Public financial management reforms in fragile states: the case of Kosovo

Heidi Tavakoli and Shkumbin Saneja

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Please note that this report covers events only until the summer of 2010. Responsibility for the opinions expressed and any errors of fact or judgement remains with the authors.

Overseas Development Institute
203 Blackfriars Road, London, SE1 8NJ

Tel: +44 (0)20 7922 0300
Fax: +44 (0)20 7922 0399
www.odi.org.uk

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Abbreviations

BDMS	Budget Development and Management System
CBF	Committee for Budget and Finance
CFA	Central Fiscal Authority
CIDA	Canadian International Development Agency
CPIA	Country Policy and Institutional Assessment
EAR	European Agency for Reconstruction
EFC	Economic and Fiscal Council
EU	European Union
EULEX	European Union Rule of Law Mission in Kosovo
EUSR	European Union Special Representatives
FRIDOM	Functional Review and Institutional Design of Ministries
GDP	Gross Domestic Product
GFS	Government Finance Statistics
IAC	Interim Administrative Council
ICO	International Civilian Office
IPSAS	International Public Sector Accounting Standards
JIAS	Joint Interim Administration Structure
KCB	Kosovo Consolidated Budget
KEK	Kosovar Energy Cooperate
KFMIS	Kosovo Financial Management Information System
LPFMA	Law on Public Financial Management Accountability
MDA	Ministries, Departments and Agencies
MDG	Millennium Development Goal
MEF	Ministry of Economy and Finance
MTBF	Medium Term Budget Framework
MTEF	Medium Term Expenditure Framework
NATO	North Atlantic Treaty Organisation
OAG	Office of the Auditor-General
PEFA	Public Expenditure and Financial Accountability
PEMTAG	Public Expenditure Management Technical Assistance Programme
PFMRAP	Public Financial Management Reform Action Plan
PIP	Public Investment Programme
PISG	Provisional Institutions of Self-Government
PPA	Public Procurement Authority
PPRB	Public Procurement Review Body
PPRC	Public Procurement Regulatory Commission
PTK	Post and Telecom Kosova
SIGMA	Support for Improvement in Governance and Management
RIMS	Recovery Information Management System
SRSG	Special Representative of the Secretary-General
UNMIK	United Nations Interim Administration Mission in Kosovo

Executive summary

In 2008 the Provisional Institutions of Self-Government (PISG) of Kosovo unilaterally declared independence. Following the end of the conflict in 1999, the United Nations was charged with governing Kosovo through its Interim Administration Mission (UNMIK). Initially UNMIK was given a mandate for full executive, legislative and judicial responsibilities in Kosovo. Over time these responsibilities were transferred to the PISG, which became known as the Kosovar Government.

Kosovo is a young state which has successfully been able to maintain political stability and security, while fostering international recognition. This has in part been due to strong post-war economic growth, which is expected to continue, although some economic uncertainties and ambitious spending commitments may undermine this. However, despite such promising growth rates, Kosovo is one of the poorest countries in Europe, with persistently high levels of poverty and unemployment and low-ranking results on human development indicators.

Over the post-war period, the framework and institutions of governance were developed alongside the gradual transfer of functions and responsibilities to the PISG. The nature of the peace resolution meant that constitutional, legal and institutional structures essentially 'started from scratch' in 1999, without accommodating the Yugoslavian legacy to any great extent. Administrative capacity also had to develop from a low base, given the limited pool of qualified Kosovars with experience of public administration in the immediate aftermath of the conflict. A year after the PISG was established in 2002, ministerial responsibilities were gradually transferred starting with key ministerial functions including finance and economy. At the same time UNMIK, under the authority of the Special Representative of the Secretary-General (SRSG), retained control of certain 'Reserved Powers' and a hybrid governance structure necessary to allow a power-sharing arrangement to exist was established. Even within the domain of finance and economy, fiscal responsibilities existed in a power-sharing context. This hybrid governance structure not only created the ground for limited and weak policy-making, but also undermined the development of a functioning accountability system. The result was a legacy that affects public financial management (PFM) performance to this day. This was not only because the SRSG retained responsibility for crucial executive functions, but also because the power-sharing arrangement between UNMIK and PISG was intricate and fluid, and marked by overlapping functions and mandates. Such an ambiguous governance structure weakened the development of national accountability structures and is one of the reasons the international community still retains considerable influence over Kosovo's development.

As with the whole of government, PFM systems in Kosovo developed from a very modest base. Although Kosovo had legal authority over some PFM functions within the Yugoslavian Federal system, constitutional amendments in 1989 resulted in this autonomy being disbanded and PFM functions being transferred to Belgrade. As a consequence there was limited physical and human capital available for managing PFM in the beginning of the reform period. Despite this, establishing finance functions was a priority in the immediate aftermath of the war, as illustrated by the first UNMIK regulation which established the Central Finance Agency (later to become the Ministry of Economy and Finance) and shortly followed by the first PFM rules. As with the development of the whole of government, the nature of the initial international administrative authority meant that very little was carried over from the pre-1999 Yugoslavian PFM systems.

In terms of the stages of PFM reforms, changes to the power-sharing arrangements can stand as proxies for PFM reform transition periods. Between 1999 and 2001/02 the PFM reform effort in Kosovo focused mostly on controlling inputs and accounting for cash. Budget planning was also supported; however, given the human resources constraints, it had to take second place after controlling the aggregate level of spending (World Bank, 2002a). Between 2002/2003 and 2007, implementation of the Constitutional Framework and the Law on Public Financial

Management Accountability (LFPMA) allowed the PISG greater autonomy over PFM functions. The reform effort continued to target budget execution and planning functions, but was also extended to develop Kosovar competencies related to external audit, capital budgeting and procurement. From 2008 to now, plans for the future PFM reform effort reflect a shift in focus away from the central level towards municipalities and budget organisations (although municipalities and line ministries had maintained a prominent position in some budget execution reforms prior to 2008).

Reform design has been heavily informed by PFM assessments and reviews. The most recent reform programme has been guided by the results of the Public Expenditure and Financial Accountability (PEFA) self-assessment. As with many of the other cases in this study, a comprehensive and integrated PFM reform programme emerged late in the reform effort. Prior to this a specific sequencing of reforms (in a comprehensive way) does not appear to have been followed. Rather, reforms reflected the focus of donor projects, with poor government planning or coordination of the reform process. Although such support has strengthened the system, weak donor coordination has led to some problems, including the duplication of reform efforts and insufficient integration of reform outputs.

Table 1 summarises the results and achievement of PFM reform in Kosovo. Although Kosovo's PFM system is relatively young and competencies will take time to develop, a range of basic and advanced reforms have been implemented, the performance of which is comparable to achievements in the region (Tandberg and Pavesic-Skerlep, 2009). The table presents the results, against three dimensions of PFM: de jure measures vs de facto functional results; upstream vs downstream performance; concentrated and deconcentrated performance (World Bank, 2010b).

Table 1: Results and achievements of PFM reform in Kosovo (1999-2010)

De jure measures vs de facto functional results	
	First, the legislative framework for PFM is fairly advanced in Kosovo (FRIDOM, 2008b). Most interviewees felt that the legal framework was appropriate for its purpose. Second, there was also general agreement that the procedures and processes underlying the legal framework were fine, although the current PIP procedures were felt to be an exception. Despite the sound framework, the challenge of implementing it was consistently raised. Two main reasons were frequently suggested. First, low administrative capacity across government (FRIDOM, 2008a) and second, the lack of political will to implement the laws, procedures and processes.
Upstream vs downstream performance	
	Strong PFM performance is not confined to one 'stream' of the budget cycle. The PFM chapter of the recent forthcoming World Development Report shows that across a range of fragile countries, countries perform better on average against a set of upstream functions than downstream functions. It also suggests that budget preparation is stronger than execution in fragile states (World Bank, 2010b). Kosovo's performance deviates from this finding. As acknowledged by various diagnostic assessments (PEFA, SIGMA, FRIDOM), the treasury system is well developed and operational. The main assets of the Treasury Department include its strong Kosovo Financial Management Information System (KFMIS), a single treasury account and a fully staffed and capable team (FRIDOM, 2008a). Not only have treasury activities worked well since 1999 relative to other areas of PFM in Kosovo, but their effectiveness continues to grow. This is illustrated by a comparison of performance as assessed in the two recent PEFAs which state that 'the assessment shows improvements in the PFM system'. The most significant improvements were made in the budget execution system, where the PEFA scores improved in cash management and accounting recording and reporting (PEFA, 2009). In addition to the treasury function, the small but well-resourced Macroeconomic and Fiscal Policy Unit is functioning well. The main challenges that exist in the up- and downstream sections of the budget cycle relate to budget planning, particularly the

	MTEF and PIP. They are both undermined by weak strategic policy direction at the beginning of the budget cycle, as well as parliamentary oversight and audit. Any improvements in the audit functions are not being reflected in parliamentary oversight.
Concentrated vs deconcentrated entities	
	Deconcentrated entities' PFM performance is weaker than that of the MEF, reflecting where reform effort is focused. At budget organisation level the budget preparation process varies and there is limited technical appreciation of the MTEF.

Full implementation of PFM systems remains a key challenge, particularly with regard to activities that have the largest scope for political involvement. Examples of these are: budget formulation and the Medium-Term Expenditure Framework (MTEF), the Public Investment Programme (PIP) and parliamentary oversight and scrutiny. Two main reasons were frequently suggested: first, low administrative capacity across government; and second, the lack of political will to fully and consistently implement laws, procedures and formal administrative processes.

1 Introduction

1.1 Purpose and objectives of the study

This paper is part of a study analysing public financial management (PFM) reform initiatives in fragile and conflict-affected states (FCS). The object of the study is to undertake a comprehensive stocktaking, review and synthesis of lessons learnt about designing, implementing and assessing PFM reform initiatives in FCS.

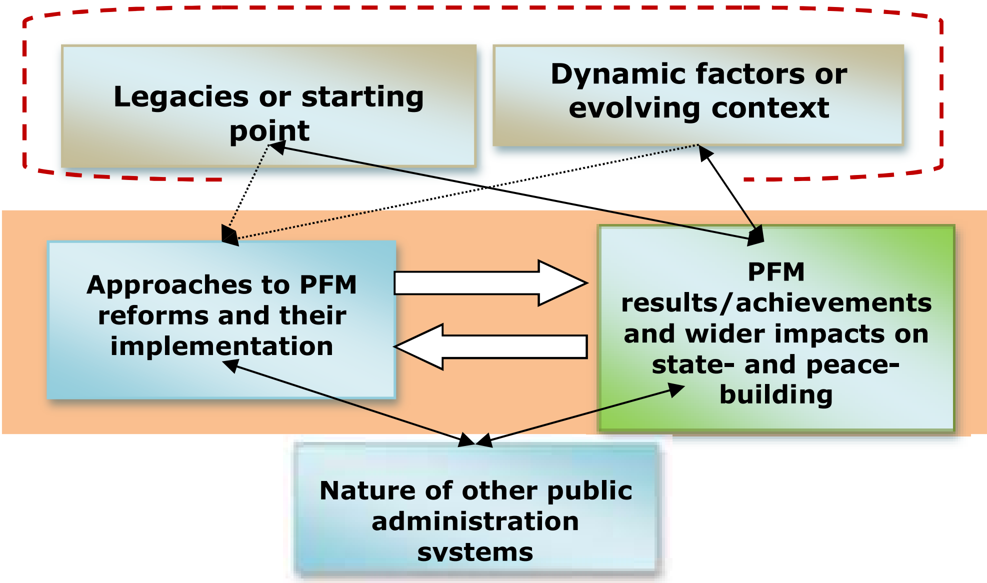
The study builds on analysis carried out in an earlier phase of the project. The first phase allowed an opportunity to summarise the literature currently available on PFM reform initiatives in FCS and to extrapolate key issues and themes from three desk-based case studies (Afghanistan, Cambodia and Sierra Leone). This current study (second phase of the project) builds on those outputs, but in doing so extends the breadth and depth of the analysis as well as its reach, by carrying out multiple country case studies and exploring synergies across them.

The Kosovo paper is one of eight in-depth country case studies which will form the basis of a synthesis paper and a World Bank Guidance Note to provide practitioners with accessible, evidence-based knowledge about PFM reform approaches in FCS.

1.2 Study questions, framework and methodology

The study attempts to answer two overarching study questions. First, how were PFM operations affected by the challenges associated with state fragility? Second, did the design and implementation of PFM operations contribute to achieving sustainable progress in the development of PFM systems, as well as to supporting wider state- and peace-building objectives?

Figure 1: Summary of contextual factors and reform interactions (fragility context)



The study focuses on issues and processes related to the expenditure side of PFM. For the purpose of this analysis public expenditure management is divided into the following stages of the budget cycle: legal and institutional framework; budget formulation; budget execution;

audit, evaluation and accountability. It does not examine revenue generation and management or the agencies responsible for the collection of revenues (i.e. Customs and Tax Administration). The study examines developments over time; across budget cycle functions; across concentrated and deconcentrated agencies (finance ministries; line ministries, sub-national entities, etc.); and across actors and stakeholders.

The case studies analyse the relationships between the dimensions (i.e. the arrows) in Figure 1 in order to understand better the PFM reform trajectory in each country. By accounting for the nature of the country context, they examine reform efforts from a political-economy perspective.

This paper primarily covers the post-war period in Kosovo from 1999 to 2010. It examines public financial management reforms related to public expenditure management and draws heavily on the desk-based report drafted for the first phase of this project. The report is based on a review of available documentation and data, fieldwork in Kosovo to interview key country-based stakeholders, and follow-up telephone interviews with other stakeholders. The fieldwork was carried out in Kosovo in June and July 2010.

2 Reform environment

2.1 Country context and indicators of 'fragility'

Kosovo was a member of the Federal Republic of Yugoslavia. The Kosovo war was the last war of the Federal Republic of Yugoslavia and led by the Kosovo Liberation Army. It started in 1998 and culminated with the NATO bombings from March to June 1999. Following the end of the conflict the United Nations (UN) was entrusted with governing Kosovo through its Interim Administration Mission (UNMIK) under UN resolution 1244. This Interim Administration was mandated to provide transitional administration and oversee the development of provisional democratic self-governing institutions. In 2002, the Provisional Institutions of Self-Government (PISG) were established and, in partnership with UNMIK, soon afterwards took responsibility for certain administrative functions. The Ahtisaari status settlement proposal laid out the conditions for Kosovo's independence and in 2008 the PISG unilaterally declared independence.

Kosovo is a young state, building international recognition. State-building in Kosovo since 1999 has developed in the context of contested recognition of its right to be independent.
The PISG's unilateral declaration of independence, on 17 February 2008, was immediately recognised by the United States and Europe's major powers (among other countries), but was considered illegal by two states of critical importance: Serbia and Russia. The declaration had followed a lengthy process to determine Kosovo's final status which ended without agreement between Pristina and Belgrade.[1] In response to the declaration, Serbia sought, through a UN General Assembly resolution, an advisory opinion from the International Court of Justice on the legality under international law of Kosovo's independence. During the two years after the declaration and prior to the International Court of Justice's ruling, Kosovo gradually fostered further international recognition. By the middle of 2010, 69 states had formally recognised Kosovo and it had become a full member of the World Bank and the International Monetary Fund (IMF). In July 2010, the Summary Advisory Opinion of the International Court of Justice stated that 'general international law contains no applicable prohibition of declarations of independence'.[2] This recent ruling is expected to facilitate further international recognition of Kosovo's independence.

