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COMMISSION STAFF WORKING DOCUMENT

Kosovo (under UNSCR 1244) 2006 Progress Report

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COMMISSION STAFF WORKING DOCUMENT

Kosovo (under UNSCR 1244) 2006 Progress Report

1. INTRODUCTION

1.1. Preface

Since March 2002, the Commission has reported regularly to the Council and the Parliament on progress made by the countries of the Western Balkans region.

This report largely follows the same structure as in previous years. The report:

- briefly describes the relations between Kosovo (under UNSCR 1244) and the Union;
- analyses the political situation in Kosovo in terms of democracy, the rule of law, human rights, protection of minorities, and regional issues;
- analyses the economic situation in Kosovo;
- reviews Kosovo's capacity to implement European standards, that is, to gradually approximate its legislation and policies with those of the "*acquis*", in line with the European Partnership priorities.

The period covered by this report is 1 October 2005 to 30 September 2006. Progress is measured on the basis of decisions taken, legislation adopted and measures implemented. As a rule, legislation or measures which are under preparation or await Parliamentary approval have not been taken into account. This approach ensures equal treatment across all reports and permits an objective assessment.

The report is based on information gathered and analysed by the Commission. In addition, many sources have been used, including contributions from the Kosovo authorities, the Member States, European Parliament reports¹ and information from various international and non-governmental organisations.

The Commission draws conclusions regarding Kosovo in its separate communication on enlargement², based on the technical analysis contained in this report.

1.2. Context

Kosovo's institutional arrangements are governed by the United Nations Security Council Resolution 1244 establishing an interim international civilian administration, the United Nations Interim Administration Mission in Kosovo (UNMIK). The Special Representative of the Secretary General (SRSG) bears the ultimate responsibility. A new SRSG, Joachim Rucker, took up this post on 1 September 2006.

¹ The *rapporteur* for Kosovo is Mr Joost Lagendijk.

² Enlargement Strategy and Main Challenges 2006 – 2007.

The Constitutional Framework for Provisional Self-government of Kosovo divides responsibilities between UNMIK and the provisional institutions of self-government (PISG) to develop self-government in Kosovo pending a final settlement. The transfer of competences from UNMIK to the provisional institutions of self government has been extensive. The Commission's assessment in this report refers to all Kosovo authorities regardless of their respective competences.

The reporting period started with the UN Security Council's endorsement of the comprehensive review on standards implementation ("Eide report³"). This paved the way for talks to commence on the future status of Kosovo. On 14 November 2005, former Finnish President Martti Ahtisaari was appointed the special envoy of the Secretary-General for this process.

Talks between the Pristina and Belgrade delegations started on 20 February 2006 under the auspices of Mr Ahtisaari. Meetings have been held between January and September on decentralisation, community rights, religious and cultural heritage and economic issues. A high level meeting was held in Vienna on 24 July 2006. Although talks have not yet yielded concrete results, they have clarified the two parties' negotiating positions on certain technical issues. Mr. Ahtisaari reported to the UN Security Council in July and in September.

The status envoy enjoys extensive European Union support. An EU representative to the Kosovo future status process has been appointed. Furthermore, the Commission provides technical input and expertise to the status process. This is particularly relevant for economic and EU matters, but also to ensure compatibility of the future settlement's constitutional arrangements with the Copenhagen criteria.

1.3. Relations between the EU and Kosovo

The European Partnership adopted in January 2006 integrated the content of all eight chapters of the "UN Standards for Kosovo" into its general structure. This resulted in one single legal framework for implementation and monitoring.

SAP Tracking Mechanism meetings, the high level policy and technical dialogue between the Commission and Kosovo authorities, were held in Pristina in December 2005 and in March and July 2006. They were complemented by sectoral workshops on trade, customs and taxation and rural development.

In June 2006, a European Parliament delegation including members of the delegation for relations with the countries of South-east Europe, the committee on foreign affairs and the sub-committee on security and defence visited Kosovo.

In December 2005 and July 2006, the EU High Representative for the Common Foreign and Security Policy and the Enlargement Commissioner submitted joint reports to the Council on the future EU role and contribution in Kosovo. The reports highlight that the EU will play a leading role in Kosovo following the end of UNMIK's mandate, particularly in areas such as the police and rule of law as well as in certain economic areas.

An EU planning team to prepare for a potential future ESDP mission in the wider rule of law was set up and became fully operational in June. In September, another EU team was

³ "A comprehensive review of the situation in Kosovo".

established. Its mission will be to prepare the possible International Civilian Mission in Kosovo with its European Union Special Representative.

EU pre-accession **financial assistance** in 2006 amounted to €59.5 million. The EU pledged up to €50 million in macro financial assistance in April 2006.

In 2006, EU funding of €23.43 million was made available to finance the operation of UNMIK pillar IV.

2. POLITICAL CRITERIA

This section examines progress made by Kosovo towards meeting the Copenhagen political criteria which require stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities. It also monitors regional cooperation, good neighbourly relations, and the respect for international obligations, such as cooperation with the UN International Criminal Tribunal for the former Yugoslavia.

2.1. Democracy and the rule of law

Kosovo's society and politics have been dominated by the status talks.

All members of the Kosovo Albanian political spectrum showed a willingness to maintain a constructive dialogue and managed to avoid the tensions that had characterised the last reporting period.

The provisional institutions of self government have shown an increased commitment to standards implementation which was further enhanced when the contact group requested to urgently implement 13 priority standards in relation to minority issues, good governance and the rule of law.

Following the death of President Rugova in January, the election of his successor Fatmir Sejdiu was carried out in a democratic and transparent way. On 26 May, President Sejdiu resigned from his post of secretary general of the LDK, thus acting in line with the spirit of the constitutional framework which bars the President from holding other political offices. However, in early September the President announced his decision to run for the LDK presidency.

The direct dialogue between Pristina and Belgrade continued during the reporting period. The working groups on returns, energy, transport and communications and missing persons met formally and informally. The Serbian Prime Minister visited Kosovo on 28 June to mark the anniversary of the battle of Kosovo.

Kosovo Serbs have continued to refuse to participate in the provisional institutions. In March 2006, the Serbian co-ordination centre for Kosovo issued a directive that those Kosovo Serbs working for the provisional institutions should choose between Belgrade and PISG salaries. This led to a massive withdrawal of Kosovo Serbs from the public service. By the end of April, 70% of all Kosovo Serbs employed by the provisional institutions had severed their relations with the PISG by formally resigning or closing their bank accounts into which their salaries were deposited. Consequently, the PISG started depositing those employees' salaries into a trust fund.

In June, the three northern municipalities of Leposavic, Zvecan and Zubin Potok cut all ties with the provisional institutions. This has led to an almost complete absence of Kosovo Serbs from the political and administrative scene. While the northern municipalities cut all links with the provisional institutions of self government, the southern Serb majority municipalities chose to continue to cooperate with the provisional institutions.

Local elections foreseen for 2006 were postponed by the SRSG for up to twelve months. Preparations for a housing and population census are ongoing. The Commission, the Council of Europe and the UN Economic Commission for Europe established a joint monitoring operation to help the statistical office prepare for the census and ensure it will be carried out in line with international standards. Efforts have also been undertaken to encourage minority participation in pilot census exercises.

Assembly

On 10 March, the Assembly selected its new president.

The operation of the Assembly has improved. Its rules of procedure have generally been followed. Plenary session agendas are prepared in advance and formally adopted by the Assembly in plenary.

In June 2006, an important reform package was adopted, addressing the shortcomings in executive overseeing, financial accountability and transparency. Public hearings have been introduced to give Assembly members the right to directly address the government without prior screening of the questions by the presidency. Political groups and committees have been given the right to participate in the design of the Assembly budget. Transparency of how the Assembly secretariat operates has been increased through introducing a document management system.

However, Assembly committees are not always able to fulfil their role in the legislative process, partly due to a lack of qualified staff working for the secretariats of the committees. There is no practice of appointing a reporter within the committees, and this role is most often taken on by the committee chairman.

The executive oversight over the implementation of laws is still insufficient. The public information department has yet to become an effective service provider to all Assembly members. The quality of legal translations is unsatisfactory - sometimes resulting in incompatibilities between different language versions of the same legal act. No training for translators and interpreters is available.

Eight of the ten Kosovo Serb members occupying reserved seats in the Assembly have continued to exclude themselves from the plenary sessions, but participated in committee work to a limited extent. The two Assembly members of the Serb Democratic Party have continued to attend plenary sessions.

Overall, progress has been made in strengthening the Assembly's role and improving working methods.

Government

The former Prime Minister announced his resignation in March after the governing coalition parties, the Democratic League of Kosovo and the Alliance for the Future of Kosovo, reached

an agreement regarding changes in the leadership of Kosovo's provisional institutions. The head of the Kosovo Protection Corps was elected as his successor by the Assembly of Kosovo on 10 March.

The new leadership reaffirmed its aspiration for Kosovo's independence. At the same time, it expressed its determination to accelerate the implementation of standards and to create a more constructive relationship with Kosovo Serbs. This was underlined by efforts from the Prime Minister and other members of the government urging Kosovo Serbs to re-join Kosovo's institutions.

The central coordination capacity of the prime minister's office has improved. The government adopted new rules of procedure in February 2006, defining the relationship between the Prime Minister and ministers, the organisation of discussions at government sessions, the publication of government legal acts, the coordination and planning of the work of the government, and the relationship with the Assembly and other provisional institutions of self government bodies and organisations.

An office for management and administration of the official gazette was established. The office is currently operational within the office of the Prime Minister. It published the first official gazette in June in Albanian, English, Serbian, Turkish and Bosniak.

In response to the European Partnership for Kosovo, the authorities adopted an action plan for the implementation of European Partnership in August 2006. Work on the Kosovo Development and Strategy Plan is ongoing to provide the overall strategic guidance for Kosovo's development.

The key cabinet post of minister of agriculture, forestry and rural development - reserved for a Kosovo Serb - has remained empty. The coordination capacity of the prime minister's office still needs to be further strengthened to provide effective strategic direction, planning and government coordination.

In order to further strengthen the overall coordination of Kosovo's European reform agenda, the government has established an agency for European integration.

Access of the public and the legal profession to legal acts, in particular to secondary legislation, is still unsatisfactory.

Overall, the government has made some progress in improving its coordination and governing capacities.

Public administration

The provisional institutions have set up an inter-governmental working group to develop a new public administration reform strategy to come into effect as of 2007. The provisional institutions have committed to cutting civil service staff by 10% over the next three years.

Two institutions, an independent oversight board and a senior public appointments committee, have been established. The senior public appointments committee has to date handled eight dismissal cases involving permanent secretaries.

The capacities of the Kosovo institute of public administration have been further enhanced.

