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Electricity Shortage in the Region Reinforces the Importance of Improving Billing and Collection Rates in Kosovo

In addition to growing regional demand and unexpected lower hydro-electric production in some countries, a major factor in the expected regional electricity shortage in 2007 is that Bulgaria will soon decommission units three and four, totaling 880 megawatts, of the Kozloduy nuclear power plant. The two oldest units (one and two), dating from the 1970s, were closed when Bulgaria started EU accession negotiations and the EU is requesting that Bulgaria also shut down units three and four for safety reasons by the end of this year. Excess capacity at Kozloduy made Bulgaria south-east Europe's biggest energy supplier, covering 80% of the region's electricity deficit last year. In 2007 though, Bulgarian officials predict that electricity exports would fall from 7,600 GWh to about 1,500 GWh, threatening winter power cuts across the region. Since Albania, Kosovo and Montenegro were in the past main importers of electricity in the region they are also likely to be worst hit. Greece and Serbia could also face power cuts at times of peak demand.

Kosovo spent around €155 million for imports in period 2000-2005. Some of these funds, in the early years after the conflict, were provided by donors, but most of the funds, and increasingly in recent years, were transferred from Kosovo Consolidated Budget. Budget subsidies for import expenditures are just one of the consequences of low levels of billing and collection. With cash collections of only around 44% of the electricity delivered by KEK, making any long term investment and import planning becomes almost impossible. KEK for 2007 has announced a tender for imports that would cover the period from January 2007 to April 2008. The intention is then to move to April-to-April import schedules that would cover the whole winter season under one contracting period. Stability of supply during winter months is crucial; however, in light of recent developments in the electricity market of the region, it will be extremely difficult to attain favorable terms for the 15 month tender. Albania, Macedonia, and Montenegro in their respective tenders for electricity imports have received offers of significantly higher prices and also limited quantities.

In the longer-term, the two more modern 1,000MW units at Kozloduy (five and six) are expected to operate for another decade following a €200m modernization to be funded by the EU and a 670MW plant is being constructed in south-east Bulgaria by AES of the USA, which will be fuelled by locally mined lignite. Bulgaria should therefore re-establish its role as a leading regional exporter of electricity in future years. In addition, other countries, including Kosovo through the development of a new Kosovo C lignite power plant, will also increase exports in order to meet the demand of a growing region in the next decades.

Higher prices in the region, unavailability of funds in KEK, and limited budget subsidies, re-emphasize the the importance of improving levels of billing and collection. Benefits from improved collection rates now will also have longer term positive effects by helping KEK to make the necessary investments in mines, generation facilities, and distribution network, and also provide comfort to prospective investors assuring that Kosovo is an attractive market for energy providers.

Key Statistics - at a glance

	2002	2003	2004	2005	2006 Aug	2006 Sept.	2006 Oct.
GDP (% change)	-2.4	-0.1	4	-0.2	..	..	..
Reg. unemployment	282.3	282.3	302	319.7	324.5	324.8	
CPI (SOK)	..	1.6	-2.5	2.6	2.8	2	0.4
Fiscal balance (mn)	106.4	62.6	-134.3	-67.8	..	..	
Exports (mn)	27.6	35.6	56.5	48.9	56.5	63.8	69.7
Imports (mn)	854.8	973.1	1,063.20	1,180	814.4	941.8	1,068.8

Source: BPK, SoK, MFE, Kosovo Employment Office and IMF staff estimates
Note: Monthly fiscal balance, export and import figures are non-cumulative.
SOK (CPI) is % change year-on-year (e.g. Oct 2004 is change from Oct 2003 to Oct 2004). Registered unemployment in thousands.
Source: BPK, SoK, MFE, Kosovo Employment Office and IMF staff estimates

A Value–Developing Tax?

A value-added tax (VAT) is an indirect tax levied at each stage in the chain of supply, on a firm's net value added. It applies to all commercial activities involving the production and distribution of goods and the provision of services. It is a *consumption* tax because it is borne ultimately by the final consumer, rather than a charge on companies. A common VAT system is obligatory for the EU members, with rates from 15% to 25%. In Kosovo, VAT is the main tax with a rate of 15% for all goods and services, and a reduced rate of 0% for agricultural production inputs. This tax policy is applicable in Kosovo since the 1st of July 2001, and a new draft law is currently out for public debate. In accordance with the EU 6th VAT Directive, exemptions are provided for the sale or import of medicine, medical services, pharmaceutical and medical products, as well as the provision of public education services. Just in June of 2006, revenues collected from the VAT on boarder amounted to €18m, and an amount of €5.1m was collected domestically, totaling to €23.1m. Annual VAT as % of government's consolidated budget revenues was 38.2% in 2005 with a projection of 35.7% for 2006.

VAT as % of Kosovo's budget revenues

		2002	2003	2004	2005	2006
Border	VAT	169	181	186	195.2	194
Domestic	VAT	29	38	43	46.4	49
	VAT refunds	0	-2	-2	-1.8	0
Total VAT		198	217	227	239.72	243.12
Total non-interest revenues		499.0	589.0	611.0	628.0	680.4
***Total VAT** as % of budget reve.*		**39.7%**	**36.8%**	**37.2%**	**38.2%**	**35.7%**

[1] Data approximated [2] 2006 data projected (Source: MFE)

