

## Economic, political, and social uncertainties pose challenges to fiscal sustainability

**K**osovo, a province of Serbia in the Federal Republic of Yugoslavia, is rebuilding from the conflict of March–June 1999 under the provisional authority of the United Nations (UN) Mission in Kosovo (UNMIK). In a recent IMF publication, *Kosovo: Macroeconomic Issues and Fiscal Sustainability*, Robert Corker (of the IMF's European I Department), Dawn Rehm (Fiscal Affairs Department), and Kristina Kostial (formerly in the European I Department and now in the African Department) review aspects of this rebuilding. The authors argue that establishing a sound tax base, as well as properly controlled and targeted public spending, is crucial to the sustainability of economic recovery.

### Economic and political developments

The conflict set back an economy already in serious decline. Kosovo had not yet started the transition to a market economy; per capita GDP was low even for southeastern Europe; banks were essentially insolvent; and infrastructure was neglected. During hostilities, housing, utilities, and industry suffered extensive damage, and population flight disrupted commerce and created a severe shortage of experienced workers.

Postconflict, the provisional authority is empowered by a UN Security Council resolution to pass regulations that override Yugoslav law; there is no recognized indigenous government, and Kosovo's political status is in limbo.

Recovery, say the authors, is well under way, spurred by a donor-financed reconstruction boom. But just how much has the economy rallied? Preliminary IMF estimates place the per capita GDP level for 2000 in the \$650–\$850 range—below the level in other regional postconflict countries (in Albania, per capita GDP is about \$1,000; in Bosnia and Herzegovina, it is about \$1,100). Income levels exceed GDP, but only because of sizable humanitarian aid and private remittances.

### Donors meeting on Kosovo

Representatives of international bilateral and multilateral donors met February 25–26 in Kosovo's capital, Pristina, to examine and reevaluate the level of their financial support for Kosovo's reconstruction budget. Donors were generally pleased with the progress made toward establishing a sustainable budget and pledged funds to bridge the gap between expenditures and locally generated revenues in 2001. Donor grants will finance about one-third of recurrent budget spending in 2001, compared with one-half in 2000.

The economic recovery program has several important dimensions other than merely repairing the infrastructure. Foremost, it is essential that basic institutions and regulations be put in place to foster private sector development. The adoption of the deutsche mark and regulations to reestablish a payments system and properly regulated banks were important early steps in this regard. But the public sector also has a vital role to play as provider of essential services, such as health care, education, policing, and a welfare net. Accordingly, the authors stress, a priority for Kosovo is to develop tax and expenditure policies to ensure that public services are comprehensive, efficiently provided, and financed mainly from locally generated resources. However, as long as Kosovo's political status remains unresolved, medium-term planning exercises are fraught with uncertainty. In particular, the degree of Kosovo's future economic and political autonomy will have an important bearing on the structure of the tax system and the extent to which public expenditures remain devolved from the rest of the Federal Republic of Yugoslavia. "Recent political change in the Federal Republic of Yugoslavia," the authors say, "opens up possibilities for moving forward on the issue of Kosovo's status, but there are as yet no firm clues as to direction."

### Fiscal structure and the 2000 budget

Given Kosovo's unique circumstances, its fiscal policy is rather rudimentary. The tax system relies mostly on tax collection at the border, and almost all revenues stem from imports; the domestic economy, in contrast, escapes virtually untaxed. On the spending side, the structure of expenditure is not comprehensive, and a large share is financed by donor grants. The initial budgets for the last few months of 1999 and for 2000 focused on essentials, such as reestablishing the provision of basic goods and services, setting up a minimal welfare net, and rehabilitating utilities. It covered only recurrent spending; reconstruction spending was drawn up separately and financed in full by donors.

According to the authors, execution of the recurrent budget has worked remarkably well so far, helped by the establishment (with technical assistance from IMF staff) of the Central Fiscal Agency, which exercises firm control over all aspects of the budget. The large foreign-financed reconstruction program has temporarily raised total government expenditure to a high level, but if capital spending is excluded, expenditure levels in Kosovo are not high by international stan-