

# What after Kosovo's membership to EBRD?

## 1. Introduction

The European Bank for Reconstruction and Development (EBRD) is a financial institution that supports projects in European countries as well as those in Central Asia. The agreement for the establishment of EBRD was signed in Paris on 29 May 1990, and has started to operate on 15 January 1991. Under Article 1 of the agreement for establishment, the main goal of the Bank is to contribute in development and reconstruction, foster transition towards market economy and promote private sector in Central and Eastern Europe.<sup>1</sup> The aim is to promote functional market economies, where businesses compete with each other, innovation is encouraged and income reflects increase of employment and productivity. The bank is financed by 64 countries from around the world including two inter-governmental institutions: European Union and European Investment Bank. EBRD is the biggest investor in the region.

By decision of the Board of Governors on 16 November 2012, Kosovo became the 66<sup>th</sup> member, as a recipient of EBRD funds. The decision came into force on 17 December 2012 and the EBRD is expected to help both private and public sectors in Kosovo.

In this study, GAP Institute aims to analyze the concrete fields and project where Kosovo could benefit as a member of EBRD. The study focuses towards comparing fields/projects financed by EBRD in its member states, as well as Kosovo's plans for economic development, based mainly in Medium Term Expenditure Framework 2013-2015<sup>2</sup> and strategies in different sectors adopted by the Government of Kosovo. GAP Institute considers that Kosovo needs to adopt a comprehensive strategy where renewable energy, multimodal transport and agriculture take a key role in economic development. With this Kosovo would increase its benefits from the membership in

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<sup>1</sup>With the decision of the Board of Governors dated 30 January 2004, EBRD has extended investments in Asia (Mongolia)

<sup>2</sup>Medium Term Expenditure Framework 2013-2015, 25 April 2011. Source:

<http://mf.rks-gov.net/sq-al/ministriaefinancave/raportedhepublikime/kornizaafatmesmeeshpenzimeve.aspx>

EBRD. This GAP analysis aims to contribute in the drafting of the Partnership Strategy between the Republic of Kosovo and the European Bank for Reconstruction and Development.

## 2. EBRD means and areas of investment

EBRD finances bank, industry and businesses projects, be that new enterprises or existing companies through the following ways:

- a) directly through lending or investments in equity
- b) in some cases, the bank acts as a guarantor;
- c) through other forms such as financing of trade;
- d) technical assistance; and,
- e) policy dialogue.

In most cases, the direct investments range from 5 to 230 million Euros,<sup>3</sup> and do not exceed more than 60-70% of the total cost of the project, or 33% when the investment is made in equity<sup>4</sup>.

The Bank's Investment is marked by three phases:

- 1) capital injection phase;
- 2) technical assistance phase, for example bringing experts, and
- 3) exit from investment after a mid-term period of 5-7 years, by selling the stock to the owner or public offerings.

Before starting investments in a country, EBRD drafts a strategy, based on experts from the bank and in accordance with the objectives of European Union, where it evaluates the fields where it could contribute with investments and expertise to facilitate the transition to free economy and EU integration. It should be noted that before the strategy is finalized, according to EBRD policies on information, the draft strategy is published in the official webpage of the bank for 45 calendar days, during which it receives comments from interested parties.

Regarding the interest rates of loans, it varies from projects and clients. In principle, the interest rate is based in marked prices such as Euribor,<sup>5</sup> and the difference is added based on the risk of investment in that country and project. Businesses of any size have access to loans and equity investments, those that undertake

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<sup>3</sup>Because the majority of businesses in Kosovo are small economies, EBRD finances projects starting from 1 million Euros.

<sup>4</sup>EBRD and International Finance Corporation are the only institutional investors with equity in the region.

<sup>5</sup>Euribor is the interest rate based on market criteria, based on which norms Euro is offered by one prime-bank to the other within the European Monetary Union.

capital investments but also for the purpose of improving the performance of management and business planning. The bank finances projects that otherwise would not be able to raise capital with the same borrowing conditions.

Projects may be considered for EBRD assistance if they fulfill certain conditions:

- are located in an EBRD country of operations
- have significant equity contributions from the project sponsor
- would benefit the local economy and would develop the private sector by contributing to transition to market economy, and,
- satisfy banking and environmental standards.

