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Kosovo:
Corruption holds no passport

Our forecast for Kosovo GDP growth is a stable 3% for 2013 and a reinforced growth of 5% in 2014. The improvement in 2014 will not only be due to improved external factors but also due to parliamentary elections likely to be held in early 2014. Thus, a fiscal stimulus can be expected to boost both consumption and investment. Budget deficit will not necessarily be affected too much altogether as there are substantial inflows of funds expected in the wake of the privatisation of the Post and Telecom of Kosovo (PTK) which is scheduled for mid-2013. The aim is to sell 75% of PTK, corresponding to the two business units Telecom (fixed telephony) and Vala (mobile telephony).

Kosovo’s appearance in Western media is sporadic and often connected to negative news. Most recently a scandal about supposedly embezzled money in a passport production contract involving the private Austrian State Printing House and the Kosovo Ministry of the Interior supports stereotypes about doing business in the Balkans. It happens that the EUR 1.4 million allegedly stolen by a local intermediary consultant make exactly 10% of the overall sum as contracted for the delivery of 200,000 passports to Kosovo, which is informally known as the going local rate for a government bribe. However, there are now more and more signs of hope for a better future for a so far unfortunate country.

A normalization of Kosovo’s relationship with its former hegemonic power Serbia is one of the preconditions for both countries’ successful European integration process. In mid-January 2013 the two prime ministers agreed in EU-mediated talks that customs officials from both sides will operate under one roof at the border crossings between Serb-controlled Northern Kosovo and Serbia. Tariffs and taxes collected there will run into a fund collectively managed by the local Serbs, Prishtina and Brussels and benefit the Serb-dominated northern municipalities in Kosovo. Even if this does not sound like a major breakthrough it still appears that for the first time serious negotiations about the future status of Northern Kosovo have been conducted. Also the two sides have agreed to appoint liaison officers in order to facilitate future negotiations.

While apart from Serbia also a number of other states as well as international organizations have not yet recognized Kosovo as an independent state, the IMF has accepted Kosovo as a full member already back in 2009. A second stand-by arrangement in the amount of more than EUR 100 million was approved by the IMF Executive Board on 27 April 2012. So far the government of Kosovo has met all the conditionalities. One of the major objectives is the restocking of the government cash buffers; these were close to the IMF's recommended level of EUR 300 million (or about 6% of GDP) by the end of 2012. The overall agreement has rather a precautionary character and does not imply any smouldering current account crisis.

Nevertheless, the current account deficit of Kosovo is persistent and large, no matter whether accepting official statistics where it hovers around 12% of GDP or the IMF estimates that rather assume a deficit of around 17%. The difference seems to be inter alia in the treatment of unrecorded remittances. In any case, remittances are vast (somewhere around EUR 600 million) and hence a decisive factor in the financing of Kosovo's imports which are as large as about half of GDP. Interestingly, the revenues from the exports of goods make up only about half of the remittances. By far the most important host countries for migrant workers from Kosovo are Germany and Switzerland. Close to 60% of all remittances are assumed to originate from these two countries, which makes a further improvement of growth there also indicative for growth development in Kosovo.

Other statistics where official sources differ from the IMF are related to the general government budget. While official figures like to include international grants in their revenue (and expenditure) data (both at about 35% of GDP in recent years), the IMF publishes figures not including official transfers, which amount to about 7% of GDP. Thus apart from the remittances also international aid is an important source of revenue to cover the huge trade deficit. Budget deficits are negligible and consequently public debt hardly exists (around 6% of GDP). The government has only recently started to auction three- and six-month treasury bills at annualized yields of between 2% and 3%. The intention is to issue bills with a maturity of 12 months in 2013, in an effort to lay the foundations for self-sustained budget financing.

After decades (or even centuries) of neglect, infrastructure is in a very poor state. The non-electrified railway network is still mostly based on the original tracks built in the 1870s by the Ottoman railway company Chemins de fer Orientaux. A low degree of passenger and freight traffic is kept alive using rolling stock from the 1960s. So far the government has mainly invested in the road construction of highway R7 from the capital Prishtina to the Albanian border. The construction started in 2010 and is scheduled to be finalized in 2013.

