

WHITE BOOK 2018

Toward a more friendly business and investment climate in
Kosovo

EUROPEAN INVESTORS COUNCIL
WHITE BOOK 2018

#wecreatejobs

WHITE BOOK 2018

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LIST OF ACRONYMS

CBK	Central Bank of Kosovo
CEFTA	Central European Free Trade Agreement
EBRD	European Bank for Reconstruction and Development
EIC	European Investors Council
EUO	European Union Office in Kosovo
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IMF	International Monetary Fund
MED	Ministry of Economic Development
MF	Ministry of Finance
MoH	Ministry of Health
MTI	Ministry of Trade and Industry
MVNO	Mobile Virtual Network Operator
RAEPC	Regulatory Authority of Electronic and Postal Communications
SAA	Stabilization Association Agreement
TAK	Tax Agency of Kosovo
WB	World Bank

FOREWORD

It is my pleasure to introduce, for the first time in Kosovo, the White Book 2018 edition published by the European Investors Council. The European Investors Council (EIC) is the main business association representing European Union and EFTA firms in Kosovo. The main objective of EIC is to make Kosovo a more attractive place to do business while supporting business reforms in line with EU directives and best business practices, which lead to job creation and economic growth for Kosovo.

Given that the European Union remains Kosovo's main trading partner and its main source of foreign direct investment (FDI), and given that Kosovo aspires toward European Union Integration, EIC is ideally positioned as the main partner and interlocutor between the private and public sectors and the main advocate of business reforms that are much needed in Kosovo.

European firms are united under the EIC umbrella to work together and to create a better business environment in Kosovo. Our presence is very important to the Kosovo's economy since we represent a significant portion of the economy through capital investments, job creation and tax contributions to the state budget. In addition, the presence of such reputable firms brings Kosovo numerous benefits while helping Kosovo to be more integrated and recognized at the European and global level.

It is obvious that FDI plays a significant role in the overall economic development of Kosovo. However, the attraction of investors is not automatic and is not evenly distributed across countries; therefore, national policies that support and incentivize FDI inflow are extremely important for Kosovo. Furthermore, the current investors are the best promoters of new investment and therefore the attraction of new potential investors

Adoption of efficient and cost effective legislation will significantly contribute towards creation of more jobs and higher economic growth for Kosovo. Our recommendations in the White Book will lead to a reduction of business costs, reduction of risk and uncertainty, and fair competition in the free market economy. Such business reforms will mean increasing profits to the firms thereby increasing investment inflows, job creation, and more tax revenue for the state budget. In addition, reducing the risks which are produced by a poorly drafted legislation and frequently changing government policies will have an impact on the value of capital and the number of investments in the market. And finally, fair competition in the free market economy stimulates the entry of new businesses and creates positive competitive forces in the free market economy for more capital investments and job creation.

Robert Erzin,
President
European Investors Council

Benefits from the recommendations of the White Book 2018

The benefits of the White Book 2018 or the business environment reform that is recommended are numerous including but not limited to:

- a. reducing business costs** - increases profits thereby increasing investment inflows, job creation, and more tax revenue for the state budget.
- b. reducing risks** – poorly drafted legislation and frequently changing government policies lead to an increased risk for businesses, therefore, reducing the value of capital and reducing the number of investments in the market.
- c. fair competition in the free market economy** – stimulates the entry of new businesses and creates positive competitive forces in the free market economy for more capital investments and job creation.

Key messages

- I.** Foreign direct investment (FDI) is an integral part of an open and effective international economic system and a major catalyst to development.
- II.** Foreign direct investment (FDI) attraction is not automatic and is not evenly distributed across countries; therefore, national policies that support and incentivize FDI inflow are extremely important.
- III.** Current Investors who have invested their capital in Kosovo are the best ambassadors for future FDI attraction therefore it is very important that the government understands their business barriers and eliminates them in a reasonable time frame.
- IV.** Most FDI flows in Kosovo originate from EU and EFTA countries and as such the European Investors have much to offer in terms of “European Best Business Practices”. The dialogue with these investors is of vital importance to the economic development of Kosovo.
- V.** The Government should lead and own the reforms in strong partnership with the Investors.

Purpose of the White Book

The White Book is a comprehensive guide designed to give proposals for improvement of the investment climate in Kosovo in order to drive economic development and job creation. The concrete recommendations come directly from the current Investors and focus on the respective sectors and issues. EIC considers that current investors who have invested their capital and currently operate in Kosovo are a very significant resource to provide inputs regarding business barriers and how to overcome them, therefore increasing the chances of new potential investment as well. In this regard, the main purpose of the White Book is to contribute to a structured and long lasting dialogue and partnership between the private sector and the Government of Kosovo in order to keep track of the recommendations and the improvements that have been taking place in Kosovo.

This year is the first time that the White Book is introduced in Kosovo by the European Investors Council. The White Book will be published each year with new issues identified and progress or lack of it being marked in a systematic format for further follow-up. The implementation of these recommendations will contribute to an overall economic well being of Kosovo and the raising of the standard of living since the businesses will be able to prosper and grow and in return creating more jobs for the citizens of Kosovo and more tax revenues for the budget of Kosovo.

The Methodology of the White Book

The White Book is a tool that creates a consensus amongst current investors in Kosovo regarding topics that they find relevant in their respective sectors. The goal is to share and discuss the White Book with the key stakeholders namely the government, the European Union in Kosovo / EU Special Representative and International Financial Institutions (IFI's), in order to collectively contribute to the improvement of the investment climate in Kosovo.

The process of drafting the White Book is very complex and credible since it involves real cases directly from the private sector which the investors face on daily basis. Furthermore, these issues and recommendations are discussed among the investors and key stakeholders and approved by the board of directors at EIC in order to ensure that these recommendations do not represent individual interests of one firm but rather they reflect the opinion of the entire respective sectors and are in line with European best business practices. This approach or methodology of writing the White Book gives it precisely its credibility in representing the key barriers and solutions for a better investment climate in Kosovo.

Furthermore, the publication of the White Book will be public and will be discussed at the high- level conference in order to clarify even further the positions of all stakeholders and

to produce a commitment and a follow up process which will ensure the implementation, at a timely manner, of such valuable recommendations.

The White Book represents the following functions:

- *Comprehensive assessment of the current legislative framework in a number of sectors*
- *A tool to track developments in the regulatory framework*
- *Draws attention to the issues to be addressed*
- *Sets practical recommendations for the improvement of the business climate*
- *Quantifies progress through measurements of “progress card” in each sector*
- *Supports further economic convergence and EU integration*

Investment Climate in Kosovo

Overview

Kosovo declared its independence on February 17, 2008. Kosovo is a potential candidate for EU membership and has signed the Stabilization Association Agreement (SAA) with the European Union in 2015, which entered into force on April 2016, opening a new phase in the EU-Kosovo relationship. The agreement maps out a framework for political and economic dialogue and cooperation in several key areas and sectors in which Kosovo is obliged to meet European standards.

In terms of business reform, Kosovo is ranked among the top 10 reformers worldwide in the World Bank “Doing Business Report 2018”. Out of 190 countries, Kosovo ranks in the 40th place. Kosovo ranks 10th on starting a business, 12th on getting credit, 34th on registering property, 45th on paying taxes, 48th on trading across borders, 49th on enforcing contracts, 49th in resolving insolvency, 122nd on dealing with construction permits, 89th on protecting minority investors, and 106th on getting electricity.

According to the “Index on Economic Freedom” published by the Heritage Foundation and the Wall Street Journal, Kosovo ranks the 56th freest economy worldwide in the 2018 Index. Its overall score has decreased by 1.3 points, with a steep decline in scores for the property rights and labor freedom indicators overwhelming improvements in fiscal health and business freedom. Kosovo is ranked 27th among 44 countries in the Europe region, and its overall score is below the regional average but above the world average.

Kosovo has continuously outperformed its neighboring countries in economic growth and is expected to expand by a real 4% in 2018 and foreseen to keep this momentum even in 2019 according to the International Monetary Fund (IMF) estimates.¹ Despite the fact that the economic growth is estimated at around 4% and outperforming its neighbors, Kosovo’s economy still remains challenged with high level of unemployment at around 30% and even much higher unemployment rate among the youth² due to its low starting position post 1999. Kosovo’s GDP per capita is at €3,479 therefore making it one of the poorest countries in the region while the trade deficit remains large with only 11.1 % of export covering the import.³ Foreign Direct Investment (FDI) has been in relative decline since 2015 when it reached €338 million while in 2016 and 2017 FDI was at €234.8million and €287.8 million respectively while the structure of FDI stock is primarily focused on real estate and renting. The Foreign Investors operating in Kosovo face significant deficiencies in the business environment which call for immediate action.⁴

¹ <http://www.imf.org/en/Countries/UVK>

² http://hdr.undp.org/humand_development_report_2016

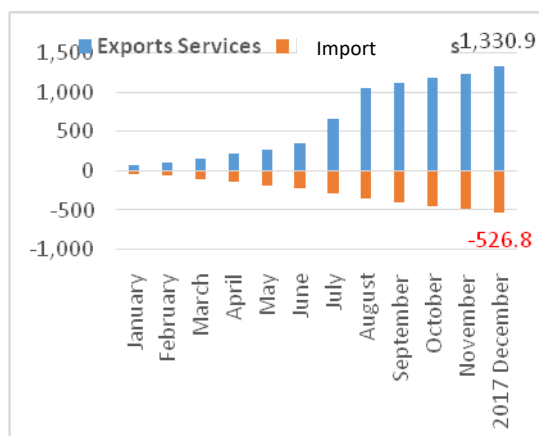
³ <http://worldbank.org/en/country/kosovo/overview>

⁴ <http://eic-ks.eu/the-institution>

Kosovo economy dependency on internal demand and foreign Remittances.