However, for an estimated population of approximately two million, Kosovo has a high number of 68,000 public servants on its payroll. The absence of a general register of civil servants and of a related inventory of competences as well as unclear and overlapping distribution of tasks make it difficult to match needs with the available human resources.

The independent oversight board and the senior public appointments committee are not yet functioning effectively. The latter's decisions are not always justified and have not always been enforced, amid concerns that the position of permanent civil servants is still vulnerable to political influence. There are reports of procedural irregularities. As the independent oversight board only became fully operational in late 2005, a backlog of cases still has to be addressed for the period between 2001 and 2005.

The level of acceptance of the Kosovo institute of public administration throughout the provisional institutions of self government has not increased. This is also due to the institute's restrictive interpretation of their mandate as provider of generic training only. As the institute is not fully using its capacities, other line ministries continue to deliver most training activities through their own training departments. The relations between the institute and the ministry of public services are strained.

Kosovo's institutions are implementing the framework document for the reform of local government, aiming to improve security and living conditions of all communities.

Five decentralisation pilot projects have been approved; three pilot municipal units are operational, including one Kosovo Turkish pilot municipal unit, Mamushe/Mamusa. In the three operational units, municipal assemblies have been established and statutes approved. The units' presidents and deputy presidents have been elected and the recruitment of civil servants is ongoing.

However, administrative capacity at the municipal level is still weak both at the administrative and at the strategic planning level, for example when it comes to developing medium to long term economic development strategies. Furthermore, the relationship between the central and the municipal level needs to be further defined in terms of competencies.

Belgrade-sponsored parallel administrative structures continue to operate in most predominately Kosovo-Serb municipalities. Two systems continue to operate in Kosovo in the fields of justice, education, health care, administration postal service. There is no mutual recognition of certificates and diplomas. Furthermore, there are still parallel administrative structures regarding property registration, causing legal uncertainty for property rights holders. The Serbian ministry of internal affairs has several offices in Kosovo which openly display symbols of Serbian statehood and which deliver driving licences, passports and identity cards. A number of Kosovans rely on these services, especially for travel to Serbia, as UNMIK documents are not recognised there.

Overall, Kosovo's local governance structures continue to be weak and continued progress is needed to reform Kosovo's public administration.

Judicial system

New ministers were appointed on 10 March 2006, following the establishment of the ministry of internal affairs and the ministry of justice in December 2005. The SRSG issued a positive assessment on the interim review of competencies. Subsequently, more responsibilities were transferred in April 2006 (including overseeing the Kosovo police service and the Kosovo

correctional service). A regulation setting out a regulatory framework for the justice system in Kosovo was introduced on the same date.

The Kosovo judicial council was established as the successor of the Kosovo judicial and prosecutorial council in December 2005. Nominations for the judicial council were approved by the Assembly in March 2006, and members were officially appointed in April 2006.

A recruitment campaign for judges and prosecutors launched in April 2006 and targeting members of under-represented communities has yielded some results. Ten judges and two prosecutors from under-represented communities were selected by the Kosovo judicial council.

In April, the law on the Kosovo judicial institute was promulgated, establishing the institute as an independent body to coordinate training of judges and prosecutors and of judicial and prosecutorial candidates. The responsibility for the administration of courts passed from the ministry of public services to the Kosovo judicial institute. This severed the link between the executive and the judiciary, which was a cause of concern in the past.

The judicial inspection unit received appropriate funding in 2005 but still has to develop its capacities.

Positive developments can be reported concerning the processing of administrative cases before the Supreme Court which has continued to improve during the reporting period. However, appeal procedures for administrative procedures are often lengthy and burdensome.

The establishment of the new ministry of justice has also been slow.

The constitutional framework defines the competence of the Assembly to appoint judges and prosecutors, thus potentially allowing for political or ethnic considerations to interfere in the selection process. The draft laws on courts and prosecutors suffer the same shortcomings. The establishment of an objective and merit-based recruitment procedure is therefore a priority to set the basis of a sound independent judiciary.

The efficiency of the judicial system is low and Kosovo's judicial institutions have made little progress in delivering an effective service, both in civil and criminal justice. The length of procedures and the case overload remains a major problem. Poor case management is one of the key reasons for the existing backlog that now stands at over 45,000 cases and is still increasing. A modern case management system is being implemented, but this is not always put to use by judges.

Courts face enormous problems in executing summons due to the fact that there is no civil register, that most houses do not have a proper address and because of the absence of Kosovo Serb court messengers.

Appointment procedures for judges are still burdensome, can take up to one year and thus do not allow for sufficient flexibility for transferring judges from one court to another.

Progress has also been slow with regard to the enforcement of judgments. Court decisions are often not fully enforced. There are reports of individuals threatening or applying force to stop judges from performing their duties. Some municipalities ignore court judgments or interim measures ordering them to perform or abstain from performing certain actions.

The body of applicable laws in Kosovo is still divided between UNMIK regulations, laws adopted by the Assembly (and promulgated by the SRSG) and certain (Yugoslav) laws in force in Kosovo on 22 March 1989. This has continued to hamper the delivery of justice as judges are not always certain of the legal basis for their judgements.

The new criminal code and criminal procedure code enhance the role of prosecutors, now directing and supervising the work of the judicial police in the pre-trial stage of criminal proceedings. Major crimes are dealt with by international judges and prosecutors.

There is still no effective witness protection. The law on witness protection has yet to be adopted by the Assembly and witness protection equipment in the district courts still has to be installed.

The prosecution and trial of cases related to the March 2004 riots is unsatisfactory due to a lack of diligence in case investigations by the police, lenient sentencing and a lack of cooperation from witnesses. 89 such cases are still pending. Out of the 426 initial charges handed by local judges, 217 convictions were pronounced and 106 cases dropped for lack of evidence. Out of the 44 cases run by international prosecutors, 13 convictions have been pronounced, 12 dropped and the others pending.

Although significant efforts have been made, overall the judicial system continues to remain weak.

Anti-corruption policy

Progress in implementing the law on the suppression of corruption has been slow. The government approved the anti-corruption action plan and the anti-corruption council was established in February 2006. The Assembly appointed the director of the anti-corruption agency in July.

Internal investigation services have been set up in the police and the judiciary. In April 2006, the Kosovo police service office for organised crime took over executive powers from UNMIK.

However, corruption in Kosovo is still widespread at all levels and little progress has been made in tackling corruption.

Kosovo is not party to the main international conventions in the field of anti-corruption. However, the provisions of these legal instruments have to some extent been integrated into the domestic legislation such as the provisional criminal code of Kosovo and the law on the suppression of corruption.

Neither the office of the auditor general nor the police are represented in the anti-corruption council. Three of its members represent political parties and one member is an acting municipal chief executive officer. There are doubts about the political neutrality of the council members.

The auditor general has published 17 external audit reports, noting widespread non-compliance with procurement laws and regulations.

Overall, little progress has been made in tackling corruption.

2.2. Human rights and the protection of minorities

Observance of international human rights law

There has been some **reporting on human rights**, notably under the Framework Convention for the Protection of National Minorities and the International Covenant on Civil and Political Rights. The Framework Convention for the Protection of National Minorities Advisory Committee Opinion on Kosovo was adopted on 25 November 2005. Since then, no decision has been made on how to implement its recommendations or on how to coordinate their implementation.

In April 2006, the SRSB promulgated a regulation on the establishment of the human rights advisory panel. The panel will decide on complaints from persons or group of individuals claiming to be the victim of a violation of their human rights by UNMIK.

The mandate of the international ombudsperson expired on 31 December 2005. Despite concerns of the outgoing ombudsperson and other international institutions, a local acting ombudsperson was nominated. In February, the continuing operation of the ombudsperson institution was transferred from UNMIK to the Assembly which will be responsible for officially appointing Kosovo's first local ombudsperson. The mandate of the ombudsperson institution does not cover human rights violations by UNMIK as this will be dealt with by the human rights advisory panel.

From December 2005 until May 2006, the ombudsperson addressed 270 queries to the provisional institutions of self government and has received 75 positive responses. Six recommendations were addressed to the SRSB and the provisional institutions of self government, but only three of them have been implemented.

Civil and political rights

There have been renewed efforts concerning **access to justice**. These aim to ensure decentralisation of justice and minority access to justice through initiatives such as the establishment of court liaison offices, organisation of court days. Measures have also been undertaken to increase the presence of under-represented communities among judges and prosecutors. Eleven court liaison offices are operating in minority areas and three court days have been held in three municipalities.

In relation to the **prison system**, the new criminal law requires special places for the detention of mentally disabled people, but there is a lack of specialised institutions to receive such persons. Due to security reasons, Kosovo Serb prisoners are not sent to Dubrava prison to serve their sentences, therefore having to remain in detention centres. There are also still frequent complaints that juvenile perpetrators, mentally incapacitated prisoners and regular prisoners and detainees continue to be detained in the same facilities. Responsibility for the Kosovo correction service was transferred to the ministry of justice in April 2006. Health standards and general conditions for inmates in Dubrava prison remain high.

On **freedom of religion**, some steps have been taken by Kosovo Albanian political leaders to improve the dialogue with the Serbian Orthodox church clergy. A meeting between representatives of the Serbian Orthodox Church and the Albanian municipal Islamic council took place in Orahovac/Rahovec in April 2006. President Sejdiu visited the Visoki Decani monastery on the occasion of Orthodox Easter.

Further progress has been made with regard to **freedom of expression (including the media)**, towards the development of professional and self regulated media. All major newspapers, including Serbian-language newspapers, are now members of the press council set up in 2005 and have signed up to a press code. The council has managed to significantly enhance the quality of Kosovo's print media and this has led to a reduction of cases of biased reporting and hate speech.

A new law governing the public broadcaster, Radio Television of Kosovo (RTK), was promulgated in April 2006. Implementation of the law in line with European practice will be crucial to help public service broadcasting fully independent.

In July 2006, the independent media commission became fully functional after the Assembly appointed a representative to the council. An acting temporary media commissioner has been appointed as chief executive of the independent media commission.

The first study course of the Kosovo institute of journalism and communication started in the academic year 2005/2006; the first graduation is expected to take place in 2007. The Kosovo media institute was founded in October 2005 and aims to build up the professional capacity in the media sector through mid-career training. The recruitment procedure for the director's post is currently underway and the institute is expected to be fully operational in late 2006.

UNMIK regulations and the constitutional framework provide for **freedom of association and freedom of assembly** which is generally respected.

No major changes since the last report occurred in terms of the capacity and influence of the local **civil society organisations**.

Economic and social rights

With regard to **women's rights**, the office of gender equality became operational in November 2005. A family law was promulgated in February 2006. Gender equality mechanisms such as the gender officers in every ministry and the municipal gender officers assigned in every municipality have continued their work.

However, women remain victims of discriminatory practices in economic and social life. Domestic violence is a serious area of concern.

