



BANKING AND PAYMENTS AUTHORITY OF KOSOVO
AUTORITETI BANKAR DHE I PAGESAVE TË KOSOVËS
BANKARSKI I PLATNI AUTORITET KOSOVA

BPK BULLETIN

(Balance of Payments of Kosovo 2004-2005)

**Research
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ABBREVIATIONS:

BOP	Balance of Payments
BPK	Banking and Payments Authority of Kosovo
BPM5	Balance of Payments Manual (5 th edition)
CA	Current Account
c.i.f.	Cost, Insurance, Freight
DOA	Department of Agriculture
ECB	European Central Bank
EMU	European Monetary Union
ESA	European System of Regional and National Accounts 1995
EU	European Union
EUR	Euro Currency
FDI	Foreign Direct Investment
f.o.b.	Free on board
FTA	Free Trade Agreements
FYROM	Former Yugoslav Republic of Macedonia
GDP	Gross Domestic Product
IMF	International Monetary Fund
ITRS	International Transactions Reports System
KEK	Kosovo Electric Company
KFOR	Kosovo Force
KPST	Kosovo Pension Saving Trust
MEF	Ministry of Economy and Finance
NATO	North Atlantic Treaty Organization
ODC	Other Depository Corporations
OECD	Organization for Economic Cooperation and Development
OSCE	Organization for Security and Cooperation in Europe
SEE	South East Europe
SNA	United Nations System of National Accounts 1993
SOK	Statistical Office of Kosovo
SRSG	Special Representative of the Secretary General
UN	United Nations
UNMIK	United Nations Interim Administration Mission in Kosovo

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1. Introduction

One of the responsibilities of the Banking and Payments Authority of Kosovo (BPK) is to present to the public information on the developments in financial and external sector. As a result, the BPK publishes this issue of the BPK Bulletin exclusively devoted to BOP statistics. Special emphasis has been put on the methodology, with the aim to establish the infrastructure for further improvement of BOP statistics.

Supporting this initiative, the BPK starting from September 2005 has launched the project on International Transaction Reporting System (ITRS). The aim of this project is to collect the necessary information for the compilation of the BOP. The ITRS measures individual BOP transactions passing through the commercial banks in Kosovo. However, the ITRS developed by the BPK covers transactions above the threshold of 10,000 EUR. Hence, the ITRS at present is a partial system, meaning that certain balance of payments transactions are not recorded. In addition, the BPK this year has introduced Enterprise Surveys with largest BOP transactors of the Kosovo economy, where the Service Level Agreements has been signed on the exchange of information on a quarterly basis for BOP compilation purposes. Furthermore, the cooperation with government and other institutions, such as: UNMIK, Statistical Office of Kosovo (SOK), UNMIK Customs, Ministry of Finance and Economy (MFE), International Monetary Fund (IMF), etc., is additional necessary process in creating the BOP compilation framework.

We address a special gratitude to the IMF Technical assistance,¹ whose support was of a great importance and unavoidable in order for the BPK Research and Statistics Directorate to be able to produce the BOP statistics on their own. Having into consideration that this edition of the BOP statistics is compiled for the first time by the BPK RSD team, we call for understanding from the readers *a priori*. We acknowledge the discrepancies that may occur in statistics, mainly due to the lack of coverage of all inward and outward transactions with the rest of the world. Thus, we draw attention to the reader on the possible drawbacks this might cause.

With the current account deficit of about 18.4% of the GDP, Kosovo takes the leading CA deficit position with respect to other countries in the region. The main indicator of this deficit remains import-oriented economy of Kosovo, with the trade deficit amounting to euro 1,058.9 million. The main financing item in the Kosovo balance of payments remains transfers, mainly remittances from Kosovo diaspora (17.5% of GDP in 2005). Capital and financial account in 2005 dropped to euro 254.2 million, compared to 295.2 million in 2004. Consequently, 'net errors and omissions' account for euro 151.6 million in 2005.

¹ Mr. Tigran TERLEMEZIAN, Ms. Tamara RAZIN and Mr. Wayne MITCHELL.

2. Methodology

The Research and Statistics Directorate of the Banking and Payments Authority of Kosovo (BPK) is in charge for the compilation of the Balance of Payments for Kosovo. The legal basis for the balance of payments compilation in Kosovo is provided in the UNMIK Regulation 2001/24, amended regulation no.1999/20 on the Banking and Payments Authority of Kosovo. Data for the purposes of the BOP compilation are collected on the basis of the Service Level Agreements made between BPK and other institutions, whether government or non-government institutions, banking rules for commercial banks on reporting information on International Transactions Reporting System (ITRS), Statistical bank Report (SBR) and data collected inside the BPK (insurance companies and pension funds supervision directorate, accounting unit, etc). The data are supplemented with information received from other sources and estimates, such as the IMF.

At present, the Banking and Payments Authority of Kosovo compiles and publishes for the first time analytic presentation as well as standard presentation of the balance of payments in accordance with the Fifth Edition of the "Balance of Payments Manual" (IMF, 1993), the "Balance of Payments Textbook" (IMF, 1996), and "The European System of Accounts (ESA95)".

Balance of payments is one of the key economic statistical information. It measures the economic transactions between residents and the rest of the world. Economic transactions are inward transactions and outward transactions. The balance of payments (BOP) provides the balance of those transactions, the net flow and reports how that flow is funded. Payments from the rest of the world are recorded in the credit side and includes economic transactions such as exports of goods, exports of services (such as international transport, travel, financial and business services) income flows (such as dividends and interest earned by Kosovars investing abroad); financial flows (such as direct investment, investment in shares, debt securities, loans and deposits) and transfers, which are offsetting entries to any one-sided transactions listed above (such as foreign aid and funds brought by migrants to Kosovo).

Conversely, payments by domestic citizens to the rest of the world (non-residents) are recorded in the debit side and includes economic transactions such as imports of goods, import of services, income flows (such as dividends and interest earned by foreigners on investments in Kosovo); financial flows (such as direct investment in shares, debt securities, loans and deposits) and transfers, which are offsetting entries to any one-sided transactions. The current account balance equals the trade balance on goods and services plus net investment income and net unilateral transfers. Capital account balance equals capital outflows (credits) plus capital inflows (debits).

Concepts and definitions

Residency criteria. Residents are **legal entities** (including branches and subsidiaries of foreign enterprises and organizations) registered and operating in Kosovo (except international and foreign liaison and representative offices located in Kosovo, including KFOR); **and natural persons** whose domiciles (households) are located in Kosovo and who do not leave Kosovo for a period exceeding one year (except students and medical patients).

Treatment of United Nations Interim Administration Mission in Kosovo (UNMIK) – UNMIK is treated as nonresident in the Kosovo BOP and this treatment is technically consistent with BPM5 recommendations. Although the treatment of UNMIK is for the Balance of Payments Statistics purposes is considered to be a nonresident, the employees of UNMIK which mainly are engaged for a period of more than one year are considered to be residents of Kosovo. Having into consideration the treatment of the UNMIK in BOP is a borderline issue, in the future, the statistical treatment of the UNMIK could be subject to change.

BOX 1. RESIDENCY OF UNMIK

United Nations Interim Administration Mission in Kosovo (UNMIK) was established in Kosovo by the UN Security Council resolution 1244 on 10 June 1999 and was called to perform basic civilian administrative functions. The UNMIK is headed by a Special Representative of the Secretary General (SRSG) of the UN, and it has the following structure, including its main four pillars:

1. Office of the SRSG,
2. Division of Administration (DOA),
3. Administrative Services, Technical Support Services
4. Pillar I: Police and Justice, under the direct leadership of the UN
5. Pillar II: Civil Administration, under the direct leadership of the UN
6. Pillar III: Democratization and Institution Building, led by the OSCE
7. Pillar IV: Reconstruction and Economic Development, led by the EU

Disputes persist on treatment of residency of UNMIK in macroeconomic statistics. It has been argued (from IMF TA) that UNMIK performs the functions of government and therefore should be treated as (A) part of government and as (B) resident.

(A) UNMIK as Part of government

According to the Government Finance Statistics Manual, 2001 (GFSM2001) "The government of a country consists of the public authorities and their agencies, which are entities established through political processes that exercise legislative, judicial, and executive authority within a territorial area. The principal economic functions of a government are (1) to assume responsibility for the provision of goods and services to the community on a non-market basis, either for collective or individual consumption, and (2) to redistribute income and wealth by means of transfer payments. An additional characteristic of government is that these activities must be financed primarily by taxation or other compulsory transfers."

Following this statement UNMIK, on the one hand, provides collective non-market services, which in normal circumstances should be rendered by the national government. On the other hand, it is not financed primarily by taxation or other compulsory transfers. UNMIK activity is funded essentially by international organizations, consequently it **can not be considered as a part of government**.

(B) UNMIK as resident

As is stated in BPM5 "An institutional unit is **resident** unit when it has centre of economic interest in the economic territory of a country." (p. 58). In this context two concepts - economic interest and economic territory - need to be clearly defined in the whole and in connection with international organizations:

a) economic territory:

"The economic territory of an international organization consists of territorial enclave(s) over which the organization has jurisdiction; these are clearly demarcated land areas or structures that the international organization owns or rents and uses for organizational purposes ..." (BPM5, p. 60).