Since 1999 Kosovo, with support from the international community, has been able to foster and maintain political stability and security to a large degree. Despite the disputed political settlement and contested recognition of Kosovo's independent status, Kosovo has been able to maintain relative political stability and security since 1999. This has been facilitated by considerable international support in providing and now (primarily) supervising state functions. Since 2000, democratic elections have been held at the local and national level. The elections have been accompanied by only rare violent incidents, limited as they have been by the continued presence of peacekeeping forces.[3] The relatively consistent annual Country Policy and Institutional Assessment (CPIA) ratings Kosovo has received across all four classifications since 2003 indicate the degree of stability that Kosovo has achieved.[4] Nevertheless, ethnically based polarisation is still a significant challenge and the unanticipated ethnic violence that spread rapidly across the country in 2004 is a stark reminder of remaining

[1] The process was sponsored by the international community and the UN Special Envoy Marrti Ahtisaari.
[2] International Court of Justice (2010), Summary of the Advisory Opinion of 22 July 2010.
[3] It is difficult to assess whether this violence could have been avoided without the continued presence of peacekeeping forces.
[4] World Bank annual CPIA ratings for 2003 to 2009, excluding 2004.

ethnic tensions.[5] Instances of unrest in the predominately ethnic-Serb north of Kosovo are still frequent, inhibiting Kosovo's ability to control its northern borders effectively.

Post-war economic growth has been consistently strong but future prospects are clouded by uncertainties. Since the end of the conflict in 1999, Kosovo has experienced consistent economic growth. Starting from a low level of gross domestic product (GDP) this was initially fuelled by a massive donor-funded reconstruction effort and then increasingly supported by the growth of remittances and the gradual recovery in economic activity (World Bank, 2010a). Furthermore, last year's recession in Europe had only a modest impact on the economy, felt through remittances, exports and foreign direct investment (IMF, 2010a; World Bank, 2010a). Despite this, Kosovo's prospects for sector development and sustainable economic growth are undermined by its structural deficiencies and the deteriorating conditions in the European Union (EU). Poor public and private infrastructure, unreliable electricity supply, and inadequate regional connectivity of transport routes weaken economic activity. In addition, the underdeveloped drivers of growth – such as the small export market – are expected to be hit hard by the EU's economic position, as it is a major source of remittances and demand for Kosovo's exports (IMF, 2010a; World Bank, 2010a).

On a positive note, the recent International Court of Justice's Advisory Opinion should go some way towards addressing some of the economic impacts of the external political constraints that Kosovo has faced since 1999. The first of these constraints concerns Kosovo's progress towards European accession, which requires a resolution of its international status. The second is the lack of customs controls in northern Kosovo, as well as the failure of Bosnia and Herzegovina and Serbia to recognise Kosovo's customs stamps, passports and licence plates, all of which have impeded the expansion of Kosovo's exports to these markets and the transit of Kosovar products via these countries. However, donor support, which has remained high up to now, is expected to decline in the medium term as Kosovo's status issue has been by and large resolved. Alongside these developments, it is expected that the relatively new banking sector and the political push for privatisation will both have a big impact on the economy, although the future path of privatisation, particularly that of the energy sector, remains unclear (World Bank, 2010a).

[5] Although the last census was in 1981, Kosovo's population is estimated at 2.1 million, broken down as 88% Kosovo Albanians, 7% Kosovo Serbs and 5% other minorities.

Table 2: Macroeconomic and Fiscal Indicators[6]

Macroeconomic and Fiscal Items	2007	2008	2009	2010	2011	2012
		Est.	Est.	Proj.	Proj.	Proj.
GDP millions	3,411	3,849	3,868	4,113	4,480	4,803
GDP per capita	1,605	1,784	1,766	1,850	1,985	2,097
GDP, real growth	4.0%	5.6%	4.0%	4.6%	5.9%	5.2%
CPI, period average	4.4%	9.4%	-2.4%	1.7%	3.2%	2.2%
General government budget (as % of GDP)						
Revenues	26.3%	24.5%	29.7%	28.9%	27.5%	27.9%
Taxes	…	…	21.1%	21.6%	22.3%	22.8%
Dividends	…	…	5.2%	2.1%	…	…
Primary expenditures	19.3%	24.7%	30.3%	32.0%	32.8%	31.7%
Recurrent	16.5%	17.1%	18.6%	18.7%	18.5%	18.5%
Capital and net lending	2.8%	7.6%	11.7%	13.3%	14.3%	13.2%
Highway	…	…	0.0%	3.2%	6.1%	6.2%
Non-highway	…	…	9.7%	8.6%	7.1%	7.0%
Net lending	…	…	2.0%	1.5%	1.0%	0.0%
Overall balance	7.1%	-0.2%	-0.8%	-3.4%	-5.5%	-4.0%
Privatisation proceeds	0.0%	0.0%	0.0%	0.0%	6.7%	0.2%
Stock of government bank balance	11.6%	10.8%	8.8%	5.9%	7.9%	6.4%

Notes: (1) Source: IMF, 2010; (2) Kosovo authorities and IMF staff estimates and projections. Excluding donor designated grants.

Following years of fiscal surpluses the newly independent Kosovo is embarking on ambitious spending commitments. Before 2008, strong fiscal prudence was enforced thanks to the careful scrutiny of fiscal plans (as it was a dual responsibility of the PISG and SRSG) and to the inability of the PISG to borrow. Since 2008, both drivers have altered and Kosovo has started to budget for fiscal deficits to cover ambitious spending commitments. One of the most ambitious commitments is the construction of the Route 7 highway, which is planned to consume nearly half of capital and net lending in 2011 and approximately 6% of GDP in both 2011 and 2012.

The persistently high levels of poverty and unemployment make Kosovo one of the poorest countries in Europe. Despite consistent economic growth since 2000, a lost decade of disinvestment in both physical and human capital during the 1990s has meant that Kosovo is one of the poorest countries in Europe, with an average GDP per capita of €1,766 (in 2009). The last comprehensive assessment of poverty in 2007 found that poverty was persistent and widespread, with 45% of the population living below the national poverty line and 15% in extreme poverty (World Bank, 2010a). This can in part be explained by the persistently high unemployment rate, which currently stands at 48% and is the worst in Europe. However, considerable formal unemployment is offset by a large informal sector and substantial remittances, which accounted for 12% of GDP in 2008 (World Bank, 2010a). It is important to note that population and labour market data has historically been weak in Kosovo, mainly because the last population census was carried out in 1981.

[6] GDP data has historically been poor in Kosovo and subsequently frequently revised. This reflects general problems in data management which, although now much improved, mean that it is difficult to collate a comprehensive set of macroeconomic and fiscal indicators for the whole post-war period.

The high levels of poverty are also associated with poor education and health indicators. Kosovo has the worst health outcomes in the region and, given the rate of progress in providing basic services, is unlikely to meet the 2015 Millennium Development Goal (MDG) targets. On all key indicators – life expectancy, maternal death rates, infant and child mortality, immunisation rates and tuberculosis incidence – Kosovo ranks far below neighbouring countries. Performance in education fares better, at least at the basic level, with enrolment rates close to universal (with a few gender and geographical disparities). However, Kosovo's secondary enrolment rate is one of the lowest in the region (World Bank, 2010a).

2.2 Sources of influence on PFM reform

Political governance and leadership

The post-war period has seen a gradual transfer of functions and responsibilities to the Kosovar government. Following the 1999 NATO bombings of Yugoslavia, the UN was entrusted with governing Kosovo through its Interim Administration Mission in Kosovo (UNMIK), under UN resolution 1244. It was mandated to provide 'transitional administration while establishing and overseeing the development of provisional democratic self-governing institutions to ensure conditions for a peaceful and normal life for all inhabitants in Kosovo'.[7] In doing so it assumed all legislative, executive and judicial authority throughout Kosovo. In 2000, the first municipal elections under the administration of UNMIK took place for the establishment of the local institutions of municipal governments and were succeeded by the first parliamentary elections the following year. Concurrently, in 2001, a Constitutional Framework was established, setting out the powers and responsibilities of Kosovar authority in the form of the Provisional Institutions of Self-Government (PISG). The PISG were established in 2002 and over the subsequent years progressively assumed functions and responsibilities from UNMIK. The first significant transfer of governance responsibilities was in late 2003, following the adoption of the UN standards for Kosovo,[8] when the PISG were assigned the key ministerial responsibilities of Finance and Economy, Health, Education, Transport and Telecommunications, and Labour and Social Welfare. At the same time UNMIK retained control of certain 'Reserved Powers' of Justice, Agriculture, Customs, Publicly Owned Enterprises and others (PEFA, 2009).[9] This created a hybrid governance structure which was necessary to allow a power-sharing arrangement to exist: part-governed by UNMIK, under the authority of the Special Representative of the Secretary-General (SRSG), and part by the PISG. The hybrid governance structure was significantly redefined following Kosovo's declaration of independence in 2008 when, in accordance with the guidelines of the Ahtisaari status settlement proposal,[10] all institutions came under the Government of Kosovo's control and the designation of PISG and the 'Reserved Powers' ceased to exist (PEFA, 2009). The national authorities began governing according to the Constitution of the Republic of Kosovo, which came into effect on 15 June 2008. UN Resolution 1244 is still formally in force and, while Kosovo is in the process of implementing the Ahtisaari status settlement proposal, the international community will continue to have an executive and legislative role in Kosovo, through the International Civilian Office (ICO)/European Union Special Representative (EUSR) and European Union Rule of Law Mission in Kosovo (EULEX) missions.

The process of transferring responsibilities to the Kosovar government led to a 'highly intricate and fluid' governance structure (World Bank, 2003a). The roles of both

7 http://www.unmikonline.org/
8 This UN Standards for Kosovo sets out the standards that Kosovo must reach to be in full compliance with UN Security Council resolution 1244 (1999), the Constitutional Framework and the original standards/benchmarks statement, endorsed by the Security Council. These standards reinforce Kosovo's parallel progress towards European standards in the framework of the EU's Stabilisation and Association Process, based on inter alia the Copenhagen criteria (taken from Standards for Kosovo, UNMIK, 2003).
9 The timing indicated seems to contradict the World Bank Project Identification Document for the Grant IV, which states: 'The 2002 budget marks an important stage in the transfer of power, with more than two-thirds of general budget resources under the authority of the PISG and the municipalities; in 2001, virtually all general budget resources were under the authority of UNMIK' (World Bank, 2002b).
10 This is the status settlement proposal of the UN-led process to determine Kosovo's final status.

the UNMIK and PISG changed as responsibilities were transferred between them. As the PISG increasingly took on executive functions, UNMIK's role changed from one that was executive in nature to one more concerned with monitoring and providing support to local institutions. However, the gradual transfer of these responsibilities led to a 'highly intricate and fluid' governance structure, which was required to implement power-sharing between UNMIK and PISG (World Bank, 2003a). To a degree this is reflected in the assignment of responsibility for Finance and Economy. This intricacy created an 'uncertainty as to the precise interim institutional arrangements between UNMIK and PISG', which in turn affected domestic policy-making and accountability structures (World Bank, 2003a).

The responsibility for Finance and Economy was one of the first to be transferred to the PISG, but fiscal responsibilities existed in a power-sharing context. In 1999, in the immediate aftermath of the war, the Central Fiscal Authority (CFA) was established and given responsibility for overall financial management of the Kosovo budget and the budget of the municipalities which together formed the Kosovo Consolidated Budget (KCB). The CFA was one of the four departments of the Joint Interim Administration Structure and implemented policy guidelines formulated by the Interim Administrative Council (IAC). Entrusted with responsibility for overall financial management, the CFA was in charge of budget process and preparation, treasury functions, revenue analysis, tax collection, customs administration and public procurement.[11] In 2001, the Ministry of Economy and Finance (MEF) was established as part of the PISG on the basis of UNMIK Regulation no. 2001/19. The MEF took over increasing responsibility from the CFA, until the latter's abolition in 2002. Despite this transfer of responsibility from the CFA to the MEF, the responsibility for economic and fiscal policy remained split between the PISG and UNMIK from 2003 until 2008. UNMIK retained responsibility for PFM in the following five important areas. First, the MEF – responsible for the preparation of the KCB – had to accommodate appropriations for the Reserved Power budget organisations which were under UNMIK control. Second, the SRSG provided final approval of the KCB, acting on the evidence of the Economic and Fiscal Council (EFC), and therefore held the final authority to set the financial and policy parameters (PEFA, 2007). In addition, the budget was reviewed by the EFC before it went to the Assembly for approval and the SRSG for final approval, allowing for supplementary steer from the international community (SIGMA, 2003). Third, the SRSG exercised control and authority over the UNMIK Customs Service, which remained as a Reserved Power Agency (FRIDOM, 2008a). Fourth, the SRSG was responsible for establishing arrangements for the independent external audit of the KCB. Finally, the Treasury had a dual reporting line to both the MEF and the SRSG. Although it is difficult to assess the extent to which this significant authority afforded to the SRSG was fully utilised, it seems that over time, some effort to limit its interventions was made. For instance, by 2006 the SRSG's intervention in the budget approval process was quite limited: 'For the 2006 budget the SRSG imposed his will on a couple of issues, the rest was effectively determined by the MEF and the National Assembly' (PEFA, 2007).

The hybrid governance structure created the ground for weak policy-making. National governance systems are relatively young in Kosovo and developing the structures to support a strong policy framework will take time. That said, the hybrid governance structure in practice meant that the PISGs' priorities, as expressed in the KCB, had to be approved by the SRSG. Despite the benefits this might have entailed, it undermined attempts to foster a national government culture of strategic management and prioritisation, which remains underdeveloped to this day.[12] The hybrid governance structure afforded considerable influence to UNMIK and other donors to shape, albeit indirectly, overall and sector government priorities. In doing so, UNMIK and donors were key players in determining the reform agenda in Kosovo, including in

[11] http://www.unmikonline.org/

[12] Until recently strategic planning and its coordination has been weak in Kosovo. In 2006, a Kosovo Development Strategy and Plan was developed, but poor political buy-in and inadequate structures in place to implement the plan meant it was not approved or implemented. The current government has a four-year 'Government Programme', but anecdotal evidence suggests it was produced in haste and is quite general. There is limited information on the number of sector strategies and their coordination with the government's plan. However, in 2010 a new unit within the Prime Minister's office was created to coordinate and design the methodology for strategic planning.

relation to PFM reform. This relationship was more explicitly evident pre-2008, but remains important today.

In addition to the requirement that the SRSG approved the KCB, the space for PISG policy-making was further reduced, owing to the management of Reserved Power institutions and 'Fair Share' Financing. First, the KCB was divided between appropriations to the Reserved Power Institutions and those under the control of the PISG. As the SRSG exercised control and authority over the Reserved Power Institutions, all expenditure decisions were left to the SRSG, leaving PISG essentially excluded from any policy decisions. Second, a 'Fair Share' Financing scheme was introduced which required municipalities to allocate to resident non-majority communities a proportionate share of their budget according to the principle of 'Fair Share' Financing (UNMIK 2003/41 regulation). In 2005, in line with regulation 2005/12, a total of 27 municipalities were obliged to allocate to resident minority groups a proportion of their own source revenues and a general grant, varying from 0.4% to 41.3%, to education and health. This scheme entailed obvious desirable benefits, which are not disputed. However, the fact that the population data had little credibility led to questions about the appropriateness of the proportions, and the scheme's implementation further reduced the proportion of the budget that the PISG could allocate to its priorities.

Status-related issues have been the main focus of public policy since 1999. Another fundamental feature of Kosovo's politics that has influenced the reform agenda to date is the prioritisation of achieving country status and governance issues over all other public responsibilities. This does not mean to say that other areas were not important, supported or developed under the PISG administration; Kosovo's development in various economic and social spheres illustrates that they were. Nevertheless until 2008, and to some extent beyond, as Kosovo's attempted to secure further international recognition and movement towards EU accession, status, security and political issues were given much higher priority than economic and fiscal issues.

Public sector management

'Starting from scratch'. The nature of the peace resolution meant that constitutional, legal and institutional structures essentially 'started from scratch' in 1999. Before 1999, under the Socialist Federal Republic of Yugoslavia, Kosovo was designated an 'autonomous province' and in 1974 drafted its first constitution outlining responsibilities for its own administration, assembly, and judiciary. In 1989, many of these powers were rolled back when the Milosevic government enacted constitutional changes limiting Kosovo's autonomy, which remained in place until the end of the war. Therefore by the time of the NATO bombing, Kosovar-controlled public sector management was virtually non-existent.