Also the budget for 2013 includes a first allocation to initiate highway R6 to the Macedonian border. Given the huge needs for more infrastructure improvement, the enormous amount of idle workforce and the extremely low levels of public (and external) debt, the government of Kosovo should consider a substantial increase of its infrastructure budget and the issuing of long maturity treasury notes and treasury bonds.

Although the exact amount of idle workforce is somewhat ambiguous, it is in any case tremendous. In recent years more than 300,000 persons were officially registered as unemployed out of a population of less than two million inhabitants. Labour force surveys suggest that the unemployment rate is up to about 45%. Kosovo having Europe’s highest fertility rate and youngest population, there is constant pressure on the labour market and so far emigration has been the main release valve. However, prolonged reliance on remittances and international aid might not be a good alternative to a sustainable growth strategy, especially in circumstances where policy options are limited.

Persistent current account deficits suggest, apart from missing productive capacities, a substantial lack of competitiveness. Average wages in Kosovo are at less than EUR 400 per month and GDP per capita at PPP is at less than EUR 6000. These are by far the lowest values among all the potential EU candidate countries. Still, a substantial devaluation could improve the country’s competitiveness and make the development of an export industry that is able to cover the expenses for imports viable. However, the means for a real devaluation are very narrow, at best.

A nominal depreciation of the currency is impossible given the fact that the euro was adopted as national currency. Also, it is to be expected that euroization would remain high if an own national currency were to be introduced. However, this is very unlikely to happen anyway. Other equivalent ways of devaluation are equally improbable. Furthermore, an introduction of higher tariff rates and export subsidies is incompatible with European integration. A fiscal devaluation via an increase of indirect and a decrease of direct taxation is not a realistic option either given the fact that current taxes on income and wealth account for only about 11% of overall government revenues and the marginal income tax rate is only at 10%. Incomes policy is difficult to organize in Kosovo given that the two most important trade unions are in constant dispute and are confined to the public sector only. Finally, as a second best solution, massive investment in public infrastructure and utilities that has the ability to lower local cost of production would be a way to simulate a real depreciation as well as to stimulate economic development which is rather sluggish given the extremely low level of GDP.

Forecasting short-run GDP growth for Kosovo is still rather difficult as there is a lack of forward looking indicators and some of the few existing ones are not that indicative. One of them are the statistics on newly issued loans. However, these have not so far been that much correlated to real GDP developments as the figures are still quite low (the flow of new loans was less than 15% of GDP in 2012) and hence rather volatile. After two years of two-digit growth rates of new loans, the 2012 figure depicts a nominal drop of 7%. This is especially due to shrinkage in long-term loans to non-financial corporations, while consumer loans faced stagnation. In general the banking system appears to be sound. The share of non-performing loans (NPL) is very small by way of comparison. In September 2012 the NPL ratio was at 7%, which is one percentage point higher than a year earlier. Over the same period, the capital adequacy ratio of the financial sector increased slightly to almost 18%, which again seems to be rather favourable when compared to other countries in the region.

Overall the best indicators for growth in Kosovo remain the forecasts for the GDP growth rates of Germany and Switzerland, where most of Kosovo's diaspora is living and sending remittances from. The European Commission forecasts for Germany an almost stable growth development for 2013 (0.5%) and a substantial improvement in 2014 (2%). The Swiss State Secretariat for Economic Affairs expects a slight increase of growth in 2013 (1.3%) and also stronger growth in 2014 (2%) in Switzerland. Certainly downside risks cannot be neglected.