"The economic territory of a country consists of the geographic territory administrated by a government..." (BPM5, p. 59). "... although territorial enclaves used by ... international organizations may be physically located within a country's geographical boundaries, such enclaves are not included in the country's economic territory." (BPM5, p. 61);

The economic territory of UNMIK is under UN jurisdiction and it is not administrated by the Kosovo government so, following the above-mentioned statements UNMIK **is not an economic territory of Kosovo**.

b) the definition of international organization:

By the definition given in BPM5, p. 88 "International organizations are created for the purpose of engaging in one, or both, or the following activities: (i) provision of non-market services of a collective nature for the benefit of members and/or (ii) financial intermediation, or the channeling of funds between lenders and borrowers in different economies. International organizations are established by political agreement among organization members. Such agreements have the status of international treaties. International organizations are accorded appropriate privileges and immunities and are not subject to the laws and regulations of the economy in which the organizations are located. Thus, such bodies **are not considered residents of any national economy, including the economies in which the organizations are located or conduct affairs.**"

Applying this statement to UNMIK it is obviously that **UNMIK meets the criteria of international organization:**

- (i) decisions regarding its creation, disappearance and budget are taken by the parent organization (United Nations);
- (ii) it is not subject of laws and regulations of Kosovo. Although UNMIK involves several international organizations it is an integral part of the United Nations and it is presided by the Special Representative of the Secretary-General for Kosovo. It was been designed in a way that other multilateral organizations are full partners under United Nations leadership.

(C) Centre of economic interest

The UNMIK, in its role of international organization, **does not maintain a centre of economic interest in Kosovo**.

Consistency of accounting practice with other countries

Accounting practices in macroeconomic statistics must be consistent across countries following the international rules. According to macroeconomic statistics current practice UNMIK staff members, working abroad less than 1 year, are treated as residents of their home countries. Thus, any classification of UNMIK staff working for less than a year as Kosovo residents would be inconsistent with the statistics of other countries.

Treatment of KFOR. The UNSCR 1244 also mandated that an international security presence be deployed in Kosovo to provide for a safe and secure environment. This presence is provided by the "Kosovo Force" (KFOR), composed of over twenty national military contingents under the command of the NATO. The objective of KFOR is to establish and maintain a secure environment in Kosovo, including public safety and order. It also monitors, verifies and, when necessary, enforces compliance with the agreements that ended the conflict. KFOR is mostly funded directly by individual countries.

Treatment of International Staff in Kosovo - In accordance with the SNA 93 (14.32; 14.18) and the BPM5 the international staff in Kosovo (hereinafter "expatriates") is treated as a staff "engaged in technical assistance or other activities on behalf of the international organization." The military contingent of the KFOR and the international staff of foreign Liaison Offices and offices of international organizations in Kosovo (diplomats, military personnel, and other employees of such organizations and their family members, who reside in Kosovo and enjoy immunity and diplomatic privileges) are treated as nonresidents of Kosovo.

I. Current Account

The Current Account comprises the acquisition and provision of goods and services, income, and current transfers between the country and the rest of the world.

The flows recorded on the credit side represent part of the gross domestic product, which is provided to the rest of the world (exports of goods and services), as well as the provision of factors of production expressed by income receivable – compensation of employees and investment income (interest, dividends, etc.). Current account records also offsets for non-refundable real and financial resources received (transfers) from nonresidents.

The flows recorded on the debit side represent the gross domestic product of the rest of the world and acquired by the domestic economy (imports of goods and services), as well as acquisition of factors of production expressed by income payable. Recorded are also offsets to non-refundable real and financial resources provided to nonresidents.

1. Goods - The standard components of the goods in the BOP are general merchandise, goods for processing, repairs on goods, goods procured in ports and non-monetary gold.

General merchandise covers most movable goods that residents export to, or import from, nonresidents and that with a few specified exceptions undergo changes in ownership (actual or imputed). Change of ownership is considered to occur when legal ownership of goods changes, when services are rendered and when income accrues.

Goods for processing. The value of goods entering or leaving Kosovo for processing and returning to the country of origin after processing should be recorded on a gross basis, i.e., recording the goods both when they enter (as imports) and when they leave (as exports), even though there is no legal change of ownership of those goods. A symmetrical treatment should be applied to the goods exported from Kosovo for processing abroad and returned.

Repairs on goods. It covers repairs that involve work performed by residents on movable goods owned by non-residents (or vice versa). Examples of such goods are ships, aircraft and other transport equipment.

Goods procured in ports by carriers. It covers all goods (such as fuels, provisions, stores and supplies) that resident/nonresident carriers (air, shipping, etc.) procure abroad or in the compiling economy.

Non-monetary gold. It covers exports and imports of all gold not held as reserve assets (monetary gold) by the authorities. Non-monetary gold is treated the same as any other commodity and, when feasible is subdivided into gold held as a store of value and other (industrial) gold.

Report of the Statistical Office of Kosovo (SOK) on merchandise foreign trade of Kosovo represents the basic **data sources** for the balance of payments items related to export and imports of goods.

Adjustments - For the BOP purposes in order to conform to the standards, BPK makes adjustments for coverage and classification. In the credit side the supplementary information on local consumption of goods by international organizations (like KFOR, UNMIK, etc.) are added. Adjustments for electricity are made also based on enterprise survey with KEK. Imports of goods as donation (Source MEF) are added as well.

The data on imports of goods are also adjusted from imports at c.i.f values to f.o.b values, excluding imports from the neighboring countries (Albania, FYROM, Serbia and Montenegro). Accordingly, export and import of goods in the balance of payments are reported at f.o.b. parity.

The UNMIK Customs service collects the information through single administrative document for the foreign trade of Kosovo and provides data on goods imported and exported for processing and repairs. Data on repairs of goods and goods acquired in ports are collected also from Enterprises Surveys.

2. Services

Trade in services covers the provision of services by residents to non-residents and vice versa. The services component of the BOP consists of three main components: **transportation, travel, and other services**, which are subdivided into further items.

Transportation - account covers sea, air and other (i.e. rail, land, and pipeline) transport. It includes the movement of passengers and freight and other related transport services, such as chartering of aircraft with crew, cargo handling, storage and warehousing, towing, pilotage and navigation, maintenance and cleaning, and commission and agents' fees associated with passenger/freight transportation.

The BPK derives the data on **freight transportation** based on foreign trade data and the data on **passenger transportation** based on the enterprises surveys from airline companies, and makes estimates on that information. The payments for freight transportation (debit) are calculated as an estimation of the payments made by Kosovars on behalf of non-resident carriers related to the country of imports of goods. The value of transport services is estimated on the basis of the estimated difference between the value of imported goods at c.i.f. and f.o.b. values. The ratio of freight transport to the total amount of c.i.f. imports is considered to be 5%. Imports from neighboring countries are considered to be in f.o.b. basis.

Travel services - cover goods and services provided to non-residents during trips of less than one year in Kosovo – credit, and provided to residents during similar trips abroad - debit. The exceptions are those military and diplomatic personnel (i.e. KFOR and Liaison Offices), whose expenditure is recorded under government services. The one year rule does not apply to students and medical patients, who remain residents of their country of origin, even if the length of stay in another economy is more than a year. Travel services are divided into two categories: business travel and personal. Business travel covers all type of business activities such as carrier crews stopping off or lying over; government employees on official travel; employees of international organizations on official business (e.g. technical assistance); and employees doing work for enterprises that are not resident in the economies in which the work occurs. All travelers going abroad (coming in Kosovo) other than business are treated as personal travel.

Business travel are estimated based on the data from enterprise surveys however, personal travel actually covers expenses of UNMIK short-term employees. It is assumed that the short-term international staff spends 30% of their salaries in Kosovo for commodities.

Other services – Under the category of other services are included exports and imports of nine categories of international services not covered under transportation and travel. Those international services are:

- 1) **Communication services** cover mainly services provided by nonresidents (or to nonresidents) in the telecommunication and the **postal and courier services**. Source of data are direct enterprise surveys.
- 2) **Construction services** cover work performed on construction projects by an enterprise or site office that is nonresident in the host country.
- 3) **Insurance services** cover the provision of various types of insurance to nonresidents by resident insurance enterprises, and vice versa.
- 4) **Financial services** cover financial intermediary and auxiliary services conducted between residents and nonresident, such as those associated with letters of credit, bankers' acceptances, lines of credit, financial leasing, and foreign exchange transactions.
- 5) **Computer and information services** cover computer data and news-related service transactions between residents and nonresidents, such as hardware consultancy; software implementation—including design, development, and programming of customized systems; maintenance and repair of computers and peripheral equipment; news agency services—including provision of news, photographs, etc.
- 6) **Royalties and license fees** cover the authorized use of intangible, nonproduced, nonfinancial assets and proprietary rights (such as patents, copyrights, trademarks, industrial processes, franchises, etc.) and with the use, through licensing agreements, of produced originals or prototypes (such as manuscripts and films).
- 7) **Other business services** cover various categories, other than those previously defined, of service transactions between residents and nonresidents (i.e. merchanting, operational leasing, miscellaneous business, professional, etc.).
- 8) **Personal, cultural and recreational services** records services such as audio-visual and related services (services and associated fees relating to the production of motion pictures and musical recordings); other cultural and recreational services (covers all other personal, cultural and recreational services including those associated with museums, libraries, archives, provision of correspondence courses by teachers or doctors etc).
- 9) **Government services not included elsewhere** - Government services n.i.e. - is a residual category covering government service transactions (including those of international organizations) not contained in previous classifications. Included are all transactions by embassies (liaison offices), consulates, military units, and defense agencies with residents of economies in which the embassies, etc. are located and all transactions with other economies.