....and re-built without accommodating its Yugoslavian legacy to any appreciable extent. Given the nature of the immediate post-war UNMIK administration, international best practice drawn from experiences across a range of countries informed the development of the new structures. Therefore, unlike many countries in ex-Yugoslavia, the current constitutional and legal framework surrounding public sector management in Kosovo is not closely related to its Yugoslavian predecessor. This distinction is particularly strong in the case of PFM.

.....and in an 'ad-hoc fashion'. Therefore, instead, the development of the public sector has drawn heavily on international and western models of 'best practice'. To some extent one would expect that this would create a relatively sound system; however, the process of rebuilding the administration post-war was criticised in a recent set of functional reviews.[13] According to the Whole of Government Review 'the Kosovo administration was re-built in an ad-hoc fashion after the war in Balkans… some ministries have responsibilities which duplicate each other, others have a structure that is not relevant to their mandate, and human resources are not always located where they are the most needed' (FRIDOM, 2008c).

13 One of the underlying challenges is that various parts of the public sector in Kosovo were set up by different international institutions, so they were never designed as a coherent system of public administration.

In addition, public administration absorbs a considerable amount of resources in Kosovo. In comparison both with other Balkan states and with the EU, public administration in Kosovo is large – in terms of the number of staff as well as the proportion of government expenditure it consumes.[14] In 2009, it accounted for approximately 24% of the total expenditure, which is approximately 10.8 percentage points higher than in the EU-7. As a result Kosovo spends substantially higher amounts on general administrative services than other countries and consequently spends less on health, education and social protection (FRIDOM, 2008c).[15]

Figure 2: Regional expenditure by functional categories

	General Public Services	Defence	Public Order and Safety	Economic Affairs	Environment Protection	Housing & Community Amenities	Health	Recreation, Culture & Religion	Education	Social Protection
Estonia	n.a.	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Finland	13.29	3.07	3.07	9.20	0.61	0.61	13.91	2.25	11.86	41.72
Ireland	10.53	1.46	4.09	13.16	1.75	3.80	22.81	1.75	12.28	28.36
Latvia	14.86	4.18	6.14	15.00	n.a.	5.09	10.44	3.71	15.53	25.06
Lithuania	11.28	4.58	5.16	11.52	2.23	1.44	15.80	3.00	16.16	28.83
Slovakia	16.56	4.01	5.08	13.42	1.81	2.20	16.86	2.80	9.88	29.01
Slovenia	11.38	3.09	4.18	10.68	1.34	1.30	13.66	2.83	14.95	36.59
New EU member average	13.18	4.11	5.61	12.77	1.10	3.26	12.73	2.63	12.97	32.03
Kosovo	24.00	2.90	9.40	15.70	0.20	1.50	10.30	0.80	16.00	19.03
Difference[1]	+ 10.82	-1.21	+ 3.79	+ 2.93	-0.90	-1.76	-2.43	-1.83	+ 3.03	-13.00
	The data from EU countries are from IMF statistics (2006), while data from Kosovo are those from the 2009 MTEF.									

Notes: (1) Source: FRIDOM (2008c); (2) All figures are given as % of the budget, excluding capital investments but including salaries (so that personnel costs for teachers or doctors fall under Education and Health). The public administration, instead, is accounted for in the column on General Public Services.

Table 3: Fiscal Items (as a % of GDP)

Fiscal Items (as a % of GDP)	2009	2010	2011	2012
	Est.	Proj.	Proj.	Proj.
Current expenditure	18.6	18.7	18.5	18.5
Wages and salaries	6.8	7.6	7.4	7.6
Goods and services	4.5	4.6	4.4	4.4

14 It is the case, though, that smaller countries and those with constitutional frameworks that entail decentralisation tend to have more public employees.
15 However, it is not clear whether the financial coding of 'administration' across all the researched countries is the same. Anecdotal evidence suggests that differences exist, which obviously affects the credibility of cross-country comparisons.

Subsidies and transfers	7.3	6.2	6.6	6.4
Pension and social assistance	3.8	4	4.2	4.2
Other transfers and subsidies	3.5	2.2	2.4	2.2
Reserve	0	0.3	0.1	0.1

Notes: (1) Source: IMF, 2010a; (2) Kosovo authorities; and IMF staff estimates and projections. Excluding donor-designated grants.

Administrative capacity has also had to develop from a low initial base. By the time the power-sharing arrangements were established in the beginning of the 2000s, there was a limited pool of qualified Kosovars with experience of public administration. In the 1990s, the reduction of Kosovar institutions' autonomy took place alongside the withdrawal of ethnic Albanians from the management of public institutions, the exit of ethnic Albanians from the formal education system and the large migration of ethnic Albanians from Kosovo (World Bank, 2003a). Following considerable international support in this area, capacity has improved, but still today 'many of Kosovo's government bodies are still inexperienced and often dependent on foreign consultants' (World Bank, 2009a). This capacity challenge was equally relevant for PFM and in order to address the initial capacity constraint technical experts were allocated to key positions across the MEF. Starting with the first minister of the MEF (who at the time was one of the co-heads of the CFA), a constant flow of technical advisers, who were given various degrees of decision-making power, were allocated to the CFA and then the MEF, and worked with a motivated cadre of local experts and technocrats.

The state remains the sole provider of public services, except for the small parallel services that exist in some Serb-majority municipalities. However, the need to improve service delivery and the demand for funding for ambitious spending plans is driving forward the government's privatisation agenda. The state remains the sole provider of all 'official' public services, having absorbed the old parallel state system for ethnic Albanians at the end of the conflict. The old parallel system was primarily for the provision of education and health services[16] and its coverage was extensive; in the 1990s the parallel education provision covered nearly all the ethnic Albanian population. Today a much smaller parallel system remains and caters for the ethnic Serbian population with financing from Serbia, but there is limited evidence about its exact scope. The need to improve service delivery and the demand for funding for ambitious spending plans is driving forward the government's privatisation agenda. Public dissatisfaction with public service delivery has grown since 2006 and concerns in particular energy, water supply, public transport and heating. A recent citizens' survey found that there is general consensus that there is an urgent need to invest in the energy sector (UNDP/USAID, 2009) reflecting the fact that the government is struggling to compensate for the pronounced disinvestment in public services between 1990 and 2000 which still affects the performance of today's service delivery (World Bank, 2010a; World Bank, 2006b) There are daily restrictions on water across most of the country, and although blackouts are now rare they were common between 1999 and 2008 and could only be prevented by the procurement of electricity abroad. However, performance analysis over time is not possible, owing to the limited available data on public service delivery performance. Privatisation appears to be the solution for a government with ambitious development demands. The controversial plan to privatise the profitable Post and Telecom Kosova (PTK) to pay for a highway to Albania is being pursued, while uncertainty remains about the future Kosovor Energy Corporation (KEK).

Decentralisation: Decentralisation is considered to be an important tool for achieving future state security and state-building in Kosovo and thus is a cornerstone of the Ahtisaari status proposal. Kosovo is based on a two-tier government system, comprising the central government and municipalities. Since 2000, there have been four sets of municipal elections (2000; 2002; 2007; 2009). In 2001, 30 municipalities were established, on the basis of UNMIK

16 Set up in the 1990s and coordinated by the self-declared Kosovo Parliament under Ibrahim Rugova.

regulation 2000/43, to which seven new ones have been added in line with the Ahtisaari status proposal (IMF, 2010b). According to the recent Functional Review, once the government fully implements the Ahtisaari plan, Kosovo will have an unusually high level of decentralisation, for a country of its size, and compared with EU states. The exception will be the Culture and Law Enforcement sectors, which will be less decentralised than those in other countries. In all other relevant areas, the decentralisation plan presents the government with a challenge to ensure high service delivery standards (FRIDOM, 2008c).

In 2005, the Kosovo Parliament initiated a decentralisation process which provided local governments with greater administrative and fiscal responsibilities to increase the autonomy of local government and raise their ability to provide more and better public services to its citizens. The first elections in 2007 under the new authority allowed Kosovars to vote directly for candidates for the Kosovo and municipal assemblies as well as for mayoral positions, instead of voting for political parties.

Municipalities are funded through a combination of a general grant, earmarked grants for education and health, and own-source revenues. Recently the financing formulas were revised to enable better targeting based on improved data. Municipalities rely significantly on central government funding for their operations, which accounted for over 80% of total municipal resources on average between 2003 and 2006.

Box 1: Municipalities in Kosovo

Municipalities are the basic territorial units of local government in Kosovo. In July 2005, UNMIK Administrative Directive 2005/11 allowed the creation of an additional five pilot municipalities within existing ones; to date, only three have been established (Hani-i-Elezit, within Kacanik; Mamush, within Prizren; and Junik, within Decan).[1]

The population density varies significantly by municipality. While population data are lacking (the last census dates back to 1991) new estimates (extrapolated in 2001) would have the largest municipality (Pristina, with a 400,000 population) outnumbering the smallest municipality (Novo Bordo, 5,000) by a factor of 80. However, the average population size by municipality, estimated at about 75,000, is fairly large by some comparator countries.

Asymmetric arrangements for the five Serb-majority municipalities are de facto in place. These municipalities are Novo Bordo, Shtërpcë; Leposaviq, Zvecan, and Zubin Potok. The municipality of Mitrovica is divided between a southern (Albanian-majority) and northern (Serb-majority) part, as per UNMIK Administrative Direction 2000/26. UNMIK maintains a separate administration of the northern part, while the municipality receives one grant from the central government, which is separated between the two administrations through a mutual agreement.

Each municipality has a Municipal Assembly, its highest representative body directly elected. Among other responsibilities, municipal assemblies are charged with approving the municipal budget. Municipal elections were held in mid-November 2007, but were largely boycotted by the Serbian population.

[1] Pilots for two Serb Majority municipalities (Gracanica, Partes) have not yet been implemented.

Sources: B&S Europe (2007) and MLGA (2007).

Source: Taken from IMF, 2007

Public expectations and public accountability

Challenges associated with the post-war hybrid governance structure have affected the development of public accountability in Kosovo. The hybrid governance structure necessary to accommodate the power-sharing arrangement in post-war Kosovo made it difficult to develop systems of local accountability in the pre-2008 post-war period. The considerable institutional problems entailed in ensuring that financial accountability shifted from external donors to the people of Kosovo, as the responsibility for public resources transferred from UNMIK to SRSG, were acknowledged by the World Bank early in the transition process in 2003[17] (World Bank, 2003a). This 'shift' was difficult to achieve, for two main reasons. First, because the SRSG retained the responsibility of crucial executive functions, accountability remained divided between SRSG and PISG: the layered governance structure had created a layered accountability structure, the application of which led to a perception of 'double standards' (World Bank, 2005a).[18] Second, the intricate and fluid power-sharing arrangement between UNMIK and PISG was 'mixed-up' – marked with overlapping functions and mandates (World Bank, 2004a) – and not very transparent. This created an ambiguous governance structure which undermined the development of national accountability structures.

Current accountability challenges surround capacities, incomplete structures for oversight and scrutiny and weak political opposition. Attempts have been made to ensure that incomplete structures for the oversight and scrutiny of public expenditure are addressed, but gaps still exist. For example, this year the Assembly's role to scrutinise and oversee the budget process was split across two (rather than one) committees (see section 3.5) to encourage more substantive scrutiny. On the other hand, despite a government decision to establish a Cabinet Fiscal Committee in 2009, it has never been set up and the function is not being carried out. The oversight of public enterprises is an illustrative example of weak capacities. Under UNMIK, the oversight of public enterprises along with privatisation fell within the authority of the Kosovo Trust Agency. UNMIK guarded this function well, owing to the sensitivity around ownership of assets, given the claims on ownership by both Kosovo and Serbia. All assets were held in trust and UNMIK officials sat on the board of public enterprises. During the transition/handover period the function, according to one observer, was essentially 'dumped' on the Kosovar government. When the Economic Pillar (IV) of UNMIK closed down, important documentation was either destroyed or remained under UNMIK lock and key, and the well-remunerated staff left. Although the EU then stepped in to support privatisation processes, the oversight of public enterprises was transferred to the MEF in line with the 2008 Law on Public Owned Enterprises. The number of staff working on the oversight of public enterprises has been reduced, and poor information transfer during the handover period has undoubtedly affected performance. A recent statement from the US Embassy supporting the privatisation agenda in Kosovo as an '…important element of a larger effort to combat corruption'[19] supports anecdotal evidence about the existence of corruption in public enterprises.

The ambiguous governance structure has led to poorly functioning public accountability systems. An illustration of weak public accountability relates to the role of Parliament in the Budget Process. Although the recent Public Expenditure and Financial Accountability (PEFA) report indicated that access to fiscal information in Kosovo is good,[20] public accountability functions related to PFM are poorly executed. The Assembly's role in

17 'There is also a considerable institutional challenge as the management of public resources shifts from the UNMIK administration to the local government institutions, and financial accountability must be not only to the external donors but also to the people of Kosovo' (World Bank, 2003a).

18 'The legal framework for financial accountability and public financial management as set out in the Law on Public Financial Management and Accountability (LPFMA), reflects good international practices but appears to be too demanding for the PISG and does not prevent the perception of double standards in its implementation. In Kosovo, the unique legal framework complicates the application of financial accountability, in that: (i) different provisions of the LPFMA may in some cases apply to certain institutions of the PISG and not to others of the UNMIK; (ii) the Special Representative of the UN Secretary-General (SRSG) is the authority responsible for the budget process for the Reserved Power Budget Organizations (RPBOs) and the MEF for the PISG Budget Organizations (BOs); but (iii)under the LPFMA, and in practice, the SRSG sign-off on the KCB' (World Bank, 2005a).

19 http://pristina.usembassy.gov/press_releases/2010-press-releases/privatisation_question.html

20 The PEFA 2009 allocates a B to PI-10, on access to fiscal information.

scrutinising the Annual Budget Law and audit accounts has been regularly criticised by assessments. The Assembly members' technical understanding of the fiscal issues is weak, as is their appreciation of their role (PEFA, 2007; PEFA, 2009). Mixed viewpoints surround the growth of civil society accountability. On the one hand, optimists cite an increase in analysis, in both newspapers and think-tanks, criticising government activities, including the recent uncovering of controversial corruption scandals. They also point to the successful strike actions taken by various interest groups. However, others argue that civil society accountability remains weak, as shown by anecdotal evidence of political intimidation and the limited number of public perception surveys. Such evidence from public perception surveys that does exist indicates that there is confusion about the responsibilities of local and central government administrations for providing services. This affects the public's ability to accurately hold the right institutions to account (UNDP/USAID, 2009). With regard to PFM, observers suggest that in the media there is still little understanding of public finance issues. Moreover, unlike in many developed countries, the announcement of the budget does not draw much public attention, because the government does little to publicise it and because there is scant scrutiny of the budget by the media. Yet, recent controversy surrounding a Minister's incorrect presentation of the 2010 budget suggests that this scrutiny is strengthening.

The international community continues to have considerable influence and engagement in the area of accountability. The application of the Ahtisaari status settlement proposal means that the international community still retains an executive and judicial role, albeit a small one, and is involved in decisions related to key accountability functions such as that of the Auditor-General. In addition to this, expanding international recognition of Kosovo's independence, attaining EU accession and maintaining financial support from donors remain important objectives for the Government of Kosovo. This environment affords the international community considerable influence and ability to hold the government to account. The weak national policy-making alongside the weak functioning of public accountability has given the international community considerable scope to influence as well as 'legitimise' government policy. This is illustrated by the development of the government's controversial and publicly unpopular decision to privatise PTK. Anecdotal evidence suggests that the airport concession process and the privatisation of PTK received backing from key donor countries including the United States, and was discussed with donors before being formally raised at the Assembly or opened for public debate. This implies that donors still maintain a role, albeit a smaller one than before, in 'legitimising' policy.[21] Therefore, to some extent, the international community fills the 'accountability vacuum' caused by weak public accountability.

