

A FUTURE FOR THE ECONOMIC DEVELOPMENT OF KOSOVO

Speech of the Finance Minister Ahmet Shala at the London School
of Economics and Political Science, 12 January, 2009

Distinguished guests, etc etc

I thank you for this opportunity to be able to speak to all of you.

It is for me a great privilege to be able to make a presentation at one of the world's most prestigious universities. The reputation and history of the London School of Economics is such that one can cannot avoid feeling humble in the shadow of the many people who have passed through this place of learning and have moved on to positions of distinction.

Today, I have been meeting with British Government officials and with the EBRD. Meetings of this kind are all part of a process, the intention of which is to integrate Kosovo into the world community.

The politics is complex, emotive and for some people divisive. Everyone involved has their own story and I do not propose to dwell on the issues other than to say that Kosovo stated its

position to the world with its formal announcement of Independence on 17 February of last year. More than fifty countries have recognized us and I speak from this position.

Therefore, as the Minister of Economy and Finance in our new country what I want to talk about today is the Kosovo economy: Where we have come from, where we are today and where we want to be for the future.

In saying this we are all conscious of the fact that the world economy is most certainly not in good shape. Only a short distance from where I stand, your ancient and venerable Bank of England has just brought its interest rate down to the lowest level in its entire history. But, extreme as it is, this is one indicator out of many. Whatever aspirations Kosovo might have, they cannot be unaffected by such events and I will come back to this point later.

I don't have to tell you that Kosovo started from a post-conflict situation. We have had to start right from the beginning and have been involved in a major nation building exercise. This has involved us in building from scratch the institutional and legal

framework that are the essential building blocks of any society.

We have had to design and implement a whole range of economic and fiscal policies. This involved the introduction of a comprehensive tax system and a public expenditure process. In other words, from first principles we have had to construct a public budget from which the government can deliver its policies to the people.

An initial priority was to put in place a credible financial sector. We set up a Banking and Regulatory Authority and have been able to not only attract a number of international banks but also provide the space within which local banks can develop. At the moment there are two banks with local ownership and five with foreign capital.

We implemented a complex privatization process that has removed successfully a large number of socially owned enterprises from the books of the public sector. The resulting privatized companies are now in full operation and are creating output and much needed jobs.

All of this has contributed to a major objective, which is to

establish the foundations for a liberal market system that is so essential for a small open economy. Moreover, one that aims to become integrated as a recognized partner in the region.

Of course, and we are well aware of the fact, none of this could have been done without the massive support from the international community. Indeed, the total cumulative amount of donor support to Kosovo since 1999 is broadly equivalent to its today's GDP.

However, what I have just said has been only a start and we face some very serious challenges.

- Unemployment is unacceptably high – probably around 45%.
- Our rate of economic growth is below that required to absorb the new job seekers coming on to the market.
- World Bank studies suggest that possibly 15% of our people are living on less than 1 euro (1.35 USD) per day.
- We have a trade balance deficit of more than 40% of GDP. A major source of financing for this deficit is remittance inflows, together with donor contributions.

Kosovo has roughly half a million people living abroad and the

contribution that they make helps to sustain living standards. But this dependency on both the Diaspora and Donors must change. It is both a benefit and a curse. Economists sometime refer to this as the “donor/remittance disease”. On the one hand, as I have said it provides income, on the other, it can act as a disincentive to development.

Although, I am relieved to say, Kosovo does not depend on gas! - we do nevertheless have a major energy supply problem. The paradox is that although we have some of the finest quality supplies of lignite anywhere in the world, our energy sector is old, parts of it are dysfunctional and this is acting as a serious constraint on business and economic development.

Yet despite all of this, the efforts that we have made over the past 9 years, do demonstrate that Kosovo has strengths.

It may be tempting fate to say this but we have managed to maintain a stable macroeconomic and fiscal environment. In achieving this we have received very good professional support from the IMF and also from USAID advisers.

Kosovo has a very good budget and financial management

system- as good as any in the region or even in Central Europe. The public sector is in pretty good shape.

From almost the beginning, and with the agreement of the UN and EU, Kosovo has been able to adopt the EURO as its currency. This has brought about, both credibility and stability in our financial system.

We place great emphasis on becoming a fully integrated partner in the region and on strengthening the ties with all of our neighbors. Within an international perspective, this for us is a first natural development.

Kosovo is now a member of Central European Free Trade Agreement (CEFTA), which yet another indicator of our desire to keep our markets opened and liberal.