The data for the compilation of Other Services are derived from various sources of information such as: enterprise surveys, ITRS, official data sources, the ratio of 1.5 percent on total imports c.i.f. for freight insurance etc.

In the debit side of the insurance services are included (1) payments for freight services (because of the presentation of merchandise imports on a f.o.b. basis), (2) reinsurance premiums paid and (3) the insurance services rendered to non-residents.

3. Income

The income component relates to income earned from two factors of production: labor and capital. Consequently, the income consists of compensation of employees and investment income.

Compensation of employees covers wages, salaries and other benefits paid to non-resident workers in the country or received by resident workers abroad. In this context, includes seasonal or other short-term workers (less than one year) and border workers who have centers of economic interest in their own economies. Compensation of employees paid to Kosovars working for International Organizations (excluding UNMIK²) and KFOR are recorded under credit side. As far as in the debit side is recorded 70% of wages of international staff working for UNMIK (employees with a contract for less than one year) which are treated as a nonresident since the amount is previously recorded under current transfers – credit. The rest is considered to be spending for commodities. The Compensation of employees are calculated based on various sources of information including data collected directly from the UNMIK, KFOR, MEF, Liaison offices and from other international organizations.

3.2. Investment income covers receipts and payments of income associated with external financial assets and liabilities. Included are receipts and payments of income from direct investment (income on equity and reinvested earnings), portfolio investment (income on equity and income on debt) and other investment (interest on deposits, loans, etc). The most typical form of income from abroad are interest earned from deposits or portfolio with foreign banks. In the debit side are included payments to direct investors in Kosovo (reinvested earnings, dividends) than interest paid for borrowings from abroad, etc.

The main sources of information on the investment income are reports of the commercial banks, the insurance companies and the BPK.

² All wages of UNMIK employees, whether resident or nonresidents are recorded firstly as current transfer on the credit side.

4. Current Transfers

Transfers are offsetting entries for real resources or financial items provided without receiving in return any good, service, or financial item. Transfers are separately identified as either current or capital. Capital transfers relate to:

- the transfer of ownership of a fixed asset,
- the forgiveness of a liability by a creditor,
- migrants' transfers or
- transfers in kind when linked to a fixed asset being acquired/disposed of by one or both parties,

when no counterpart is received in return. All other transfers are current transfers. Current transfers are subdivided into those of central government and other sectors.

In Kosovo case, current transfers are classified according to the sector of the compiling economy, into two main categories:

- a. General government – which current transfers include:
 - (1) Grants to the Kosovo Consolidated Budget (Donor Designated Grants)
 - (2) Donor aid in kind (Public Investment Program)
 - (3) Direct spending of the UNMIK and its pillars, and
 - (4) Provision by the KFOR of services in kind to the government of Kosovo.
- b. Other sectors – whose current transfers are further divided into:
 - (1) *Workers' remittances*

In the credit side of other sector transfers from workers' remittances are included mainly the flow from Kosovars living abroad, in cash and in kind to their relatives in Kosovo. The calculation of the remittances is based on the survey conducted by the Statistical Office of Kosovo. According to this survey, 78% of households are receiving remittances from their relatives abroad. On average, each of this households receives around euro 1,500 per year. Also, according to the Statistical Office of Kosovo, number of inhabitants in Kosovo as of 2005 is assumed to be around 2 million, while in each household on average lives 6.3 members. Data source in debit side are recorded the flows from international staff working in Kosovo, for a period of one year and more, in cash and in kind to their relatives abroad.

- (2) *Other transfers* – cover pensions received by residents of Kosovo from Serbia, Germany, Switzerland and other countries, some grants related to different institutions and a significant amount of funds submitted from migrants to their relatives which are related on invested in the privatization process.

II. Capital Account

The major components of the **capital account** are capital transfers and acquisition/disposal of non-produced, nonfinancial assets. Capital transfers consist of those involving transfers of ownership of fixed assets; transfers of funds linked to, or conditional upon, acquisition or disposal of fixed assets; or cancellation of liabilities by creditors without any counterparts being received in return. Capital transfers include two components:

- (i) General government, which is subdivided into debt forgiveness and other;
- (ii) Other, which is subdivided into migrants' transfers, debt forgiveness and other transfers. Acquisition/disposal of nonproduced, nonfinancial assets largely covers intangibles—such as patented entities, leases or other transferable contracts, goodwill, etc. This item does not cover land in a specific economic territory but may include the purchase or sale of land by a foreign embassy.

III. Financial Account

The financial account covers transactions in foreign financial assets (i.e., claims on nonresidents) and foreign financial liabilities (i.e., liabilities to nonresidents). The four categories of functional investment which are distinguished (**direct investment, portfolio investment, other investment and reserve assets**) are based primarily on the relationship between the parties and secondly on the nature of the instrument involved.

1. Direct investment. Direct investment is a category of international investment that, based on the equity ownership of at least 10%, reflects a lasting interest by resident in one economy (the direct investor) in the enterprise resident in another economy (the direct investment enterprise). Using this criterion, a direct investment relationship can exist between a number of affiliated enterprises whether the linkage involves a single chain or a number of chains. The components of direct investment transactions are:

- a. Equity capital - comprises investment in branches, shares in subsidiaries and associates (except non-participating preferred shares that are treated as debt securities) and other capital contributions;
- b. Reinvested earnings - consist of the off-setting entry to the corresponding current account income item: it is the direct investor's share of the undistributed earnings of its branches, subsidiaries and associates.
- c. Other capital - covers all other inter-affiliate financial transactions (borrowing and lending of funds), including debt securities and suppliers' credits (trade credit).

Following the recommendations of the IMF, ECB, EUROSTAT and OECD, direct investment flows are recorded on a directional basis (rather than the more usual assets/liabilities basis): direct investment abroad – as an asset, and direct investment in the reporting country – as a liability. Direct investment abroad covers net investment by parent companies resident in Kosovo in their foreign branches, subsidiaries and associated companies. Direct investment in Kosovo covers the net investment by foreign companies in their affiliates located in Kosovo.

The Banking and Payments Authority of Kosovo uses different sources of information for the calculation of FDI. Kosovo Trust Agency (Privatization Agency), Banking Supervision and Pension and Insurance Supervision Directorates of the BPK, and in the near future Kosovo Business Registry and ITRS will be the main sources of information on FDI.

2. Portfolio investment. Portfolio investment covers the acquisition and disposal of equity and debt securities, which cannot be classified under direct investment or reserve assets transactions. The securities involved are traded (or tradable) in organized and other financial markets. Debt securities cover bonds and notes, which have an original maturity term of more than one year, and money market instruments with original maturity of one year or less. In the case of Kosovo, in this category are included investments in securities abroad from both, BPK and commercial banks. The main sources of information on portfolio investment are the data provided by the BPK, and commercial banks operating in Kosovo.

3. Other investment. Other investment covers assets and liabilities other than those classifiable to direct investment, portfolio investment or reserve assets. It comprises short and long-term loans, currency and deposits, trade credits and other assets and liabilities. Information about them is obtained from MEF, BPK, commercial banks, other financial intermediaries, KPST and enterprise surveys.

4. Reserve assets. They consist of those external assets that are readily available to and controlled by monetary authorities for direct financing of payments imbalances, for indirectly regulating the magnitude of such imbalance through intervention in exchange markets to affect the currency exchange rate and/or for other purposes (BPM5, p. 424). Reserve assets consist of: Monetary gold, Special Drawing Rights, Reserve position in the Fund, Foreign exchange (Currency and deposits and Securities), Other claims.

Other foreign currency assets refer to foreign assets of the monetary authorities that are not included in reserve assets, but as reserve assets, must be liquid foreign currency assets that meet the criteria of being available for use by the authorities in the time of a crisis (International Reserves and Foreign Currency Liquidity: Data Template, p. 118)

Data sources for calculating the reserve assets are:

- a. Monetary statistics: BPK Survey; Other Depository Corporations Survey; Other Financial Corporations Survey (Other Financial Intermediaries Survey, Insurance Companies Survey and Pension Fund Survey);
- b. Ministry of Economy and Finance (MEF) accounts abroad.

BOX 2. FOREIGN EXCHANGE RESERVES – The case of Kosovo

BPK Foreign Assets and Liabilities

Kosovo monetary authority (BPK):

(a) holds foreign currency assets in the form of:

- (i) euro in cash;
- (ii) deposits and securities with banks abroad

(b) has liabilities to:

- non-residents in the form of:

- (i) deposits

- residents in the form of:

- (i) deposits of central government;
- (ii) reserve deposits of commercial banks;
- (iii) other banks deposits;
- (iv) other residents deposits;
- (v) remaining items (accounts receivable).

Following the reserve assets definition only two components of the BPK Foreign Assets and Liabilities meet the main characteristics of reserve assets (to be readily available and to be controlled by the BPK): Euro in cash and reserve deposits of banks with BPK. Consequently these components are classified in BOP as reserve assets.

Net Errors and Omissions

The sum of the credit entries should in principle equal the sum of the debit entries over period. In practice, because some transactions may not be captured or because of differences in coverage, valuation and timing of transactions, exact symmetry does not occur and the balancing item *net errors and omissions* is inserted to balance the overall account. Ideally, the scale of this item should be relatively small in relation to the combined value of all credit and debit transactions expressed in absolute terms. It should also fluctuate frequently from positive to negative values.