Concerning **children's rights**, infant mortality is estimated at 46 per 1,000 live births, while under-five years of age mortality is estimated at 69 per 1,000. This is the highest in Europe. Access to early childhood programmes is limited. An estimated 40 % of the population is under the age of 18 and 33 percent of the population is under 15. Kosovo also has the lowest rate of pre-school attendance in Europe, with estimates that less than ten percent of children aged two to five attend. A pre-school education law was promulgated in March 2006 but does not make pre-school (age 5-6) compulsory nor does it ensure budget allocation to pre-primary education.

Key protection issues for Kosovo children include violence, exclusion of children with disability and minority children from education, child labour and child trafficking. Protection mechanisms for children are inadequate. The family law and the law on social services are contradictory in some respects and there is a need to develop specific regulations to ensure implementation of these laws.

A health inspectorate was established to monitor health care institutions in Kosovo. Access to health care remains difficult, especially for socially vulnerable or people with disabilities. The budget for community health care has dropped by more than 50% over three years. Seven mental health centres have been established in the main regions in Kosovo but the number of staff and the level of resources remain low. Apart from these centres, mental health services are offered through integration houses and the psychiatric departments in regional hospitals. Mental health services are offered to children through family health care centres. Corruption is however commonplace and access to specialist care, especially in rural areas, is inadequate. The government of Serbia has continued to provide health care through parallel structures in the Serb enclaves.

The resolution of **property rights** impacts on many issues in Kosovo, including the rule of law as well as refugee and IDP return.

In March 2006, the Kosovo property agency was established as an independent body and successor to the housing and property directorate. The agency receives, registers and assists the courts in resolving property claims (including those related to agricultural and commercial property). It also enforces the related decisions and administers abandoned properties.

Measures were taken to address the backlog of property related cases. The ministry of environment and spatial planning has asked the ministry of justice to assess the legal possibilities and available resources in the courts. This is to assist the reallocation of judges to address cases in the courts with the highest backlog.

A Kosovo-wide information campaign against illegal occupation has been implemented. A new memorandum of understanding was signed between the police and the Kosovo property agency that outlines responsibilities of both in securing the enforcement of evictions orders. The government has begun to implement a policy to sanction civil servants illegally occupying property.

The implementation of the immovable property rights register is ongoing. The cadastral agency has linked seven municipal cadastre offices to the digital register. The fieldwork has been completed for three pilot cadastre reconstruction projects and the agency is considering the claims filed. Serbia has still not transferred cadastral records to Kosovo.

Minority rights, cultural rights and the protection of minorities

In spring 2006, the President and the Prime Minister started an extensive and highly visible outreach campaign towards minorities. Both repeatedly called on Kosovo Serbs and other minority communities to consider Kosovo their home and to work together with Kosovo's provisional institutions of self government.

In October 2005, the government adopted an action plan for the implementation of the anti-discrimination law during the period 2005-2007. So far no cases have been brought to courts and tribunals on the basis of the anti-discrimination law.

Over the last year, the security situation and freedom of movement for minority communities have somewhat improved. There has been a decline in serious crimes with an ethnic motivation.

However, minority communities, mostly Serbs and Roma, face discrimination, serious restrictions in freedom of movement, access to education, health care, public utilities and

social assistance due to the poor quality of services and security concerns. The overall implementation of the anti-discrimination law is unsatisfactory. Kosovo Serbs continue to be subject to incidents such as harassment and intimidation.

With regard to **cultural rights**, some overall progress has been made at central and municipal level. Interpretation is available at all Assembly meetings and all municipal assembly and committee meetings whenever minority members are present. The ministries of public services and local government administration have units to monitor language compliance in ministries and municipalities respectively. Official documents are being translated in most of the municipalities and most municipalities comply fully or partially in terms of the language. Most ministries' websites offer a Serbian language version.

The provisional institutions of self-government authorities have redoubled efforts to replace or repair road and place-name signs where names written in Serbian have been defaced.

However, in many cases there has been insufficient allocation of resources to ensure compliance with language standards. The law on languages still needs to be adopted. Numerous provisional institutions' websites are only partially translated or regularly updated.

The first phase of consolidation and emergency works on 30 orthodox sites damaged during the March 2004 riots was completed in December 2005 under the lead of the Reconstruction Implementation Commission. In June 2006, the SRSB assigned the Kosovo protection corps a major role in completing the reconstruction work and in utilising the KPC's humanitarian and public services to help resolve other pending claims related to the March 2004 reconstruction programme throughout Kosovo.

The third meeting of the cultural coordinators appointed by the ministers of culture of Serbia and Kosovo took place in Pristina in May 2006.

In April, the SRSB signed an executive decision extending the special zoning area around the world heritage site, the monastery of Deçan/Dečani. The special zoning area around the monastery prohibits illegal construction, industrialisation and unregulated exploitation of natural resources near the monastery.

Radio Television Kosovo minority programming amounted to 9.2% of RTK broadcast time, significantly less than the 15% required by both the relevant UNMIK regulation and the new law. The system for awarding and administering grants for the minority media fund has been finalised in accordance with the strategy for minority broadcasting. The government has allocated € 50,000 and the RTK Law allocates 5% of the broadcasting fee to the fund. The first grants were distributed in July 2006.

However, there has been an increase in incidents relating to cultural heritage, property and monuments which involved damage to cemeteries, thefts from Serbian Orthodox churches and damage to religious sites.

Concerning the situation of the **Roma**, some progress has been achieved in the reconstruction process of the largest informal settlement in Kosovo, Roma Mahala of Mitrovica. Here the municipality issued construction permits for two apartment blocks that will host some of the inhabitants.

Some of the potential beneficiaries, 58 Roma, Ashkali and Egyptian IDP families, have moved out of the lead-contaminated camps in northern Mitrovica and Zvečan/Zveçan into

lead free facilities in the northern part of the city. However, about 170 individuals opted to remain in the contaminated camps.

In May 2006, social housing complexes, funded through the Kosovo consolidated budget, were inaugurated in Lipjan/Lipljan municipality and Plemetin/Plemetina village for some 62 Roma, Ashkali and Egyptian families from the Plemetin/Plemetina camp for internally displaced people.

However, the situation of the Roma, Ashkali and Egyptians continued to be difficult. Most members of these communities live in informal settlements, with serious lack of access to public services, income generating activities and education. They also lack access to documentation.

An estimated 200,000 **internally displaced persons and refugees** have been displaced since 1999. As of 31 August 2006, 3,236 people returned voluntarily in 2005 and 2006. The highest number of returns took place in the regions of Pec and Pristina. The total number of minority returnees since 1999 is estimated at 15,615. Out of approximately 515 families that were displaced in March 2004, 154 have returned to their homes permanently. Urban returns are on-going. Some 36 Kosovo Serb families have returned to urban Klina.

The signature of a Protocol on Voluntary and Sustainable Return⁴ between UNMIK, the PISG and Serbia is a positive step. The protocol seeks to improve the conditions for return and enhance capacity for implementation of the return process through provisions that range from providing access to basic services for the returnees to promoting integration of internally displaced persons.

In May 2006, the government promulgated updated return policies and procedures. The ministry of communities and returns has made efforts in taking up its mandate but does not fulfil its role effectively and the cooperation with other organisations has continued to be challenging.

The process of forced returns from third countries has continued. In 2005, 3750 mainly Kosovo Albanian people were returned to Kosovo, mainly from Germany, but also from Switzerland and Sweden. The reception and integration mechanisms for returning individuals remain weak and no reconstruction assistance is provided to these individuals. Few are eligible for social assistance. UNMIK has started pilot projects with the International Organisation for Migration and municipalities to ensure proper reception mechanisms.

In June 2006, the community security council was established to fill the gap in cooperation between agencies by providing an executive forum to discuss and work towards common policies and activities. The plan will be led by the Prime Minister's office in close coordination and cooperation with all local and international stakeholders and include a secretariat.

Communities and mediation committees have been established in all municipalities. Communities committees are operating in 10 municipalities, and partially operating in 15 municipalities.

⁴ Protocol on voluntary and sustainable return, signed by UNMIK, the PISG and the government of Serbia on 6 June 2006.

2.3. Regional issues and international obligations

UNMIK remains responsible for cooperation with the **International Criminal Tribunal for the former Yugoslavia** (ICTY), whereas certain related tasks have been delegated to the provisional institutions of self government. These include KPS investigations into crimes committed against war crimes witnesses, which has sometimes been detrimental to prosecution efforts. Access to documents and the protection of witnesses also need to be enhanced.

As regards **domestic war crime trials**, no war crimes cases are currently being handled by local courts and/or prosecutors directly. International judges have started to try local war crimes but there have been few convictions. The domestic prosecution and trial of war crimes remains a problematic issue, partly because of insufficient witness protection mechanisms.

Regional cooperation and good neighbourly relations form an essential part of the process of Kosovo's moving towards the European Union. Kosovo has further increased its participation in regional co-operation initiatives⁵.

Kosovo continues to actively participate in Stability Pact activities. It is committed to the establishment of the Regional Cooperation Council. The SRSG and the Prime Minister participated in the Bucharest meeting on 6 April, where a joint declaration was approved on the establishment of a regional free trade area within the framework of an enlarged and amended Central European Free Trade Agreement (CEFTA). In September and October 2006, free trade agreements were signed with respectively Croatia and Bosnia and Herzegovina. Kosovo has also concluded bilateral free trade agreements with Albania and the former Yugoslav Republic of Macedonia. In April 2006, Kosovo signed an investment protection agreement with Turkey. (in 2002 a similar agreement was signed with Albania).

Kosovo is party to the Energy Community Treaty that entered into force in July 2006. It also signed the agreement on the European Common Aviation Area in June 2006.

Bilateral relations with partners in the region continue to develop, in particular with *Albania, Montenegro, the former Yugoslav Republic of Macedonia and Bosnia and Herzegovina*. The completion of the demarcation of the border with the former Yugoslav Republic of Macedonia remains to be resolved, but dialogue with Skopje on this matter has been increasingly constructive. Co-operation with the former Yugoslav Republic of Macedonia also resulted in the reopening of a regular passenger rail service between Skopje and Pristina, which had been interrupted since 1999.

3. ECONOMIC CRITERIA

3.1. Introduction

In examining the economic developments in Kosovo, the Commission's approach was guided by the conclusions of the European Council in Copenhagen in June 1993, which stated that

⁵ Under UN Security Council Resolution 1244, Kosovo's participation in regional fora and negotiation of international agreements falls under UNMIK authority. However, PISG line ministries are closely associated in these initiatives to ensure that the Kosovo government is fully capable of fulfilling its obligations under the constitutional framework for self-government.

membership of the Union requires the existence of a functioning market economy, and the capacity to cope with competitive pressure and market forces within the Union.

