnover or VAT	Excises	Import duties	Social security taxes	Other taxes
Kosovo	**7.7**	**0.3**	**7.4**	**0.0**	**0.0**	**3.9**	**1.3**	**1.9**	**0.0**	**0.4**
Albania	18.6	3.6	15.0	0.2	1.1	4.7	1.2	2.7	3.9	1.2
Bosnia and Herzegovina	46.8	3.9	42.9	3.8	0.8	11.3	5.2	5.9	14.6	1.3
Bulgaria	33.1	7.6	25.5	2.6	4.0	7.1	2.3	1.9	7.1	0.4
Croatia	44.1	2.5	41.6	3.6	1.5	13.6	4.5	3.5	...	...
Czech Republic	33.6	1.5	32.1	2.0	2.8	6.9	3.8	1.0	14.8	0.8
Hungary	37.9	5.0	32.9	5.2	2.0	7.8	3.2	2.3	10.6	1.8
FYR Macedonia	39.0	2.9	36.2	...	...	5.4	7.2	3.7	13.0	...
Poland	36.7	3.3	33.4	6.8	2.8	7.7	3.9	1.7	10.4	0.1
Romania	30.4	3.5	26.9	5.9	...	4.8	1.5	1.4	7.3	...
Slovak Republic	45.0	6.1	38.9	5.6	4.5	8.2	3.4	1.8	14.4	1.0
Slovenia	42.6	2.5	40.1	6.7	1.1	13.0	0.3	2.2	14.1	2.8

Sources: IMF Government Finance Statistics Yearbook; and staff reports.

1/ Average share of GDP during 1996-98, excluding Romania (1996-97), Bosnia and Herzegovina (1998-99), and Kosovo (2000).

Table 5. Kosovo: Consolidated Budget Presentation--Main Scenario

(DM millions; percent of GDP)

	2000	2001	2002	2003	2004	2005	2006
Revenue	230	330	449	516	612	725	893
	7.7	*9.4*	*11.4*	*11.7*	*12.3*	*13.0*	*14.3*
Expenditure	1265	1291	1147	1004	995	1055	1171
	42.2	*36.7*	*29.1*	*22.7*	*20.0*	*18.9*	*18.7*
Current spending	509	535	517	531	567	631	723
	17.0	*15.2*	*13.1*	*12.0*	*11.4*	*11.3*	*11.6*
Underlying recurrent expenditure 1/	455	495	517	531	567	631	723
	15.2	*14.1*	*13.1*	*12.0*	*11.4*	*11.3*	*11.6*
Electricity imports	54	40	0	0	0	0	0
	1.8	*1.1*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Capital spending	756	756	630	473	428	424	448
	25.2	*21.5*	*16.0*	*10.7*	*8.6*	*7.6*	*7.2*
Foreign-financed	756	756	630	473	368	315	263
	25.2	*21.5*	*16.0*	*10.7*	*7.4*	*5.6*	*4.2*
Domestically financed	0	0	0	0	60	109	185
	0.0	*0.0*	*0.0*	*0.0*	*1.2*	*2.0*	*3.0*
Balance	-1035	-961	-698	-488	-383	-330	-278
	-34.5	*-27.3*	*-17.7*	*-11.0*	*-7.7*	*-5.9*	*-4.4*
Financing	1035	961	698	488	383	330	278
Donor budget support 2/	201	150	53	0	0	0	0
Foreign-financed reconstruction	756	756	630	473	368	315	263
Off-budget donor contributions	78	55	15	15	15	15	15
Memo items:							
Nominal GDP (DM millions)	3,000	3,519	3,948	4,430	4,970	5,577	6,257
Real GDP growth (percent)	...	15	10	10	10	10	10
Inflation (percent)	...	2	2	2	2	2	2

Sources: CFA; and staff estimates.

1/ Excluding electricity imports.
2/ Includes run down of cash balance (DM 10 million) in 2000.