3. Balance Of Payments In 2005

Amounting to euro -405.8 million, Current Account (CA) deficit³ for the year 2005 accounted to 18.4% of GDP. However, the CA deficit is higher relative to 2004, when accounted for 12.3%. As table represents, the gap is increased mainly due to the persistent deficit on goods and services (euro 1,112.8 million). Still, goods (trade balance) are composing the biggest item within the structure of current account. Actually, the deficit of goods in 2005 accounted to 47.9% of GDP from 41.4% in 2004. The increase in the deficit to GDP is result of both, decrease in the nominal GDP and increase in goods deficit.

Table 1. Balance of payments of Kosovo, 2004 – 2005

Period	2004	2005
Current Account	-281.5	-405.8
Goods	-945.3	-1,058.9
Services	-31.2	-54.0
Income	23.9	30.0
Current transfers	671.2	677.1
Capital and financial account	295.2	254.2
Financial account	295.2	254.2
Direct investment	17.6	58.8
Portfolio investment	-116.6	-6.2
Other investment 1/	393.8	227.4
Reserve Assets	0.4	-25.8
Net errors and omissions	-13.7	151.6

Source: BPK (2006)

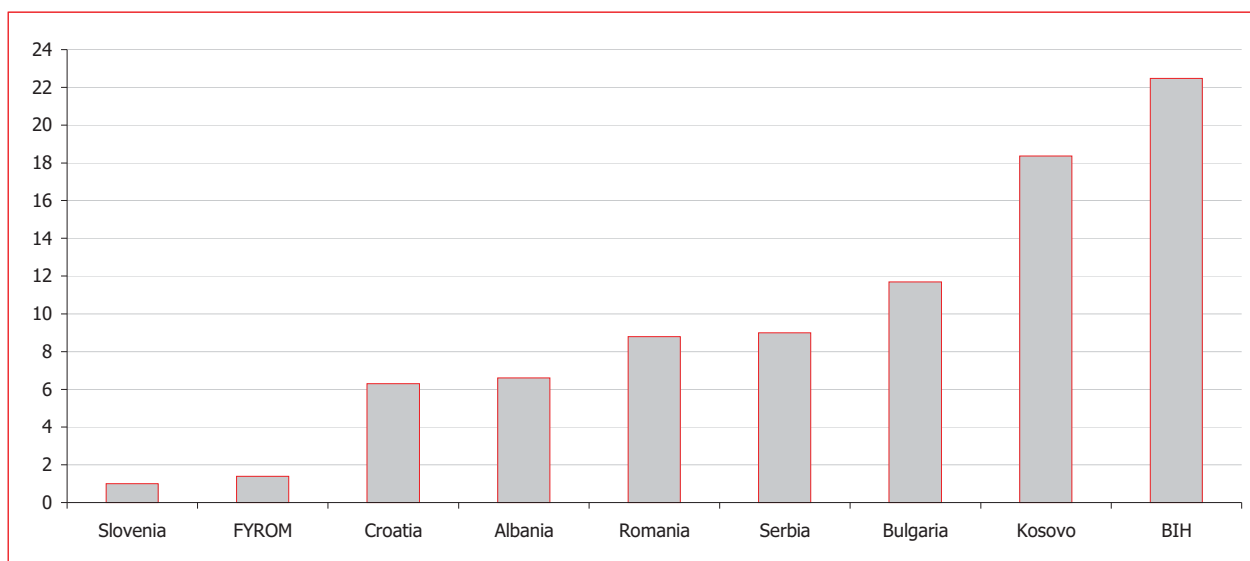
1/ Including trade credit (IMF sourced).

The presence of international community in Kosovo since 1999, to some extent, affected the overall Kosovo economy, to a large extent Kosovo's balance of payments picture. Computing the CA deficit excluding foreign assistance can be seen that deficit is much higher. Namely, the Kosovo CA deficit excluding foreign assistance in 2005 accounts for euro 688.8 million (31.2% of GDP) from euro 606.5 million (26.6% of GDP).

Comparing the Kosovo's CA deficit with the countries in the region, easy can be recognized that Kosovo leads in that respect. As figure 1 presents, excluding Bosnia and Hercegovina, Kosovo is far away from countries in the Western Balkans. Bulgaria is in the third place regarding the current account deficit, at the level of 12%, while Slovenia which is expected to join the EMU in January 2007, experienced 1% current account deficit.

³ Including foreign assistance (UNMIK, KFOR, etc)

Figure 1. Current account deficit in SEE, as of 2005, in % of GDP



Source: Business Monitor International (2006); BPK (2006)

Kosovo is import depended economy, while the serious challenges remain in external account. Apart from that, since 2004 the current account deficit is followed with the government deficit representing a case of twin deficits. Very low ratio of exports to imports caused large external imbalances. The rationale of persistent high current account deficit (see figure 1) in the case of Kosovo, might be attributed to trade deficit.

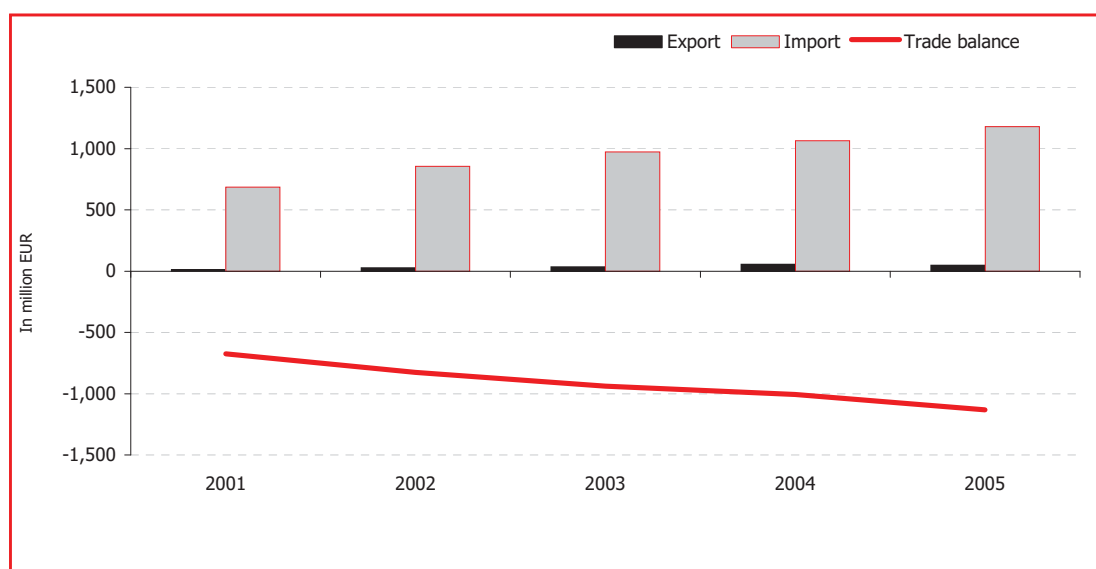
4. Current Account

Kosovo's current account deficit for the year 2005 stood at euro 405.8 million (18.4% of GDP) from euro 281.5 million in 2004 (12.3% of GDP). The huge external imbalance came mainly due to the persistent high deficit in the balance of trade since 2000, composing for a biggest spending item of the current account. In other side, main financing item within the current account module is current transfers, representing the remittances from Kosova diaspora (mainly western europe), thus offsetting balance of trade deficit. Current transfers in 2005 amounted to euro 677.1 million from euro 671.2 million in 2004. Services account recorded a negative balance and was higher by euro 22.8 million, whereas income account has shown a higher net inflow in the amount of euro 6.1 million.

4.1. Foreign Trade in goods

In 2005 the economy in Kosovo continued to be the import-oriented economy with the exports (excluding local consumption of goods by international organizations) covering only around 4.2% of the total imports (c.i.f.). This insignificant coverage implies the position of trade deficit of goods to GDP⁴ to be 51.2% over 44.1% in 2004. In fact, trade in goods deficit (amounting at euro 1.131 million) in 2005 deepened by 12.36% compared to 2004.

Figure 2. Exports and imports (c.i.f.) and trade balance, 2001 – 2005



Source: Customs and Statistical Office of Kosovo (2006)

⁴ GDP is an IMF staff estimate, Aide Memoire, May 2006.

From 2001 and up to 2004, Kosovo increased the exposure to the foreign trade by showing an upward trend in both, imports and exports (see figure 2). An exception was 2005 with about 13% less exported goods than in 2004. Interesting fact is that up to October 2005 the exports followed the same trend and accumulated almost the same amount as in 2004 (euro 39.1 million, in cumulative basis), but it was the development of the last two months that produced that percentage change, year-on-year. The reason might be new customs recording procedures initiated in that period.

However, the intensification of foreign trade was followed with the deepening of the trade deficit through 5 years period. With the amount of the imports being so high and very insignificant amount of exports, it is very deceptive to conclude that the trade deficit follows similar growth rates as import growth rates.

General merchandise. When adjusted to f.o.b. values, the ratio exports/imports experiences a slight improvement by reaching 6.3%. The volume of the initial export amount increases due to the coverage adjustments mainly generated from the estimation of the local consumption of goods by KFOR. While on the import side, the classification adjustment (euro 50.6 million) is moderately offset by the coverage adjustment (euro 1.2 million). This brings the imports (f.o.b.) down to euro 1,130 million. Nevertheless in both, c.i.f. and f.o.b. values, the financing of imports by exports was lower than in 2004, when coverage ratios were 5.3% and 7.8%, respectively.