3.2. Assessment in terms of the Copenhagen criteria

3.2.1. The existence of a functioning market economy

Economic policy essentials

The budget remained the main macro-economic variable of adjustment under the current monetary situation with the euro as legal tender. The authorities finalised the first Medium-Term Expenditure Framework (MTEF) in March 2006 on the basis of which a donor meeting took place in early April 2006. In line with the requests from the international community, this MTEF consolidated all budget and off-budget expenditure and resources and covered both recurrent and investment expenditures, including public investment projects. A medium-term economic policy framework was defined with the support of the IMF by a Letter of Intent and a Memorandum on Economic and Financial Policies, which aims to ensure a sustainable fiscal path. It was then signed by UNMIK and Provisional Institutions of Self Government (PISG) in November 2005. Consensus on the fundamentals and directions of economic policy was maintained. However, substantial weaknesses in compliance with the agreed policies and commitments surfaced in the first half of 2006 as their implementation lacked guidance and monitoring.

Macroeconomic stability

Economic developments continued to be shaped by a decline in donors' support and a lack of dynamism of the economy. According to IMF estimates⁶, GDP is estimated to have declined by 0.2% in 2005. There have nevertheless been some signs of recovery over the first half of 2006, mainly due to the resilience of private sector activity. Significant increases in the number of new businesses registered, tax revenues, and trade, as well as steady growth in credits provided to businesses are underlying this trend. Kosovo has a per-capita GDP of around €1,100. The World Bank estimates that around 37% of the population live in poverty, with around 15% living in extreme poverty. The negative growth in 2005 is a particular concern in view of the territory's considerable development needs. The overall economic situation in Kosovo remained bleak.

The trade deficit of Kosovo continued to be considerably high, at around 43% of GDP in 2005. The current account deficit -after foreign assistance- remained close to 15% of GDP in 2005. The exports remained extremely low (14 times lower than imports in 2005), mainly due to a lacking export capacity and competitiveness. Given the limited foreign direct investment (FDI) inflows, the financing of the current account deficit continued to rely on foreign assistance (decreasing from 24% of GDP in 2004 to 21% of GDP in 2005) and, to a lesser extent, on private capital transfers (17% of GDP in 2005). Still, a modest gradual increase in FDI inflows has been recorded, in the wake of acceleration of the privatisation process. It reached 3.0% of GDP in 2005. This positive trend continued in the first half of 2006. Overall, the external accounts of Kosovo have remained precarious.

Unemployment is estimated between 42-44% in 2005, according to national sources. However, the real unemployment rate might be lower due to the existence of a sizeable

⁶ Macroeconomic data in this report are based on the IMF staff estimates, except otherwise indicated.

informal economy. Long-term unemployed represented 90% of the total registered unemployed. The number of registered job seekers increased by 6% year-on-year to around 320,000 in 2005 and further to over 323,000 by June 2006⁷. Labour costs in Kosovo remained excessively high in regional terms, dampening private sector development and export competitiveness. Registered female unemployment accounted for almost two thirds of the total. Overall, the level of registered unemployment remained high.

The euro continued to be the main currency in circulation. The Central Banking Authority of Kosovo (CBAK)⁸ is in charge of regulating foreign exchange operations, providing payments services and supervising banks and other financial institutions. The CBAK closely monitors liquidity in the banking sector and credit expansion, with liquidity ratios and reserve requirements as main tools of intervention. The monetary aggregate M2⁹ declined by 3% in 2005 and remained stable in the first seven months of 2006. The monetary framework remained anchored on the use of the euro as sole legal tender.

The downsizing of the international community's presence continued and led to deflation. The international community in Kosovo had boosted prices in the early years of UNMIK's mandate. Its downsizing resulted in adjustments downwards, also reflecting the weakness in economic activity. Consumer price index inflation fell on average by 1.9% in 2005. The relative price adjustment continued also in 2006 as the general price level further decreased by 1.3% over the first seven months of 2006¹⁰. Inflation remained negative.

The budget deficit was curbed down after a peak in 2004 at 6.0% of GDP to 3.2% of GDP in 2005. The share of capital expenditure fell from 23% in 2004 to 19% in 2005. The reserve of accumulated cash deposits, the only source of financing the deficit, fell by €70 million in 2005, reaching €113 million at end-of-year. Given a foreseeable exhaustion of this reserve in the near future and the impossibility of the PISG under the current UN mandate to finance the deficit through public borrowing, the fiscal situation has become particularly tense. In the first half of 2006, revenue collection met the budget target, while expenditure was realized only up to 71% for the same period¹¹. This resulted in a budget surplus of €76 million by 2006, which was higher by 139% than in the same period in 2005. Capital investment realized over the first semester of 2006 registered the most significant decrease and amounted to 45% compared to the same period last year. Fiscal policy has been tightened.

Good progress was achieved at the end of 2005 and the first quarter of 2006 in the authorities' efforts in complying with Letter of Intent commitments. However, the second quarter of 2006 saw lesser efforts by the authorities, particularly in promoting and facilitating a sustainable fiscal position over the medium term. This concerns the promulgated Law on War Martyrs. Implementation of this Law would have considerable costs and lead to an unsustainable fiscal situation. In addition, little progress has been achieved in targeting social benefits to the most needy and in developing the civil service reform. Co-operation with the IMF and full compliance with the commitments in the Letter of Intent needs to remain an absolute priority

⁷ M2: measure of money in circulation which includes all physical denominations of coins and currency, demand deposits, and travellers' checks, plus net time deposits (other than large certificates of deposits).

⁸ In August 2006, the SRSG signed a new regulation transforming the Banking and Payments Authority of Kosovo (BPK) into the CBAK.

⁹ Source: Kosovo Business Register.

¹⁰ Source: Statistical Office of Kosovo (SOK). In 2006, the SOK changed the methodology for calculating the CPI. The historical data were however not revised accordingly and thus, the reliability of annual inflation estimate for July 2006 was limited.

¹¹ Data of the Ministry of Economy and Finance.

for the authorities of Kosovo. Overall, the macroeconomic policy mix was broadly adequate. However serious challenges remain in implementing the policy framework contained in the Letter of Intent.

Free interplay of market forces

Private sector investment accounted for 20% of GDP in 2005. Privatisation of socially-owned enterprises progressed markedly in 2005 and continued in 2006: the 18th wave was launched in August 2006. The Kosovo Trust Agency aimed at privatising 90% of total assets and 50% of the total number of socially-owned enterprises by the end of 2006. By June 2006, 178 enterprises have been tendered and 143 sales contracts have been signed. As a result, total privatisation proceeds amounted to 10.5% of GDP by September 2006. The sale of Ferronikeli, an industrial minerals company, was concluded in April 2006, and represented the most important privatisation operation so far. The private sector further expanded, also on the back of acceleration of the privatisation process.

Free market entry and exit

The number of new businesses registered increased considerably, by 29% in 2005, corresponding to over 11,000 new registrations. The total number of registered businesses stood at 53,700 at the end of June 2006¹². Kosovo had a short (on average 23 days¹³) and lean (requiring 5 procedures) market entry process in 2005. In addition, the average cost of starting a business (5.5% of income per capita), rigidity of employment index and number of days needed to register a property appeared to be relatively low. However, due to an inefficient judiciary and to legal uncertainty with respect to enforcement of property rights, Kosovo showed high levels of indicators measuring costs to create collateral, the average number of procedures to resolve a dispute (requiring on average 22 procedures) as well as regards costs to close a business (18% of the respective estate). Kosovo continued to offer a business-friendly environment in terms of minimum administrative requirements for market entry. However, deficiencies in law enforcement and the judicial system, corruption, uncertainty over property rights and the status, as well as poor infrastructure and unreliable electricity supply, continue to impede investment and economic activity.

Adequate legal system

The efficiency of the judiciary system and law implementation remained low and only little progress was made in enforcement of court rulings and the establishment of property rights. The business environment and investment activity in particular continued to suffer from legal uncertainty. This was also due to the unresolved status of Kosovo, contingent liabilities and wide-spread fraudulent practices. Overall, the fundamentals of the legal framework of Kosovo remained sound and market-oriented. However, significant shortcomings in the rule of law continued to hamper economic activity and investment.

Sufficiently developed financial sector

The level of financial intermediation remained low. At the end of 2005, loans reached only 21% of GDP and assets 39% of GDP. The main factors behind are high interest rates (the

¹² Source: Kosovo Business Register.

¹³ Indicators covering quality of the business environment mentioned in this report are based on the World Bank's "Doing Business" business conditions index methodology.

spread between the deposit and loan rates is more than 12%), low competition in the banking sector and legal uncertainty, including concerning the recovery of collateral. Credit growth remained substantial (38% year-on-year in 2005 and 30% year-on-year as of July 2006, down from 61% in 2004). In particular, loans with a maturity of over one year grew by around 50%. Recently the structure of credits shifted towards long-term credits and credits provided to non-financial corporations. However, most of the loans have still been of a rather short-term maturity, mainly due to the reluctance of banks to take significant risks.

The volume of non-performing loans decreased slightly to 2.5% in 2005. The CBAK launched the Kos-giro project in 2005, which introduced a new system for processing domestic payments. The aim was to develop low value / high volume retail transactions. Although the system was fully operational, it was not yet accepted by all commercial banks. The Credit Register of Kosovo was established to improve the efficiency of the banking sector. Credit expansion continued, nevertheless from relatively low levels.

The capital adequacy ratio of commercial banks was 14.7% at the end of 2005, down from 16.7% in 2004. Local banks remained very liquid, with a loan-to-deposit ratio of around 61% at the end of 2005 and 70% in July 2006. This was partly as a result of high prudential requirements set by the CBAK. The CBAK also increased minimum capital requirements for banks to €5 million in 2005 to bring capital standards more in line with EU directives. The minimum liquidity reserve ratio remained at 10% of the banks' deposits.

The competition in the banking sector remained limited. In March 2006, the CBAK revoked the licence and ordered the closure of the Credit Bank of Pristina, with little detrimental impact on the credibility and liquidity of the overall financial sector. Since then, there have been only six commercial banks operating in Kosovo. As a result, the degree of concentration of the three largest banks further increased in terms of assets by 6%, reaching almost 80% of total banking sector deposits. Around 55% of the equity of all banks was owned by foreign capital at the end of 2005. The banking sector in Kosovo appeared to be sound, profitable and well capitalised. Still, the available financial indicators should be interpreted with caution.

3.2.2. The capacity to cope with competitive pressure and market forces within the Union

Existence of a functioning market economy

A continuous and rapid shift from donor-financed investment to investment financed from the budget has created substantial pressure on both fiscal and external sustainability. Macroeconomic stability has not yet been satisfactorily achieved in Kosovo so far, mainly due to the fragile fiscal and unsustainable external position.