The table below shows that total investments of the Bank during the 20 years of its activities are around 71 billion Euros, out of which 55,8 billion Euros are investments in the private sector and 15,2 billion Euros are investments in the public sector.<sup>6</sup> Bank lending remains the main investment, where EBRD assisted to strengthen financial stability by investing in banks and by offering loans for businesses and individuals. The assistance includes new lending forms, which fulfill economy needs, restructuring of financial institutions, developing bank products as well as small loans for women in business.

Tab.1: EBRD investments by sectors (1991-2011)

Sector	Amount (€ ,000)
Bank lending	16,907,924
Transport	9,173,715
Manufacturing and services	7,817,948
Energy	6,664,555
Agribusiness	6,155,506
Natural resources	4,290,221
Municipal and Environmental Infrastructure	4,163,012
Equity funds	3,057,576
Bank equity	3,037,401
Telecoms Informatics and Media	2,953,414
Insurance and Financial services	2,866,742
Small business finance	2,055,531
Property and Tourism	1,953,764

<sup>6</sup> European Bank for Reconstruction and Development, 7 December 2012. Source: <http://www.ebrd.com/downloads/research/annual/invest11.xls>

EBRD also supports state and local capacity building in order to have a functional economy. These projects include power distribution, generation and transmission of electricity, water, public sanitation and other urban projects. As in other fields, EBRD also supports capacity building of the management of energy and infrastructure institutions. As the table below shows, investments in renewable energy, direct or indirect, are significant with around 18% of investments in this sector.

Tab. 2: Sub-sector breakdown in energy sector

Sub-sector breakdown	Total project amount (€ ,000)
Electric Power Distribution	3,304,562
Electric Power Generation	12,816,177
Electric Power Transmission	3,178,816
Natural Gas Distribution	1,330,825
Renewable Power	4,558,281
<b>Total</b>	<b>25,188,663</b>

Another important sector is agribusiness, where investments include areas from production to modernization of distribution and selling networks. All these projects contribute directly in economic growth and in many cases in improving environmental standards.

### 3. EBRD investments in countries in the region

Based on EBRD statistics, the sector that received the biggest investments during the years when EBRD was present in the region is transport with 1,2 billion Euros. The investments are dominated by road infrastructure; however, other forms of transport such as rail and airports have received considerable amounts. In the sector of bank lending the majority of funds went to supporting small and medium businesses and financing of trade. Investments in energy were directed towards increasing efficiency and investments in renewable energy.

Tab. 3: 1. EBRD investments in countries in the region

Sector/Country	Albania	Macedonia	Montenegro	Serbia	Total investments in sector (€ ,000)
Transport	177,663	244,806	75,825	727,669	1,225,962
Bank lending	22,677	227,296	27,310	528,771	806,056
Energy	171,526	189,356	35,000	220,694	616,576
Agribusiness	10,549	33,565	8,329	380,149	432,592
Municipal and Environmental Infrastructure	14,600	54,043	27,350	252,021	348,013
Natural resources	38,744	19,314		230,862	288,920
Manufacturing and services	64,277	55,965	3,853	138,056	262,150
Bank equity	37,938	25,787	3,324	154,473	221,522
Property and Tourism	38,943	29,621	62,435	57,663	188,662
Telecoms Informatics and Media	62,807	47,766	500	50,944	162,016
Small business finance	5,462	14,085	8,220	94,736	122,503
Insurance and Financial services	8,305	3,058	31,250	41,250	83,863
Equity funds	8,090	5,266		52,560	65,915
<b>Total (€ ,000)</b>	<b>661,581</b>	<b>949,928</b>	<b>283,395</b>	<b>2,929,847</b>	<b>4,824,750</b>

In 2011, EBRD invested around 220 Million Euros in **Macedonia**, mainly in infrastructure and renewable energy. In the energy sector, renewable energy received investments. EBRD approved a loan of 65 million Euros for the public energy generation company “ELEM”, to construct a 70 MW hydro power plant in Boskov. Other investments include investments in infrastructure with 49%, which mainly comprises of municipal infrastructure and improving the environment, where energy accounts for 30% of investments, investments in corporations 12% in sectors such as agribusiness, manufacturing, property, tourism and telecommunications, and the rest of the funds is invested in financial institutions with a total of 9%.

Also in **Albania**, in 2011, the main investment sectors were infrastructure and energy with a total of 72% of investments. In 2011

EBRD invested 50 million Euros in improving the electricity distribution network, so that when the project ends in 2014, the loss in the distribution network will be reduced.<sup>7</sup> EBRD also invested in building of four new hydro plants with 9,2 million Euros.