Table 2. Goods, 2004 – 2005 (in million of euro)

Period	2004	2005
Goods	-945.5	-1,059.3
1. General Merchandise Trade Balance	-944.5	-1,059.2
1.1. Credit	79.5	71.4
1.1.1. Export (f.o.b.) in trade statistics	56.6	48.9
1.1.2. Adjustment for coverage	22.9	22.5
1.2. Debit	-1,023.9	-1,130.6
1.2.1. Import (c.i.f.) in trade statistics	-1,063.2	-1,180.0
of which: import from neighbor countries	-330.7	-401.3
1.2.2. Adjustment for coverage	-8.4	-1.2
1.2.3. Adjustment for classification	47.6	50.6
3. Repairs on goods	-1.0	-0.1
4.1. Credit	0.0	0.0
4.2. Debit	-1.0	-0.1

Source: BPK (2006)

4.1.1. Export of Goods

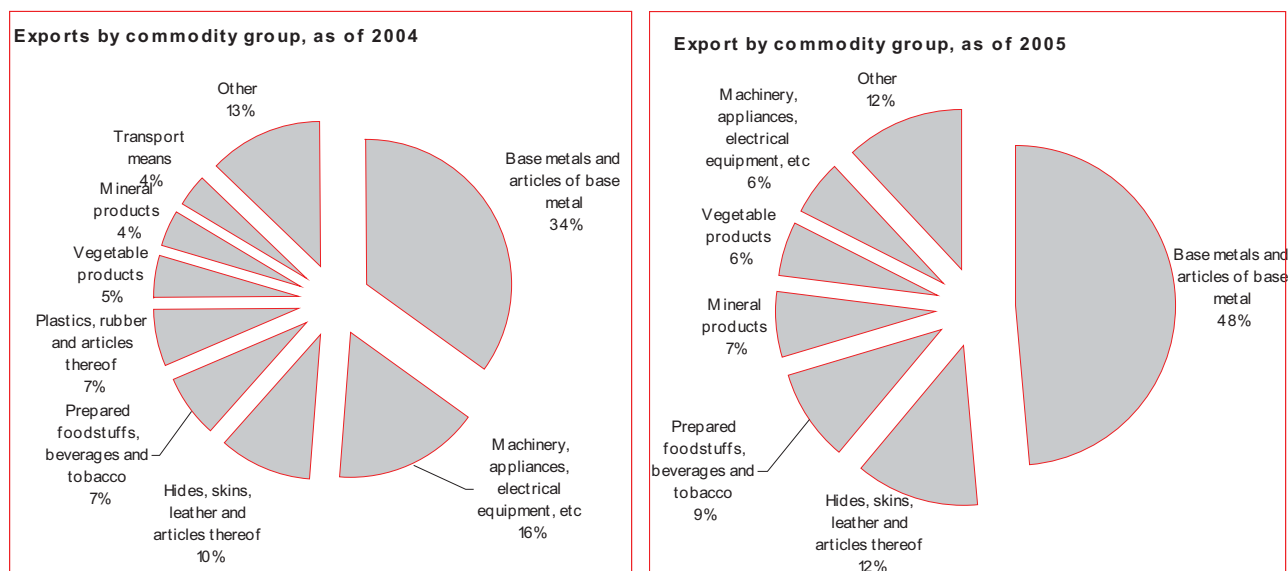
Despite the increasing trend performed during the previous years, in 2005 exports showed distinct movement by falling for 13.3%. As such, their total amount by the end of 2005 was euro 48.9 million from euro 56.6 million in 2004. Aside from small portion of goods exported from Kosovo in general, their orientation remains similar to 2004, seen by both: commodity group and trading partner.

By commodity group

Almost half of the exports is made up by 'base metals and related' (48.5%), what assisted in offsetting the total negative growth of the exports caused mainly by the categories of 'machinery, appliances, etc' (-11.4 pp) and 'plastics, rubber and related' (-4.9pp). The 'iron and steel' remain to hold the largest share of the metals exported (56.6%), followed by the aluminium (17.5%) that contributed mostly to the metal exports (by 4.1pp). In addition, export of zinc, although in a very small amount, was something new occurring in 2005, which was not the case of the previous years. Another optimistic category are the agricultural products such as: 'live animals and their products' with the half a million euro exported in 2005, from none since 2002. However, not to get misled by the 'percentage language', the amount of the exports is yet far behind of having evident impact in the Kosovo economy.

On the other hand, the drop of the exports was recorded for goods, such as: machinery, appliances, vehicles – so this can lead us towards pragmatic thinking that this drop is not directly affecting the exports of domestically produced good, but rather the goods temporary imported in Kosovo and then re-exported (this difference amount would most probably fit in the 'goods for processing' position in 2005, since new system of customs procedures was introduced by Customs Service by the end of 2004.

Figure 3. Exports by commodity group, 2004 and 2005



Source: Customs statistics and Statistical Office of Kosovo (2006)

By trading partners

Apparently, Kosovo benefits from the countries in the region regarding the export of goods. The main importer of Kosovo goods remains to be FYROM although the amount of euro 9.6 million in 2005 is similar to 2004. Another area open for the Kosovo products is EU by absorbing 36.5% of the total exports. In particular, Italy and Greece are the main EU importers of the Kosovar exports with the share of around 11.0%, each. Exports to Greece are constantly increasing through last years, whereas trend with Italy maintains the similar development (see table 3).

Table 3. Exports by main trading partners, 2003 – 2005 (in millions of euro)

Trading partner	2003	2004	2005	share in 2003 (in %)	share in 2004 (in %)	share in 2005 (in %)
EU	14.7	15.0	17.4	41.3	26.6	35.6
of which:						
Italy	6.2	5.5	5.6	17.5	9.8	11.5
Greece	1.8	4.3	5.4	5.0	7.5	11.1
Albania	1.9	1.8	5.2	5.3	3.2	10.7
Bosnia and Hercegovina	0.8	1.5	3.4	2.4	2.7	6.9
Macedonia	6.9	9.6	9.6	19.5	17.0	19.7
Serbia and Montenegro	6.8	10.1	6.9	19.0	17.8	14.1
Total	35.6	56.6	48.9			

Source: Customs and Statistical Office of Kosovo (2006)

In particular, regardless of the small amount it is worth mentioning new tendency of exporting 'Live animals and animal products' to the neighboring countries, such as: Macedonia and Serbia & Montenegro, which was not the case of the previous years. While the export of this category to Albania increased considerably contributing with around 12.0pp to the total exports to Albania that accounted for three times more than in 2004. The category of goods which contributed mostly in this increase is 'Base metals and its articles' (108.0pp), followed by 'prepared foodstuffs, etc' (by 50.8pp). Alternatively, the total export to Serbia & Montenegro in 2005 decreased mainly due to the significant reduction of machinery exports (for about 93.4%) - which was the main exported category of goods in 2004.

4.1.2. Import of Goods

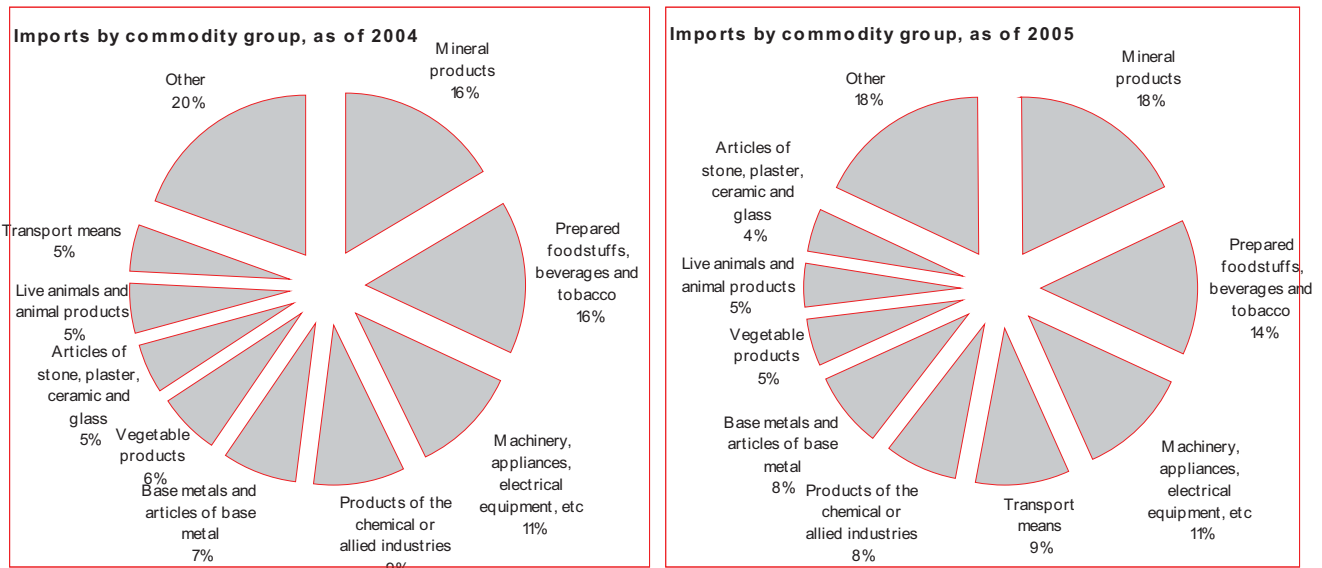
By the end of 2005 goods imported into Kosovo reached the amount of euro 1,180 million (11% more than in 2004), what suggests high consumer demand (having into consideration the low level of production in Kosovo). Throughout the years allocation structure of the imports in Kosovo did not experience any significant change, neither with respect to their country of origin, nor by category of goods imported. The consumption goods are still dominant, however some positive trends were shown with the decrease in the imports of vegetable products and an increase in investment goods.