Kosovo has a very high trade deficit. In recent years Kosovo has experienced a large increase in export of services and as a result has a positive trade balance in the services sector with positive +252% coverage. This is obviously a positive development and has provided employment opportunity to Kosovo's IT sector, call centers, and similar businesses.

Chart 1: Cumulative services on imports vs. exports



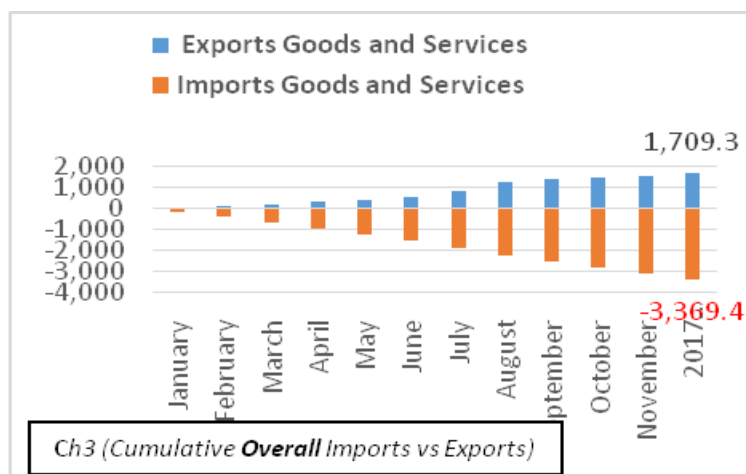
However, the negative trend in the balance of goods is still very significant and has only 11% coverage.

Chart 2: Negative trade balance of goods



The overall GDP of Kosovo is reduced significantly due to large net negative trade balance of exports which show only 50.7% coverage.

Chart 3: Overall exports of goods and services vs imports of goods and services



Therefore the Government must engage further in proactive and policy driven activity to encourage economic development, with the aim to convert the current model which is based on internal demand, to an economic model which is export driven supplementing the current internal demand economy and government capital investments as key drivers of the economic output of Kosovo. The Government must encourage positive legal and economic climate, for local and foreign investors in order to increase its attractiveness as an investment hub for the goods production and therefore further reduce the negative goods trade balance of exports of Kosovo.

Telecommunication sector

Key elements of the telecom sector

The Regulatory Authority of Electronic and Postal Communications (RAEPC) reported the total number of fixed internet users (Q4, 2017 with 274,743) and mobile internet 3G/4G users (Q4, 2017 with 1.58 million user) was 1,813,494 in 2017, representing 92.5 percent penetration rate on fixed broadband and 84.8 percent penetration rate on mobile internet. Three main companies offer fixed services in Kosovo market such as: IPKO, Kosovo Telecom (TK), and Kujtesa which covers over 85% with its fixed service Kosovo's market, while IPKO and TK provide mobile internet (3G and 4G). However, there are only two Network operators in Kosovo: the State owned Telekom Kosovo (Vala) and the European (Slovenian) company IPKO. Both received licenses for mobile broadband (3G, 4G) in 2013. In the past 5 years the telecommunication market in Kosovo has shrunk by almost 30%, with revenues falling from EUR 239.6 million in 2012 to less than EUR 168.3 million in 2016. Kosovo's telecommunications services are one of the least expensive in the region and have similar quality voice services in comparison with other providers in the region. RAEPC data indicates mobile telephony penetration in Kosovo is over 111.9 percent, covering over 100 percent of inhabited places and 94 percent of Kosovo's territory. In early 2017, a branch of Serbia's telecom company, MTS, was licensed to provide mobile services in Kosovo. Two other mobile companies from Serbia – VIP and Teleport – suspended their unlicensed operations in May 2017. Through the auspices of the EU, Kosovo and Serbia have worked with ITU to grant Kosovo a dialing code. Kosovo began transitioning to the new (383) code in 2017 and plans to migrate all phone numbers to the dialing code by 2018.

Leading Sub-Sectors

- General service mobile (GSM) operator
- GSM network supplies, equipment, and technology
- Network management
- Telecommunications infrastructure development, including WiMax and other municipal wireless internet services.
- Digitalization of TV broadcasting

Opportunities

IPKO launched 3G and 4G services in 2014, and Vala launched 4G in 2015. Both operators are committed to improving their 4G services so there will be opportunities for provision of related infrastructure while starting to assess opportunities for 5G in the near future.

The Independent Media Commission (IMC) will soon initiate the transition of TV broadcasting from analog to digital, so opportunities may arise in the near future in this sub-sector as well.

Challenges

The telecommunication market is predominantly prepaid (95 percent) and has been severely affected by a very high adoption of free online applications as well as the widely available free WiFi access. All these factors have contributed to a very substantial decrease in voice and SMS services in international and national traffic, while the take up of mobile data is by contrast proceeding very slowly.

Network operators are also challenged by the aggressive pricing from Mobile Virtual Network Operator (MVNO) which means that services on retail market are easily sold below wholesale cost of Telekom Kosovo. This MVNO agreement has been questionable by many and challenged in court by the private firms.

The Kosovo Government considers Telekom Kosovo as public authority or administration and not as publicly owned company or a public undertaking. Such classification which was actually done by public procurement regulator in 2016, and since 2017 is being respected by the commission for complaints on public tender, therefore allowing the direct granting of all state institutions' contracts' to Telecom Kosovo without using open tender procedures. Mobile operators need to invest in mobile broadband data but they face regulatory challenges such as: very high prices for frequencies.

Kosovo telecommunication regulator (RAEPC) has defined, based on a benchmark model, very high prices for a low income mobile market like Kosovo's. As a result, both operators are operating with losses: IPKO paid in 2015 EUR 6 million for 2x10MHz in 1800MHz for 3.5 years while for example operators in Macedonia paid only EUR 10 million for 2x10MHz in

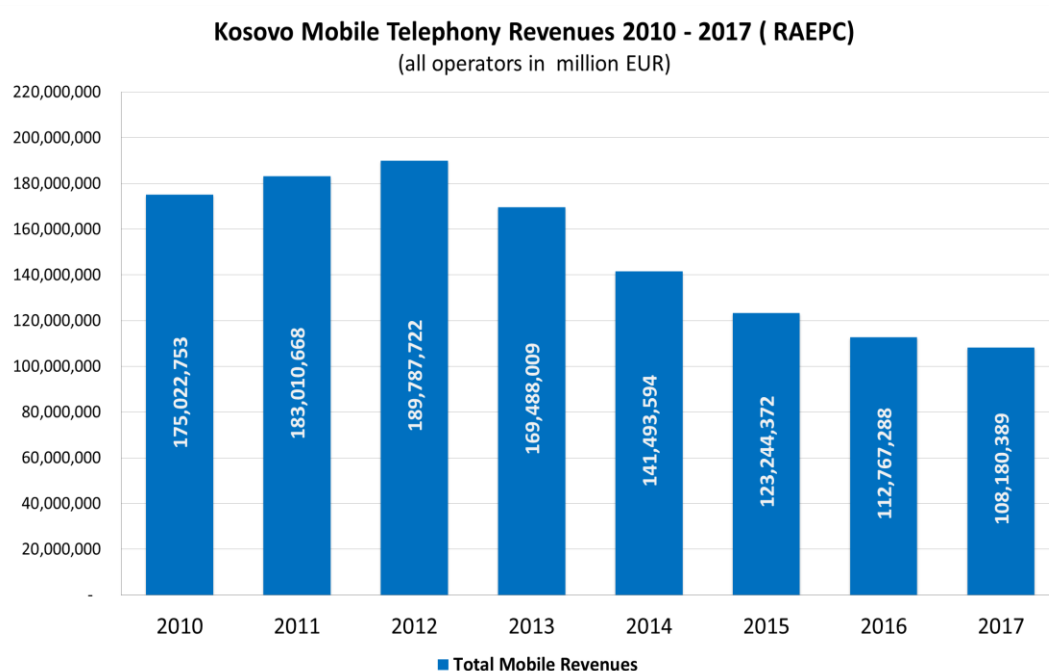
1800MHz and 2x10MHz in 800MHz, for 20 years. Based on the current model, the price to be paid for a similar bundle and for only 15 years would be at least EUR 40 million.

Difficulties with permits to roll out the network: it is very difficult also to obtain permits to extend the mobile network and also fixed infrastructure especially in some municipalities.

Moreover, municipalities are inventing also new, additional taxes for operators.

The fixed telecommunication market is characterized predominantly by fixed broadband services. The market is also mainly prepaid and with constant problems of copyright breaches on the TV. There is infrastructure competition with many operators since they can easily spread infrastructure on power distribution poles. Smaller operators and lately many illegal OTT IPTV providers are delivering online channels without any copyrights for retransmission.

Table 1: Kosovo mobile revenue (in million Euro)



(Source: RAEPC/IPKO telecommunications)

Regarding the telecom sector, Kosovo Mobile Market is under huge pressure because operator's revenues have decreased for 43% from 2012 to 2017. This is because business conditions for telecom operator in Kosovo are almost 10 times less favorable than in Slovenia, which we took as an example to compare with Kosovo's case. The main problem in the telecom sector is considered the high frequency cost which needs to be analyzed in a more systematic manner in order to find the adequate solution.