**Serbia** is one of the largest recipients of EBRD investments. Only in 2011, Serbia received around 526 million Euros for 28 projects. Of 187 million Euros invested in infrastructure and energy, include a long-term loan for the “Energo” company to build two hydro plants in south Serbia. 57 million Euros were approved for investment in the Belgrade Public Transport to repair and build the tram railway. 201 million Euros was invested in financial institutions, means that mostly go to support small and medium private enterprises. Another sum of 107 million Euros was invested in agribusiness.

**Montenegro** in 2011 signed five projects with EBRD totaling 43 million Euros. The main investment was done in a project, which substitutes coal with using wood waste as means for heating homes in Plvelja.

#### 4. Kosovo's economic development plan in relation to the EBRD's investment

Based on abovementioned examples, we can see that the biggest EBRD investments were in infrastructure, financial sector and energy sector, focusing mostly on improving efficiency, clean and renewable energy, agribusiness and improving environment.

With regard to road infrastructure, the Medium Term Expenditure Framework plans to spend around 645 million Euros, which constitutes the main focus for capital spending of the Government of Kosovo. One of the attractive projects where EBRD could invest is the building of the highway R6 (Prishtinë-Hani i Elezit). However, when discussing the transport strategy based on this Framework, the Ministry of Infrastructure does not mention the budget for multi-modal transport (rail-road-air), overlooking a crucial form with potential for efficient transport, especially for transporting goods. Whereas in the draft budget for 2013<sup>8</sup> the Ministry of Infrastructure has capital projects for roads and highways amounting to 300million

<sup>7</sup>Recently, (January 2013), the Energy Regulator Office in Albania has cancelled the license of CEZ company.

<sup>8</sup>Draft Budget 2013, Ministry of Finance, 8 December 2010, <http://mf.rks.gov.net/sq-al/ministriaefinancave/buxhetiirepublikessekosoves/draftbuxheti2013.aspx>

Euros, the Ministry for Economic Development is allocated only 2,8 million Euros for projects in railways and locomotives, which shows that this form of transport is not a priority for the Government of the Republic of Kosovo.

While the EU target for 2020 is that 20% of EU energy comes from renewable sources, 97% of the production of electrical energy in Kosovo is lignite based. Based on Medium Term Expenditure Framework 2013-2015, in the context of sustainable economic development, one of the capital and strategic projects to resolve the problem of power cuts is the building of a new power plant “New Kosovo”, which for its 40 years of operational capacity is planned to use lignite as well. Although the “Energy Strategy of the Republic of Kosovo 2009-2018” mentions a number of steps towards supporting clean sources of energy, in the abovementioned framework, apart from the Zhuri Hydro Plant, the Government of Kosovo does not mention concrete renewable energy projects, which would meet EU targets and would be supported by EBRD. Therefore, EBRD should encourage alternative forms of energy, so that Kosovo could meet EU targets.

It is known that Kosovo suffers from gross losses of energy in the distribution network and commercially. For example, in 2011 overall losses were 1.786 GWh or 38.15% of energy that was produced, whereas commercial losses were 1,000 GWh or 21.37% of consumption.<sup>9</sup> The project of improving the distribution network and reducing the commercial losses would be one of the project that Kosovo would apply in EBRD and the distribution network could be kept in public ownership.

Based on the report of Central Bank of Kosovo for the Financial Stability (2011),<sup>10</sup> the average interest rate for the first half of 2011 was 14.3%. These high interest rates do not support economic development. Further, the credit structure remains oriented in the trade sector with 52.2% of overall issued loans for enterprises. One of the most important economic sectors such as agriculture continues to have low acceptance rates for loans by the banking system, with only 3.5% of overall loans. Loans for agriculture sector are discouraged with even higher interest rates, where the average

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<sup>9</sup>Annual Report, Energy Regulator Office, [http://ero-ks.org/Annual%20Report/Annual%20Report%202011/Raporti\\_Vjetor\\_2011.pdf](http://ero-ks.org/Annual%20Report/Annual%20Report%202011/Raporti_Vjetor_2011.pdf)

<sup>10</sup>Financial Stability Report, No. 2, Kosovo Central Bank, December 2011  
<http://www.bqk-kos.org/repository/docs/2011/Raporti%20i%20Stabilitetit%20Financiar%20Nr.%2002.pdf>

rate for these enterprises is around 15.6%. EBRD's strong focus in supporting small and medium enterprises, through financial mediation to offer loans and financial instruments that are adapted to the needs of economy, could be a strong promoter of the development private sector and the economy in general. Only in 2011, EBRD has made new investments in banks with 2,9 billion Euros, whereas the current portfolio of investments in banks reaches 9,4 billion Euros. The majority of the investments are dedicated to stimulate the credit of real economy. Meanwhile, through financial or technical investments, EBRD has invested around 945 million Euros in agribusiness, making the Bank the largest investor in the region in this sector.