By commodity group

Type of commodities imported remained very similar to the 2004 with the three main imported goods being: 'mineral products' (18.0%), 'prepared foodstuff, beverages and tobacco' (14.0%) and 'machinery, appliances and related' (11.4%). Although in 'top three', the share of 'prepared foodstuff, beverages and tobacco' decreased slightly – mainly due to less imported 'preparations of meat, fish' (50.0% less) and 'tobacco' (24.4% less). Whereas, import of 'mineral products' was fully generated by the imports of 'mineral fuels and oils' (with contribution of 22.7pp). In addition, the significant increase was recorded for the imported vehicles, which amount reached euro 110.2 million, more than double compared to 2004 (euro 48.3 million). In fact, the highest contribution to the total imports growth in 2005 was generated by vehicles (+5.25pp) and mostly during the first half of the year. This significant increase was not surprising due to the introduction of the new car registration policy by Customs, that prohibits the registration of cars older than 8 years after March 2005, which deadline was extended up to mid-2005. This was evident in the statistical flow data for this specific category of imports during this certain period of time.

Even though the amount of vegetable products imported accounts for only 6.0% (euro 57.5 million) of total imports, the decrease of their import (by 15.6%) might have positive implications in the production sector. On the other side, imports of animals and their products remains nearly the same with euro 54.2 million.

Figure 4. Imports by commodity group, 2004 and 2005



Source: Customs and Statistical Office of Kosovo (2006)

By trading partner

Similar to export trend, countries in the region are the major exporters in Kosovo (mainly FYROM and Serbia & Montenegro). In addition to the main trading partners on exports, the import side of the Kosovo trade involves more countries with considerable influence in the total imports. About 34.6% of the goods are imported from EU countries, with Germany in the leading position (11.0%), followed by Italy (4.3%) and Greece (4.0%). However, imports from Greece compared to 2004 experienced a decrease, in their amount as well as in their share to total imports, what implicated their negative contribution (-1.97pp) to the total growth of the Kosovo imports. Apart from countries in the region and EU, rather significant amount of goods is imported from Turkey (about 7.2%) and China (4.7%), as well.

About 62% of the total 'mineral products' imported in Kosovo during 2005 came from FYROM. With almost double amount than in 2004, this category of goods gave the highest contribution (39.6pp) to the 2005 growth of FYROM imports to Kosovo. 'Vegetable products' and 'articles of stone, plaster, etc' are mostly imported from Serbia & Montenegro (34.0% and 43%, respectively). The minor amount of goods imported from another neighbor country, Albania (only 1.5%), is mainly composed by the categories of 'base metals and its articles', and 'prepared foodstuffs, beverages, tobacco'.

Table 4. Imports by main trading partners, 2003 – 2005 (in millions of euro)

Trading partner	2003	2004	2005	share in 2003 (in %)	share in 2004 (in %)	share in 2005 (in %)
EU	242.5	377.4	408.8	24.9	35.5	34.6
of which:						
Germany	38.5	78.2	129.9	4.0	7.4	11.0
Italy	26.3	44.5	50.4	2.7	4.2	4.3
Greece	52.2	68.5	47.6	5.4	6.4	4.0
Albania	6.1	20.2	18.1	0.6	1.9	1.5
Bosnia and Hercegovina	11.5	12.8	19.0	1.2	1.2	1.6
Macedonia	290.9	149.2	219.7	29.9	14.0	18.6
Serbia and Montenegro	102.8	161.3	163.6	10.6	15.2	13.9
China	12.5	34.3	55.8	1.3	3.2	4.7
Turkey	66.4	86.8	85.4	6.8	8.2	7.2
Total	973.1	1063.3	1180.0			

Source: Customs and Statistical Office of Kosovo (2006)

BOX 3. Trade with neighboring countries and Free Trade Agreements (FTA)

Year 2005 maintains the trend from the previous years, with neighboring countries as most important trading partners to Kosovo, concerning both exports and imports. Their share reaches 43.9% and 34.0% of total exports and imports, what corresponds to the growth contribution of 0.3 percentage points (pp), respectively 6.7pp to total export and import growth.

With exports amounting euro 9.6 million and imports euro 219.7 million, Macedonia retains the highest share to the total trade of Kosovo with the neighboring countries (44.8% and 54.7%, respectively). Follows Serbia and Montenegro holding the share of 30.8% for exports and 40.8% for imports. Despite the fact that these share percentages are lower than in 2004, Serbia and Montenegro remains one of the Kosovo's main trading partners. However, this trading activity is mostly import-oriented, perceived also by the negative contribution of 5.6pp to the total exports of Kosovo.

Of a great importance is the Free Trade Agreement (FTA) between Kosovo and FYROM signed in September 2005, and ratified on January 2006. According to the agreement, certain categories of goods will face 8 per cent tax, while from 2008 trade exchange will be free of customs taxes. Thus, the influence of the FTA in the trading activity is expected to be more evident during the course of the current and future years. This liberalization of trade is expected to increase considerably the flux of trade from both sides of the border. Year 2005 was characterized with the increase in the percentage share of both exports and imports with FYROM, with respect to the total Kosovo external trade (by 2.6 pp and 4.6 pp, respectively, compared to

2004). Whereas, their contribution to the total growth was not so substantial with exports demonstrating negative contribution (-0.04 pp) and imports positive contribution of 6.6pp.

In addition to this agreement, in 2005 also negotiations for a FTA with Bosnia and Herzegovina were taking place. These negotiations were successfully concluded by the end of 2005 with the signature of the FTA being scheduled for the first half of 2006. So, currently agreement is not implemented. However, trade with Bosnia is increasing even though not big amounts involved yet. Surprisingly, the exports to Bosnia were more than doubled in 2005 (reaching euro 3.4 million) by attaining a share of 7% to total Kosovo exports.

On the other hand, the trade with Albania experienced the opposite trend against the 2004 practice. While in 2004 there was an increase in imports and decrease in exports, 2005 exports to Albania were almost tripled (reaching the amount of euro 5.2 million), and imports decreased by 10.7% (amounting euro 18.1 million). In comparison with 2003, trade with Albania demonstrated significant change in year 2005 by tripling the amounts in both, exports and imports. One would apparently relate this improvement with the followings of the FTA between Kosovo and Albania signed in late 2003.

New FTAs (FYROM and Bosnia and Herzegovina) together with the existing FTAs (Albania and Serbia and Montenegro) will create the new trade environment in Kosovo, much suitable for expansion and development of the trade and economic relations within the region.

4.2 Services

During 2005 Kosovo received more services on transport and travel, whereas offered 'other services' (table 5.). In general, Kosovo had somewhat a better situation with respect to services in 2004, when the services' deficit was for 22.9 million less compared to year 2005 – what suggests that more services were received than provided during 2005. While the net amount generated from the transportation services remained close to last year's figure, travel and other services showed a decrease on their net amounts, by 23.8% and 62.2%, respectively. However, the services deficit was not generated due to less services provided to non-residents but as a result of the increase in the demand for services from abroad.

Table 5. Services, 2004-2005 (in millions of euro)

Period	2004	2005
Services	-31.0	-54.0
1. Transportation	-46.8	-47.8
1.1. Credit	24.0	24.2
1.2. Debit	-70.8	-72.0
2. Travel	-14.1	-17.5
2.1. Credit	26.8	26.4
2.2. Debit	-41.0	-43.9
3. Other services	29.9	11.3
3.1. Credit	62.4	67.1
3.2. Debit	-32.6	-55.8

Source: BPK (2006)

The transportation services received were mainly related to the freight of goods imported (euro 38.9 million) and to the tickets spending of the Kosovars traveling abroad (around euro 31.5 million). However, these costs were eased by the air transportation services provided by the airport and other airlines agencies, which services accumulated the amount of about euro 17.0 million, as well as from the provision in selling tickets for foreign airline companies.

Travel services offered within Kosovo during 2005 accumulated very similar amount as in 2004, while the requirement of the services related to travel of Kosovars abroad was for 7.2% higher than in 2004, amounting euro 43.9 million. This is mainly due to the increase in tourism expenditures abroad. It is worth mentioning that the 'balance' of the travel services in Kosovo is mainly maintained by the Kosovar migrants, who compose about 77.6% of total travel services provided to non-residents.