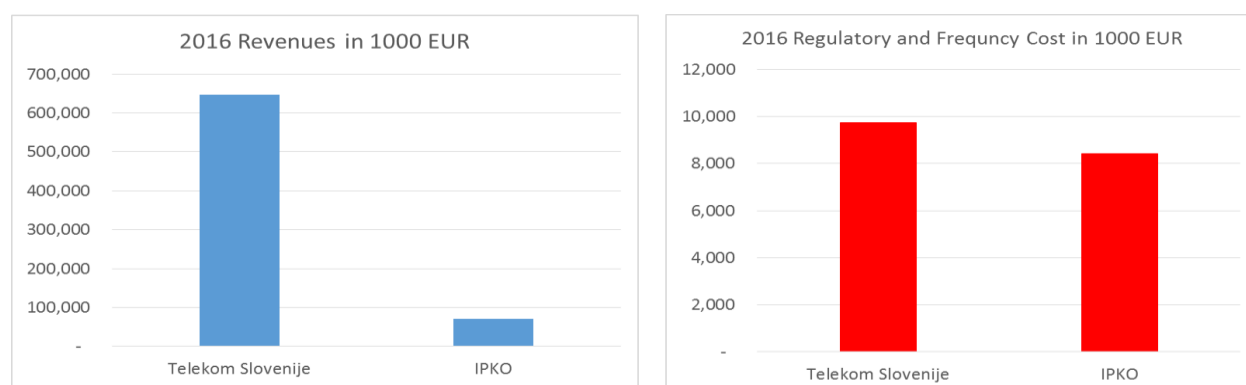
Business conditions for telecom operator in Kosovo are almost 10 times less favorable than in Slovenia

Telekom Slovenije revenues in 2016 were 9.2 times higher than IPKO.

Frequency costs in Telekom Slovenije are almost the same as in IPKO – only 15% higher

Telekom Slovenije has altogether 240MHz of frequencies while IPKO has only 60MHz.

Table 2: Revenues and frequency fees compared Telekom Slovenije vs. IPKO)



(Source: IPKO telecommunications)

Main problems identified

Excessively high frequency pricing and regulatory costs

The telecommunication regulator (RAEPC) has defined price for frequency spectrum in 2015 (allocating frequencies in 1800MHz band) based on a benchmark model using PPP index. Reference prices from European countries were adjusted with inflation rate and PPP index (defined by World Bank) to international USD in year 2015, then calculating adjusted average price of spectrum in Europe. This average price was then exchanged back in local Kosovo currency which is EUR using exchange rate USD/EUR from US market (1 EUR = 0,898USD) instead of using PPP index (Kosovo local currency = 0,332USD).

If the model would be recalculated using PPP index for Kosovo it would result in reference prices 2, 7 times lower. Frequency prices in Kosovo represent huge burden for operators: IPKO, in 10 years, invested in Kosovo 150 million EUR in mobile infrastructure and over EUR 80 million only for purchasing frequency. With current frequency pricing we can predict that these conditions are getting even worse and that in next 10 years we will have to invest in mobile

network the same amount as for frequency spectrum which we need even to optimize due to high prices. In addition, the regulator is charging a very high price for yearly maintenance cost of mobile frequencies. When comparing IPKO regulatory cost (both depreciation and maintenance fees) with Telekom Slovenije (as the owner) IPKO has costs on the same level as Telekom Slovenije, but Telekom Slovenije has revenues 10 times higher and has allocated 4 times more frequencies (IPKO 60MHz and Telekom Slovenije 240MHz in all bands).

Lack of implementation of procurement law in the telecommunication market

Following a recent interpretation by the Public Procurement Regulatory Commission (PPRC) which considers Kosovo Telekom as a public authority/administration, now State institutions can directly grant contracts for telecommunication services to Kosovo Telekom without opening tender procedures. Based on this interpretation, private operators are now not able to compete on the large market of state institutions, thus losing a number of clients such as municipalities and ministries, which in the past had conducted tenders and granted contracts to private operators.

Distortion of competition

IPKO considers that Kosovo Telecom is not a public authority but merely a state owned company and that this restrictive interpretation of the legislation by PPRC represents a huge change in business environment which totally distorts the competition and has therefore filed a case with the Competition Authority in 2017.

IPKO considers this a way of 'protecting' the state owned operator, Kosovo Telecom who has in turn given a favorable contract to private MVNO Zmobile (apparently charging MVNO only small percentage of revenues, not covering the whole cost of mobile network and operation) and thus enabling MVNO Zmobile to compete with extremely low prices and helping Zmobile to have a competitive advantage while both network operators are in losses).

1. Illegal operators and copyright issues on fixed market

There are many illegal operators providing IPTV services (hundreds of channels) without any copyrights for Kosovo and without any intervention from the media regulator (IMC).

For more than 5 years now, IPKO has filed dozens of complaints at IMC and court, without any result. It has also initiated criminal charges against individuals conducting such illegal

activities, and also against Board members of the IMC for abusing of their power. However, specific results thus far have not been produced and cases are still pending for years.

2. Illegal taxation by municipalities

Although the law on Electronic Communications provides that the construction of public communication networks is in the public interest, not all municipalities take this into account. Each of them has different procedures for application, and especially very unfavorable and illegal taxes for network operators. Such illegal taxes include:

Tax for lease for GSM antennas which is applied despite the fact that antennas are located in private lands, and operators pay lease to the owners of such lands.

Tax on establishing/spreading the infrastructure: this tax is applied each year even when infrastructure is already built. All these taxes are very high and unreasonable, and create an important additional burden for network operators.

Recommendations for market improvement:

Frequency pricing and regulatory cost

To correct frequency allocation pricing model and to adjust average reference price with purchase price index (PPP - 0,332) for Kosovo. Price should decrease at least 3 times.

Lack of implementation of procurement law on telecommunication market

PPRC should revise their interpretation of Telekom Kosova status and all public institutions should open tenders for telecommunication services. If PPRC does not do so, the Competition Authority should react based on operator's complaint.

Distortion of competition

Competition Authority should open a case based on operator's complaint and revise the contract conditions and influence on market situation.

Illegal operators and copyright issues on fixed market

IMC is expected to address the situation. Stronger and more serious engagement of police investigators together with media regulator is needed.

Illegal taxation by municipalities

A unique and lawful taxing system should be adopted by all municipalities, avoiding all illegal and unnecessary taxes. The relevant ministries should all cooperate in order to create such unique system.

Banking sector

Key elements of the banking sector

The banking system in Kosovo is currently well capitalized, liquid and profitable. 10 banks operate in the market with 6 commercial banks (4 subsidiaries of foreign banks and 2 locally owned) and 4 branches of foreign banks with total assets of €3.4 billion or 60 per cent of GDP. The banking system is majority foreign-owned, and dominated by the subsidiaries of German (ProCredit), Austrian (Raiffeisen), Slovenian (NLB) and Turkish (TEB) parent banks. System-wide CAR is above 18 per cent, liquidity ratio is well above the regulatory minimum and return on equity above 25 per cent. Asset quality is acceptable. NPLs are the lowest in the region and on a downward trend (6.2 per cent at year-end 2015), as a result of stricter lending standards, better enforcement for problem loans and overall expansion of lending by commercial banks. Also, because of the relatively low level of cross border integration with the European Financial System and the small export base, the financial sector remained relatively stable throughout the turbulence of the crisis. Whilst remittances from the Kosovo diaspora initially slumped in 2009, they have recovered strongly and add some stability to the deposit base.⁵

Key indicators of the banking industry

The banking industry in Kosovo has shown continuous stability and sustainability since the war until recent years, providing security and reliability to the citizens of the Republic of Kosovo. The banking industry has recorded positive growth in almost all its key indicators, which shows a sound market of this industry.⁶

The structure of banking sector liabilities is dominated by deposits, which represent 79.7 per cent of total liabilities. Deposits at the banking sectors have recorded an annual growth of 7.3% percent, amounting at euro 3 billion. Deposits in the banking sector consist of household deposits, which participate with a share of 75.40% percent in total deposits, whereas the deposits of private sector enterprises compose 23 percent of total deposits.

⁵ European Bank for Reconstruction and Development (EBRD)

⁶ Kosovo Banking Association

Table 3: Structure of Assets of the Banking Industry

Structure of assets

Table 3 shows data on total assets of the banking industry and the structure of this industry.