It is difficult to assess the extent to which addressing corruption is considered 'serious' or rather 'window-dressing'. It is publicly accepted that corruption is a particular problem in procurement, despite considerable technical assistance in this area. Recent corruption scandals involving public works procurement that have been linked to the Minister of Transport and Communications indicate the scale of the problem.[22] According to the findings of one of the functional reviews, 'The Kosovo Assembly has rarely asked for political accountability for the mismanagement of the taxpayer funds, even though it is the main institution controlling the spending of these funds' (GAP, 2008). This is demonstrated by the inadequate follow-up on audit reports, and limited application of sanctions, which have frequently identified the mismanagement of public resources at all levels of government, central and municipal, and publicly owned enterprises.

There are, however, high levels of public dissatisfaction with the levels of corruption. This was noted by two public perception surveys. The first, by UNDP/USAID, indicated the high levels of public concern about the levels of corruption (UNDP/USAID, 2009). The second, Transparency International's recent Corruption Perceptions Index (2010), in which

21http://pristina.usembassy.gov/dell_statements/christopher-dell-u.s.-ambassador-to-kosovo---airport-concession-may-19-2010 and editorials by Kosovo Corruption Watchdog "Cohu": http://euobserver.com/7/30404; http://www.balkaninsight.com/en/main/comment/28682/
22 http://kosovo.birn.eu.com/en/1/50/29761/

Kosovo was included for the first time, showed that Kosovars' opinions are similar to the average for the region. Kosovo scored 11th out of 19 countries the region of Eastern Europe and Central Asia, but compared with all other countries in the survey it was near the bottom of the 'highly corrupt' scale (Transparency International, 2010).

The potential for corruption appears to be being reduced. Nevertheless, the potential scope for corruption is reduced by the non-existence of extra-budgetary funds, except for the privatisation fund, and the recently established National Level Task Force for fighting corruption. Set up by the Prime Minister following public and international pressure, it has initiated some high-level investigations including targeting cabinet ministers and the findings from which have led to the arrest of the Governor of the Central Bank.

International engagement and modalities of external support

International presence and engagement in Kosovo since 1999 has been fundamental to its development and remains significant today. Starting in 1999 UNMIK, headed by the SRSG, provided a transitional administration supported by a NATO-led KFOR peacekeeping force. Since 2008, in accordance with the Ahtisaari status settlement proposal, international supervisory support has been provided through the International Civilian Office (ICO)[23] – double-hatted as the European Union Special Representative (EUSR); the European Rule of Law Mission in Kosovo (EULEX);[24] and the Organisation for Security and Cooperation in Europe mission in Kosovo (OCSE).[25] The Ahtisaari status settlement proposal states that the supervisory role of the international community is envisaged to end only when Kosovo has implemented the measures in the status settlement proposal (UN, 2007).[26] Strong corrective powers are afforded to the ICO, such as 'its ability to annul decisions or laws adopted by the Kosovo authorities and sanction and remove public officials whose actions he/she determines to be inconsistent with the Settlement' (UN, 2007). In addition, executive authority, albeit limited, has been transferred to EULEX (UN, 2007). Therefore, international engagement in Kosovo still fulfills an executive and legislative role in Kosovo, although this role is now more supervisory, with reduced capacity. As discussed above, this hybrid governance structure continues to have implications for the fostering of public accountability.

In addition to the international engagement outlined above, multilateral, bilateral and non-governmental donors have provided considerable support to Kosovo since 1999. The significance of this support was reflected in financial terms in the proportion of the budget and revenues that was initially funded by donors. In 1999 the budget was fully financed by donors, while direct budget support comprised more than 50% of the total revenue received in 2000.[27,28] The proportion declined until 2004, when the budget started to be fully financed by in-country collected revenues. Alongside this development, by the end of 2003 a series of surpluses had enabled Kosovo to build up a cash reserve of more than €300 million (PEFA, 2009). Weak systems for capturing donor planned and actual expenditure, with most information provided outside the budget process, make it difficult to estimate current aid dependency in Kosovo (PEFA, 2009). This poor performance is reflected in the recent PEFA, for which the three donor indicators[29] received a D score (PEFA, 2009). A Donor Coordination Unit, responsible for coordinating and recording donor engagement, has been in place since 2005. It has existed under various titles and in various forms and locations within government, but more recently merged with the Ministry for European Integration. A development gateway to

23 The ICO shall be the ultimate supervisory authority over implementation of the status settlement (UN, 2007).
24 EULEX, the European Security and Defence Policy Mission, assists and supports the Kosovo authorities in the rule of law area, specifically in the police, judiciary and customs areas. While UNMIK still exists, it does so in a minor role following the creation, in December 2008, of the European Union Rule of Law Mission in Kosovo (EULEX website).
25 The OSCE assists in the monitoring necessary for a successful implementation of the status settlement (UN, 2007).
26 As a result, EULEX's time-bound missions have been extended.
27 In the first donor conference in Brussels 1999, more than 100 countries and dozens of aid organisations promised over $2 billion in humanitarian aid at a conference; available at http://news.bbc.co.uk/2/hi/europe/405726.stm
28 Based on a 2003 Riinvest Institute Report, the ratio between donor-funded budget vs country revenues is as follows: in 1999, 66%:34%; 2000, 55%:45%; 2001, 20%:80%; 2002, 7%:93%; and 2003 7%(or 5%):93%.
29 D1: Predictability of Direct Budget Support; D2: Financial information provided by donors for budgeting and report on project and programme aid; D3: Proportion of aid that is managed by use of national procedures.

record donor finances is being developed with the assistance of UNDP, in an attempt to improve on/replace the Recovery Information Management System (RIMS), which was not comprehensive in its coverage or timely in its reporting (PEFA, 2009). The last of three donor conferences was held in mid-2008 to support the unilateral declaration of independence, at which participants pledged €1.2 billion, with the EU pledging €508 million and the United States $400 million.[30]

In terms of PFM, the main donors that have supported this area since 1999 have been USAID, EU (including the EAR and ECLO), the World Bank and DFID, with smaller inputs from SIDA and CIDA. The United States has been the most significant financer of PFM reforms in Kosovo since 1999, spending approximately $100 million from 1999 until now on both expenditure and revenue development. On expenditure management the most significant donors and the areas they have supported have been: (1) USAID: treasury functions, budget planning and macroeconomic forecasting; (2) EU: internal audit, procurement, external audit, Public Investment Programme (PIP); (3) World Bank: fiscal decentralisation, budget organisations. This support has helped build the institutions of public finance in Kosovo and has facilitated the achievement of sound PFM performance across various functions of the budget cycle, as illustrated by the results of various PFM diagnostic reviews and more recently the PEFA (see sections 3.5 and 4 for more details). Its role in building capacities should not be undervalued. That said, international engagement in this area has also been associated with a number of problems, as laid out below.

The main problems connected with donor engagement in Kosovo to date relate to (1) donor coordination; (2) the diversity of ideas and approaches pursued by donors and their funded international experts; (3) the authority afforded to donors and its effect on accountability. First of all, donor coordination has historically been an unsatisfactory process in Kosovo. Before to 2005, and the establishment of the Donor Coordination Unit, there was no government-led formal process for coordinating and managing donor involvement. Since 2005, formal procedures have been established and in the last two years anecdotal evidence suggests that donor coordination has improved as 'status' issues are no longer driving the donors' agenda. However, poor coordination between some donors remains a problem. The government's management of this process is equally weak, as illustrated by the formal monthly meetings on the coordination of priorities, which are considered to be largely ineffective. In relation to PFM, the most noticeable example of poor donor coordination has been the development and subsequent integration of the Budget Development and Management System (BDMS) and the Kosovo Financial Management Information System (KFMIS). The development of these systems was funded by different donors and lack of coordination of the projects' objectives resulted in the systems being insufficiently integrated. Despite this, anecdotal evidence suggests that coordination between some donors has historically been strong and the importance of addressing donor coordination in the 'crowded field' of PFM has been acknowledged by donor completion reports[31] (World Bank, 2009b).

Secondly, there was a general feeling among many of the officials interviewed that the PFM system was designed by a diverse group of international advisers who brought with them a diverse set of experiences, approaches and views on PFM reform. Although this helped to set up the advanced PFM system, it also led to the establishment of ad hoc systems and procedures. Finally, as mentioned above, donor intervention continues to have a significant role in directing policy and holding government to account. This will be extended with the introduction of the IMF stand-by programme, which will lock in fiscal policy-making through expenditure and revenue controls.

30 http://ec.europa.eu/enlargement/archives/seerecon/kdc/pressrelease.pdf
31 According to the completion report of the World Bank PEMTAG project, 'The problem of donor coordination was addressed by deliberately designing the project to focus on gaps in assistance provided by other development partners' (World Bank, 2009b).

3 Approach to PFM reform

3.1 Baseline of PFM and reform starting point

'Starting from scratch': public expenditure systems are relatively young. Prior to the 1999 conflict, there was no system in place to manage PFM for the area of Kosovo. Pre-1989, Kosovo had the legal authority to operate an administration that included some PFM functions allowed within the Yugoslavian federal system, including the management of policies, currency and a centralised payments system. However, following Milosevic's constitutional amendments in 1989, this autonomy was disbanded and PFM functions were transferred to Belgrade. In addition to establishing the physical PFM capacity, human capacity had to be developed post-conflict as there was only a limited pool of qualified Kosovars with experience of public administration and even fewer with experience of PFM.

Establishing finance functions was a priority in the immediate aftermath of the war. One of the first priorities of the UNMIK administration was to develop the PFM apparatus. The first UNMIK regulation established the CFA which was followed by the first PFM Rules. The CFA was responsible for the overall financial management of the Kosovo budget and the budgets of the municipalities that together form the KCB. It was responsible for the budget process and preparation, treasury functions, revenues, public procurement, tax collection and customs administration. It was co-headed by an international expert and a Kosovar and implemented policy guidelines formulated by the IAC. The second UNMIK Regulation 2/1999 set out public procurement rules and the following year the law 2000/45 set out the framework for establishing the municipalities.

The circumstance of PFM being started from scratch in Kosovo, together with international administrative authority, resulted in very little being carried forward from the pre-1999 Yugoslavian PFM systems. Given the nature of the immediate post-war UNMIK administration, international best practice drawn from experiences across a range of countries informed the development of the new structures. Therefore, unlike in many countries in former Yugoslavia, the current constitutional and legal framework surrounding public sector management in Kosovo is not closely related to its Yugoslavian predecessor. This distinction is particularly strong for PFM. Instead it was established largely from 'first principles' and drew heavily on international and western models of 'best practice'. The area of PFM fell under Pillar 4 of UNMIK's pillars of administrative development. Pillar 4 related to economic development and was officially led by the EU but with considerable input from the USAID Economic Recovery Project. This USAID project took on the responsibility for establishing the PFM regulations, procedures and structures and in doing so helped to establish the CFA and its structures. The system was based mainly on an Anglo-Saxon model. The Tax Administration was set up as a separate entity, as well as the UNMIK Customs Service, including the regulatory banking institution of the Central Bank of Kosovo. Only the UNMIK Customs Service was set up and managed by the EU, while USAID's technical assistance strongly influenced all PFM institutions.

3.2 Progress of PFM reforms

Changes to the power-sharing arrangements can stand as proxies for PFM reform transition periods. Before 2009 there was not a comprehensive, government-owned, PFM reform plan. Policy and reform coherence were not formally established and as a result reforms targeting different aspects of the budget cycle were staggered across different time periods. Given this, there are no obvious PFM transition periods. Nevertheless, implementation of PFM reform projects was to some degree driven by changes in the power-sharing arrangements between the SRSG and the PISG. This is illustrated by the fact that, as the PISG became increasingly responsible for certain PFM functions, reform efforts intensified in the associated areas. The transfer of responsibilities was fairly fluid and not entirely transparent (see section

2), so it can provide only a tentative indication of transition periods in PFM reform efforts. However, for the purpose of this analysis the transition periods presented here relate to the timing of key changes in the power-sharing arrangements in Kosovo since 1999. The first reform period considered is 1999-2001/02; the second is 2002/2003-2007; the third 2008 until now.

Between 1999 and 2001/02 PFM reform efforts in Kosovo focused mostly on controlling inputs and accounting for cash. Even though budget planning was also supported, given the human resources constraints, it had to take second place to controlling the aggregate level of spending (World Bank, 2002a). This prioritisation of the budget execution function is reflected in the frequency of reform activities implemented between 1999 and 2001/2002 as well as in the outcomes achieved by the end of 2002. In Annex 1 it is evident that between 1999 and 2001/2002 the largest number of activities took place in the 'budget execution' function of the budget cycle. In addition, by the end of 2002 a large proportion of PFM achievements commended by a World Bank review relate to the budget execution function.[32] The World Bank review goes on to say that 'budget development in Kosovo has until recently been more compliance-focused and aimed at fiscal discipline rather than at mechanisms to enhance the efficiency and effectiveness of public spending' (World Bank, 2002a). Over this period, the budget planning function also received a lot of attention, and by the end of 2002 a medium-term approach to budget planning had been introduced. However, the medium-term approach was weak and there were problems – some of which remain today – in relation to the fragmentation of the policy formulation process, the inability to use the budget as an effective policy tool, and the lack of a comprehensive resource framework for the budget (World Bank, 2002a). In this first reform period, support to other parts of the budget cycle was provided, e.g. the Office of the Auditor-General (OAG) was established, as was the Assembly's Committee for Budget and Finance, but priority was given to budget execution and planning.

Between 2002/03 and 2007 implementation of the Constitutional Framework and the Law on Public Financial Management Accountability (LFPMA) allowed the PISG greater autonomy over PFM functions. The reform effort continued to target budget execution and planning functions, but was also extended to develop Kosovar competencies related to external audit, capital budgeting and procurement. The OAG was established in 2002 and in 2003 it started to receive EU-funded support, which continues to this day. In this second reform period the OAG assumed responsibility for external audits, endorsed a Professional Code of Ethics and a Strategic Development Plan for 2006-2012 and started developing its own audit manual. Although the OAG was established as a 'Reserved Power' in 2002, the Auditor-General was entrusted with the task of building up and 'Kosovarising' the audit office in anticipation of its eventual transfer to Kosovar authorities (SIGMA, 2007). In the same reform period, the two EU-funded budget planning systems become operational; the BDMS used for budget planning – primarily recurrent expenditures – and the Public Investment Programme (PIP) used for planning and managing capital investments. As with the OAG, the PIP and public procurement have received continuous technical support since the second phase of the reform process, while treasury and other budget planning functions have received uninterrupted support since the first phase of the reform process.

32 'The first three years of budget management in post-conflict Kosovo have seen the establishment of a commendable framework for public expenditure management. Many of the technical principles of sound budget management are in place. (a) Funds are spent in accordance with a pre-formulated, publicized and authorized annual plan; (b) Basic tax and customs administrations have been established and are being developed; (c) A treasury function was established, with a consolidated fund and appropriate checks and balances on fund releases against budget; (d) Sufficient flexibility in budget management is maintained, including through a contingency reserve allowing for expenditure and revenue uncertainties, and a mid-year budget review process; (e) Expenditures are recorded on a modified cash accounting basis, within a pre-determined GFS compliant chart of accounts; (f) Regular internal and external reporting routines are in place; and (g) Audits are conducted' (World Bank, 2002a).