Sufficient human and physical capital

The education system in Kosovo suffered from a lack of necessary capital investment. The adult illiteracy rate in Kosovo remained high, at around 6% of the population. The municipalities, which had the administrative and financial responsibility for primary and secondary schools, continued to lack adequate resources which were previously provided by donors as well as necessary administrative skills. The overall education expenditure provided from the Consolidated Budget amounted to 4.7% of GDP in 2005. It remained stable as compared to 2004. In addition to capital investment, the quality of education needs to be further enhanced.

Local infrastructure continued to urgently need maintenance, repairs, upgrading and extension, especially the energy and transport infrastructure. Investments were often delayed, leading to under-spending in budgeted capital expenditure in 2005. This was, mainly due to a lack of institutional capacity for procurement. The power supply infrastructure remained unreliable and frequent power cuts negatively affected private sector productivity. Local companies considered this as the biggest single impediment to enterprises performance and investment. KEK, the electricity utility, was not able to reduce operational and technical losses and substantially improve its financial situation. It was only able to respond partly to local energy consumption needs and a large share of KEK's considerable financing needs could not be met. As a consequence, electricity had to be imported. Infrastructure remained insufficient and often of poor quality, in particular in the energy sector.

Investment dropped somewhat in 2005 and was estimated at around 27% of GDP. Private investment nevertheless picked up in 2005 and accounted for about 72% of the total in 2005, increasing from 61% in 2004. Half of private investment was allocated to housing. However, these figures should, in the absence of reliable economic statistics, be interpreted with caution. They could be revised considerably in future revisions. Investment provided by foreign donors more than halved in 2005, accounting for 6% of the total. Government capital expenditure decreased by 23% to 5.9% of GDP in 2005 and by 45% in the first half of 2006 compared to the same period last year. Gross fixed capital formation remained insufficient in view of the considerable investment need.

Adequate sectoral and enterprise structure

Only limited reliable data on the sectoral structure of production and employment were available for the reporting period. The share of the main sectors was relatively stable according to the first set of national accounts prepared by the Statistical Office of Kosovo for the years 2002-2004. The contributions to GDP in 2004 were as follows: agriculture and fishing 9% of GDP, mining, manufacturing, electricity and water 15% of GDP and services 76% of GDP. Shifts in sectoral structures in the Kosovo economy are not well recorded.

Small firms continued to represent the bulk of businesses in Kosovo. The number of enterprises of less than 9 employees accounted for 99% of all registered enterprises in 2005. Sole traders or single owner businesses represented 94% of total number of enterprises. Almost half of the SMEs undertake trade-related activities 32% production facilities, while 18% are service based, according to a survey conducted in 2005 by the Department of Private Sector Development under the Ministry of Trade and Industry. Nearly 61% of SMEs were managed by their owner. Kosovo Investment Promotion Agency was established following the introduction of the Law for SMEs in September 2005, to support and assist foreign investors. Overall, high cost and difficult access to external finance, unreliable power supply and underdeveloped infrastructure remain the main barriers to business.

State influence on competitiveness

Incorporation of publicly-owned enterprises (POEs) progressed markedly. The Kosovo Post and Telecommunications utility and Pristina Airport were incorporated in June 2005, while the incorporations of KEK, UNMIK Railways (re-named Kosovo Railways) and two District Heating enterprises were completed at the end of 2005. Preparations for another round of incorporation started in the last quarter of 2005. These will include water, waste and irrigation

enterprises, with the support of international donors. Progress was made in unbundling KEK into two subsidiary enterprises¹⁴. This is in line with provisions foreseen in the Energy Community Treaty, signed in October 2005 and put in force in mid-2006. Little progress was however recorded in bringing KEK closer to financial sustainability by improving poor billings and collections. This is a crucial issue and needs to be tackled without delay. In the current circumstances KEK is unviable and represents an impediment to economic development. KTA introduced in 2006 a Code of Corporate Governance for POEs, based on OECD guidelines which established a set of minimum corporate governance standards.

Considerable subsidies continued to be provided to public enterprises and socially-owned enterprises, mainly KEK and Trepca. These constitute a major burden on the budget. Subsidies and transfers provided from the Consolidated Budget reached 3.6% of GDP or 12% of the budgeted revenues in 2005. Around 70% of the total subsidies was allocated to KEK (2.5% of GDP) and around 17% to the industrial company Trepca (0.6% of GDP).

Trade integration with the EU

The value of Kosovo's exports and imports of goods and services accounted for about 70% of GDP in 2005. Imports accounted for 57% of GDP, slightly higher than in 2004. Exports to the EU represented about 36% of total exports in 2005, according to national sources. Imports from the EU accounted for approximately 35% of total imported goods and services. Kosovo's exports continued to be directed mainly to South East European countries, which accounted for almost 60% of the total exports in 2005. The main countries of destination were the former Yugoslav Republic of Macedonia (20%), Serbia and Montenegro (14%) and Albania (11%). Imports from the South East European countries represented about 48% of the total imports in 2005. The main countries of origin for the imports were the former Yugoslav Republic of Macedonia (19%), Serbia and Montenegro (14%) and Turkey (7%). The degree of openness of Kosovo's economy somewhat increased in 2005.

Kosovo's export structure continued to be geared towards lower value-added goods. Metals and scraps together with plastics and wood together account for almost 70% of Kosovo's total exports¹⁵. A decrease in the share of skin and leather products in total exports was compensated for by a gradual increase in food products. These also increased in absolute terms. The main commodity products imported to Kosovo in the first quarter of 2006 were mineral products (22%), machinery and electronic equipment (15%) and food products (13%).

4. EUROPEAN STANDARDS

This section examines Kosovo's capacity to gradually approximate its legislation and policies with those of the *acquis* related to the internal market, sectoral policies, and justice, freedom and security, in line with the Stabilisation and Association Process and the European Partnership priorities. It also analyses Kosovo's administrative capacity.

¹⁴ These are the independent Transmission, System and Market Operator JSC, owning the fixed assets relating to the transmission network, and KEK JSC, the entity dealing with power generation, distribution and supply.

¹⁵ Source: SOK, based on the first quarter 2006 data.

4.1. Internal market

4.1.1. Free movement of goods

Progress regarding **standardisation and certification** as well as conformity assessment activities has been very limited. The Kosovo Standardisation Agency (KSA), which was formally established in March 2005, is not yet fully operational. As long as Kosovo's status remains unresolved, the KSA cannot become a member of European or international standardisation organisations. In particular, its non-membership of the International Organisation for Standardisation (ISO) and the resulting impossibility to co-operate with the European standardisation organisations (CEN and CENELEC), constitute an obstacle for the development of standardisation in Kosovo.

The Law on Accreditation was promulgated by the SRSB in May 2006. The Law regulates the scope of activities of the accreditation unit within the Kosovo standardisation agency. It stipulates that accreditation procedures should be implemented on the basis of European and international standards.

Kosovo's **metrology** system started to develop only recently. The Law on Metrology, which was also promulgated in May 2006, regulates the metrology system, including legal, scientific and industrial metrology. The law provides for a metrology department of Kosovo as an executive agency within the ministry of trade and industry.

Besides the Law on General Product Safety, EU directives on free movement of goods have not yet been transposed or implemented. Horizontal legislation and coordination structures concerning **market surveillance** issues need to be further developed and sectoral product legislation adopted.

The ministry of trade and industry has approved a regulation on technical equipment designed for usage in limited tensions, based the EC low voltage directive. The ministry has also approved an administrative directive on conformity markings and their graphical presentation. Based on this directive municipal inspectors have begun inspections of sale points.

The Law on Internal Trade of 2004 is in the process of being implemented (*see section 4.2.1 on industry and SME*).

There has been some limited progress in the area of **consumer and health protection** on the basis of the law on consumer protection.

Overall, progress as regards the establishment of the necessary quality infrastructure has been limited.

4.1.2. Movement of persons, services and right of establishment

Movement of persons is primarily hampered by the political situation and real and perceived security threats. The northern municipalities' decision to cut all ties with UNMIK/PISG has further reduced the already very limited movement of persons, services and companies between those municipalities and the rest of Kosovo.

In September, the Banking and Payment Authority of Kosovo (BPK) was changed into the Central Banking Authority of Kosovo (CBAK). The banking authority's powers have been broadened to ensure operational independence and neutrality. Its governing board will be

composed of five SRSG-appointed members, three out of which will be Kosovans. Furthermore the banking authority's international functions have been enhanced and it will play a greater role in the field of economic information.

There has been some progress in strengthening the supervisory process in the financial sector. In March 2006 the former BPK revoked the licence of one commercial bank. All commercial banks and a number of micro-credit institutions have made their credit information available to the credit register of Kosovo.

Overall, some progress has been made since the previous report.

4.1.3. *Free movement of capital*

Legislation on the deterrence of money laundering and related criminal offences is in force (*see section 4.3.2 on money laundering*). Apart from this legislation, financial capital movements into and out of Kosovo remain unregulated.

In the northern Kosovo Serb municipalities and a few other Serbian enclaves, payments are still made mostly in Serbian dinars rather than in Euro. This poses an obstacle to the free movement of capital and payments within Kosovo and undermines the authority of the BPK in those areas.

4.1.4. *Customs and taxation*

Customs is still a reserved competence of UNMIK, although the day-to-day management is handled by locals, with three international staff remaining in the customs service. In January 2006, the post of deputy director general was filled by a Kosovan. UNMIK customs has a staff of 570 trained officials who collect approximately 65% of revenues for the Kosovo consolidated budget. Kosovo's general trade regime is based on a 10% flat-rate customs duty on imports, although a few exceptions exist regarding customs duties on certain capital goods and raw materials. There are no customs duties on exports and on goods entering from Serbia and from Montenegro. No tariff quotas or tariff suspensions are applied.

The new customs code (from March 2004) is expected to become operational by 1 January 2007 and will bring further alignment with the *acquis*. Except for IT compatibility and risk management, most areas of UNMIK customs are compatible with EU regulations.

A revised Integrated Tariff for Kosovo (TARIK) entered into force on 1 July 2006. TARIK is available on the UNMIK customs Service website and on special TARIK-CDs. It has been fully incorporated into the computer system (Integrated Tariff Management System – ITMS) in Albanian, Serbian and English from February 2006.

A comprehensive reorganisation of UNMIK customs took place in April 2006. The intelligence unit and the investigation unit were strengthened. Risk management was introduced in the customs service in April and has been a priority throughout 2006. Significant progress has been made in terms of training. The first risk assessment strategic model, as of spring 2006, has been produced by UNMIK customs. Cooperation with the Border/Boundary Police is ongoing in the area of risk assessment with a joint approach in common areas of interest. A pilot project to introduce selective controls based on risk assessment at the main border post with the former Yugoslav Republic of Macedonia (covering 90% of border traffic) has brought positive results. 15 flexible customs teams are operating Kosovo-wide.