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Table XK

Kosovo: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014 Forecast	2015
Population, th pers., average	1720	1748	1775	1802	1830	1859	1888	1917
Gross domestic product, EUR mn, nom.	3940	4008	4291	4776	5000	5300	5800	6300
annual change in % (real)	7.2	3.5	3.2	4.5	2.7	3.0	5.0	4.0
GDP/capita (EUR at exchange rate)	2291	2293	2418	2650	2700	.	.	.
GDP/capita (EUR at PPP)	5102	5038	5296	5632	5800	.	.	.
Consumption of households, EUR mn, nom.	3647	3605	3822	4220	4300	.	.	.
annual change in % (real)	12.1	8.9	-0.2	5.9	-0.6	1.0	4.0	3.0
Gross fixed capital form., EUR mn, nom.	938	1027	1193	1374	1500	.	.	.
annual change in % (real)	27.8	20.4	8.6	15.5	6.6	8.0	10.0	9.0
Gross industrial production 2)								
annual change in % (real)	32.7	-1.5	-5.6	19.2	-10.0	0.0	7.0	10.0
Gross agricultural production 2)								
annual change in % (real)	19.9	19.3	0.5	26.3	0.0	4.0	4.0	3.0
Construction output 2)								
annual change in % (real)	4.7	32.8	-27.7	11.2	3.0	2.0	6.0	4.0
Unemployment rate, LFS, in %, average	47.5	45.4	45.1	44.8	44.0	43.0	41.0	39.0
Reg. unemployed persons, th, end of period	336	339	335	325	264	.	.	.
Average net monthly wages, EUR	205	246	286	348	360	.	.	.
annual change in % (real, net)	-5.8	22.8	12.5	14.6	0.9	1.0	10.0	5.0
Consumer prices, % p.a.	9.4	-2.4	3.5	7.3	2.5	3.0	4.0	4.0
Producer prices in industry, % p.a.	1.3	3.8	4.7	5.7	0.3	.	.	.
General governm.budget, nat.def., % of GDP 3)								
Revenues	33.0	36.7	33.8	35.3	35.2	35.0	37.0	38.0
Expenditures	33.0	32.6	35.1	35.5	36.3	36.0	39.0	38.0
Deficit (-) / surplus (+)	0.0	4.1	-1.3	-0.2	-1.2	-1.0	-2.0	0.0
Public debt, nat.def., % of GDP 3)	.	6.2	6.1	5.3	6.2	6.9	8.3	7.6
Central bank policy rate, % p.a., end of period 4)	13.8	14.1	14.3	13.7	12.7	.	.	.
Current account, EUR mn	-460.9	-412.1	-558.6	-673.6	-564.0	-600	-900	-800
Current account, % of GDP	-11.7	-10.3	-13.0	-14.1	-11.3	-11.3	-15.5	-12.7
Exports of goods, BOP, EUR mn	216.6	177.2	305.0	324.9	283.1	290	330	350
annual growth rate in %	22.2	-18.2	72.1	6.5	-12.9	2.4	13.8	6.1
Current account, % of GDP	1866.3	1828.9	2057.1	2383.9	2348.3	2400	2800	2600
annual growth rate in %	22.0	-2.0	12.5	15.9	-1.5	2.2	16.7	-7.1
Exports of services, BOP, EUR mn	392.4	479.8	530.1	634.0	570.3	600	630	650
annual growth rate in %	6.1	22.3	10.5	19.6	-10.1	5.2	5.0	3.2
Imports of services, BOP, EUR mn	240.8	285.3	386.1	352.8	297.8	310	350	330
annual growth rate in %	-7.2	18.5	35.3	-8.6	-15.6	4.1	12.9	-5.7
FDI inflow, EUR mn	366.5	291.4	365.8	394.6	238.5	700	400	500
FDI outflow, EUR mn	25.0	10.5	34.7	15.7	15.8	20	30	40
Gross reserves of NB excl. gold, EUR mn	670	576	634	575	806	.	.	.
Gross external debt, EUR mn	707	1146	1348	1427	1537	.	.	.
Gross external debt, % of GDP	17.9	28.6	31.4	29.9	30.7	.	.	.
Purchasing power parity EUR/EUR	0.449	0.455	0.457	0.471	0.468	.	.	.

1) Preliminary and wiiw estimates. - 2) According to gross value added data. - 3) National definition based on ESA'95. - 4) Average weighted lending interest rate (Kosovo uses the euro as national currency).

Source: wiiw Database incorporating national statistics. Forecasts by wiiw.