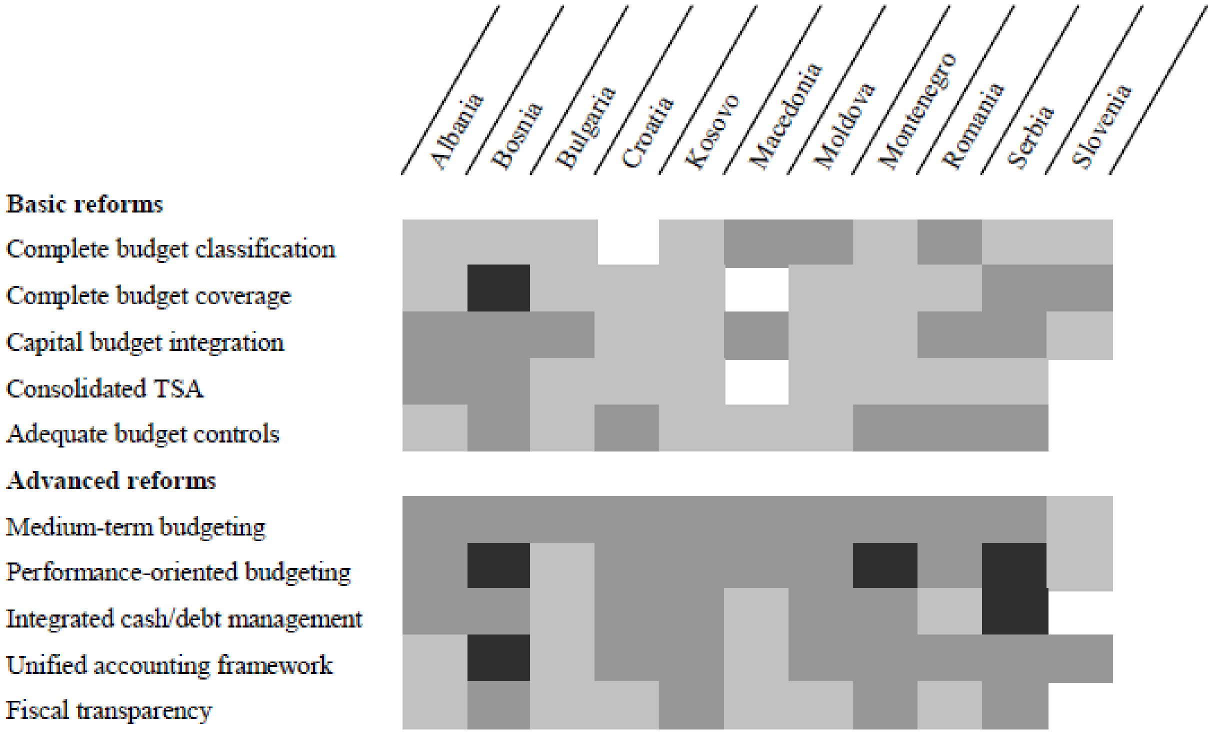
From 2008 until now, plans for the future PFM reform effort reflect a shift in focus away from the central level towards municipalities and budget organisations. In 2008, the declaration of independence and the new constitution marked the beginning of the end of SRSG authority in line with the Ahtisaari status proposal. Although donors continue to support all the PFM functions discussed above, there has been a slow retrenchment of technical advisory support. This support is targeted towards the activities in the Public Financial Management Reform Action Plan (PFMRAP), the first government-produced comprehensive and integrated reform plan for PFM, developed in 2009. From 2007 onwards, there has been an intensification of decentralisation and a revision of the rules for fiscal transfers, mainly due to the law on municipal finances which granted considerable authority to municipalities. Facilitated by a World Bank project, the Ministry of Education has started a pilot project for direct funding for schools, via the municipalities. Recent analysis, including the functional reviews, point to weakness in bottom-up aspects of PFM and this has turned the attention of future donor projects to this area. This third reform period has also seen greater attention to debt and cash management, in line with the government priorities to establish a domestic debt market.

Before 2009 a specific sequencing does not appear to have been followed, yet establishing the 'basics' seems to have been prioritised. As discussed above, the lack of a comprehensive, government-owned PFM reform plan prior to 2009 makes it difficult to assess whether the government or the SRSG were implementing reforms according to a specific sequencing model. That said, it is clear that establishing effective control and, to a lesser extent, planning functions were prioritised early on and received considerable support, despite their varied performance now. To a large extent, this can be seen as 'getting the basics right' as first laid out by Schick's components (Schick, 1998). Attention and support was focused on 'basic' functions and basic functions that were not initially supported were outsourced, e.g. external audit.

Nevertheless, there were some areas where more advanced – technically complex – reforms were implemented alongside more basic ones earlier on. First, the KFMIS computerised system was introduced in 2000 and implemented in 2001 (the same year as the defined chart of accounts). Second, a medium-term approach to budget planning was implemented in 2002. This can be associated with a demand to establish an 'international best practice' system at an earlier stage, a sentiment applied to the general reform effort in Kosovo. Consequently, although the legal framework for financial accountability and PFM was considered to reflect good international practices by 2005, it also 'appeared too demanding for the PISG' (World Bank, 2005a). As a result, some of the advanced reform efforts were too ambitious and past weaknesses are still evident, particularly around the MTEF process (although this seems as much to do with political commitment as to technical challenges in MTEF application). At the same time, some of the advanced reforms implemented early on have been very successful, particularly the KFMIS.

On the whole, evidence suggests that Kosovo has been successful in implementing and establishing a comprehensive set of basic reforms, while at the same time introducing some elements of advanced reforms with varied success. Figure 1 illustrates this performance. When compared to the region, Kosovo is performing reasonably well, particularly with regard to basic reforms, but more advanced reforms need greater support. What is interesting from this figure is that *all* basic reforms perform equally well, as do advanced reforms, suggesting that since 1999 attention has been allocated in a balanced way across a comprehensive set of basic PFM functions in Kosovo.

Figure 3: Remaining PFM reform needs in south-east European countries



Notes: (1) Source: Tandberg et al., 2009; (2) The shading in the figure indicates areas where there is still need for some improvement (light grey), substantial improvement (dark grey) or very substantial improvement (black) to achieve the basic and advanced reform benchmarks set out in the paper. The fields without any shading reflect areas where countries have met or are near to meeting the benchmark in question.

Post-2009, the PFM reform plan – PFMRAP – is implementing a platform approach. The PFMRAP is the first government-led, comprehensive and integrated PFM reform plan. Its diagnostic basis is the 2009 PEFA self-assessment, based on which it outlines several platforms to strengthen PFM in Kosovo. It covers 10 themes covering the whole budget cycle, including revenue and expenditure, and in that sense provides a comprehensive and integrated coverage of the budget cycle. Its development was supported by several key donors, primarily the World Bank, USAID, DFID and the EU. Anecdotal evidence suggests that relative to other attempts to coordinate donor support to PFM, the development of the PFMRAP was deemed quite successful, particularly in relation to coordination between the former three donors. Although PFMRAP implementation is still recent, some success has been achieved to date on some of the platforms, as outlined in the quarterly reporting templates. Its design and implementation is seen as a significant step forward on the PFM reform agenda. There seem to be no significant problems, although a few issues need to be resolved concerning the sequential implementation of the activities and responsibility for implementing reforms. One of these is that, so far, there have been more achievements in relation to the second platform than to the first. An observer explained that this is because some basic, but difficult, reforms included in platform 1 have yet to be achieved, such as filling the staff complement of the Budget Directorate. A second outstanding issue is that the PFMRAP does not clearly allocate responsibilities to relevant staff, thus limiting direct accountability, and although the reform-minded Deputy Minister currently heads and drives the initiative, there is a risk that progress would stagnate if he was moved to another post.

3.3 Design basis for PFM reform

PFM assessments and reviews have heavily informed and directed PFM reform initiatives. There have been many reviews and assessments of PFM in Kosovo since 1999, reflecting the considerable donor involvement in this area. They include two PEFAs, two public expenditure reviews, an Operational Financial Accountability Review and an Observance of Standards and Codes (ROSC), among others. The findings from the reviews and assessments have strongly directed the PFM reform initiatives. For instance, the activities in the PFMRAP explicitly address the PFM weakness documented in the 2009 PEFA. Prior to the PFMRAP, the findings of the World Bank's Medium-Term Expenditure Policy Analysis in 2002 directed the reforms proposed in the World Bank's IV Grant in 2003, and the World Bank's 2005 PEMTAG project was heavily informed by the Operational Financial Accountability Review and the Procurement Review, both of which took place in 2005.

In the absence of a comprehensive PFM reform plan until 2009, there have been problems concerning donor coordination and duplication. The first implementation of PFM reforms in Kosovo has not been based, until recently, on a comprehensive and integrated reform plan. Before 2009 PFM reform strategies and associated initiatives were based on donor interventions. The donor projects covered specific parts of the PFM system and, as a result, no comprehensive approach was taken. As discussed in section 2, donor coordination has presented a challenge in Kosovo. Despite the recognition of its importance in donor completion reports, over the years the degree to which coordination has taken place between donors has been very variable. Although only a dozen or so donors were involved in PFM in the post-war period, many donors funded considerable programmes, and there was often overlapping support for the same functions. As a result, poor overall coordination between donors has allowed some duplication of activities as well as weak coordination of activities. This state of affairs was partly due also to the government's weak coordination efforts. The adoption and approval of the PFMRAP, which was built on the results of a self-assessment PEFA 2009, indicates a clear commitment to PFM reform that should translate to better management of future reforms and donor engagement.

3.4 Coverage of PFM reform

Legal and institutional framework

Legal framework: According to the latest PEFA there has always been an understanding that the responsibility for PFM was an important issue and this was reflected by early efforts to establish an advanced PFM framework (PEFA, 2009). In 1999 and 2000 a series of UNMIK regulations established the CFA, the first set of rules related to PFM, and specific regulations relating to procurement, internal audit and municipal financing. In 2001, the MEF was established (UNMIK Regulation 2001/19) and became responsible for conducting the full range of national-level finance ministry functions as set out in the Constitutional Framework (introduced in 2001) and the Law on Public Financial Management and Accountability (LPFMA), which came into effect in 2003 (Law No. 2003/02). By 2005, an Operational Financial Accountability Review stated that the 'overall legal framework for budgeting and budget management is largely compatible with internationally recognized standards'. However, it went on to note that some aspects appear to be too advanced for the current administration's capacity (World Bank, 2005a).

Over time the legal framework has been amended to accommodate changes in the governance structure as well as other developments, and the current legislative framework for PFM is based on the 2008 LPFMA and the Law 03/L-049 on Local Government Finance. In addition to the 2008 LPFMA, there are separate laws and regulations covering internal audit and public finances, internal control, the Office of the Auditor-General, public procurement and tax revenue. The municipalities are constitutionally separate from central government and subject to both the 2008 LPFMA and the law on Local Government Finance. In addition to central government funding they have the capacity to generate income through local property taxes and own-source revenues (including user charges, traffic fines, etc.) (See PEFA, 2009). Furthermore, there are other laws and regulations that deal with specific activities, such as the Annual Budget Law, and subordinate legislation in the form of financial rules and administrative instructions support the 2008 LPFMA (PEFA, 2009). There is general acceptance, according to interviewees, that the legislative framework for PFM is sound, and this is supported by the recent Functional Review (FRIDOM, 2008b). However, concerns about its full implementation were raised by several interviewees.

In terms of legacy, 'the legacy of UNMIK policies and procedures is still found in many institutions and the Government's system as a whole (e.g. the civil service pay and grading system, though many of these are in the process of change and "Kosovarisation", routinely or as part of the implementation of the Ahtisaari plan regarding Kosovo's independence' (PEFA, 2009). The largest 'Kosovarisation' of laws happened when the Kosovo Constitution came into effect on 15 June 2008, along with many new and amended laws. Nevertheless, references to UNMIK regulations are still common, most notably in legislation related to employment and taxes.

Institutional framework: In practice the MEF inherited the CFA's structure following the transfer of PFM responsibility from the CFA to the MEF. Currently the MEF's organisational structure covers all the important aspects of financial management and state revenue collection. The MEF has a Macroeconomic and Fiscal Policy Unit, a Budget Department, a Treasury Department and a separate Agency for Tax Administration. The Customs Unit was until recently governed by EU bodies, but has been transferred to the MEF portfolio (FRIDOM, 2008a).

Budget formation

Marcoeconomic forecasting: By 2003, basic macro and revenue forecasting capability existed in the MEF (World Bank, 2003a). There has always been a core group of civil servants working in what is now the Macroeconomic and Fiscal Policy Unit in the MEF. The unit is responsible for the macro-fiscal framework, including projecting revenues and expenditures. Until 2008, all macro and revenue forecasts were discussed with the EFC and then approved by the SRSG prior to the launch of the budget process. In 2008, the EFC was dissolved and the SRSG's role in the process was transferred to the Assembly. Since 1999, macro-fiscal forecasts have been heavily scrutinised by the IMF. Firstly, large discrepancies in revenue forecasts (especially in 2006 and 2007) resulted in extensive discussions, regular reporting requirements and conservative revenue estimates. Secondly, from 2005 a tough budget constraint for current expenditure was agreed between the IMF and the Kosovo Government in the Letter of Intent in October 2005 (FRIDOM, 2008a). This significantly reduced the government's financial 'room for manoeuvre', which was already limited by Kosovo's inability to borrow as well as the restrictions from Kosovo's adoption of the Euro, which meant that Kosovo was unable to allow expenditure to exceed revenues plus donor funds. The accuracy of financial projections has gradually improved, facilitated by a small team of well-qualified experts, whose salaries continue to be topped up via the Brain Fund.[33] Over time, international experts have trained specifically recruited local experts who have gained western degrees in economics. By providing technical support to UNMIK pillar IV, USAID implemented a working model of the Kosovo economy. This has improved forecasting capacity and enabled modelling scenarios, such as economic impacts of potential large investment, etc. Although fiscal data reported by the treasury system is good, poor data on the real economy (especially the labour market) still undermines the credibility of projections – even though these have improved in recent years. Additional problems relate to the reporting of donor funds. One of the functional reviews in 2008 found that donor activities were not captured in the budget and therefore have been outside of regular fiscal control. In addition, data on donor-funded expenditures was only

33 The Brain Fund is a donor-funded initiative which provides additional financial incentives for public sector employees.

collected *ex post facto*, with resulting serious time delays (FRIDOM, 2008a). However, recent reforms of the aid management system should improve this.

Strategic and policy planning: In February 2010, a unit was established in the Office of the Prime Minister charged with supporting and coordinating strategic planning in Kosovo. The aim of the unit is to address the weak coordination and implementation of strategic planning that has existed in Kosovo since 1999. Various attempts have been made to develop a strategic policy framework, starting with the draft strategy for economic development in 2004 and the creation of sector strategies for health and education the following year. In addition, in 2006, a Kosovo Development Strategy and Plan was developed, but poor political buy-in and inadequate structures in place to implement the plan meant that it was not approved or implemented. Currently, a four-year government plan ('The Government Programme') exists, but anecdotal evidence suggests that it was produced in haste and is quite general in its coverage. There are several overarching strategic documents – the four-year Government Programme; the MTEF; the EU partnership action plan and annual action plan – but their weak coordination undermines their effectiveness. Furthermore, there is limited information on the number of sector strategies and their implementation. This fragmented strategic framework affects budget formation as there is a lack of strategic focus on the allocation of resources and therefore 'the MTEF process has weak policy content and hence no medium term perspective' (FRIDOM, 2008b).

Budget planning and allocations: Starting in 2000 the process of establishing a functional budget preparation process received early attention in PFM reform efforts and became one of the main beneficiaries of support. From 2002, there was a partial transfer of responsibilities (discussed above) from the SRSG to the MEF, and in 2003 the MEF led the development of the 2004 budget process.

One of the first interventions was the development of the budget preparation system, known as the Budget Development and Management System (BDMS). The custom-made system, supported by the EU, has been in development since 2004. One of the more recent adjustments was to increase its capacity to accommodate three-year rather than one-year estimates. It supports the preparation of the annual recurrent budget, and budget organisations submit their budget requests using the BDMS. In its present capacity it can report the current year's budget, previous year's outturn and forward estimates for the two years following the next budget year (FRIDOM, 2008a). According to the current Budget Director, prior to the system's implementation, budgets were based on ad hoc requirements, implying that when the BDMS became operational it facilitated a more policy-based budget planning and preparation process. Despite its benefits, criticisms surround its weak interfacing with the FKMIS and its efficacy. For example, other systems, such as Excel, are still used for some budget revisions during the budget planning and preparation process.

Alongside the development of the BDMS, a budget classification system and Treasury chart of accounts consistent with the IMF's Government Finance Statistics (GFS) was established in 2001, and updated in 2006 (World Bank, 2003a).