However, there is no customs laboratory in Kosovo. UNMIK customs uses private laboratories on a needs basis. Important mismatches between the data on exports from Serbia to Kosovo and on imports from Serbia into Kosovo suggest that an important amount of goods entering from Serbia is not properly declared. There are frequent reports about disappearance of cargos between the administrative boundary and the customs terminal in North Mitrovica, as well as about the existence of a parallel customs and taxation system operated by the Serbian authorities in the northern municipalities of Kosovo. Investigations on these issues are hampered by the fact that Kosovo Albanian investigators cannot carry out their tasks in the northern municipalities. No intelligence activities can be conducted in the north. No Kosovo Serbs working in the intelligence and investigation units of UNMIK customs.

In the field of **taxation**, VAT was introduced in Kosovo in 2001 with a standard rate of 15%. Some zero-rates on domestic products are not compliant with the *acquis*. The current VAT registration threshold is too high.

A new draft law on VAT has been prepared in close cooperation between the tax administration of Kosovo and the ministry of economy and finance. It was forwarded for approval to the government of Kosovo in May 2006. The draft is broadly compatible with the *acquis*. There are four personal income tax rates (0-20%); the corporate income tax rate is 20%.

However, Kosovo has not yet carried out a gap analysis, aimed at identifying existing harmful measures which could contradict the Code of Conduct on Business Taxation. Tax reforms in the field of direct taxation need also take account the company tax directives. A Treaty Network based on the latest OECD model should be completed. Domestic tax collection is very weak, and in 2005 approx. 65% of revenues were collected by customs. Tax revenue amounts to around 20% of GDP. There is a large grey economy and a reform of tax collection and control is needed to progressively move toward EU standards.

Regarding administrative capacity, a gap analysis with the EU tax blueprints has been carried out and concluded that there are five taxation areas in need of significant support to develop toward EU standards: human resources management, administrative cooperation and mutual assistance, fraud and tax avoidance, information technology, and communications. There is a need to set up a working group to work on the follow up.

Overall, significant progress has been made within the UNMIK customs service. Customs legislation is broadly in line with the *acquis* and good progress has been achieved in several areas related to administrative capacity in the customs area (e.g. computerisation, risk analysis, fight against corruption), although further progress is needed. Some progress has been made in the area of taxation; however tax collection remains very weak.

4.1.5. *Competition*

Little progress can be reported in the area of competition and state aid. In the area of **anti-trust**, the Kosovo competition council is in the process of being established.

4.1.6. *Public procurement*

The Public Procurement Law was promulgated by the SRS in 2004 but encountered serious difficulties in its application. The Law has therefore been subject to a lengthy revision process. A new draft law was presented to the Assembly in May 2006 and is intended to be in

line with EU standards and requirements. The revised draft provides for a separation between regulatory and judicial functions: the former should be under the responsibility of the public procurement regulatory commission, while the latter should be exercised by a judicial review body. In June 2006, the Assembly sent the draft law back to the Government on procedural grounds, requesting that the new law should be presented in the form of amendments to the old law.

In order to facilitate the procurement process, a set of secondary legislation has been adopted such as rules, directives, documents and application forms which contracting authorities, procurement officers and other authorities have to implement during the exercise of procurement activities.

However, it is unclear when the new Public Procurement Law will be adopted. Between November 2005 and April 2006, the Office of the Auditor General issued 17 external audit reports regarding procurement procedures in municipalities and some ministries. The auditors noted widespread non-compliance with laws and regulations regarding procurement.

Overall, this remains a problematic area. While steps have been taken that may help to overcome certain difficulties in the future, no progress can be reported at this stage. Preparations for alignment with the *acquis* in this field are lagging behind.

4.1.7. *Intellectual property law*

Protection of intellectual, industrial and commercial property rights remains insufficient. The area has not yet been given appropriate administrative and political attention. Intellectual property rights are infringed upon in Kosovo in a widespread and visible way. Counterfeit consumer goods (notably CDs, DVDs, software and clothing) are available for sale and traded openly.

Overall, very limited progress in the field of protection of intellectual and industrial property rights has been made. Steps need to be taken both in terms of legislation and capacity building as well as in terms of enforcement mechanisms.

4.1.8. *Social policies*

Unemployment in Kosovo continues to be very high.

The capacity of the public employment service to assist the unemployed with labour market integration has been developing, but its ability to deal with the chronic numbers of jobless is severely constrained. The role of an employment office is fulfilled by the division of employment of the labour and employment department of the ministry of labour and social welfare. The division has approx. 330 staff, including seven regional employment centres and 22 (sub-) municipal offices. The division largely plays a passive role, mainly registering unemployed persons. No pro-active labour market measures are planned as there is no budget for this. There are no unemployment benefits. As few jobs are advertised via the employment centres and municipal offices (not even public employers are obliged to advertise there), the number of people who find jobs there seems to be very limited.

A network of eight vocational training centres, which is also part of the ministry's labour and employment department and employs approximately 140 staff, provides training courses for unemployed people. These courses tend to reflect local employers' needs, but demand for courses far outweighs supply.

Social assistance covers some 20,000 persons as the requirements are very strict (capable and willing to work and unemployed and with a child younger than five). Beneficiaries receive around €40 per month. Public health benefits tend to be very limited in practice, as patients frequently have to bring their own medicines and pay for medical services.

The **labour law** framework provides for basic protection of worker's rights and the prohibition of compulsory labour and child labour. A labour inspectorate within the ministry of labour and social welfare is responsible for enforcing labour standards, but lacks the skills and resources to do so effectively. In October 2005, the SRSG promulgated the Law on Social and Family Services, which regulates the provision of social and family services to persons and families in need.

The **Gender Equality** Act of 2004 provides that equal treatment means the elimination of all forms of direct and indirect discrimination. Both concepts are defined in the law, as are harassment and sexual harassment. Women have the right to return to the same position after maternity leave.

The office for gender equality, established in 2005 within the office of the Prime Minister, has initiated a range of activities including workshops, trainings and seminars aimed at improving the position of women in public institutions. In May 2006, the government approved a strategy to increase the number and improve the position of women in the PISG between 2006 and 2015.

However, unemployment among women may be as high as 60% and the lack of child care has a detrimental effect on women's decisions to return to work. The combination of women's low participation and high unemployment rates leads to an extremely low employment rate – only 10% according to some estimates. The office for gender equality does not provide any assistance to victims of discrimination.

People with **disabilities** continue to face poor access to healthcare and a weak legal position. Little progress has been made regarding the inclusion of disabled children into mainstream society. A new Criminal Law requires persons with mental disabilities currently placed in prisons to be transferred elsewhere, but there is a significant lack of capacity and the persons concerned continue to be confined in prisons alongside non-disabled criminals.

In relation to the **education system**, laws on primary and secondary education and on higher education are in place. The administrative and financial responsibility for primary and secondary schools has been devolved to municipalities. Pre-primary, primary and secondary education is available in Albanian, Serbian and Turkish. The ministry of education is making efforts to offer Albanian and Serbian language classes to all communities in order to integrate them into the Kosovo educational system. Roma language school courses are being developed.

Two public universities operate in Kosovo. The university of Pristina operates under the authority of the provisional institutions whereas Mitrovica university operates under the authority of Belgrade. There are currently no Kosovo Albanians enrolled or teaching at Mitrovica University and no Kosovo Serbs at Pristina University. Some 15 private universities operate in Kosovo.

However municipalities often lack the necessary administrative skills to manage schools. Infrastructure is poor and schooling is provided in up to three shifts in extreme cases. Many vocational training and higher education programmes lack not only laboratories and

equipment, but also relevance to the labour market. The education system is characterised by high levels of early school leavers, in particular from vulnerable groups.

Kosovo's higher education is in a critical situation, lacking in quality curricula, staff development, administration and research. The quality of many private universities remains questionable. Pristina university is a member of the European University Association but is under observation following the institutional crisis. Pristina university is still highly politicised. Mitrovica university cut all links with the PISG and UNMIK in May 2004.

Overall, little progress has been made in the areas of employment, social policy and education. Improvements in these areas are costly and narrowly connected with economic development.

4.2. Sectoral policies

4.2.1. Industry and SME

A basic framework for SME support has been created. The Law on Support to SMEs was promulgated by the SRSG in September 2005. It provides for the establishment of an investment promotion agency. The agency has become operational and its chief executive officer was appointed in June 2006. The main role of the agency is advisory service and information, serving as a one-stop-shop for all investors.

SME access to finance is increasing with the financial system's recent growth. Credit expansion is high with an increase of around 20% from the end of 2004 to the end of 2005. Kosovo has 19 micro-finance institutions, of which eight dominate the micro-finance market with €36 million in loans. Micro finance institutions provide micro-loans to formal and informal SMEs, agricultural businesses and individuals. Kosovo has advanced in developing a voucher scheme for training and advisory services for SMEs.

Kosovo has established a fairly fast company registration process. The Law on Industrial Design was promulgated by the SRSG in April 2006. An important step forward in April 2006 was the adoption of the Law on Foreign Investment.

However, Kosovo has not yet developed a medium-term strategy on SME development and support. A short term SME strategy is not being implemented due to budgetary and staffing limitations. The administrative capacity in the ministry of trade and industry remains limited. No consistent approach to policies and actions in support of the development of the private sector has yet been formulated. The investment promotion agency operates with very limited staff and funds and the CEO currently covers also the function of director of the trade department. There is no systematic analysis of business barriers in Kosovo.

Progress in the implementation of the European Charter for Small Enterprises has been below expectations, due mainly to a lack of financial resources and insufficient human capacity in the provisional institutions.

The agency for SME support, foreseen in the law on SME support, has not yet been established due to budgetary limitations. However, the private sector development department of the ministry of trade and industry has partially assumed the role of the agency.

Overall, some notable but uneven progress has been made to improve Kosovo's business environment and SME policies.

4.2.2. *Agriculture and fisheries*

The **agricultural** sector remains strategic for the development and growth of Kosovo's economy. An agricultural and rural development master plan for 2007-2013 has been prepared by the ministry of agriculture, forestry and rural development in close cooperation with municipalities, NGOs as well as other relevant government institutions. The aim of the master plan is to create a mid-term framework for the agricultural sector. The master plan still needs to be integrated into the overall Kosovo development plan.

13 agricultural enterprises have been privatised during the reporting period.

However, the Kosovo consolidated budget allocates very limited funds to the agriculture and rural development sector to realise the priorities of the master plan. Agricultural products generally do not meet international standardisation and certification requirements necessary for exports. The expertise in the sector remains very low. The privatisation of agricultural socially owned enterprises remains problematic due to significant cadastral problems as well as illegal occupation and construction, that need to be solved before an enterprise can be privatised. The size and assets of farms are still characterised by a low level of productivity and production mainly for household subsistence.