STRUCTURE OF ASSETS OF THE BANKING INDUSTRY (million euro)							
Description	2010	2011	2012	2013	2014	2015	Jan-16
Cash and balances with CBK	307.0	331.5	425.7	463.3	447.1	491.2	496.6
Balance with commercial banks	439.1	329.5	287.9	339.9	390.7	316.0	334.0
Securities	173.4	202.0	256.6	354.5	383.8	473.5	445.4
Loans and leasing	1,458.7	1,698.1	1,763.4	1,805.8	1,882.4	2,019.4	2,005.7
Fixed assets	44.0	47.4	57.7	55.5	53.7	57.3	58.1
Other assets	32.9	41.3	38.1	40.3	27.9	29.8	31.7
Total assets	2,455.1	2,649.7	2,829.3	3,059.3	3,185.6	3,387.3	3,371.4

Tab. 3 | Source: CBK – Balance sheet of other depository corporations (March 2016)

(Source: CBK – Balance sheet of other depository corporations March 2016)

Table 4: Loans of other depository corporations by economic activity

LOANS BY ECONOMIC ACTIVITY (million euro)											
Description	Agriculture	Mining	Manufacturing	Energy	Construction	Trade	Hotels & Restaurants	Other trade	Financial services	Other services	Total
2010	38.2	14.6	127.6	18.0	109.1	521.2	39.5	18.9	22.0	113.6	1,022.8
2011	40.5	17.2	136.7	14.5	116.3	606.2	39.9	23.4	55.0	99.9	1,149.5
2012	43.6	16.2	133.1	15.9	125.2	635.3	38.8	22.7	54.5	108.8	1,194.2
2013	45.8	20.1	131.7	20.8	118.7	640.6	49.2	19.1	68.8	102.6	1,217.4
2014	49.8	19.7	153.0	20.3	107.0	674.5	51.4	18.1	60.6	102.0	1,256.4
2015	59.9	19.2	164.1	17.8	99.5	683.0	50.7	21.3	94.0	123.8	1,333.4
16-Jan	53.8	18.9	167.8	17.1	99.1	673.7	50.2	22.2	92.1	114.2	1,308.9

(Source: CBK – Balance sheet of other depository corporations March 2016)

Main problems identified

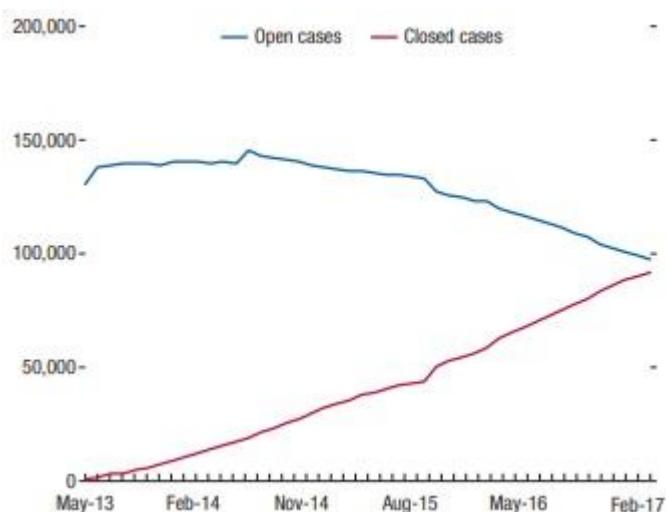
a) Contract enforcement

One of the main barriers of the banking sector for doing business is contract enforcement. Based on our internal survey, there are over 7,000 backlogged court cases only for the banking sector left from previous years in Kosovo justice system. It is accounted that these backlogged court cases have a value over 150 million EUR!

Recommendation for market improvement:

We recommend that respective responsible institutions should hire more legal officer for different levels of the courts within justice system, which will help judges to handle the large number of cases. We recommend also that financial sector cases to be treated with priority since this will have direct impact to Kosovo economy overall!

Figure 1: Kosovo: Court Backlog Clearance



(Source: USAID-Contract Law Enforcement)

Kosovo introduced a system of private enforcement agents in 2014, which has significantly reduced court backlogs and eased asset recovery.

Recommendations for market improvement:

Write-offs: (recommended) define mandatory time limits for write-offs. Other: close remaining gaps in regulation incl. for (i) country and transfer risk; (ii) collateral valuation; (iii) pre-set forbearance criteria.

Private Bailiff's law: (Completed) close loopholes in law on enforcement procedures that allow debtors to escape enforcement actions through appeals; improve the collateral auction system; improve fee structure for bailiffs; strengthen oversight.

Cadastral information: (Ongoing) intensify efforts to bring Kosovo's cadastre system into line with international standards.

b) reduction of cash transactions

Based on different publication for Kosovo economy, it is estimated that 30% of Kosovo GDP is informal⁷. Informal economy is developed mainly through cash transactions which are not reported. Our society is cash based which burdens this issue even more. Bringing this amount of money within the legal system will help to invest this money in the economy.

Recommendation for market improvement:

Fighting grey economy from the respective institutions will help the Kosovo economy overall as well this means more money for the banking sector which can be invested.

c) electronic signature

The usage of electronic signature is not yet formalized within Kosovo, which represents another barrier for doing business in Kosovo.

Recommendation for market improvement:

Drafting a law which will clearly define the use of electronic signature would help the banking sector as well as other businesses to sign long-distance contracts, to speed up the process of doing business, reduce costs and reduce physical archiving of documents and toward a more digital environment.

d) Prevention of legal uncertainty

Banking sector often has been challenged by different respective institution where laws have been interpreted in arbitrary way where in some cases banks have been asked to implement legislation

⁷ European Commission 2018 Kosovo Report - <https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20180417-kosovo-report.pdf>

even on retroactive bases. These cases have created uncertainty on doing business where every public institution can interpret the law in its own way.

Recommendation for market improvement:

We recommend that each public institution should have or establish the appeal instance which will have increased independence and is comprised by independent members which are not staff members of the respective institution.

e) Development of Residential mortgages

Currently the residential mortgages are at the very low level of developing due to the problems that our citizens are facing on getting the ownership of their properties. Mainly most of the new buildings all over Kosovo have not yet completed the technical acceptance by the respective municipality. Due to this fact, the buyers/citizens can't transfer the ownership of their property. Therefore, the banking sector can't use the advantages that are given by the Central Bank through the regulation for residential mortgages due to the absence of the ownership by the citizens for these properties. In fact, it is almost impossible to issue loans by the banking sector based on the criteria's set out in this regulation.

Recommendation for market improvement:

Request to the Ministry of Environment and Spatial Planning to define the ownership title of the property owners all over Kosovo.

f) Enabling capital markets in Kosovo

With exception of government debt, there is currently no established capital market in Kosovo,

and no dedicated legislation on tradable securities and related market activities in place. Private debt is able to patch together different currently applicable pieces of legislation, which cover issuance (Law Nr.04/L-093) on Banks, Microfinance Institutions and Non-Bank Financial Institutions, enforcement (Law 04/L-139 on Enforcement and others. With regard to equity instruments, or financial derivatives there is currently no legislation in place which would regulate their activities. Consequently, there is no venue where trading of such instruments would occur.

Recommendation for market improvement:

To create and develop dedicated legislation and a regulatory authority.

As we move forward and the market takes off, the need to develop dedicated legislation that would regulate basic market activities (including debt, equity and money markets) and venues (including over-the-counter, stock market and other securities depository facilities) are strongly recommended.

In addition, establishment of a regulatory body for capital market activities would ensure coherence of market activities in compliance with applicable law, setup a framework for education and licensing of local market participants to ensure an appropriate level of expertise, and generally providing for a stable and resilient financial system. Provision of legislative reference⁸ would vastly enhance issuers' reliance on diversified sources of financing, whereas investors would gain confidence in the market and attract additional capital to it. Investment banks' interest is to bring together the issuers and investors and thus make earnings, which do not burden their balance sheet.

Special consideration should be given to government tax policy with regard to the capital markets, in particular by avoiding unintended differences between tax regimes across various market instruments. A government policy that attracts foreign capital could include tax allowances for the Diasporas' capital invested in Kosovo, even if no double taxation treaty is in place yet. Open, diversified, liquid, transparent and efficient markets are in the interests of all participants involved in them, as well as to the benefit of end-users.

⁸ ForEU bestpractices see: https://ec.europa.eu/info/sites/info/files/171120-corporate-bonds-report_en.pdf

Recommendation for market improvement:

The following next steps must be taken:

1. Discuss with relevant interest groups
2. Create multi stakeholder task force which builds up feasibility plan of action
3. Come up with a white paper outlining the proposed action plan

Insurance Sector

Key elements of the insurance market

Insurance Industry in Kosovo is considered as underdeveloped. Insurance sector represents only 3% of the financial sector. Furthermore, two main indicators reveal that Penetration (Gross Written Premium / GDP – measured at 1.4%-c.a.) and Density (Gross Written Premium / Capita – Measured at EUR 44/capita) are the lowest in the region, while remaining far from the EU average. Market is oversaturated with a high number of companies in the market. Currently there are 12 companies competing for 84Milion EUR market in Non-Life segment. This situation has led to a price war among companies in a fight for market share. These price wars have pushed a number of companies into insolvency, and some others albeit solvent they are illiquid.

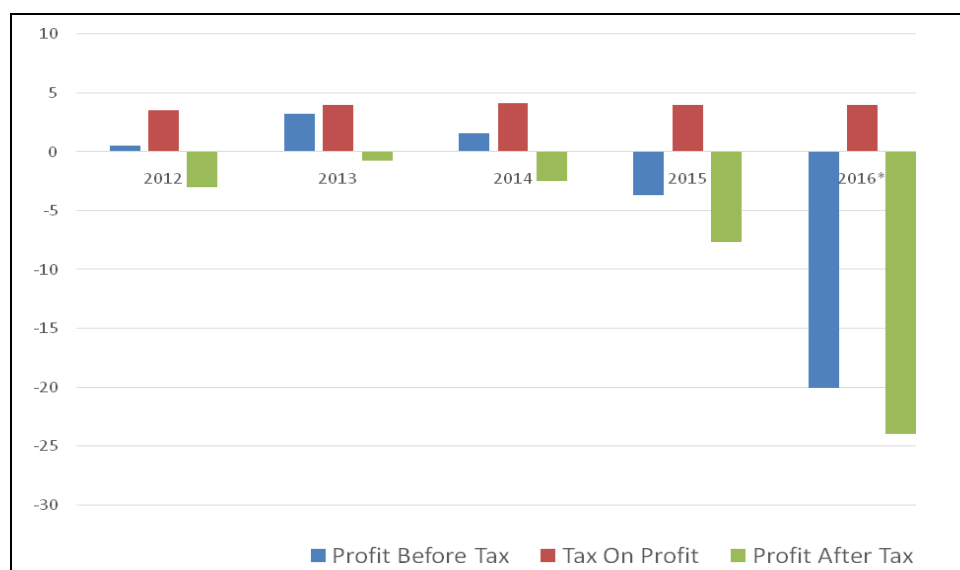
Law enforcement is lacking. Insurance Law is clear in this aspect, if a company doesn't maintain adequate capital level, they have to either inject fresh capital, or license must be taken and they shall be liquidated. However, this is not happening in the market.