Efforts to introduce a multi-year approach to budgeting began with the 2003 budget process. Elements of a Medium Term Expenditure Framework (MTEF) were introduced, supported by donors (first USAID and then others), and were taken forward for the 2004-2006 budget (World Bank, 2003a; FRIDOM, 2008a). Nevertheless, it was not until the donor conference in December 2005, that the first full MTEF for the 2006-2008 period was developed. Since the conference, the MEF has produced three more MTEFs (2008-2010; 2009-2011; 2010-2012). The 2008-2010 MTEF was driven by the Macroeconomic and Fiscal Policy Unit of the MEF, while the following MTEFs were prepared jointly with the Budget Departments. As with the BDMS, the development of the MTEF has received considerable attention and assistance from donors, primarily from USAID but also the World Bank and EU. Despite this, evidence suggests that the links between the MTEF and annual budget are still weak (PEFA, 2009; FRIDOM, 2008a) and although the MTEF is now a legal requirement by the 2008 LPFMA, critics suggest it has been driven by 'the donors for the donors' (FRIDOM, 2008a).

The latter sentiment can be largely explained by two factors in particular. First, donors have requested a very detailed MTEF. This was particularly the case in 2008, when the MTEF was to form the key budget document for the donor conference. Essentially donors wanted to have a clear indication of spending plans and subsequent spending gaps that they could fund. Second, budget reallocations are common in Kosovo. Reallocations occur at the end of the budget preparation cycle and regularly during the financial year. This is partly caused by many examples of unapproved/unbudgeted committed expenditure. For example, in 2010, the Ministry of Labour and Social Welfare made a political commitment to increase welfare payments to families with children with disabilities. Payments were made without an associated appropriation in the 2010 budget. Similar unbudgeted expenditure has been committed by the Ministry of Health (for increases in both salaries and meal allowances) and the Ministry of Education for school books. In additional, anecdotal evidence suggests that municipalities have also signed contracts for services for the forthcoming financial year, without knowing their final budget appropriations. Until the government is able to control and reduce the levels of unapproved expenditure for the current financial year and in doing so strengthen the credibility of the budget, it is unlikely it will be able to produce credible multi-year budget plans.

The guidelines for each year's budget process are set out in the LPFMA, which provides for 'quite a modern and disciplining framework for the budget process' (PEFA, 2007), including a definite budget preparation calendar and a series of budget circulars. A budget manual was produced to support the implementation of the budget process by the World Bank-funded project Public Expenditure Management Technical Assistance Programme (PEMTAG). Given the nature of the power-sharing relationship between the SRSG and the PISG, the aggregate expenditure ceiling for the KCB used to be divided into a ceiling for the 'Reserved Power' budget organisations and all other budget organisations. Since 2008, the ceilings have been consolidated.

The second system for budgeting planning is the Public Investment Programme (PIP). The PIP system and procedures require the government to justify, prioritise, programme, plan and budget capital projects (FRIDOM, 2008a). In the early post-war period when reconstruction was prioritised, most donor funds financed capital projects through the PIP. Yet it was not until 2005 that the capital investments process received attention from the PFM reform effort. At the time, alongside evident weaknesses in the PIP process, the IMF's effective cap on recurrent expenditure increased attention to capital expenditure (FRIDOM, 2008a). Since 2005, the EU has supported reform of the PIP process through three projects. The projects took place between 2005 and mid-2007 (1st project); 2007 and mid-2009 (2nd project); and mid-2009 and 2011 (3rd project).

The first project was charged with creating the necessary templates, rules, procedures and methodology for the PIP; the 2003 LPFMA required 'detailed' capital proposals, but pre-2005 no formal procedures were in place. The revised PIP process was rolled out for the 2006 budget process following training at both the municipality and budget organisation levels; however, the technical justification of proposals for the 2006 budget was weak. Over 2006 and 2007 an electronic system was developed which allowed proposals to be submitted, approved, and ranked according to priorities electronically. Although the first project had established what were considered generally good systems, the systems were not implemented effectively. To improve implementation of the PIP procedures, reduce political influence in decision-making and professionalise the process, a World Bank review recommended establishing a Public Investment Committee, to evaluate and prioritise proposals. However, this was not implemented, and revisions to the methodology introduced in the second project were also not implemented.

Current problems undermining the implementation of the PIP procedures are considerable and relate to the high degree of political intervention in the decision-making process, weak MEF sanctions and a complicated methodology. This has resulted in poorly justified proposals, which are often completed after the capital investment has been approved, and delayed PIP submissions. This all undermines the effective prioritisation and planning of activities, leading to weak project implementation (IMF, 2010b). The third project, which is currently being implemented, aims to address some of these challenges by making the process more user-friendly to encourage its implementation and to train officials from budget organisations and municipalities.

PFM reforms at both the municipal and budget organisation levels have taken place primarily in the latter half of the last decade. Reforms at the *municipal level*: In 1999, with the establishment of the CFA, budget preparation for the central and municipal levels was consolidated in the form of the KCB. In 2007, in accordance with the amendments to the LPMFA and the new law on municipal finances, the central and municipality budget directorates were separated. Reforms at the *Budget organisation level* have mainly focused on the main spending ministries. The World Bank PEMTAG project was tasked to build capacity in budget preparation in the ministry of Health, Ministry of Transport and Communications, Ministry of Labour and Social Welfare, as well as the Ministry of Finance and the Economy. The PFM reform action plan also aims to strengthen budget preparation and planning process at both the municipal and budget organisation level.

Budget approval: Responsibility for approving the annual budget law was transferred from the SRSG to the Assembly in 2008. Prior to this, under the power-sharing arrangement, the SRSG was responsible for final approval of the budget. In terms of timeliness, evidence from both PEFAs shows that since 2006 the budget has been approved by the assigned legislature before the beginning of the fiscal year. The exception was 2008, when the budget was approved in the current financial year at the request of the newly elected government which wanted time to review the proposed budget more thoroughly (PEFA, 2007; PEFA 2009).

Budget execution

As with budget planning, the treasury function was one of the first beneficiaries of the PFM support effort and it has remained a priority for reform attention since 1999. Development started in 2000, with the introduction of commitment-based budgeting which became a cash-basis IPSAS accounting system in 2004, and the donation of the FreeBalance software which led to the establishment of the KFMIS. In the same year the recruitment and training of local staff started to take place.

Decentralising budget execution functions from the UNMIK to the PISG and then from the MEF to municipalities and budget organisations has been a key element of the reform process and considered to be a significant achievement. Initially in 2000 the treasury opened regional treasury departments to service municipalities (closed only at the end of last year). Following this, between 2002 and 2004, local staff were given commitment, obligations and payment authority. After which, in 2003, this authority was transferred to municipalities and budget organisations, with commitments transferred in 2003, obligations between 2006 and 2007 and payments in 2009 and 2010. Municipalities received functions first, followed by central budget organisations. By 2005, the budget execution department was considered 'relatively efficient and transparent' as the treasury and cash management were considered well-regulated areas of PFM (World Bank, 2005a). However, inefficiencies existed with regard to the paper trail required for commitments and payments from budget organisations that were not able to enter data on to the system. Other delays related to the link between the Treasury Department and the Banking and Payments Authority in Kosovo (delays that were resolved in 2004), and delays regarding capital budget execution, which exist to this day. However, the current delays regarding capital execution are primarily due to procurement, seasonality, poor planning and weak project management, rather than to the Treasury. The gradual transfer of authority across spending entities has not only required a good system with clear associated rules, but also regular training and support. The Treasury has achieved this by, firstly, developing the first financial rules in 2006 and outlining them in an extensive set of detailed accounting manuals produced in 2007 and, secondly, establishing a permanent unit responsible for training in the Treasury Department.

Internal control procedures are well understood and a modern internal audit is being developed, both supported by the Central Harmonisation Unit established in 2006. The unit is charged with moving to a modern system that harmonises the control and audit of public resources in accordance with best practice (PEFA 2009). Prior to the Central Harmonisation Unit, an Internal Audit Unit was established within the MEF in 2003, built on the unit established in the CFA in 2000. Currently the large majority of budget organisations have Internal Audit Units, but they are insufficiently staffed and concerns exist about the strength of internal control at the budget organisation level (PEFA, 2009).

The single treasury account was established in the immediate post-war period. Currently, all government revenues and expenditures are recorded through it and it allows access to real-time online information on the KCB. Reconciliations between the bank and treasury records are performed on a daily basis and the financial information is included in the KFMIS which produces reports (PEFA, 2009). The existence of both the single treasury account and the KFMIS allow for a reporting regime that is able to produce regular, timely, comprehensive and accurate in-year and annual financial reporting (PEFA, 2009). For the last two years, the Auditor-General has offered an unqualified opinion on the government's Consolidated Annual Financial Statements.

Procurement has also had its trajectory of reforms, starting from the establishment of the first Public Procurement Regulatory Body. Later on this was amended with the law on public procurement (2003) and all responsibilities were transferred to the Public Procurement Regulatory Commission (PPRC) and Public Procurement Authority (PPA). Supported by EU technical assistance, there has been a three-phase project supporting public procurement reform in Kosovo, the last phase of which is still active. In 2008, the PPRC duties were divided and in part transferred to the Public Procurement Review Body (PPRB). Corruption is a major challenge for public procurement and as a result there have been calls for further reform of the system, with law amendments currently being proposed to the Assembly.

Debt management: Until 2008, Kosovo's unresolved status meant that it could not borrow, either domestically or internationally. Pre-2008, the annual accumulation of reserves eased cash flow management problems. Since 2008, cash and debt management have become more important, not only because the government has started using some of its reserves by budgeting for deficits since 2008 to pay for ambitious spending plans, but also because the Ahtisaari status settlement proposal outlines the need for an ex-Yugoslavia debt service agreement (FRIDOM, 2008a). In addition to this the World Bank's Public Sector Modernisation Programme includes the provision of loans.[34] As a consequence a public debt law was enacted in 2008 and a Cash and Debt Management Division in the Treasury Department (headed by an international expert and supported by USAID) has been established to develop debt management functions. The division is tasked with developing an electronic domestic debt market with the aim of issuing government bonds by 2012, managing the Paris Club obligations, and establishing a sovereign credit rating for Kosovo.

Audit, evaluation and accountability

External audit: Between 1999 and 2003, the Netherlands Court of Audit was contracted to undertake external audit responsibilities. In 2002, The Office of the Auditor-General (OAG) was established by UNMIK Regulation No. 2002/18 (which defined authorisations, responsibilities and general standards for auditing the public sector) and assumed responsibility for the external audit of KCB financial statements from the fiscal year 2004. The OAG was

34 At the time of writing the associated loan had not been approved by the Assembly.

independent of both the SRSG and PISG but reported to the SRSG, and the SRSG retained the right not to publish all audit information it received (SIGMA, 2007). In the second half of 2003, the first Auditor-General and his deputy were appointed. Both appointees were internationals from EU states and funded as part of a wider European Agency for Reconstruction (EAR) project (2003-2006), designed to support the establishment of the OAG and internal audit. In 2005, the role of the OAG was amended by Regulation 2005/33, and a Professional Code of Ethics for the OAG was endorsed. A new international (non-EU state) Auditor-General was appointed in January 2006 (until the end June 2008). A Strategic Development Plan covering the period 2006-2012 was endorsed and the OAG started developing its own audit manual. The Auditor-General was entrusted with the task of building up and 'Kosovarising' the audit office; although the OAG was still headed and assisted by a small team of international experts (SIGMA, 2007).

In 2007, a brief four-month EU-funded project was followed in the same year by a two-year EAR project to make the OAG 'fit for purpose'. In 2008, a new law, no. 03/L0-75, amended the legal status, mandate, functioning and activities of the OAG to meet international standards. The OAG became the highest institution of economic and financial control and started to report directly to the Assembly (SIGMA, 2009). In 2009, a new international Auditor-General was appointed and he introduced a platform approach to reforms. An international Auditor-General will be in place until supervision of implementation of the Ahtisaari status settlement proposals comes to an end. Although the number of staff has remained relatively constant over the last few years (in 2008 the OAG had 85 staff: 63 audit staff and 22 support staff, the majority of whom were nationals), the number of annual mandatory audits has increased considerably (SIGMA, 2009).

Donor support to the OAG has existed alongside the Office's steady improvement, which has been illustrated more recently by the large number of audits produced and their timely submission. However, the effective use of audit information by the government and the Assembly remains weak.

Parliamentary oversight: The 2003 and 2008 LPFMA provide for the Assembly's Parliamentary oversight role, which in practice it has delegated to the Committee for Budget and Finance (CBF). The CBF was established in 2001, under an UNMIK regulation, and has been given the responsibility for scrutinising the Annual Budget Law and the external audit reports. Under the power-sharing arrangement between 2002 and 2008, the Assembly had authority to approve the budget, but final approval was made directly by the SRSG. In addition, the OAG reported directly to the SRSG. As a consequence, the SRSG retained the right to approve any recommendations presented by the CBF, leading the current chair of the CBF to suggest that initially the role of the CBF was more formal than real. Today, procedures on the deliberations of the budget are well established and involve engaging other parliamentary committees, the MEF and where needed other budget organisations, although the process works less well in practice despite various donors supporting this function. In both the PEFA 2007 and PEFA 2009 the Assembly's ability to scrutinise and issue recommendations to the executive on the Annual Budget Law and the audit reports from the OAG, but especially the latter, was heavily criticised. Key constraints cited include weak technical capacity and follow-up mechanisms, as well as claims of greater interest in scrutinising the budget than audit reports, and weak political accountability (PEFA, 2007; PEFA, 2009; GAP, 2008). To address some of the challenges, an Oversight Committee on Public Finance was established in 2010,[35] with responsibility for scrutinising external audit reports, the audited financial statements of the KCB, and other audit reports, thereby splitting the role of parliamentary scrutiny between two committees to encourage more thorough enquiry.

35 The opposition party was able to nominate the chairman of the new committee, who is an ex-minister of the MEF.

Coverage of reforms across the MEF, budget organisations and sub-national entities

Analyses and assessments of PFM performance and reform processes up to now have focused mainly on the central level, particularly in relation to the MEF and the OAG (Source: various diagnostics). Only limited analysis of reforms at the budget organisation level has been conducted. This concentration of analysis reflects to a significant degree the PFM reform effort that has taken place in Kosovo since 1999. Reform effort has been implemented mainly with a 'top-down' approach, concentrating at the central level. Donor efforts to improve PFM have focused largely on the MEF (World Bank, 2009b). This has meant that support offered to budget organisations has been relatively small and has concentrated on a few budget organisations, of which the World Bank PEMTAG project was the most significant.[36] This in part explains the weak implementation of procedures from a bottom-up perspective,[37] as well at the recent focus on strengthening PFM at the budget organisation and municipal level in the latest donor projects.[38] In addition, there have been reviews of procurement reforms of the three procurement bodies PPRC, PPA and PPRB, as well as more recent reforms at the level of municipalities. Significant support during the second half of the last decade was also allocated to the OAG and the procurement agencies, and increasingly municipalities, as responsibilities have been decentralised. For OAG and procurement, this support has also followed a 'top-down' approach.

Approach to PFM capacity development

In line with the 'standards before status' approach, capacity development has been a significant component of all reform interventions in Kosovo. In the immediate post-war period, the nature of the UNMIK administration meant that international experts held key decision-making positions regarding PFM. After its establishment, the CFA was led jointly by an international expert and a Kosovar, and the four CFA departments were headed by international experts. Following the establishment of the MEF in 2001, the international co-head of the CFA became the first Minister of MEF. The MEF's dependence on international experts was noted in a World Bank report in 2003 which, while commenting on the USAID's large capacity-building programme in the MEF, highlighted the importance of skills transfer and the current efforts under way in this regard.[39] Over time, in line with the 'standards before status' initiative[40] more powers were transferred to the PISG and a process of 'Kosovarisation' took place. International staff began to be replaced by Kosovars, many of whom had often worked alongside the international technical advisers,[41] but continued to be supported by the international staff who frequently stayed on as advisers (SIGMA, 2003). This led to many of the former 'bosses' being transformed into 'advisers'. As a result, capacity substitution moved to capacity supplementation, as international experts shifted roles from being heads of departments, to co-heads and then key advisers sitting in their Kosovar counterparts' offices. This is still the case today, as most directors in the MEF are assisted by key advisers, e.g. the two Budget Directors and the Director of the Treasury Department. The Auditor-General position is an exception, and in line with the Ahtisaari status settlement proposal will continue to be filled by an international expert until the international supervisory period has ended.