The significant drop of 'other services' (table 5) was caused mostly due to the significant increase in communications and construction services received from abroad. About 56.8% more communication services were required from abroad during 2005, but also communication domestic services provided to non-residents rose by around 15.3%. This resulted with lower positive balance of 'communication services' in 2005 (euro 7.7 million), with respect to the positive balance of euro 12.2 million in 2004. In addition, construction services remain to be one-sided, with Kosovo only receiving such services (euro 8.7 million) and not providing them. However, these one-sided services (either provided or received) and their figures might occur as an outcome of not fully covering all enterprises dealing with different resident-nonresident service transactions. An interesting fact is that while most of the components of the 'other services' (constructions, insurance, financial, computer and information, other business, etc.) mainly show negative balance, the one that grasps

the merit for the positive balance of the 'other services' for 2005, in total, is the 'government services', which incorporates essentially the services provided to military and diplomatic missions that operate in Kosovo (about euro 28.1 million). This trend was very similar to 2004.

4.3 Income

The positive balance of the income account was maintained also in 2005 (euro 30.0 million). Although Income position of CA was primarily financed by the compensation of employees (70.1%), its growth of about 25.7%, in 2005, was generated mostly by investment income with the positive contribution of 23.2pp. In fact, compensation of employees compared to 2004 increased by 3.0% what indicated the contribution of 2.3pp to total Income growth in 2005. The investments of the financial corporations (mainly BPK and ODCs) into securities abroad resulted with the moderate profit of euro 5.6 million. However, placements with other banks remain to be considered as more reliable generator of investment income, and so the profit from the FCs' other investments reaches euro 18.9 million (about 65% more than in 2004).

Table 6. Income, 2004-2005 (in millions of euro)

Period	2004	2005
Income	23.9	30.0
1. Compensation of employees	20.4	21.0
1.1. Credit	26.9	27.0
1.2. Debit	-6.5	-6.0
2. Investment Income	3.4	9.0
2.1. Credit	15.4	24.5
2.1.1. Direct Investment	0.0	0.0
2.1.2. Portfolio Investment	3.9	5.6
2.1.3. Other Investment	11.5	18.9
2.2. Debit	-12.0	-15.6
2.2.1. Direct Investment	-11.2	-14.1
2.2.2. Portfolio Investment	0.0	0.0
2.2.3. Other Investment	-0.7	-1.5

Source: BPK (2006)

This positive growth of the income is generally offset by the reinvested earnings of the Foreign Direct Investments in Kosovo. In standard case, the latter would be offset by its' counterpart (reinvested earnings of Kosovar Direct Investments abroad), but currently no such information is available. Furthermore, the present impression suggests that there are no Kosovar investments abroad, yet.

4.4 Current Transfers

The net amount of current transfers in 2005 has shown a surplus of euro 677.1 million, with no evident change compared to 2004 (see table 7.). The changes were more apparent in their share structure, while in 2004 the major share of the current transfers was composed by 'general government' (54.2%), in 2005 the leading part was consisted by current transfers related to 'other sectors' (about 56.1%). Current transfers related to general government dropped by 18.3% (mainly due to the reduction of the donors' contribution) and as such influenced with the negative contribution (-10.0pp) to the total current transfers. But this negative contribution was somewhat balanced by 'other sectors' positive contribution of 10.8pp. An important role in the 'other sectors' plays the position of workers' remittances with the net amount of euro 290.8 million or 42.9% of total current transfers net amount. This coverage of current transfers by workers' remittances is higher in 2005 for around 7.4pp, compared to 2004 (net basis).

Table 7. Current transfers, 2004-2005 (in millions of euro)

Period	2004	2005
Current transfers	671.2	677.1
1. General government	363.8	297.2
1.1. Credit	427.8	352.5
1.2. Debit	-64.0	-55.3
2. Other sectors	307.4	379.9
2.1. Credit	411.1	475.5
2.1.1. Workers' remittances	341.4	385.8
2.1.2. Other transfers	69.7	89.7
2.2. Debit	-103.7	-95.7
2.2.1. Workers' remittances	-102.9	-95.1
2.2.2. Other transfers	-0.8	-0.6

Source: BPK (2006)

5. Capital and Financial Account

Below the line item (Capital and financial account) of Kosovo in 2005 amounts to euro 254.2 million, a decelerating decline from euro 295.2 million in 2004. As table 8 shows, FDI inflows amounts to euro 44.7 million. Apart from the BPK NFA decrease of currency in circulation remains to be the significant item, while the decline (outflow) can be addressed to the high trade deficit.

Table 8. Capital and Financial Account, 2004 – 2005 (in million of euro)

Period	2004	2005
Capital and Financial account	295.2	254.2
Direct Investments	17.6	58.8
of which: Privatisation	9.6	44.7
Portfolio and Other Investments	277.2	221.2
Government accounts (abroad)	-0.7	3.5
Other Investments	-0.7	3.5
BPK's NFA	108.8	-24.0
Portfolio Investments	-124.4	-35.1
Other Investments	233.2	11.0
Commercial banks NFA	-61.9	2.7
Portfolio Investments	7.8	28.8
Other Investments	-69.7	-26.2
OFC's NFA	-1.4	4.2
Portfolio Investments		
Other Investments	-1.4	4.2
KPST's foreign assets	-44.6	-62.2
Other Investments	-44.6	-62.2
Other sectors accounts (abroad)	72.5	110.7
Portfolio Investments		
Other Investments	72.5	110.7
Currency in circulation	204.4	186.4
Reserve Assets	0.4	-25.8
Foreign exchange	0.4	-25.8

Source: BPK (2006)

Regarding the sectoral breakdown of the portfolio investments, from the table 4, can be recognized that driving items are BPK foreign assets and currency in circulation⁵. BPK portfolio investments, made from investments in securities other than shares, in 2005 stood at euro -35.1 million a sizeable lower increase relative to euro -124.4 million in 2004. The rationale for the pace of BPK portfolio investments is the fact that

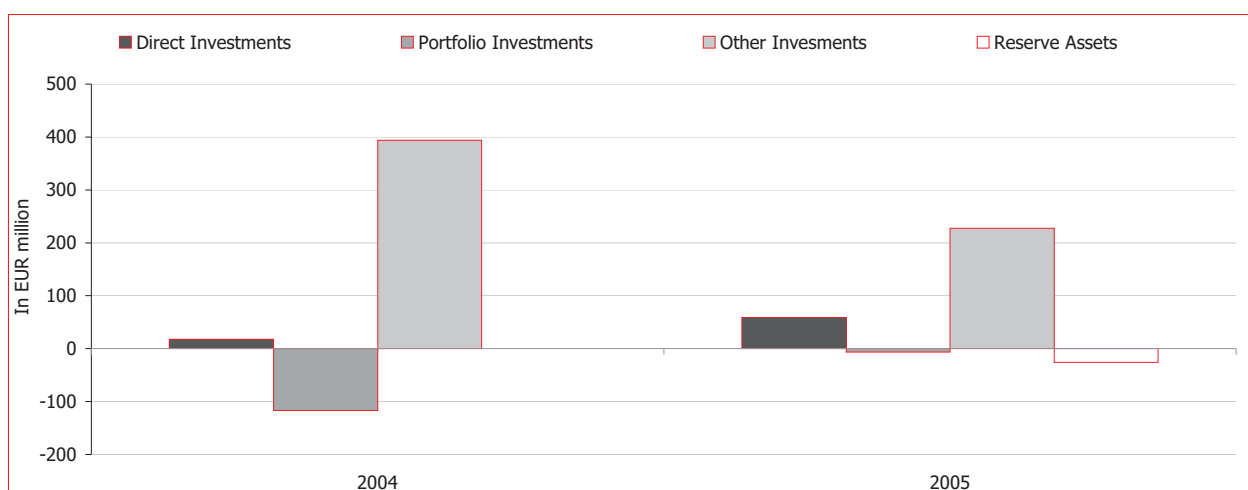
⁵ Kosovo is unilaterally euroised economy. Since Kosovo does not issue any currency, amount of euro currency out of monetary sector (currency in circulation) is an estimate and subject to revision.

BPK in 2004 for the first time started to invest in the securities, so, basically the increase to euro 124 million is from zero. To some extent, the BPK portfolio investments represent complementary side of investments in deposits. Regarding the currency in circulation it shows year on year decline, which can be explained as aftermath of current economic conditions in Kosovo (high current account deficit and partially as deposits at banking sector show increase).

5.1 Financial Account

Financial Account for 2005 shows an inflow of euro 254.0 million, from inflow of euro 295.2 million in 2004. The trend is driven from portfolio and other investments. Explicitly, from outflow of euro 116.6 million in 2004, portfolio investments in 2005 turned to smooth the increase to euro -6.2 million. At the same time, other investments show capital inflow to euro 393.8 million from euro 227.4 million in 2004 (see figure 5).

Figure 5. Capital and Financial Account, 2004 - 2005



Source: BPK (2006).