VAT is a major step forward towards the creation of a self-sustaining economy. It has an impact on the business environment and the creation of a sustainable budget for public services. Yet, there are problems that need to be addressed in order for the authorities in Kosovo to strengthen VAT. First, domestic collection of the VAT is ineffective to a certain effect as the reliance is on business to report their sales while that is not the case with border collection. Currently this may not impose a great risk given the existing trade deficit, but it will become a serious problem once domestic production increases towards trade balancing. Second, VAT is paid by corporations with annual turnover above €50.000 or own assets of €50.000. Tendencies of the government are to apply VAT even for corporations that have a lower level of annual turnover, because as it is, companies may stay below the threshold to avoid the tax. The debate between the government agencies and the business community is to decrease the threshold to €20.000-€30.000m, and slightly increase VAT for 1%-2% in order to make up for the budget loss without risking its competitiveness. Yet, there is a trade-off between minimizing distortions of competition and fraud by including as many traders in the VAT system and the administrative advantages of excluding small ones from whom little revenue can be gained. The problem that may arouse is that administrative costs would be higher because it requires more information and audit to be reported, thus become much more expensive to administer. On the other hand, the conventional wisdom is that higher tax rates dampen incentives to report official business. Even though, studies have indicated that a slight increase of VAT has not had a major adverse effect on Eastern European countries, in principle the regressive nature of the VAT system could imply that an increase of VAT might have an adverse effect on the poor. However, VAT revenues can provide additional funds for poverty-reducing spending. Thus, as the debate continues for the reformation of the value-added tax policy in Kosovo, its fiscal implications and how it would compliment growth are not certain.

VAT Rates in the Region

Country	***Standard VAT***	***Reduced VAT***	***VAT as % of Budget Revenues***
Albania	20%	0%	31.6%
BiH	17%	/	31%
Bulgaria	20%	12%	11.3%
Kosovo	**15%**	**0%**	**38.2%**
Macedonia	18%	5%	26.8%
Montenegro	17%	7%	28.9%
Serbia	18%	8% or 0%	29%

[1]2005/06 is the base year for VAT as % of budget revenues

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Public Private Partnerships in South-East Europe

While many Kosovar socially-owned enterprises have been privatized by the Kosovo Trust Agency (KTA), almost all of the publically owned infrastructure services – such as energy, water, sanitation, airports, roads, and fixed-line telecommunications – are still operated under a structure of publicly-owned enterprises (POEs) under the trusteeship of KTA. While there are already a few private infrastructure companies in Kosovo, such as the first mobile operator Vala and an independent hydro-electric power plant of the capacity of 40MWs, in the past year there has been increased discussion in Kosovo on those remaining POEs responsible for public infrastructure services and the advantages and disadvantages of private sector participation to develop and manage these POEs within appropriate concession arrangements.

Prior to 1990, PPPs in infrastructure were restricted to a few developed countries, such as Australia, France, and the United Kingdom. State-owned and operated monopolies were mainly responsible in other developed countries and almost all of developing countries for supplying electricity and water, managing airports and toll roads, and providing telecommunications services. Since that time, however, almost $1 trillion dollars has been invested in over 3,200 PPP projects in developing and transitional countries. There are many reasons for the PPP boom of the past 15 years: Two major ones often cited are, firstly, the need for governments to increase infrastructure investment to facilitate economic growth in a context of limited public availability of investment funds; and secondly to improve the financial and technical performance of inefficient publicly-owned services. In Eastern Europe, the transitions to market orientated systems also contributed to a philosophical shift towards private sector provision. As a result, Eastern and Central European countries have seen some of the highest levels of investment in recent years and accounted for over 35% of global developing country investment in 2005. The Balkans are also starting to receive significant levels of investment, particularly in Bulgaria, Croatia, and Romania. Most of the investment in the Balkans has been in the telecom, energy generation, and transport sectors. Some countries have recently begun to branch out by developing PPPs in other sub-sectors as well. For example, a few years ago the governments of Bulgaria and Romania signed 25-year concessions for their capital cities' water utilities, with the projects being won by major international firms bringing in hundreds of millions of euros in investment. Overall, Bulgaria and Romania are now being asked by the EU to bring there systems in order with EU standards regarding concession regulations and public procurement, privatization and post-privatization control. Tirana airport has also recently been concessioned in Albania, as have three major toll roads in Croatia. New projects currently under discussion include airports in Bulgaria, toll roads in Bosnia and Serbia, and electricity distribution in Albania, just to name a few. In Kosovo, some PPPs are currently being developed, such as attracting foreign investment into the mining and electricity generation sectors and the upcoming tender for the second mobile license. The private sector is expected to bring in over 1 billion euro in investment for a new Kosovo C power plant. There are also discussions of how to get the private sector more involved in areas of the transport sector that are often managed as PPPs, in one form or another, in most developed countries, such as airport management and operation and the development, rehabilitation and maintenance of roads. However, PPPs are not a panacea, and preparing and developing PPPs requires considerable capacity and preparation on the part of governments. The institutional framework, encompassing the legal and regulatory regimes, organizations, environmental standards, and procurement processes all need to be consistent with best international practice, if the potential benefits of a PPP is to be realized by the public sector. As these are often extremely complex and expensive projects, sometimes hundreds of millions of euros in investment, potential private operators will conduct extensive due diligence and request very detailed background information and studies from government. The risks of PPPs cannot be mitigated entirely, however, and the history of PPPs in the transport sector in SEE has not been good, with the majority taken forward in non-optimal frameworks requiring renegotiation.. But overall, given adequate preparation and an optimal institutional framework, PPPs offer one way to undertake procurement in the public sector that can realize significant benefits for a country.

Investment Year	Total Investment – Balkans (US $million)	Total Investment – Eastern/Central Europe (US $ million)	Total Investment – All Developing Countries (US $ millions)
2000	2,129	25,303	92,285
2001	2,111	14,118	74,273
2002	1,009	17,240	58,039
2003	1,925	11,776	53,152
2004	3,602	15,112	70,874
2005	5,159	34,352	95,792
2006	21,985	181,748	969,432

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