Based on the estimates for 2007, Kosovo is the country with the highest percentage of agricultural (52%) and arable (27%) land<sup>11</sup>, following Serbia. Having in mind the high priority of EBRD's investments in this sector, and at the same time Kosovo's potential regarding agricultural land, agribusiness should be one of the sectors where Kosovo could benefit from EBRD's direct investments. As a result, these investments would reduce import, increase employment, reduce poverty and reduce the difference of income between rural and urban areas. According to European Union policies, Kosovo does not expect to have many subsidies, but needs to have infrastructure and necessary conditions for competing in the market. When discussing the conditions of doing business, regardless of the improvement in ranking in the World Bank report 'Doing Business'<sup>12</sup>, Kosovo is ranked 98<sup>th</sup> out of 185 countries. Furthermore, it should be mentioned that, even with the increase of the budget for the Ministry of Agriculture, Forestry and Rural Development, the budget of this Ministry for 2013 constitutes only 2% of the central budget, whereas EBRD's investments in agribusiness in the region constitutes around 35% of investments. Based on the Kosovo Budget 2013, this Ministry is allocated only 8,8 million Euros for capital projects.

Ranked according to Transparency International, as a country with a high perception of corruption regarding public institutions,<sup>13</sup> Kosovo could benefit from the technical assistance in fields such as procurement and transparency. The Bank also offers advice on

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<sup>11</sup>World Bank, 17 December 2012, Source:

<http://databank.worldbank.org/Data/Home.aspx>

<sup>12</sup>World Bank, 18 December 2012, <http://www.doingbusiness.org/rankings>

<sup>13</sup> Transparency International, 7 December 2012,

<http://cpi.transparency.org/cpi2012/results/>

dialogue on the forms of financing through public-private partnership and policy dialogue.

With the low quality of environment in Kosovo, especially with regard to the quality of water, waste management, air and land pollution, the Ministry of Environment and Spatial Planning (MESP) has allocated only half a million Euros in the budget 2013 for capital projects for environment, where apart from some awareness campaigns, planting trees and rehabilitations, there is no concrete project that would lead to improving the situation. MESP should draft a concrete plan on how to access EBRD and use financial possibilities.

## 5. Concluding remarks and recommendations

Whereas Kosovo became the 66<sup>th</sup> member of EBRD as a receiving country on 17 December 2012, this Bank remains the largest investor in the region with 71 billion Euros invested to date. The goal of the bank remains functioning of the marked by providing the largest investments in the private sectors and sectors such as transport, energy and agribusiness. On the other side, Kosovo is still in a difficult position to do business, where there is a lack of a comprehensive and sustainable strategy for economic development. Starting with high interest rates, high level of corruption and the lack of vision to establish a strategy in using renewable sources of energy, orienting investments in road infrastructure and sidelining investments in rail transport suggest a non-promising environment for economic growth.

Based on the findings of this study, GAP Institute recommends:

- Kosovo as a country should focus on drafting a strategy for economic development that is in accordance with the objectives and standards of EBRD.
- To draft a strategy for the energy sector, where in addition to the increase of efficiency in this sector, include projects and support policies to build capacities to use renewable sources of energy.
- With regard to transport, road infrastructure remains a potential for investments by the Bank, therefore including rail as an efficient means of transport should be one of the key projects that would support economic development.
- Agriculture should be given a higher priority, as one of the most potential sectors to gain funds and generate employment.
- The economic development strategy of Kosovo should be oriented towards creating conditions and infrastructure for the development of the private sector, as the main bearer of economic development. Meanwhile, policies should be drafted to ensure the functioning of the market such as: ensuring competition and respect for environmental standards.



Institute for Advanced Studies GAP is a local think-tank founded in October 2007 in Kosovo. GAP's main purpose is to attract professionals by creating a professional research and development environment commonly found in similar institutions in Western countries. This will include providing Kosovars with an opportunity to research, develop, and implement projects that would strengthen Kosovo society. A priority of the Institute is to mobilize professionals to address the country's pressing economic, political and social challenges. GAP's main objectives are to bridge the gap between government and people, and to bridge the gap between problems and solutions.