36 In addition to limited public expenditure management directed at the budget organisation level, there has been only limited attention to policy and procedural reforms in key sectoral ministries, which are essential to overall improvement in public sector management (World Bank, 2009b).
37 This was noted most recently in explaining the rationale for the World Bank's latest initiative to support public sector modernisation: 'This approach is highly relevant, especially considering that the bulk of other partners' support for PFM reform focuses on the MEF, while relevant capacity in most line budget organisations is considered to lag behind the MEF' (World Bank, 2010a).
38 The USAID project focuses on improving PFM systems at the municipal level, while the World Bank Public Sector Modernisation project aims to strengthen PFM systems at the budget organisation level.
39 '… the Ministry is highly dependent on USAID resident technical advisors, who occupy principal positions in the Ministry, including the Budget Department. Efforts to ensure skills and knowledge transfer to local counterparts is critical for the sustainability of these technical assistance projects. Efforts are underway to expand local capacity, to hire local staff to work alongside the international advisors, and to move to suitable office accommodation' (World Bank, 2003a).
40 UNMIK's core political project, which required Kosovo to make progress on eight standards to be achieved by the PISG before Kosovo's final status could be addressed.
41 Both the current Director of Treasury and the two Directors of Budget have been working in the MEF for the past decade.

Capacity development has been facilitated by a host of international and local experts. In addition to the international experts mentioned above, since 1999 local experts have been employed to assist the development of PFM systems, such as the BDMS and the KFMIS. However, over time the number of international and local technical advisers has decreased considerably. In order to attract and retain qualified and experienced local staff from the small pool of human resources in Kosovo, a 'Brain Fund' was set up, funded by various donors. This has provided a small number of top-up salaries to local staff and currently funds staff in the Macroeconomic and Fiscal Policy Unit, among others. Although it has been successful in retaining capacity, a number of interviewees criticised its level of transparency and of sustainability as well as its targeting. In addition to the Brain Fund, the Minister has the discretion to allocate financial allowances to staff, as a form of salary top-up. It is difficult to obtain data on how these funds are used, how much is targeted, and the level of allowances received but, as with the Brain Fund, criticisms surround the appropriateness of the targeting. Finally, as in many countries, donor study tours are seen as a lucrative investment.

Support for capacity development has been varied across PFM levels and functions. First, technical assistance and associated opportunities for capacity development have focused primarily on the central level, particularly the MEF, notwithstanding the initiatives in key budget organisations and municipalities. Second, unlike other departments, the Treasury Department has established a permanent training unit in the Treasury, staffed by local experts to provide continuous training and support, especially targeted at the roll-out of the KFMIS and the decentralisation of payment functions.

4 Results and achievements

4.1 Challenges and achievements of the PFM reform process

Since 1999 considerable effort has been applied to establish and strengthen PFM in Kosovo. The PFM system is relatively young and competencies will take time to develop. Despite this, a range of basic and advanced reforms have been implemented, the performance of which is comparable to achievements in the region (Tandberg and Pavesic-Skerlep, 2009). A more revealing way of summarising the patterns of Kosovo's PFM performance is to present the achievements within three dimensions of PFM: de jure measures vs de facto functional results; upstream vs downstream performance; concentrated and deconcentrated performance[42] (World Bank, 2010b). This analysis is presented below and in **Error! Reference source not found.** (which discusses the results in more detail). It is clear that achievements have been made across the board, but performance varies within dimensions.

De jure measures vs de facto functional results:[43] First, the legislative framework for PFM is fairly advanced in Kosovo (FRIDOM, 2008b). Most interviewees felt that the legal framework was appropriate for its purpose. Second, there was also general agreement that the procedures and processes underlying the legal framework were fine, although the current PIP procedures was felt to be an exception. Despite the sound framework, the challenge of implementing it was consistently raised. Two main reasons were frequently suggested. First, low administrative capacity across government (FRIDOM, 2008a) and second the lack of political will to implement the laws, procedures and processes.

Upstream vs downstream performance:[44] Strong PFM performance is not confined to one 'stream' of the budget cycle. The PFM chapter of the forthcoming World Development Report shows that across a range of fragile countries, countries perform better on average against a set of upstream functions than against downstream functions. It also suggests that budget preparation is stronger than execution in fragile states (World Bank, 2010b). Kosovo's performance deviates from this finding. As acknowledged by various diagnostic assessments (PEFA, SIGMA, FRIDOM), the treasury system is well developed and operational. The main assets of the Treasury Department include its strong KFMIS, a single treasury account and a fully staffed and capable team (FRIDOM, 2008a). Not only have treasury activities worked well since 1999 relative to other areas of PFM in Kosovo, but their effectiveness continues to grow, as illustrated by a comparison of performance between the two recent PEFAs which state that 'the assessment shows improvements in the PFM system'. The most significant improvements were made in the budget execution system, where the PEFA scores improved in cash management and accounting recording and reporting' (PEFA, 2009). In addition to the treasury function, the small but well-resourced Macroeconomic and Fiscal Policy Unit is functioning well. The main challenges that exist in the down- and upstream of the budget cycle relate to budget planning, particularly the MTEF and PIP. Budget planning is undermined by weak strategic policy direction at the beginning of the budget cycle, as well as poor parliamentary oversight and audit at the end. Any improvements in the audit functions have yet to be reflected in improved parliamentary oversight.

42 Performance dimensions based on the analysis presented in the PFM chapter of the forthcoming World Bank World Development Report, 2010.
43 A comparison between the legal framework and practice.
44 'The former includes strategic budgeting (multi-year forecasting, strategic planning, investment planning, debt planning); annual budget preparation; legislative analysis of the annual budget; and the structure of formal budget documents. Downstream performance includes resource management (including cash inflow and outflow management, procurement, payroll); Internal control, internal audit and monitoring; Accounting and reporting; External audit; and Legislative analysis of audit reports" (World Bank, 2010b).

Concentrated vs deconcentrated entities:[45] PFM performance of deconcentrated entities is weaker than that of the MEF, reflecting the concentration of reform effort. At the budget organisation level the budget preparation process varies and technical appreciation of the MTEF is limited.

Table 4: Snapshot of PFM results in Kosovo to date: achievements and challenges

Legal Framework and Institutional Rules		
		* The legislative framework for public finance management and tax/customs administration is fairly advanced in Kosovo (FRIDOM, 2008b). *There is a general acceptance, according to interviewees, that the legislative framework for PFM is sound, but its implementation remains a challenge.
Budget Formulation		
	Macroeconomic forecasting	* A permanent Macroeconomic and Fiscal Policy Unit has been established in the MEF, with qualified staff. The accuracy of financial projections have improved, and fiscal data is good, but poor data on the real economy (especially the labour market) undermines the credibility of projections.
	Strategic and policy planning	* 'The MTEF process has weak policy content and hence no medium term perspective' (FRIDOM, 2009a). This is expected to improve with the establishment of a unit responsible for strategic planning and its coordination in the Office of the Prime Minister, to drive strategy and, working with the Budget And Finance Assembly Committee, to frontload political decisions to the beginning of the budget cycle.
	Budget classifications	* The adoption of a budget classification system and treasury chart of accounts consistent with the IMF's Government Finance Statistics (GFS) was established in 2001, and updated in 2006. The budget structure was adapted in 2006 to reflect programmes.
	Budget planning and allocations (MTEF and annual budget)	* Two systems to support the formulation of the budget have been set-up: BDMS and PIP. *The BDMS is considered complicated and criticised for not easily interfacing with the FreeBalance KFMIS. *The PIP has received significant support but fails to be implemented effectively due to, its complexity, weak implementation capacity, poor political buy-in and limited use of sanctions. Problems with under spending have improved but still exist due to technical capacity and delays in calculating legal obligations from the previous year (FRIDOM, 2008a). * The annual budget process is more developed than the MTEF; the latter has 'no major impact on the budget process' (FRIDOM, 2008a) because the expenditure aggregates contained in the MTEF 2009-2011 were changed two weeks after its publication (PEFA, 2009; FRIDOM, 2008a) * A clear annual budget process exists allowing MDAs reasonable time to prepare their budgets, but some delays often experienced in implementation can concentrate a significant and vital part of the process into a short period of time (PEFA, 2009; FRIDOM, 2008a). *The short timeframes, combined with late changes to budget ceilings, compromise the quality of the budget, reflected by high levels of reallocations and transfers that are made during the year (FRIDOM, 2008a). * Top-down: The budget ceilings vary significantly during the budget preparation process reflecting weakness in policy prioritisation at the beginning of the budget preparation process {e.g. for 2009 the Cabinet did not deliberate or approve the ceilings prior to the second circular being sent out to the Budget organisations (PEFA, 2009)} and considerable political input through a non-structured process at the end (FRIDOM, 2008a). *Bottom-up: The budget preparation process varies greatly between different Budget organisations; some have budget committees and internal planning documents, while others don't. Yet most do ' not perceive the MTEF and budget planning as a planning process but rather a document that they have to fill forms and submit numbers' (FRIDOM, 2008a).
	Budget approval	* The timeliness of budget approval has been good, except for 2008 – the year of self-

45 A comparison between the MEF and budget organisations, municipalities, the Assembly, External Audit.

		declared independence (PEFA, 2009).
Budget Execution		
	Financial management reporting system	* Acknowledged by various diagnostic assessments (PEFA, SIGMA, FRIDOM), 'the Treasury system is well developed and operational, it supports processing of commitments, purchase orders, payments, debt and cash management, financial control, and financial and management report' (FRIDOM, 2008a).
Budget Execution		
	Internal control	* Devolution of commitments, obligations and payments has been implemented at both the municipality (first) and budget organisation level. The MEF is responsible for its own spending and monitoring. *Internal control procedures are well understood, but there are concerns that internal control at the Budget organisation level is relatively weak (PEFA, 2009; FRIDOM, 2008a).
	Debt management	*Debt and cash management unit has been established in the Treasury Department and has started developing a domestic debt market.
	In-year financial reporting	* 'Budget execution reports are by structure of the budget and present functional balance commitment on a monthly and quarterly basis for each economic category and Budget organisation. The fiscal reports are reliable and present all financial data in a timely manner' (PEFA, 2009).
	Annual financial reporting	* Annual Financial Statements are produced by the KFMIS. The statements are comprehensive, submitted in a timely fashion and since 2007 prepared according to LPFMA and Cash Basis IPSAS Financial Reporting under the Cash Basis of Accounting. PI-25 marked as an A in both the 2007 and the 2009 PEFAs (PEFA, 2007; PEFA 2009).
	Internal audit	* Internal audit is operational for the majority of central government entities, although insufficient capacity is a problem. For example, out of the 50 budget organisations that had Internal Audit Units in 2009, 33 had only one auditor, which according to the PEFA was considered insufficient for the efficient functioning of internal audit (PEFA, 2009). Audits meet professional standards and are submitted in a timely fashion (PEFA, 2009) although delays beyond the finalisation of external audits were noted. Prompt and comprehensive follow-up action is taken by many (but not all) managers (PEFA, 2009). *The government (through the Central Harmonisation Unit) is implementing a Public Internal Finance Control regime to harmonise control and audit of public resources in accordance with international best practice (PEFA, 2009).
Audit, Evaluation and Accountability		
	External Audit (OAG)	* Capacity of OAG, and coverage and timeliness of audit reports has improved (weak capacity noted in 2007 and 2009) (PEFA, 2007, PEFA, 2009). Training and certification established, but the high turnover and reliance on international experts remain a problem. In 2010, audit reports for the KCB for financial year 2009 were produced and publicly available by June 2010. * However, improvements in the quality of audits are undermined by little evidence of systematic follow-up on recommendations (PEFA, 2009).
	Parliamentary oversight	* Procedures well established but depth and scope of scrutiny of Annual Budget Law and audit reports is weak: lack of professional staff undermines understanding of key issues (PEFA, 2009; SIGMA, 2009). Improvements in the Auditor-General's capacity to produce audits is not mirrored by those responsible for examining and using them (PEFA, 2009). * Recommended follow-up actions are rarely carried out by government (PEFA, 2009). * The responsibility for scrutinising the Annual Budget Law and audit reports has been split, following the establishment of the Oversight Committee for Public Finance. *Clear rules exist for in-year budget amendments, which are usually respected, but in both 2007 and 2008 extensive reallocations occurred outside the Mid-Year review process (PEFA, 2009).
	Public oversight/ accountability	* Processes are in place, particularly at the municipal level, to allow for and encourage public oversight. However, public oversight and accountability remains weak, despite increasing attention given to PFM matters by the media and think-tanks.

Sources: PEFA, 2009; PEFA, 2007; FRIDOM, 2008a; FRIDOM, 2008b; SIGMA, 2009; various interviews – not sourced.

Capacities vary both within the MEF and across the actors involved in PFM and different perceptions of the strength of PFM administrative capacity exist. There is general consensus that capacity is weaker at deconcentrated entities, on account of both staffing and technical knowledge considerations. Present capacity constraints that are frequently referred to include: (1) budget planning activities and internal audit in budget organisations; (2) general administrative capacity in the new municipalities; (3) technical competencies of the Assembly and the Budget and Finance Committee members; (4) 'Kosovarisation' of external audit.

At the central level, specifically the MEF, different perceptions of the strength of PFM administrative capacity exist. Several stakeholders, including international advisers in the MEF, suggested that administrative capacity in the MEF was adequate to carry out most PFM functions despite variations across teams. However, the Project Appraisal Document for a new World Bank Sector Reform Project states that even in the MEF, 'which is among the longest-established ministries, has benefited from extensive international support, and has a comparatively high level of professional capacity, the pool of civil servants with adequate technical skills remains shallow' (World Bank, 2009a).[46] While acknowledging that these divergent opinions may in part reflect the various incentives individuals and organisations face, it is clear that there is some ambiguity about the level of technical capacity that exists within the MEF. This ambiguity is compounded by the technical assistance 'shadowing system' that is currently in place in the MEF. These perceptions may also reflect a growing sense of technical assistance fatigue that was mentioned by some interviewees, as the dependence on foreign expertise continues to decline.

Despite the differing views on overall MEF capacity, a stronger consensus was evident regarding the capacities at a departmental level. Stronger technical capacity is evident in the Macroeconomic and Fiscal Policy Unit, as well as the Treasury Department, while the recent functional review suggests that capacity in the Budget Department needs strengthening, in terms of both staff numbers and technical skills (FRIDOM, 2008a). According to the current Director, the Treasury Department has been better able to absorb the high concentration of technical assistance in the last couple of years, supported by its permanent training unit.

Challenges related to retaining staff were frequently mentioned, especially related to pay and job evaluation reform, which led to the development of the Brain Fund. Staff turnover is a concern, as is the risk of the politicisation of key managerial positions in the MEF, which in turn could increase the risk of politically driven expenditure (World Bank, 2009b).Currently, remuneration at MEF is lower than in the private sector and publicly owned enterprises, and employees in Kosovo, unlike in many other civil services, are not compensated by more secure/long employment contracts (FRIDOM, 2008c).

Finally, according to the recent functional review of the public expenditure management systems, the organisational structure of the MEF covers all the important aspects of financial management and state revenue collection. The MEF has a Macroeconomic and Fiscal Policy Unit, a Budget Department divided into a central budget department and a municipal budget department, a Treasury Department and a separate agency for tax administration. The customs unit, until recently governed by EU bodies, has been transferred to the MEF portfolio (FRIDOM, 2008a).

46 Commenting on the level of administrative capacity that exists in the MEF, the recent functional review on Public Expenditure Management Systems stated that 'evidence from the function and interviews with key MEF actors suggests that "the skeleton is there but not the spine"' (World Bank, 2008a).