The situation poses a significant Systemic Risk, since if one company is liquidated; the outstanding liabilities toward policyholders are transferred to other remaining companies in the market.

Kosovo has arguably one of the most unfavorable taxation regimes with regard to the insurance market.

- VAT is applied in insurance transactions (except for life and health recently). Insurance transactions are out of the scope of VAT in regional countries as well as in EU.
- Corporate Income Tax for insurance companies is not regular Tax on Profit (calculated on profit), but it is calculated on Gross Written Premium, regardless of profit/loss generated by the company. It doesn't take into consideration any of claim payment expenses, administration expenses or anything. Such an unjust taxation system cannot be met not just in other countries, but also in none of the other industries in Kosovo, where all other industries pay regular tax on profit.

Table 5: Unfair tax on insurance companies in Kosovo



(Source: Central Bank of Kosovo)

Main problems Identified

Issue 1 - Regulation

The European Commission Report on Kosovo for year 2018, when addressing the Insurance sector states:

- “The insurance sector is weakly supervised despite improvements in transparency”⁹
- “Solvency I measures need to be fully implemented and enforced”, *which tell that currently they are not implemented/enforced [emphasis added]*

The evidence that support these conclusions is the fact that four out of twelve companies are insolvent, and another one, albeit solvent, they are illiquid.

Two companies have negative equity, since their liabilities toward policyholders are higher than their assets.

Central Bank of Kosovo (which is regulatory and supervisory authority) didn’t take the measures toward these companies as prescribed by legal framework. This is in direct violation of the following legal provisions:

⁹https://eeas.europa.eu/delegations/kosovo_en/43220/2018%20Kosovo%20Report Page 42

- Law on Insurance - 05/L 045,

Article 21 of the Law
- Regulation On Calculation Of The Minimum Solvency Margins, Capital Adequacy And Guarantee Fund For Non-Life Insurers[*Regulation of Central Bank of Kosovo*]

Articles 7 and 8 of the Regulation
- Regulation On Investment Of Assets Covering Technical And Mathematical Provisions And Investment Of Charter Capital[*Regulation of Central Bank of Kosovo*]

Articles 5, 6 and 7 of the regulation.

The five companies which are insolvent or illiquid continue to operate without any problems in the market place whatsoever. During 2017, they underwrote 35% of the total market premium.

The situation presents significant risk to the industry (systemic risk within the sector), since if/ (when) these companies will be liquidated, the outstanding insurance liabilities from these companies will be transferred to Compensation Fund, which in turn shall be financed from the insurers remaining in the market. This might in turn, push even more insurers into insolvency give the weak capital adequacy position.

In the face of solvent insurers, this situation presented double punishment, first they have to compete in the market with the insolvent companies and second, they might have to pay their claims later on.

Solvency I, is the current capital adequacy regime, while no preparations whatsoever are made in regards to Solvency II and upcoming IFRS17.

The industry was in constant losses since 2012, it reached its bottom in 2016 to staggering 24 Mil. In 2017, books of the industry showed profit (7.7 Mil), albeit this came as a result of CBK changing a regulation on Compensation Fund, which allowed companies to release some claims liabilities from their books (Amount 5.5 Mil c.a.).

Recommendations for market improvement:

The solution is rule of law! CBK must implement/enforce the legislation which is in force. CBK doesn't have any discretion on taking measures; they are obliged to do it!

- Implement/enforce Solvency 1 measures
- If a company cannot/ doesn't want to add capital, put it into liquidation process
- Further "soft" regulation on Corporate Governance shall be implemented
- Increase the conditions for granting licenses to new insurance companies

Issue 2 – Corporate Income Tax

Insurance companies have been unfairly treated from the beginning. Tax on profit on insurers is not calculated as regular tax rate on profit which is 10% tax on profit across all industries and private firms, but instead it is calculated as 5% on revenues, ignoring completely the expenses on the companies. As a result there were paradoxes when companies were in loss, and still had to pay millions as "tax on profit".

As mentioned above, no other industry in Kosovo is treated like this, everyone pay's regular tax on profit. Furthermore this practice does not occur in the region and does not occur in EU countries.

Starting from year 2015, year in year out, government promised that it will change the law: first on 2016, than on 2017, than on 2018.

Currently, the draft law has been amendment to eliminate this discriminatory practice against insurance industry and as foreseen it shall enter into force in 2019. The current state as of August 2018 is that the draft law has been approved at the government level. Despite this significant step forward, the draft law is not in harmony with EU legislation in regards to the treatment of expenses that insurers have in establishing Technical Provisions. Technical Provisions represent key element in the books of insurers and they are precisely regulated by insurance legislation (Law on Insurance and secondary legislation deriving from this law). However, current draft law on CIT does not rely on the legislation that regulates insurance (that's how EU legislation is written), but opts to draft another sub legal act by Ministry of Finance to address the tax treatment of Technical Provisions and put limits on it's recognition as expense for tax purposes. This approach can lead to a legal uncertainty as these different regulations can be in violation with one another.

Recommendation for market improvement:

Change the Corporate Income Tax Law so that corporate income tax for insurers becomes regular tax rate (currently 10%) on profit and not 5% on Revenues as currently is.

Ensure that the law is in harmony with the EU legislation. Emphasis in the treatment of the expenses for establishment of Technical Provisions prescribed by insurance legislation.

Proceed to the Parliament without any further delay the draft law on Corporate Income Tax, which has been approved by the government, must be preceded to the parliament without any further delay. The parliament must vote in favor as this will regulate and stop the discriminatory treatment of this industry and will help toward stabilizing this sector in line with European and regional practices.

Issue 3 Law on Red Cross

Law on Red Cross 03/L-179 was approved by Parliament of Kosovo on June 10th 2010. Among other stipulations, the law regulates the financing of Red Cross, and specifically Article 14, 1-7 states:

Article 14 - Financial resources

1.7 Obligatory insurance of the vehicles 1% (one percent) from gross prim of the value of vehicle insurance;

However, there are no other legal acts whatsoever that specify this article of the law. Therefore this law is not implementable as it does not specify whether this tax is passed on to the consumer or what are the modalities. As such, no one has ever paid this tax since 2010 when it went into force.

It is also very important to note that the drafting of this law was based on the Croatian law; however the Croatian Constitutional Court has declared this practice as anti constitutional and has overthrown it in the recent years. The main reason why this law is anti constitutional is due to the fact that private capital cannot be confiscated without some procedure of expropriation or compensation. Therefore, no one can arbitrarily impose on one sector to finance another entity directly from their revenue sources. Furthermore, the legal provision quoted above in paragraph 1.7 does not address directly Insurance Companies; however it is tangible to core business of insurance companies. Insurance companies have tried to clarify this issue with the Central Bank; however they were not successful as they received no instruction on how to proceed. It is important to note that Premium for MTPL Insurance is regulated by a regulation from Central Bank, and it cannot be changed without approval from Central Bank.

Red Cross of Kosovo initiated law suits against all insurance companies in Kosovo claiming for 1% of revenues from Insurance companies from MTPL insurance. Different companies are in different stages of the court process some are still at Basic Court, some in Appeal Court and one in Supreme Court. Basic and Appeal Court ruled in favor of Red Cross.

Companies have acquired legal opinion on this issue. The legal opinion(s), among other elaborations, come to the following conclusions:

- Article 14, paragraph 1, subparagraph 7 is in violation with:
 - Article 46 of the Constitution of Republic of Kosovo
 - Article 1 of the European Convention on Human Rights
 - Legal practices of European Court of Human Rights
 - Article 17 of Universal Declaration of Human Rights
 - Law on foreign investments in Kosovo 04/L-220

Financial impact in the industry is quite high with an estimation of over EUR 3 million.

The issue was addressed to Ombudsperson. Ombudsperson issued an “Amicus Curiae” on the issue, stating that the law is in violation with the above mentioned principles.

Recommendation for market improvement:

The ultimate solution for the issue is Constitutional Court to rule this legal provision as unconstitutional and void. This would mean that the specified provision will not constitute any legal/financial effect. The issue has to be brought to Constitutional Court.

Article 113 of the Constitution of Republic of Kosovo, Jurisdiction and Authorized Parties; regulate how an issue can be referred to the court:

As Paragraph 7, Insurers can address the issue in Constitutional Court, but only after the issue have been addressed in all lower level courts (Basic, Appeal and Supreme), but by then, the claim becomes payable.

The issue can be addressed to the Constitutional Court, as stipulated Paragraph 8 that is through the judges that handle the case at Basic, Appeal or Supreme Court.

Other ways how to address the issue is through either: Assembly of Kosovo, President, Government and Ombudsperson.

Issue 4 – Unregistered vehicles

Although official data do not exist, it is estimated that there are more than 40 thousand (c.a) unregistered and uninsured vehicles that actively participate in traffic. Having a Third Party Liability Insurance and registration of the vehicle is mandatory by law. The non implementation of this law has a significant negative impact on the Insurance industry which is already heavily discriminated. These are the two main ways in which the non implementation of the law damages the industry:

a) Registering these vehicles would increase the premium written by insurers for 5-6 Mil per year and also implementing the law.

b) Further to being deprived from this income, insurers have to pay the claims coming from these vehicles, as the victims of traffic accidents caused by uninsured vehicles must be compensated by Compensation Fund and Compensation Fund is financed by insurers.