It must be remembered that although we use the EURO, Kosovo is not a member of the EURO Zone and has no access to the European Central Bank. As a consequence, because we do not have either our own monetary policy and our own exchange

rate, we must place a major emphasis upon maintaining market flexibility and improving our competitiveness. We cannot do it by simple nominal devaluation.

Another strength which we have sought to establish is to maintain good relations with the international community and the major international financial institution.

I must emphasize that Kosovo has come a very long way in a very short space of time. What we have been involved in is a nation building and sustainability exercise. The task now is to move from simple sustainability to the real job of generating economic development.

As we see it today, the end game of what may well be a long process is to become integrated with our European Partners. We point ourselves firmly in the direction of the EU.

We are already installed as a partner in the Pre-accession process and we have moved rapidly towards accommodating a vast range of European standards. In other words, although it is

the beginning, we are already placing ourselves on the path towards Europe.

Of course moving along a given development path is quite easy. Moving to a new one however, is very difficult. Transitions are always costly and one needs to be sure about the benefits.

In short, we must place ourselves on a new and higher growth path

What does this mean for Kosovo?

The main thing is that we have to get our policy priorities right and the Government over the past few months has been occupied precisely with this issue.

We have targeted four essential pre-requisites to achieve our ultimate objective.

First of all, economic growth is so obvious that I don't really have to state it. As the eminent macroeconomic theorist and noble laureate – Robert Lucas - once wrote “growth is all about opportunities” – Kosovo needs such opportunities for its young and ambitious labor force.

Approximately one half of our population is under the age of 25. These people need education, they need good health care, they need good infrastructure and of course they need jobs. This is what growth provides.

Secondly, we are determined to provide a framework for good governance.

And thirdly we must provide sufficient resources to address the issue of Poverty and Social Deprivation.

Finally and of much importance, our political commitments related to our new independent status demand that we implement the policies of the Ahtisaari status settlement.

The Government of Kosovo is firmly committed to ensure that all minorities are fully integrated into our society with rights and

responsibilities that are shared by all.

These are our aspirations.

So how far have we got?

Well, I can inform you that recently we made a serious effort to produce a well-articulated and comprehensive Medium Term Macroeconomic and Expenditure Framework which incorporated our priorities, and if I may say in much greater detail that I am able to state here. For those who are interested, it can be found on The Ministry of Finance website.

This important document was the vehicle for the major international Donor Conference held on behalf of Kosovo and hosted by the EU in Brussels in July of last year.

What our exercise demonstrates is that if Kosovo is to meet these priorities and to raise our underlying growth potential, we estimate that there will be a financing gap of around 1.4 billion Euro. This is around one third of our current GDP and is a simple financial measure of our economic development deficit.

Donors in fact have agreed to finance nearly all of this to the benefit of the development of Kosovo and also to the benefit of its people.

There are many other actions taking place. We have made formal applications for IMF and WB membership and we will be doing the same with respect to the WTO, EBRD and other organizations.

I mentioned earlier the world economic situation and clearly, there may well be some implications for Kosovo. My simple understanding of the current crisis is that there have been two parts; firstly a financial bubble that has burst and which has been followed by recession in the real economy.

Kosovo, as I noted, has no monetary policy, no independently determined interest rate, no exchange rate and has only an emerging financial sector. The exposure of Kosovo to current events rest on such elements as the flow of remittances provided by Kosovar workers abroad and the willingness or ability of the international community to provide financial support. Both of

these are outside of our control.

In so far as any decline in remittances occurs, it will feed through directly to spending and business. Thus it is quite possible that for Kosovo any adverse effects from outside could affect the real economy first and then the financial second –this is the reverse to what we are seeing in developed economies.

The truth is that because of our peculiar circumstances, we are not entirely sure. But we are now monitoring the overall liquidity situation on a daily basis and as a precaution have established a ‘Stabilisation Reserve’ as a separate programme in the Budget.

In conclusion, there is a very long way to go, but I am minded to observe that other very small countries, such as those in the Baltic region emerged from their transition from the former Soviet Union, today are formal members of the EU.

There is no reason why Kosovo together with its other partners in the Balkan region cannot achieve precisely the same.

I am minded to think that twenty years looking forwards is rather longer than twenty years looking backwards!

Once again, I want to thank you for your kind invitation. I trust that what I have said has provided you with a credible vision of what I believe Kosovo can achieve.

Thank you indeed.