5 Analysis of interactions and conclusions

5.1 Linking context to PFM reform approaches and results

Even though the Kosovar PFM system is relatively young, most areas of PFM are functioning well and have been doing so for some time. The Kosovar PFM system is relatively young and competencies take time to develop. Public administration, including PFM, essentially started from scratch in 1999. Although Kosovo had been assigned executive, legislative and judicial responsibilities as an 'autonomous province' in 1974, many of these powers were rolled back in 1989 and by 1999 Kosovar-controlled public sector management was virtually non-existent. Therefore, following the NATO bombings in 1999, only limited institutional capacity existed in Kosovo. Despite starting from this weak foundation, PFM capacities have developed relatively rapidly and basic functions across the whole system have been established, albeit to differing degrees. Furthermore, a range of diagnostic assessments indicate that some PFM functions in Kosovo are functioning well and have been doing so for some time (source: various diagnostics). The main strengths of the PFM system include the legislative and procedural framework, the treasury function, particularly the KFMIS, and the Macroeconomic and Fiscal Policy Unit (PEFA, 2009; FRIDOM, 2008a). The development of the PFM system has benefited from significant and in some areas continuous international support since 1999, covering nearly all areas of the budget cycle. Technical assistance brought with it international 'best practice' approaches to PFM, reflected in the advanced overall legal framework for budgeting and budget management (World Bank, 2005a).

However, starting from scratch has also meant that some things were rebuilt in an ad hoc way. The Kosovo administration was rebuilt in an ad hoc way immediately after the war in the Balkans (FRIDOM, 2008c). This was driven by the urgent need to establish a core set of systems and processes but set against weak comprehensive planning and coordination among the main actors involved in the transition process. The development of the PFM system has to some degree mirrored this process. Although concerns about duplicated responsibilities[47] and the weak alignment of structures and mandates are not commonly raised, frequent references are made about the duplication of technical support and activities, the diverse approaches to PFM, and the weak alignment of some financial systems. Two main reasons are given for this: first, weak planning and coordination by PISG and government officials and, second, poor coordination between donors. A comprehensive and integrated government-owned strategic plan for PFM was developed only in 2009, following a PEFA assessment. Before that, the PISG and donors had carved out certain sections of the PFM system according to the priorities at the time. The absence of a fully implementable strategic vision from the government for PFM, and the sometimes weak policy coordination between donors meant that there was some duplication of technical support. Furthermore, this resulted in some technical systems and processes not being as harmonised as they should be, as most markedly reflected in the problems related to the interfacing between the BDMS and KFMIS.

Weak government planning and coordination of the PFM reform process can be explained by the government's prioritisation of status issues, the weak policy environment and complex accountability structures. The limited capacity and appetite of the government to drive and hence own the reform agenda can be explained by a number of interlinking behaviours, of which the main ones are the following:

- First, economic and fiscal affairs including PFM reform have not been a key priority for the PISG and the Government of Kosovo. The prioritisation of status and related governance issues, particularly concerns about security and political matters, have been paramount and have absorbed most policy attention. Anecdotal evidence suggests that this behaviour is still reflected in the government today, illustrated by the limited

47 Beyond any arrangements that exists between the PISG and the UNMIK administration.

number of political champions of PFM reforms and the limited understanding in the Assembly of the technical PFM processes.

- Second, the hybrid governance structure and power-sharing arrangement between the PISG and SRSG undermined efforts to foster a national government culture of strategic management and prioritisation and resulted in a weak policy environment. This is reflected by the challenges associated with strategic planning efforts made by the Kosovar government discussed above, as well as the fact that the first government-developed comprehensive PFM reform programme was not produced until late 2009.
- Third, the power-sharing arrangements also created complex and ambiguous accountability structures which afforded UNMIK and other donors considerable influence in shaping sector policies. In the first PFM reform phase, before the transition of authority to the PISG, donors, through UNMIK, were afforded essentially a carte-blanche role in the PFM reform agenda. Although UNMIK's authority over PFM functions decreased significantly in the second reform phase, the SRSG retained responsibility for crucial executive functions, so that accountability remained divided between SRSG and PISG. In addition to this, during both the first and second reform phases, the CFA and then the MEF were dependent on donor-funded technical advisers. Although their roles shifted from being heads of departments to co-heads and then key advisers sitting in their Kosovar counterparts' offices, they remained instrumental in the system development process. The third PFM reform phase has been characterised by the recognition that strengthening PFM is central to other important government objectives such as expanding international recognition of Kosovo's independence, attaining EU accession and maintaining financial support from donors (particularly budget support). This led one interviewee to suggest that the Government of Kosovo feels 'obliged' to develop PFM. In addition, the international community will continue to retain a small executive and judicial role until the Ahtisaari status settlement proposal is fully implemented. Therefore, the complex accountability structure and associated incentives it created and continues to create has developed an environment that affords the international community considerable scope to influence PFM reforms.
- Finally, the lack of political appetite frequently referred to as 'political will' may have been also affected by perverse incentives. The implementation of PFM involves establishing rules and processes that limit the opportunities for rent-seeking. Anecdotal evidence suggests that political interventions in the process of allocating resources, particularly in relation to procurement and the PIP process, continue to be prevalent in Kosovo. This implies that implementing activities that may reduce 'political financial manoeuvrability' are likely to be contested by those who face a reduction in their influence.

As a consequence, the PFM reform process since 1999 has reflected the implementation of a donor-driven PFM reform agenda. This has been associated with the development of a sound PFM system (legislation, procedures and processes). The weak government capacity or appetite to plan, coordinate and drive the PFM reform process has meant that it has been mainly donor-driven. Reform activities have been based chiefly on donor projects and international support has not been equally spread across the system. The prioritisation and sequencing of reforms is closely associated with the current performance of certain functions, with those that achieved greater prioritisation earlier on performing better. This is most noticeable when comparing the performance of central level entities versus some deconcentrated ones. However, some areas have received a relatively high degree of technical support yet considerable weaknesses still exist. Such areas relate to budget planning, particularly the MTEF and PIP, parliamentary oversight and audit. That said, on the whole the international engagement and the subsequent reform agenda it has driven has been associated with various PFM achievements which were discussed in section 4.1. And, although the system is marred by some duplication and weak integration (of systems), it has facilitated the development of what is generally accepted to be a sound PFM framework (legislation, procedures, processes).

Full implementation of the PFM systems remains a key challenge, particularly regarding activities that have the largest scope for political involvement, reflecting weak political buy-in of the reform process. Despite the development of a sound PFM system, the challenge of its full implementation was consistently raised. Two main reasons were frequently cited. First, low administrative capacity across government (FRIDOM, 2008a) and second, the lack of political will to fully and consistently implement the laws, procedures and formal administrative processes. Nevertheless, it is important to note that weak implementation does not exist equally across the whole system. For instance, the KFMIS and related procedures are being implemented relatively well. On the other hand, implementation is weakest where it concerns dimensions of the budget cycle that are most closely linked to political processes and have the greatest scope for political involvement: principally, spending prioritisation in the budget formation process – annual budget, MTEF and PIP process – and follow-up on audits. The performance of the PIP process is particularly weak and is probably linked to the fact that capital expenditure is the main source of discretionary finance in Kosovo. This suggests that, although the donor-driven PFM reform agenda has been associated with establishing a solid framework for technical improvements, weak government ownership of *some* reform processes, illustrated in part by a lack of political appreciation and appetite for such reforms, has led to the poor implementation of improvements in some aspects of the budget cycle.

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Annex 1: Table mapping reform measures by actors and PFM dimensions

	1999	2000	2001	2002	2003	2006	2008
PFM Legal and institutional framework							
PFM-related legal and institutional framework	Regulation provides for the establishment of the CFA and first PFM rules; Regulation 2/1999 on Public Procurement Rules; Regulation 1999/16 on internal audit.	Regulation 2000/45 on Municipal Self-Government in Kosovo.	MEF established as part of the PISG, based on the UNMIK Regulation No. 2001/19.	Regulation No. 2002/18 provides for the establishment of the Office of the Auditor-General.	Law No. 2003/2 on Public Financial Management and Accountability; Law No 2003/17 on Public Procurement and provides for the PPRC, PPA and PPRB (comes into effect in 2004).	Regulation to establish the Public Finances Internal Control unit.	Law No. 03L-048 on Public Financial Management and Accountability amendments; New Law on Municipal Finances – Law No. 03/L-049 on Local Government Finance; Internal Audit Law (approved by the Assembly in 2006 and the SRSG in 2007) establishes a Central Harmonisation Unit; Law No. 03/L-75 2008 gives the OAG more powers and it starts reporting directly to the Assembly.

	1999	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Budget Formulation											
Macroeconomic forecasting				Basic macro and revenue forecasting capability exists.		Hard budget constraint for current expenditure agreed between the IMF and Kosovo Government in the Letter of Intent (October 2005).				Permanent macroeconomic and fiscal unit established in the MEF.	
Strategic and policy planning					Draft of Strategy for Economic Development.	Developed Sectoral Strategies (Education, Health).	Start to develop the Kosovo Development Strategy Programme that was not approved or implemented.				Establishment of new unit for Strategic Planning in the Office of the Prime Minister.
Budget classifications		Adoption of budget classification system & treasury chart of accounts consistent with IMF's Government Finance Statistics methodology.					Updated Chart of Accounts and budget structure revised.				

	1999	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Budget Formulation											
Budget planning and allocations (MTEF and annual budget)			Medium-term approach introduced for the 2002 budget cycle.	MEF becomes responsible for budget planning for 2004.	BDMS operational.	1st PIP project starts.	Full MTEF introduced for 2006-2008 budget and presented to donors at a donor conference.	Separation of Central and Municipality Budget Directorates; 2nd PIP project starts.	Following a donor requirement MTEF becomes more detailed.	3rd PIP programme starts.	
Budget Approval	Budget is approved by the SRSG (no information on timeliness).					Budget for 2005 approved by the SRSG in February 2005 (no information on timeliness pre 2005).	Budget for 2006 approved by the SRSG in December 2005.	Budget for 2007 approved by the SRSG in December 2006.	Authority for final approval of the budget is transferred to the Assembly. Budget for 2008 approved by the Assembly in February 2008.	Budget for 2009 approved by the Assembly before the start of the fiscal year.	

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Budget Execution												
Financial management reporting system	The Banking and Payments Authority of Kosovo (BPK) is established.	Accrual-based budgeting introduced; FreeBalance is donated by CIDA.	FreeBalance implementation.		Start delegating commitments form the Treasury to municipalities and budget organisations.	Budget moves to cash-based budgeting.		First Financial Rules developed; start delegating obligations from the Treasury to municipalities and budget organisations.	Treasury Accounting Manuals .		Start delegating payments form the Treasury to municipalities and budget organisations.	Near complete delegatation of payments from the Treasury to budget organisations.
Internal control		UNMIK officials act for authorisations of payments.		Local staff authorise commitments (in transferred powers).	Local staff authorise obligations (in transferred powers).	Local staff authorise payments (in transferred powers).			Central Harmonisation Unit established			
In-year and Annual financial reporting	Centralised system reporting basis established.		Reporting based on FreeBalance reports.						Financial reporting based on Treasury Accounting Manual			
Internal audit		Financial Audit Unit set up in the CFA.			Internal Audit unit established in MEF.				Central Harmonisation Unit established.		Internal Audit Functional Review.	

	1999	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Audit, Evaluation and Accountability											
External Audit (General Auditor Office and third party audit)	The Court of Audit of the Netherlands is contracted to undertake external audit responsibilities for the period 1999-2003.		OAG is established by UNMIK Regulation No. 2002/18. The OAG is independent of the SRSG and PISG, but reports to the SRSG because of its 'Reserve Power' status.	The first Auditor-General and his deputy are appointed; first EAR project starts.	OAG assumes responsibility for the external audit of KCB financial statements from the fiscal year 2004.	The role of the OAG is amended by Regulation 2005/33. A Professional Code of Ethics for the OAG is endorsed.	The Strategic Development Plan covering the period 2006-2012 is endorsed. OAG starts developing its own audit manual.	An EU-funded project and second EAR project commence, aimed at supporting the OAG in carrying out its annual audit plan and at making the OAG 'fit for purpose' with attributes that are expected to be fully in line with those of a supreme audit institution, respectively.	The new law no. 03/L0-75 gives more power to the OAG, which now reports directly to the Assembly and allows a degree of financial independence. The Auditor - General of the Republic of Kosovo becomes the highest institution of economic and financial control and takes full responsibility for auditing government operations included in the consolidated budget (central and local governments) and publicly owned enterprises. A new Code of Professional	New Auditor-General introduces a platform approach, starting with a well-performing supreme audit institution. New activities: first annual performance report submitted to the Assembly in April; start of EU-funded twinning project; writing comments to Parliament on internal audits, procurement, control reports (first in 2008)	The OAG introduces a new methodology for carrying out audits including interim-audits; a New Corporate Strategy; new Guidance on Performance Audit; new code of conduct – quick wins. The OAG and Anti Corruption Agency sign cooperation agreement.

	1999	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Audit, Evaluation and Accountability											
									Conduct meeting the expectations of international standards is adopted.		
Parliamentary oversight		Parliamentary Committee for Budget and Finance established and is responsible for scrutinising the annual budget and external audit reports. The SRSG retains the right to approve recommendations.		LPFMA provides for the Assembly's Parliamentary oversight role. In practice, the Assembly delegates its role to the Committee for Budget and Finance.							Oversight Committee on Public Finance established, responsible for scrutinising external audit reports, audited financial statements of Consolidated Budget (KCB), and other audit reports, thereby splitting the role of Parliamentary scrutiny across two committees, with the opposition party nominating the chair of the new committee.

Annex 2: List of people interviewed

13 July 2010	**Time**	**Meeting**
	09.00	Ministry of Education Haki Sfishta – Director of Budget Department Azem Azemi – Planning Unit, Fehmi Berisha, Budget Officer
	10.15	Chairman of the Budget and Finance Committee Mr Gani Koci
	13.00	Gracanica Municipality Bojan todorovic, Igor Aritonovic, Micic Tamara
14 July 2010	**Time**	**Meeting**
	10.30	Mr Ilaz Duli, Chairman of the Public Procurement Regulatory Commission Safet Hoxha, Next Chairman of the Public Procurement Regulatory Commission
	13.00	David Jankovsky, Team Leader, Public Investment Programme
	14.00	Mr Lulzim Ismaili, Director of Treasury
15 July 2010	**Time**	**Meeting**
	08.30	Lage Olofsson, The Auditor-General
	10.00	Mr Selim Thaqi, Director of Macroeconomic Department; Valmira Rexhebeqaj, Macroeconomist
	11.00	Haki Shatri, Chairman of Public Expenditure Oversight Commission, Assembly of Kosovo
	14.00	Mr Muhamet Mustafa, RIINVEST Institute
	15.30	Shpend Ahmeti, GAP Institute
16 July 2010	**Time**	**Meeting**
	09:00	Kris Kauffman, USAID Adviser, Central Budget Department
	10:30	Agim Krasniqi, Director, Central Budget Department
	14.30	Ramush Haradinaj, Chairman, Opposition Party – AAK Blerim Shala, Deputy Chairman Melihate Termkolli, Member of Board
	16:30	Agim Demukaj and Blerta Elezi, World Bank
19 July 2010	**Time**	**Meeting**
	10:00	Bill Lawrence, USAID

	13:00	Shar Kurtishi, World Bank Consultant
	14:30	Edgardo Ruggiero, IMF
	16:30	Alan Packer, ICO
20 July 2010	**Time**	**Meeting**
	09:00	Bernard Nikaj, PFM Functional Review
	10:00	Mimoza Kusari, Opposition Party – AKR
	11:00	Ann Schwartz, US Treasury, Debt Management Unit
	13:00	Qemajl Mustafa, Mayor of Gjilan Municipality
21 July 2010	**Time**	**Meeting**
	08:30	Ruzhdi Halili, Strategic Planning Unit
	09:00	Elvane Bajraktari, Donor Coordination Unit, Ministry of Integration
	10:00	Mimoza Kusari, Opposition Party – AKR
	15:00	Petrit Popova, Head of Municipal Budget Department

Overseas Development Institute
203 Blackfriars Road
London SE1 8NJ
UK

Tel: +44 (0)20 7922 0300
Fax: +44 (0)20 7922 0399
Email: publications@odi.org.uk
Website: www.odi.org.uk