Some limited progress has been achieved in the **veterinary** area. The Veterinary Law provides for the establishment of the Kosovo veterinary and food agency as an executive body under the ministry of agriculture, with organisational units in the municipalities. Experts from the new agency have completed three administrative instructions, transposing EU legislation on the hygiene of food stuffs, on specific hygiene rules for food of animal origin, and on specific rules for the organisation of official controls on products of animal origin intended for human consumption.

Identification and registration of live animals in all the territory of Kosovo was completed in May 2006. The sector for identification and registration of live animals within the Kosovo Veterinary and Food Agency has been equipped with hardware and software.

A programme for monitoring of residues has been adopted and is being implemented by the sector on drugs and residues within the Kosovo veterinary and food agency.

No development can be reported in the **phytosanitary** area. The Law on Food Safety has not yet been adopted, although it has passed the first reading in the Assembly. There has been limited progress in establishing the food safety control agency.

Overall, the situation of Kosovo's agricultural sector remains difficult.

4.2.3. *Environment*

Concerning **horizontal legislation**, the alignment process with the environmental *acquis* is making progress. Amendments to the Law on Environmental Protection in order to align it with EU standards are expected to be adopted in October 2006. A Law on Strategic Evaluation of the Environment is being drafted by the ministry of environment and spatial planning. No progress has been made towards ratification and implementation of respective international conventions in the field of environment. Further efforts are needed.

In May 2006, the ministry launched the Kosovo environmental action plan. Among other priorities, the implementation of the action plan should lead to the introduction of

environmental impact assessments. An information campaign on environmental protection, addressed to the citizens, has been launched by the ministry. The environment as a subject has been introduced into school curricula and more than 1,000 teachers have been trained on environmental protection issues. Civil society remains in relation to the environment remains weak, limiting its possibilities for participation in public awareness campaigns.

Good progress in legal approximation has been made in **waste management** with the adoption of the Waste Law in May 2006.

No particular progress can be reported regarding **water quality** and **air quality**. The Law on **Nature Conservation** was promulgated by the SRSG in April 2006. Implementing legislation is being drafted on the central register of the zones under protection; on marking the borders of the zones under protection; for the protection of caves; and on the Red Book (endangered and protected plant and animal species). The Assembly adopted the Law on Hunting in December 2005. Legislation in the field of **chemicals** is under preparation.

As regards **administrative capacity**, the new chief executive officer of the Kosovo environmental protection agency was appointed in June. The agency's responsibility is to carry out administrative, professional and scientific activities related to the protection of the environment. In addition, the inspectorate for environment, a department within the ministry, is responsible for monitoring the application of legislation on environmental protection (including water protection). Due to a lack of funding, the implementation of the environmental action plan has not yet begun.

Overall, there has been some progress in the field of environment. Kosovo continued its efforts to align itself with EU environmental legislation, institutions and standards. However, little progress has been made on the effective enforcement of environmental legislation.

4.2.4. *Transport policy*

In the field of **transport networks**, a multi-modal transport policy paper was adopted by the Government in March 2006. The main components will be included in the sectoral strategy currently being drafted by the ministry of transport and communications in the framework of the preparation of the Kosovo Development Plan. Kosovo is actively participating in the Core Regional Transport Network and in the South East Europe Transport Observatory (SEETO), in particular by approving the first Rolling Five Year Multi-Annual Plan 2006-2010 (MAP). Continued cooperation in the framework of SEETO is required in the context of the annual revisions of the plans in order to make further progress on the definition of regional priorities and the coordination of investments.

A transport strategy for minorities has been drafted by the ministry of transport and communications. The actual implementation of the strategy will become the full responsibility of the ministry from 1 January 2007.

However, the administrative capacity of the ministry of transport and communications to justify and prioritise investment needs and to develop a consistent and strategic approach to multi-modal transport remains poor.

The Law on **Road Transport** was promulgated in May 2005. The 2004 Law on Transport of Dangerous Goods is in the process of being fully implemented: a centre for issuing ADR (*Accord européen relatif au transport international des marchandises dangereuses par route*) certificates is under preparation and a train-the-trainers programme on ADR regulations and

procedures has been finalised. The Law on Road Safety has been approved by the Government and is now under review by the Assembly. Road safety improvement through education, changed behaviour of drivers and control of vehicles is one of the key priorities of the multi-modal transport policy paper.

A feasibility study and an environmental impact assessment are being carried out for the Merdarë – Pristina – Vermicë road to be linked with Corridor X in Serbia and with Tirana and Dürres, as well as for the Blacë – Pristina – Montenegro road to be linked with Corridor X in Skopje and with Podgorica. The implementation of the bilateral road transport agreement with Albania is on-going and a mutual technical team is operational. Technical meetings have taken place with a view to preparing such agreements with the former Yugoslav Republic of Macedonia and with Montenegro.

However, there is a need to create better transport links between Kosovo and neighbouring countries and to establish better control and maintenance mechanisms for public roads.

The incorporation process of UNMIK **railways** was completed at the end of 2005. The resulting joint stock company was registered under the new name "Kosovo Railways JSC". Furthermore, a functional board of directors has been set up and the establishment of advisory committees is in progress. Substantial work has been carried out to improve railway safety with the ongoing implementation of a project to refurbish interlocking systems and level crossing systems. Kosovo railways saw its container traffic increasing.

A passenger service between Pristina and Skopje resumed in February 2006 after having been interrupted since 1999. While important for citizens, the service is unlikely to become commercially viable and will depend on subsidies. One of the main objectives of Kosovo railways is the rehabilitation and modernisation of the north-south railway line (Railway Route 10), which connects Serbia, Kosovo and the former Yugoslav Republic of Macedonia.

However, major investments are needed to upgrade the railway infrastructure in order to improve safety and to purchase new rolling stock. Staff have difficulties in maintaining the old rolling stock. The railway regulatory office has not yet been established. Railway traffic to and from Serbia remains suspended.

In the field of **air transport**, by signing the European Common Aviation Area Agreement (ECAA), Kosovo has undertaken to integrate into the EU internal aviation market and to apply EU aviation standards. This will require the application of the ECAA agreement in practice and the fast implementation of the first transitional phase of the relevant aviation *acquis*, including market access conditions, safety, security, airport policy, environmental and social issues and air traffic control, in line with the European Partnership short term priority.

Pristina International airport received the "Best Airport 2006 Award" at the 16th Airports Council International Europe Annual Congress in Athens. The airport was selected as the winner in the category of airports serving fewer than one million passengers per year.

However, Serbia still does not grant airlines the right to use Serbian airspace for flights from and to Pristina International Airport, which leads to considerable extra flight-time and costs on flights between Kosovo and central and northern Europe.

Overall, good progress has been made in the area of transport, particularly in terms of strategic planning and international cooperation.

4.2.5. *Energy*

As regards oil stocks and security of supply, no progress has been registered. Kosovo does not hold sufficient oil stocks.

Good progress has been made in the electricity sector. A strategy on energy was approved in October 2005, and an implementing programme 2006-2008 has been established, aiming at rational and sustainable use of natural resources, economic and social development and environmental protection. Kosovo was the first signatory to ratify the Energy Community Treaty.

The energy regulatory office became operational in September 2005 and has issued substantial implementing legislation in the reporting period, including on tariffs, dispute settlement, licensing, and a code of conduct. The electricity market was opened in March when all four consumers connected at 110kV and over were declared eligible. It is not yet possible to identify consumers by their consumption levels due to inadequate supply.

However, Kosovo's electricity supply situation remains very difficult. The distribution network is in a very poor state after years of underinvestment and poor maintenance. Mining of the dominant fuel, coal, also suffers from underinvestment. The utility KEK lacks adequate funds to invest in and properly maintain the electricity supply system. Little progress has been made on promoting energy efficiency and renewable energies. Cash collection rates, although markedly improved, remain at unsustainably low levels and technical losses and theft remain very high.

Concerning nuclear safety, an appropriate regulatory body and necessary legislation to comply with the Community legislation is not in place. This relates in particular to environmental monitoring and radiation protection in connection with medical and industrial applications, including provisions on waste management and on control of radioactive sources.

Overall, while the some progress has been made in the energy area, particularly regarding reforms at the energy utility and in the preparations for a regional energy market, the sector remains in an acutely critical situation.

4.2.6. *Information society and media*

As regards **electronic communications and information technologies**, in April 2006, the government of Kosovo approved a strategy on information society for 2006-2012. The overall objective of the strategy is the creation of a favourable environment for the development of technology and human capacities in the field of information society.

The primary law on telecommunications of 2002 is based on the 1998 EU framework. However, much secondary legislation based on the 2002 Law on Telecommunications remains to be adopted. The telecommunications regulatory authority (TRA) does not yet have sufficient capacity to fulfil its role as the regulatory body in charge of implementation of the legislation. In general there has been limited progress with regard to introducing competition in the market. After the cancellation of the first selection procedure for the second mobile operator, there is still no competition in the mobile telephony market. In the fixed telephony market PTK remains the only operator licensed to offer fixed telephony services in Kosovo. Carrier pre-selection, number portability and local loop unbundling have not been introduced. No official reference interconnection offer is in place.

As regards **information society services**, some progress can be reported. In May 2006, new legislation on electronic commerce, electronic signatures and data protection was promulgated. However, the Council of Europe Convention on Cybercrime has not yet been ratified.

Reasonable progress has been made in **audiovisual policy**. The Law on Radio and Television of Kosovo was promulgated in April 2006.

RTK is the only Kosovo-wide broadcaster providing minority-language broadcasting. However, minority broadcasts amount to only 9.2% of broadcast time, thus falling short of the 15% required by the new Law. The Law on Defamation and Insult, which decriminalises these offences, has passed its first reading in the Assembly with the intent to establish the necessary safeguards in civil law.

The regulatory framework for Kosovo's media improved significantly during the reporting period. Kosovo is taking the right steps towards reform, although some important issues are still outstanding. The 2005 Law on the Independent Media Commission establishes an independent media regulator. The Council of the Independent Media Commission has now been appointed. The establishment of a multi-ethnic press council, comprising most of Kosovo's editors-in-chief, has added an important piece of self-regulation to Kosovo's media framework. The council is in charge of print media, has the right to impose sanctions, and can order media to print retractions or to execute other remedial action.

While the RTK law generally meets European standards, there are concerns about the impact it may have on the financial independence of the public broadcaster. The law does not define a minimum threshold for advertising of RTK. Moreover, the broadcasting fee, collected via the electricity bill, will no longer go directly to the RTK. Instead, it will be disbursed through the Kosovo consolidated budget instead of directly to the broadcaster.

Overall, there has been little progress in the area of information society and media. The market has been formally liberalised but in practice there is no competition in the fixed and mobile telephony markets. The market would benefit from a strengthened role of the regulatory authority. There is a lack of administrative capacity both in the regulatory authority and in the ministry of transport and communications.