On yearly basis, industry pays 3.5-4 Mil EUR claims for uninsured vehicles.

c) At the same time, the state budget experiences losses in taxes as well, the losses being estimated at 3 - 3.5 Mil (c.a).

d) Further and more important than financial losses, this issue has social consequences as these vehicles do not pas technical inspections, and pose higher risk to participants in traffic. This issue was evidenced also in the European Commission Kosovo Report 2018.

Recommendation for market improvement:

Stronger inter-institutional coordination is required to address the issue of non-insured, non-registered vehicles.

Solutions are in the legal provisions of the existing laws

- Law No. 04/L-018 On Compulsory Motor Liability Insurance

-Law No. 05/L-132 On Vehicles

-Law No. 05/L-088 On Road Traffic Provisions

Mining and minerals sector

Key elements of the market

In 2010 the Assembly of Kosovo adopted the Mining Law, the main objective of which was to establish the much needed order in the mining sector and offer investors clarity and predictability with respect to their investments. The Mining Law was introduced as a special law with a superseding effect over all laws and/or subsidiary legal instruments that are inconsistent with it. As it will be elaborated in greater detail below, the superseding effect of the Mining Law was not limited solely to the narrow field of mines and minerals but included also any and all other fields of law that have an impact in the mining sector.

In light of the ambiguities that were prevalent in the mining sector at the time of its adoption, the Mining Law provides for an explicit provision repealing conflicting provisions. Namely, the repealing effect of Article 88 of the Mining Law is twofold: (a) firstly, this legal provision repeals existing legislation that governed the mining sector prior to its adoption, i.e. UNMIK Regulation No. 2005/2 on “The Establishment of the Independent Commission for Mines and Minerals” and, *inter alia*, UNMIK Regulation 2005/3 on “Mines and Minerals in Kosovo”; and (b) secondly, and more importantly, Article 88 of the Mining Law establishes that the Mining Law shall “prevail over and supersede any provision or aspect of any other law of Kosovo that is inconsistent or in conflict therewith.” The latter element of Article 88 of the Mining Law is quite broad and applies to any legislative instruments, whether laws of subsidiary legal instruments, which related to or have an impact in the mining sector.

The repealing effect of the Mining Law is based on two general principles of legal interpretation. Namely, in addition to the principle of *lex specialis derogate legi generali*, under which the Mining Law as a special law repeals all laws of general nature, the Mining Law also takes precedence over prior laws by virtue of being a latter law. Indeed, based on the principle of *lex posterior derogate legi priori*, the Mining Law takes precedence over the Law on Agricultural Land and Administrative Instruction on the Change of Use of Agricultural Land, both of which predate the Mining Law. Consequently, the inconsistencies between the Mining Law and the other legal instruments impacting the mining sector do not require any amendments or further legislative work. On the contrary, these inconsistencies can easily be removed with the appropriate application of the aforementioned principles of interpretation

Main problems identified

Inconsistencies exist between the Mining Law and other legal and subsidiary legal instruments governing and/or impacting the mining sector in Kosovo.

Without prejudice to the fact that there may be more inconsistencies between the Mining Law and other legal and subsidiary legal instruments governing and/or impacting the mining sector,

in this section we shall expose certain inconsistencies on the requirement to secure surface rights for exploration and exploitation activities, provided for by Article 31 of the Mining Law, as they relate to the limitations on the size and the duration of leases for forest land foreseen by Article 13.7 and Article 13.8 of the Administrative Instruction on the Change of Use of Agricultural Land. In this respect, it should be noted that Article 21 of the Mining Law provides that an exploration license for construction materials can be granted for a period of two (2) years, which can be extended for another two (2) year period. With respect to the surface over which exploration license can be granted, the aforementioned provision provides that the exploration license cannot be granted for a surface that exceeds fifty (50) hectares.

On the other side, with regard to exploitation licenses, Article 30 of the Mining Law provides that an exploitation license can be granted for a period of twenty-five years (25), which can be renewed once. It is important to note that Article 30 of the Mining Law does not foresee any restrictions on the size of the area in which exploitation is conducted. Namely, paragraph 1.2 of Article 30 of the Mining Law provides that the exploitation license “shall apply to such area as may be required for the concerned mineral resource.” It is evident that the aforementioned provisions of the Mining Law aim to accommodate investments based on the characteristics of the minerals that are sought to be exploited. This explains why - while for exploration purposes the size is limited - for exploitation activities the size of the mining area is based on the concerned mineral.

Notwithstanding the aforementioned provisions, Article 13.7 and Article 13.8 of the Administrative Instruction for the Change of Use of Agricultural Land limit to five (5) hectares the area for the provisional change of use of agricultural for mining activities. The limitation pertaining to the surface area, which has been introduced by a subsidiary legal instrument, is not only in contradiction with the Mining Law but also has no legal basis in the Law on Agricultural Land. Namely, Article 11.7 of the Law on Agricultural Land provides in explicit terms that the provisional change of use of agricultural land for mining purposes can be done only for superficial quarries that are larger than 0.5 hectares. As it is evident, this legal provision establishes the minimum surface area threshold for considering the change of the use of agricultural land for mining purposes. Such a minimum threshold indicates that change of use of agricultural land is not allowed for small mining projects. This could be explained by the fact that the economic and social benefits caused by a mining project conducted in a surface area of less than 0.5 hectares do not outweigh the detrimental impacts caused to agricultural land by it.

Having said the above, it is also important to note that the Law on Agricultural Land does not foresee any limitations for the maximum surface area of agricultural land the designation of which can be changed. This is due to the fact that such a maximum threshold is not foreseen even by Article 30 of the Mining Law given that - as noted above - the ultimate size of the mine depends on the mineral that is sought to be exploited.

In light of the above, the restrictions on the surface area for the change of use of agricultural land, which are foreseen by Article 13.8 of the Administrative Instructions on the Change of Use of Agricultural Land, not only have no legal basis in the Law on Agriculture but are in contradiction with Article 21 and Article 30 of the Mining Law. Indeed, it should be noted that

the change of use of agricultural land foreseen by Article 11.7 of the Law on Agricultural Land and Article 13.7 and Article 13.8 of the Administrative Instructions on the Change of Use of Agricultural Land, govern change of use of agricultural land for mining purposes. In light of this and based on the interpretation methodology described under section 1 of this opinion, the surface area limitations for the change of use of agricultural land, provided by Article 13.8 of the Administrative Instructions on the Change of Use of Agricultural Land, has been superseded by the surface restrictions, and the lack thereof, for exploration and exploitation purposes, provided under Article 21 and Article 30 of the Mining Law, respectively.

Recommendation for market improvement:

There must be harmonization of the inconsistencies or contradictions regarding the time restrictions on use of agricultural land provided by Article 11.9 of the Law on Agricultural Land, it should be noted that the five (5) year limitation is in direct contradiction with Article 30 of the Mining Law, which provides that the exploitation license can be granted for a period of twenty-five (25) years, which can be renewed once. Since the purpose of the change of use of agricultural land, foreseen under Article 11.7 of the Law on Agricultural Land is to facilitate exploitation of minerals that are located beneath such land, the time period of such temporary change of use must be in line with the maximum duration of an exploitation license, as foreseen under Article 30 of the Mining Law. Indeed, given that the purpose for the change of use of the agricultural land is facilitation of mining activities, the term of the provisional use must accommodate its intended re-designation. Consequently, Article 30 of the Mining Law takes precedence when determining the maximum duration of the provisional change of use of agricultural land for mining purposes.

In light of this and based on the interpretation methodology described under section 1 of this opinion, the time period limitation for the change of use of agricultural land provided by Article 11.9 of the Law on Agricultural Land has been superseded by the restrictions provided under Article 21 and Article 30 of the Mining Law, respectively.

Legal Status of the Mining Strategy

The Mining Law has also established the legal basis for the adoption of the Mining Strategy, which is defined as the “framework document which defines long-term policies of the mining sector.” While Article 73 of the Mining Law does not stipulate the precise legal status of the Mining Strategy, paragraphs 3 and 4 of this legal provision provide some guidance as to the status of this document and its effect on other laws that impact the mining sector. Namely, paragraph 3 of Article 73 of the Mining Law provides that “during the preparation and implementation of spatial and urban plans, all public authorities shall take full account of and comply with the Mining Strategy promulgated by the Assembly.

Such Mining Strategy shall prevail over any inconsistent spatial or urban plan.” The term “Public Authority”, as used in Article 73.3 of the Mining Law is defined by Article 1.52 of

the Mining Law as “any governmental executive authority, public body, ministry, department, agency, or other such authority that exercises executive, legislative, regulatory, public administrative or judicial powers. The term “public authority” shall also include any otherwise private organization or establishment to that extent it exercises any of the aforementioned powers pursuant to a grant of authority under a normative or sub normative act or pursuant to a delegation of authority from another Public Authority.”

In addition to the above, paragraph 4 of Article 73 of the Mining Law provides that no Public Authority shall approve any spatial or urban plan without the consent of the Ministry of Economic Development. According to this legal provision, the Ministry of Economic Development shall approve such spatial and urban plans only after getting the consent of the Independent Commission on Mines and Minerals that such spatial and urban plans have no detrimental impact on the Mining Strategy. On the basis of the above, it is clear that the Mining Strategy not only takes precedence over the all spatial and urban plans adopted by any public authorities but that such public authorities cannot adopt spatial and urban plans without getting the confirmation from the Ministry of Economic Development that such plans are not in contradiction with the Mining Strategy of Kosovo.