4.2.7. Financial Control

There has been progress in the field of **public internal financial control (PIFC)**. The 2005 strategy paper has been updated. A sound basic legal framework with clear structures of accountability is in place. The establishment of internal audit units in all central institutions as well as in most municipalities is under way. The development of the system is under the responsibility of the ministry of finance and economy. An internal audit manual is available in Albanian, Serbian and English. Every municipality has between one and three internal auditors, but the system is still facing imbalances in terms of staffing levels as well as regarding its implementation across all parts of Kosovo. Professional training activities are ongoing.

A new Internal Audit Law has been drafted. It aims to create a central harmonisation unit in the ministry of finance and economy, responsible amongst others for the training and licensing of internal auditors. It is not fully in line with international standards. Ex-ante control does not yet exist but is foreseen in the draft Law on Public Financial Management and accountability.

However, while an overall-structure is largely in place, its effectiveness remains rather low. Audit reports are presented to the top management of the audited institutions, but managers often do not yet understand internal audit as a management tool. Moreover, the present legislation does not foresee auditors reporting directly to the higher management.

While responsibility for public internal financial control has been transferred to the provisional institutions, **external audit** – performed by the office of the auditor general – is still a reserved power. An audit office that would meet INTOSAI auditing standards is being introduced.

Overall, some progress has been made in the area of financial control, particularly regarding internal audit. The ministry of finance and economy has continued implementing its strategy to develop managerial accountability, internal control and functionally independent audit in the public sector.

4.2.8. *Statistics*

A new statistical law has been drafted and submitted to the government. Memoranda of understanding have been signed with important data providers in Kosovo. This ensures regular data delivery, for instance from the business register. The statistical office has also improved the dissemination of results by harmonising the lay-out and contents of publications and by launching a new website.

The statistical office's managers have taken part in training to improve their management capacity, and staff at all levels have taken part in language training, statistical software training and training in statistical methodology, generally with good results.

As regards sector statistics, a few new statistics have been established and a number of existing statistics have been improved. For demographic and social statistics the main issue has been the planned population and housing census. The cartography and the census questionnaires are at an advanced stage while work is on-going to improve other areas. Good co-operation has been established with the international monitoring operation of the census.

The labour force survey and household budget survey have been further improved. A working group for the development of education statistics has been established. Regarding macro-economic statistics, the development of national accounts is making progress. A framework for estimating GDP at constant prices has been created. GDP figures for 2002 - 2004 in current and constant prices have been published. In addition, the framework for calculating the informal economy has been further developed. Preparations for a business survey have begun. An agricultural household survey has been conducted, the results have been published and databases have been created.

However, the statistical infrastructure and the management capacity at the statistical office remain very weak. Frequent reorganisations at the statistical office have slowed down progress. The office faces severe constraints in the number and quality of its human resources. In the area of classifications, compliance with EU standards remains limited. Several important classifications have yet to be introduced. Many statistics can only be produced with external help. However, no progress has taken place regarding regional statistics and transport statistics.

Overall, the statistical system of Kosovo has made some progress in a few statistical areas and particularly in horizontal fields such as language, methodology and computer skills. The

situation in terms of harmonisation remains unsatisfactory. The statistical office's infrastructure, human and financial resources are limited.

4.3. Justice, freedom and security

4.3.1. Visa, border, control, asylum and migration

Kosovo does not have a **visa** regime.

Travel documents, identity cards and driving licenses issued by UNMIK comply with ICAO standards and include security features.

A memorandum of understanding was signed between the border police and customs in January 2006 to facilitate integrated **border management**. Working protocols have been established in key areas, with working groups for intelligence, operations, and administration/logistics. The agricultural border control is in the process of joining the MoU and its working groups.

Co-operation on cross-boundary issues with the Serbian customs and tax administrations is proceeding relatively well under working protocols agreed by UNMIK customs acting on behalf of UNMIK. Furthermore, memoranda of understanding on border issues have been signed with Kosovo's neighbours.

UNMIK Regulation 2005/16 has given the border/boundary police better control of people who enter, remain in or leave Kosovo and some positive results have been achieved regarding the trafficking of human beings (*see section 4.3.5 on fighting organised crime and terrorism*).

However, no formal system is in place to deal with **asylum** seekers, as this issue is not mentioned in Regulation 2005/16 on the Movement of Persons into and out of Kosovo. A review of the legislation is therefore required to clarify certain areas and to create comprehensive guidelines for asylum seekers.

Overall, limited progress has been made in the area of border management and migration.

4.3.2. Money laundering

The Financial Information Centre (FIC) has revised the anti-money laundering regulations with input from the Central Banking Authority of Kosovo (CBAK) (formerly Banking and Payment Authority of Kosovo – BPK)

The CBAK has revised its onsite examination procedures and has refined its implementing rules regarding financial institutions. It has also seconded a senior supervision staff member to the FIC to obtain training and experience. In addition, the central banking authority, the financial information centre, the Kosovo Police Service and UNMIK Police have conducted a joint promotion campaign against illegal currency exchange offices. The focus of this campaign was to combat illegal currency trading activities taking place mainly in the streets, which generate various trafficking activities, including money laundering. In addition, the CBAK has granted a licence to four foreign exchange offices.

However, the CBAK is not able to exercise its authority in some of the majority Kosovo Serb areas, such as the northern municipalities.

Overall, limited progress has been made in this area.

4.3.3. *Drugs*

Kosovo is located on a heroine trafficking route and consumption continues to increase. A special narcotics investigation unit in the directorate for organised crime of the Kosovo Police Service deals with drug-related investigations.

In 2005, the narcotics investigation section dealt with 232 cases (94 trafficking and 138 possession cases) involving 354 suspects, which amounts to an increase of 20 cases and 94 suspects compared to 2004. Most cases were related to marijuana, followed by heroine and marijuana plants.

However, local policing capacities to fight drugs need to be strengthened.

Overall, there has been little progress.

4.3.4. *Police*

Policing in Kosovo is carried out by the international UNMIK police and the Kosovo police service. All local **police** stations with the exception of the Mitrovica regional HQ have been transitioned to the Kosovo Police Service. The war crimes and witness protection units are still under the responsibility of UNMIK. Traditional police and investigative functions are handled almost entirely by the KPS. In February 2006, the first local commissioner of the Kosovo correctional service was appointed by the penal management division of the ministry of justice.

After the nomination of the minister of interior in March 2006, the SRSG appointed several Kosovans to high-level positions within the KPS structure in April (the KPS deputy police Commissioner and four KPS assistant police commissioners).

Basic training for KPS officers has already been fully transferred and around 60% of specialised and advanced training have been transferred. The Kosovo academy of public safety education and development (KAPSED) and the Kosovo public safety standards and education board have been established.

In December 2005, the SRSG issued a new regulation on the guiding principles of the Kosovo police service. The regulation outlines the principles that should govern the KPS and sets out its organisation and responsibilities. It also gives the municipal authorities an important role in the appointment of local police chiefs. In May 2006, some additional competences concerning the KPS such as oversight over the management and performance of the KPS, including disciplinary proceedings against police officers, were transferred to the ministry of interior.

Recruitment from minorities has further progressed in the Kosovo police service and currently stands at 15.5% (a 0.5% increase compared to last year's report). Kosovo Serbs make up about nine percent of Kosovo police service employees. There are mixed patrols in mixed areas in order to give every citizen the possibility of getting assistance in his or her own language. A renewed effort has been made in 2006 to ensure decentralisation and minority access. New rules for the appointment of police station commanders have been established for this purpose and police substations have been created in minority areas (six have been opened

in Kosovo Serb settlements, with six more expected to be opened). Local public safety Committees have been established in ten Serb settlements and several more are planned.

However, the selection procedure of the new KPS commissioners was not fully transparent. There have been a number of complaints that police reports were written in a language not understood by the citizen.

Overall, the Kosovo police service has continued to make good progress towards becoming a credible and professional police force. The KPS has proven able to competently fulfil its tasks, especially in areas inhabited by members of the majority population. Further long-term efforts must be pursued to develop an effective police service and strengthen local capacity.

4.3.5. *Fighting organised crime and terrorism*

A directorate for **organised crime** (DOC) was created in January 2005 within the Kosovo police service. Its creation increased synergies in the investigation of organised crime and facilitated information-sharing between different departments. The directorate is composed of four sections: an organised crime investigation section, an organised crime support and service section, a section for the investigation of trafficking in human beings, and a narcotics investigation section.

At the end of May 2006, the directorate was staffed with 72 international police officers and 92 Kosovo police service officers. Because of the ongoing transition process towards local control and the downsizing of international police officers the number of local officers is gradually increasing to 140. Since January 2005, a Kosovan director of organised crime is being trained in a shadow position and Kosovo police captains or lieutenants have been appointed as heads of the already transitioned narcotics and human trafficking sections and as shadow heads of the other sections. KPS personnel receive intensive training to become specialists in their field of work.

As regards combating illicit trafficking of small arms and light weapons, UNMIK customs does not have a specific targeted risk for this type of traffic and relies on general profiles in checking movements of people and freight. This has produced some results with periodic seizures of ammunition and small arms in small quantities.

Border/boundary police consisting of UNMIK Police and KPS officers are currently running operation Stringent Security, a long-term and high-profile police action. It involves all police regions and some crime pillar units. The purpose is to reduce weapon related crimes, enhance minority security, and increase police visibility. This operation targets arms trafficking and involves anti-smuggling measures such as additional green border/boundary patrols, and joint operations with KFOR. A mounted police unit was established in March 2006 to patrol the green border with Albania.

However, organised crime remains a serious problem in Kosovo. Criminal networks extend to various socio-economic sectors and into politics. Finding the highly skilled police personnel which the DOC needs remains a major challenge. Legislation is still lacking to keep the identity of informants confidential in court. This remains an obstacle for the fight against organised crime.

In the **trafficking in human beings** section of the directorate for organised crime, 95 cases with 92 arrests (34 cases with charges) were opened in 2005. Two large-scale, Kosovo-wide operations were conducted, resulting in twelve arrests for a variety of offences.

Over 5,000 people across Kosovo participated in the anti-trafficking campaign 'Not for Sale'. The victims' advocacy and assistance unit (VAAU) has opened three new victims' Advocate Offices in various regions of Kosovo. The interim secure facility has continued to support victims of trafficking.

However, Kosovo remains a source, transit, and destination point for trafficking. There has been a decline in international victims referred but an increase in Kosovan victims referred and an increase in trafficking children. Most trafficking cases concern women and girls, trafficked for sexual exploitation.

Overall, efforts are underway to intensify the fight against organised crime. In terms of results, however, little progress can be reported.

4.3.6. Protection of personal data

As regards the right to the protection of personal data, no developments are accounted for in this period. No general legislation transposing the Data Protection Directive is in place, and no independent data protection supervisory authority is set up.

STATISTICAL ANNEX