Recommendation for improvement of the sector:

The Mining Strategy must take precedence over any spatial and urban planning documents that are in contradiction with it. On the basis of this, it can be argued that the Mining Strategy has made obsolete the Regulation No. 01/2011 on the “Treatment of Communities in the Mining Sector”, as amended, the main purpose of which is to ensure that the mining project is in line with spatial, urban and municipal development plans.

Petroleum Industry

Key elements of the market

Petroleum market in Kosovo even today remains dependent on imports. There are currently nine (9) major import companies in Kosovo who have storage plants (farm tanks) to store large quantities and 600 Operational Petrol Stations. Kosovo is a 360 million liter market in “white products” such as Diesel and Unleaded fuel. Kosovo has no domestic oil supply and no pipelines. There are no refineries in Kosovo while most of the regional countries (Western Balkans) do have refineries. The petroleum industry is facing high duties and taxes such as the high excise tax which makes petroleum products less competitive. The main law governing the oil sector in Kosovo is the Law no. 2004/5 on Trade with Petroleum and Petroleum Products enforced in 2004, amended by Law nr. 03/L-138 enforced in 2009. The Law applies to the wholesale and retail supply, transport, and storage of petroleum and petroleum products. The petroleum market structure is controlled by the Ministry of Trade and Industry through the Division for petroleum market regulation within Department for petroleum market regulation and strategic goods. The Division for petroleum market regulation was established in December 2012 as a successor of the Office for licensing, regulating, and monitoring oil sector.

Main problems identified

1. Customs Duties on Non-Received Goods (Evaporation of Petroleum)

Due to the nature of the product, petroleum product every time that it is transported or even stored a portion of it evaporates. This is an internationally recognized fact and practice. Therefore, no excise duty should be charged on product never received and thus never sold. The solution is not to pay customs and VAT on product which in reality was never received and never sold and this must be corrected.

On the other hand, the Law on Value Added Taxes through Articles 22 and 23 sets out provisions when this tax becomes chargeable. Article 22 specifies that "the moment of the occurrence of the obligation occurs and the VAT becomes chargeable when the goods and services are supplied", whereas Article 23, paragraph 2.3 states that in the case of the importation of goods the "Applicable provisions regulating customs duties apply to the moment of loading and the moment when VAT becomes chargeable for imported goods which are not subject to customs

duties in Kosovo.” This means that any treatment that a product will have in terms of customs duties in case of customs clearance, this treatment will apply to VAT, whether it is for final products or for raw materials that may affect all value chain.

As explained above, while the customs and excise code provides for cases of losses during transport and storage in customs warehouses, and despite the fact that Article 22 of the Law on VAT provides for tax to be applied only to goods supplied, in practice there are frequent complaints from companies that losses incurred during transport, production or storage as a result of evaporation, destruction or alienation are not recognized by customs or tax officials and are therefore liable to pay customs duties and taxes on goods they have never had released for free circulation. This also applies when companies can verify through sufficient documentation that the product in question has evaporated or broken during any of these processes as a result of its specifications.

Recommendation for improvement of the market:

Drafting of the Law on petroleum and petroleum products market in Kosovo is foreseen as per the legislative programme of 2018 to take place on 29.06.2018. This process must start as soon as possible and recognition of product loss (evaporation of petroleum) must be recognized. Product loss in this case can be recognized in line with regional practices which are already in place and determine a pre-set amount (a percentage) which will be recognized as a loss throughout this industry.

This clarification must happen in the Law and not via an Administrative Instruction.

2. Discriminatory treatment among petrol importers

Unequal treatment is observed between wholesalers and retailers as both are eligible for obtaining an import license. The existence of too many Import Licenses of Petroleum Products in Kosovo is diminishing the importance of existing tank farms investments. Today, it is physically impossible to control all the trucks that enter Kosovo on a daily basis. Wholesalers have tank

farm installations (where quantity and quality can be checked, registered and certified at any time), while retailers are owners of petrol stations, with limited storage capacity.

Quantity: Importers are obliged to keep at all times an emergency stock - a fraction of their own storage capacity. Retail importers however, are allowed to import for other / third retailers while keeping as an emergency stock only the volume corresponding to their own installation. On the other hand, “wholesalers” receive the goods at their “Tank Farm” which are equipped with measuring systems that give exact evidence and must keep emergency stock based on their enlarged capacities at all times.

Moreover, it is practically impossible to control all retailers (numerous trucks and destinations) as this would require a great deal of resources allocated to this purpose.

Quality: Wholesalers could easily be controlled for the Fuel Quality at any given time if it stored inside the Tank Farm. As for the retail importers, quality controls are only at random since practically impossible to control every truck that enters Kosovo and going to multiple destinations which may not even be their own petrol station.

Recommendation for market improvement:

Have clear criteria and pre-requisites for obtaining an Import License with minimum petroleum tank farm facilities (perhaps 2 million liters storage capacity for each product), not petrol stations.

All petroleum products imported should be placed first inside the tank farms of Importers and after being tested for quality and quantity then to be released to the wider market.

Therefore we request to minimize the import licenses to only those who use their tank farms, as this will allow to check the quality of most of the fuel in Kosovo and also gives incentive to the investors of such facilities.

4. SUBJECT: Lack of Requirements for Compulsory Stocks (COS)

Security of energy supply in Kosovo is where there is constantly an increasing demand while Kosovo remains fully reliant on imports. The Compulsory Oil Stock (COS) should be implemented with the purpose to secure the society with sufficient energy supplies also in periods with restricted or limited supplies. The 90 days COS capacity should be implemented by the end of 2020.

Practices in the European Union

The issue of product breakdown, loss and evaporation is regulated in the European Union through Regulation no. 952/2013 on the Customs Code of the Union and through the Directive 2008 / 118 / EC on General Rules on Excise. Article 124 of the Customs Code specifies cases where the customs debt is annulled, inter alia, paragraph 1, item g) provides for cases when *"The disappearance of products or the non-fulfillment of the obligations arising from the legislation is the result of total destruction or irrevocable loss of products as a result of the nature of the products or unforeseeable force majeure or as a result of instructions from the customs authority; for the purposes of this paragraph, products shall be considered irrevocably lost when they are no longer usable by any individual"*.

Additionally, paragraph 4 of the same article states that "The provisions in force regarding standard rates of non-taxable loss as a result of the nature of the products shall be applicable where the person concerned cannot establish that the true loss exceeds that calculated by applying standard rates for the products in question".

On the other hand, the aforementioned directive states that Member States have the right to set specific conditions to establish the losses incurred as a result of the nature of the products, whether in transport or in processing processes. However, paragraph 5 of Article 7 - Time and place of loading [with customs duties] clearly states that Member States must draw up rules and publish conditions when the loss of products will be acceptable.

Regarding tax treatment, Directive 2006/112 / EC on the Common System of Value Added Tax states that "Except in certain cases, the moment of the occurrence of the liability occurs and the tax becomes chargeable at the time of the supply of goods or services. The relevant provision in Kosovo's legislation is in full compliance with this provision of the European directive. However,

as explained above, the practices so far do not indicate the proper implementation of this or other provisions elaborated in the following paragraphs.

The case of Croatia

As a new member state of the European Union, the state of Croatia has already regulated the issue of recognizing losses. In their case, the Ministry of Finance based on the Customs Code has issued sub-legal act on excise tax. This document containing the general conditions, simplified procedures, refunds and other provisions also foresees cases of product losses by laying down certain conditions for recognizing losses in the case of products subject to excise duty and used in simplified procedures (customs warehousing or internal processing, namely, paragraphs 2 and 3 of Article 4 of this sub-legal act show that the losses incurred during the production, storage or transport of products resulting from the specifications will be recognized for the same no excise tax will be charged to the extent permitted. Additionally, annex 2 to this sub-legal act specifies the extent to which losses are recognized for each specific product.

Recommendation for market improvement:

Obligate importers (above a monthly volume threshold) to store the product into their tank farm installations for the Inspection of quality and quantity before it is sold to the retail market. Ensure safety stock based on “sales” instead of “tank capacities”.

Pharmaceutical Sector

Key elements of the market

A properly functioning pharmaceutical sector can make a big difference to the quality of people's lives and has a significant economic effect. The Kosovo Medicines Agency (KMA), in combination with Kosovo Customs, controls the importation of pharmaceutical products and medical devices. A valid import license is required for the importation of these products. The importation of pharmaceutical products and medical devices is regulated by the Law on Medical products and Equipment, No. 04/L-190, Article 12, and other legal norms. The Kosovo Medicines Agency (KMA) is responsible for protecting people's health by providing quality and guaranteed medical products and equipment, and services related to medical products and devices through the licensing of professional companies and individuals.

Kosovo spends around 3% of GDP on health sector which is a very low amount compared with the regional countries which average around 6% of their GDP and while in the EU countries this percentage exceeds 10%. In addition, Kosovo lacks a public health insurance system and as a result patients do not get reimbursed for the purchase of pharmaceuticals unless they have private health insurance.

Kosovo pharmaceutical market is primarily represented by the pharmaceutical distributors (namely wholesalers and retail pharmacies) as well as suppliers such as manufacturers. Currently there is only one pharmaceutical manufacturer in Kosovo, Trepharm. Kosovo pharmaceutical manufacturers face difficulties in exporting and only cover about 5%-10% of the market therefore there is a considerable trade deficit with respect to import – export.

Kosovo is far better in crude birth and death rates than its neighbors with crude birth rate at 15.7% (while in the region they are as low as 8.7% in Bosnia and Herzegovina) and crude death rate at 5% (while in the region they go up to 14.6% in Serbia). Analysis of the health status of the population shows that the number of deaths in 2011 in Kosovo was 421.9 deaths per 100,000 inhabitants. In comparison with European countries, this number is very low where there are 813 deaths per 100,000 inhabitants, according to data from 2012. The health status analysis of the population shows the degree of illness in Kosovo is the lowest with a total of 422 cases per 100,000 inhabitants in 2011 compared to the EU with 663 cases per 100,000 inhabitants

The health system in Kosovo

Kosovo health system is relatively new bearing in mind the fact that Kosovo has only recently (in the last decade) begun to function as an independent entity. In the former Yugoslavia the health system was relatively well organized, advanced and comparable with health-systems of other developed European countries.

Based on the available data, it is shown that the pharmaceutical market in Kosovo is largely covered by the import-foreign pharmaceutical companies which almost completely cover it, and the participation of local companies is around less 5%; although data of the two companies claim that they cover 10-20% of the market as we have mentioned above [18]. Serious competitors are the companies from pharmaceutical companies of the former Yugoslavia that dominate in the pharmaceutical market in Kosovo. But the foreign companies should not be overlooked because they are also largely penetrating in the pharmaceutical market. The strong competitors based on this work are: the competitors from the territory of the former Yugoslavia as Krka and Lek-Sandoz Slovenia, Pliva, DietPharma, Apipharma & Mdph from Croatia, Alkaloid and Fitopharm & Medi Macedonia, Hemofarm and Zdravlje Serbia, Bosnaljek of Bosnia and Herzegovina, but also as well as some world known companies from the wider circle (Roche, BerlinChemie, Aventis, Sanofi, Dade Behring, Beti-Fickinson, Menarini, Bayern Schering, B. Braun, Chem & Ursa, Theis Pharmamed, Nobel, GSK, etc.). We can say that Roche, Krka, Pliva and Alkaloid cover 30% of the pharmaceutical market in Kosovo ¹⁰

Kosovo public healthcare sector employs 14,617 people. Out of it 6,231 work at the primary level across 38 municipalities, 7,228 work at secondary (7 regional hospitals) and tertiary level (University Clinical Center in Prishtina) and 1,158 work for the Ministry of Health.

Overall public budget covering all the healthcare system is EUR 130 mio. Out of it 75% or around EUR 100 mio. goes for its employees, maintenance and capital investments. Whereas only EUR 30 mio. is left for financing “pharmaceutical and equipment”, meaning this should cover needs starting from basic goods like needles and gloves up to expensive biologic treatments, which for a population of 1.8 mio inhabitants is by far not enough (Albania: ca. 110 mio EUR; Macedonia: ca. EUR 120 mio EUR only for pharmaceutical drugs).

¹⁰ Ezar, P. and Zori, O. (2007). Organising for Network health care: towards future organizational models. Network health care Journal of medical Marketing.

Positive Developments

In 2015 the new Law on Value Added Tax (VAT) called for the application of the 8% VAT on medicine and medical equipment. Previously the VAT on such products was 0%, however the customs tax was fully eliminated which used to be at 10% prior to 2015 changes. Medicine and medical equipment entering Kosovo from CEFTA members was in any case free of customs duties.

The raise in 8% VAT on one hand, and the elimination of 10% customs duty tax on the other was welcomed by the pharmaceutical manufacturers since the new tax law releases the manufacturers from customs tax on the import of raw materials used in production, and VAT reimbursement on investments on facilities, equipment etc.

- In cooperation with World Health Organization the Ministry of Health has set “ceiling” pricing for each medical product. The Administrative Instruction for price regulation of medical products and appliances applies only to medical products and equipment that are part of the “Essential List”. The Essential List is a "register" of drugs, compiled by the state, which are mandatory for MH to buy. In addition to the Essential List this year will be drafted the List of Refundable Medicines.
- This list will initially have about ten products that are mainly for chronic diseases for which Kosovars have higher mortality. The list has not yet been finalized; it is planned that by the end of this year the products from this list will be taken free of charge by Kosovar patients in pharmacies.

Another positive initiative is the current work of MoH on an administrative instruction, which will regulate a referential pricing, based on 4 countries of the region (Albania, Macedonia, Montenegro and Croatia).

Main problems identified

1. **REFERENTIAL PRICING SYSTEM:** This system would enable to compare local prices with those of several countries chosen and to impose a pricing ceiling to pharmaceutical distributors. Creation of such a system avoids the misuse of the healthcare system, like increasing prices without justification. It can as well regulate margins of the pharmaceutical distributors.

Recommendation:

MoH has already identified this issue and is currently drafting an administrative instruction, which will regulate the referential pricing. It is important that MoH doesn't do the same mistake as MoH Albania, by taking the lowest price of the referential countries and enabling a negative incentive to the well-established pharmaceutical companies.

2. **PROCUREMENT LAW:** If aiming a qualitative healthcare system, the lowest price is not always a solution. Healthcare professionals shall be involved more when choosing the right solutions and not the procurement officers. These right solutions might sometimes differ from the lowest price and healthcare professionals shall be entitled to choose such if justified as for the benefit of the patients.

Recommendation:

MoH should be able to negotiate directly with the producers, in order to get the maximum rebates and benefits for its patients. Countries in the region (Albania, Montenegro) have already closed so called "Managed Entry Agreements" with different producers, enabling to get substantial rebates through direct negotiations. Albania did this by adopting an administrative instruction from the government, enabling them to enter into direct negotiations with the producers.

3. **HEALTHCARE SPENDING:** Kosovo currently spends around 3% of the GDP for its healthcare system. It is the lowest in Balkan and Europe and among the lowest in the world. In order to reach the next lowest country in the region, it should at least double its spending. Increasing healthcare spending is a must for increasing healthcare quality.

4. **REGULAR SUPPLY OF MEDICATIONS AND THE ESSENTIAL LIST** - International companies present in Kosovo are the major contributors to regular drug supply and the leading providers of access to modern therapies.

5. **LACK OF NATIONAL HEALTH INSURANCE PROGRAMME** - In theory, Kosovo provides free healthcare. In a system established by Yugoslavia, however, medicines are scarce in many healthcare facilities. Most patients have to pay for their medication. Many treatments are unavailable, or only received after long waiting periods. The government has acknowledged these problems and is planning to reform the system. The centerpiece of the reform is the introduction of compulsory health insurance for all. In spring 2014, the parliament passed relevant legislation for a complete overhaul of the public health system.

6. **Healthcare spending out of the country:** There circulates a number that approx. 150 mio EUR per year is spent from Kosovars for healthcare services out of the country (predominantly in Macedonia, Turkey and Albania). This leads to the conclusion that there is a huge lack of services even in a private health care sector. This money should be kept in the country by increasing healthcare services in the public and private sector. Public sector should include co-payment possibilities for enhanced healthcare services.

7. **Non-prescription medical sales in the pharmacies:** Today in the Kosovo pharmacies *everything* can be purchased without a prescription. Due to uncontrolled usage of medicines, Kosovo has the highest usage rate of antibiotics in Europe.

RECOMMENDATIONS

The legal framework must be completed and harmonized with EU legislation; transparency and predictability of business and legal security are the basic prerequisites for the sustainable functioning of the pharmaceutical industry in Kosovo. Representatives of the pharmaceutical industry should to be included in the legislative process.

Kosovo's health budget must be financially consolidated and increased; to ensure continued growth of the budget for medicines at double rate compared to the rate of GDP growth and the health

needs of the insured in the Republic of Kosovo. Make the budget more transparent to increase business predictability and safety of investment in the health and pharmaceutical sector.

Establish healthcare requires a systematically established and functionally efficient link between its three underlying pillars: manufacturers, wholesalers and healthcare institutions (public and private).

Conclusion

Being the first publication of this nature, the White Book 2018 has focused only on five sectors namely telecommunications, banking, insurance, petroleum and pharmaceutical sectors. In the upcoming years these sectors will expand even further to encompass even more important issues.

The main objective of the White Book is to deepen the dialogue with the authorities and to draw attention to the precise and concrete problems in the market place and hence the improvement of the investment climate. A good investment climate in Kosovo means there will be more jobs created, more taxes to the state budget, higher standard of living and well being of citizens, a transfer of knowhow to the youth of Kosovo and an overall benefit to the society as a whole, not just firms.

Through successful investments, Kosovo can attract more foreign direct investors who will work with local investors and partners to expand on trade and exports as well as other areas of the service sector. Such improvements on the investment climate can only be positive for the country as a whole. The Government and relevant authorities must work with such investors and such recommendations without any hesitation to implement such recommendations as fast as possible.

The sectors which have been addressed in this White Book represent very important issues that have been discussed now by EIC for a number of years. The White Book will keep track, monitor and measure future progress on the key areas which have been raised. It is intended to serve as a follow up tool as well in ensuring that the Government takes ownership of these issues which have been raised.

We remain hopeful that this effort of the European Investors in Kosovo and its partners will be only the beginning of a very structured approach to problem solving and opportunity creation for the future of Kosovo. We invite the Government and relevant authorities to take ownership in resolving such outstanding business barriers and to make Kosovo more attractive for doing business and investing.

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