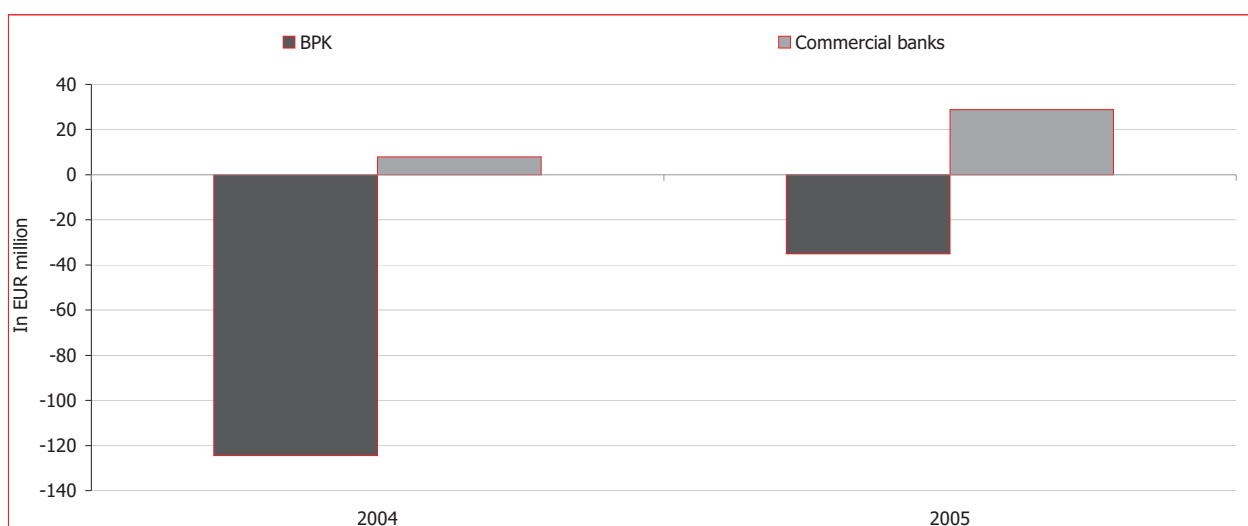
There are very rare cases of Kosovars investing abroad, so, the direct investment item is composed only from foreign investments of nonresidents in Kosovo. The items composing the direct investment are revenues collected through privatization process and reinvested earnings (of foreign institutions operating in Kosovo). Namely, in 2005 these revenues (from privatization) accounts for 76.1% of direct investments. As regards to the reinvested earnings, due to their profitability they increased their reinvested earnings, mainly as increase in their share capital. Actually, in 2005 reinvested earnings stood at euro 14.1 million compared with euro 8.0 million in 2004.

In 2005, portfolio investments shows money outflow for euro 6.2 million, sizeable lower relative to money outflow in 2004 (euro 116.6 million). There is no evidence of money inflow as portfolio investment. Up to

now, this item is compound only from BPK and commercial banks, investments in debt securities (money market instruments).

As figure 6 depicts, portfolio investments are driven from the BPK money outflow, even it was offset from the inflows of commercial banks. This can be explained by the fact that BPK started to invest in securities other than shares since August 2004. So, in this case, the trend is aftermath of change in the instruments through which BPK is investing money abroad. While concerning the commercial banks, they are squeezing their investments in securities, while the cause can be partially attributed to the increase in the commercial banks domestic claims.

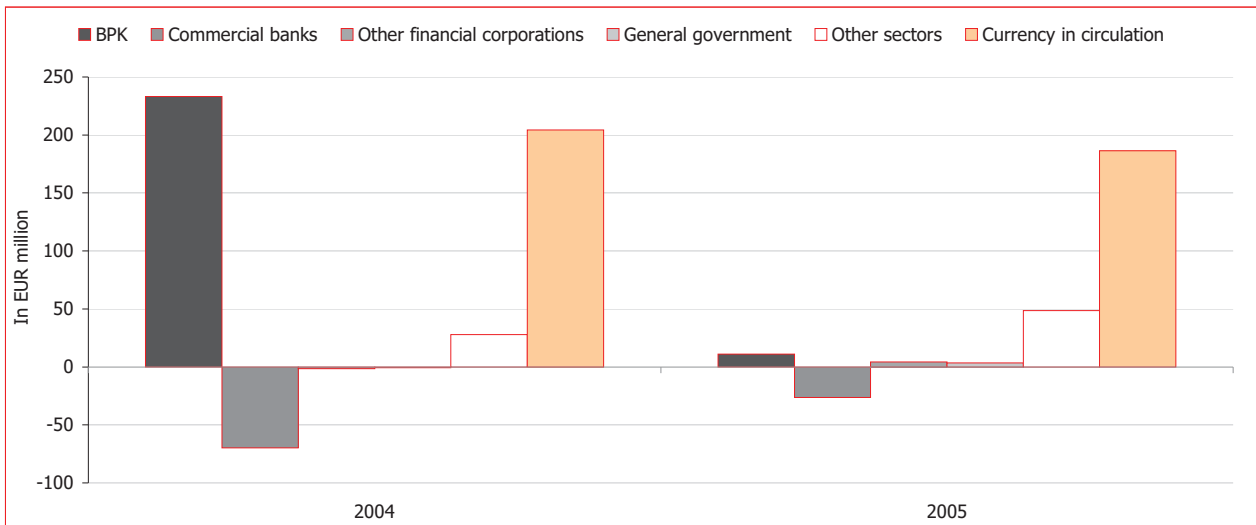
Figure 6. Portfolio Investments by institutions, 2004 - 2005



Source: BPK (2006).

In 2005 other investments recorded an inflow of euro 393.8 million from inflow of around euro 227.4 million in 2004. Currency and deposits (other investments) shows a considerable inflow in 2004 (euro 121.9 million) but then followed with strong outflow in 2005 (euro 91.0 million). Regarding the sectoral breakdown, in 2004 BPK accounted for biggest share, as depicted in figure 7. Banks for two consecutive years represent money outflow for euro 90.4 million and euro 39.3 million, in 2004 and 2005 respectively. Nevertheless, as regards to the assets side of other investments there is a decrease in the commercial banks loans abroad to euro 6.9 million in 2005 from euro -11.7 million in 2004. Liabilities side of other investments shows that in 2005 loans from nonresidents stood at around euro 10 million (inflow) from euro 26 million in 2004. Driven mainly by commercial banks, deposits as liability to nonresidents increased for euro 5.7 million (inflow), representing opposite case relative to 2004 when out flowed for euro 4.4 million.

Figure 7. Currency and deposits (other investments) by institution, 2004 - 2005



Source: BPK (2006).

As contrary to the 2004, in 2005 Reserve assets increased for euro 25.8 million relative to decrease of euro 0.4 million in 2004. Having into consideration the fact that all currencies used in Kosovo, are foreign currencies, i.e. claims on nonresidents, the definition of reserve assets is subject to discussion. Actually, the reserve assets are compound from euro currency in BPK vaults and required reserves of commercial banks at BPK.



6. Statistical Appendix

Table 1.

Balance of Payments of Kosovo 2004-2005

(Outstanding amounts, end of period, in millions of EUR)

Description	2004	2005
1. CURRENT ACCOUNT	-281.5	-405.8
A. Goods and services	-976.5	-1,112.8
1. Goods	-945.3	-1,058.9
2. Services	-31.2	-54.0
2.1. Transportation	-46.8	-47.8
2.2. Travel	-14.1	-17.5
2.3. Communications	12.2	7.7
2.4. Construction	-0.9	-8.7
2.5. Insurance	-5.7	-6.8
2.6. Financial services	-0.2	-0.2
2.7. Computer and information	-2.2	-3.0
2.8. Royalties and license fees	-0.2	0.0
2.9. Other business	-1.5	-5.7
2.10. Personal, cultural and recreational	0.0	0.0
2.11. Government	28.1	28.1
B. Income	23.9	30.0
1. Compensation of employees	20.4	21.0
2. Investment income	3.4	9.0
2.1 Direct investment	-11.2	-14.1
2.2 Portfolio investment	3.9	5.6
2.3 Other investment (including earnings on reserve assets)	10.7	17.4
C. Current transfers	671.2	677.1
1. Central government	363.8	297.2
2. Other sectors	307.4	379.9
2. CAPITAL AND FINANCIAL ACCOUNT	295.2	254.2
A. Capital account	0.0	0.0
1. Capital transfers	0.0	0.0
2. Acquisition/disposal of non-produced, non-financial assets	0.0	0.0
B. Financial account	295.2	254.2
1. Direct investment	17.6	58.8
In Kosovo	17.6	58.8
1.1. Equity capital	9.6	44.7
1.2. Reinvested earnings	8.0	14.1
1.3. Other capital	0.0	0.0
2. Portfolio investment	-116.6	-6.2
Assets	-116.6	-6.2
2.1. Equity securities	0.0	0.0
2.2. Debt securities	-116.6	-6.2
Liabilities	0.0	0.0
2.1. Equity securities	0.0	0.0
2.2. Debt securities	0.0	0.0
3. Financial derivatives (net)	0.0	0.0
4. Other investment	393.8	227.4
Assets	302.6	103.1
4.1 Trade credits	-12.1	0.8
4.2 Loans	-11.7	6.9
4.3 Currency and deposits	326.3	95.4
4.4 Other assets	0.0	0.0
Liabilities	91.2	124.3
4.1. Trade credits	84.6	110.1
4.2. Loans	9.0	10.8
4.3. Currency and deposits	-2.4	3.4
4.4. Other liabilities	0.0	-0.2
5. Reserve assets	0.4	-25.8
5.1. Monetary gold	0.0	0.0
5.2. Special drawing rights	0.0	0.0
5.3. Reserve position in the IMF	0.0	0.0
5.4. Foreign exchange	0.4	-25.8
NET ERRORS AND OMISSIONS	-13.7	151.6

Source: BPK (2006)

Table 2.

Current Account Balance

(Outstanding amounts, end of period, in millions of EUR)

Description	2004	2005
Credit		
Export of goods and services		
Export of goods	79.0	71.4
Export of services	113.4	117.8
Total export of goods and services	192.4	189.2
Income		
Compensation of employes	26.9	27.0
Investment income	15.4	24.5
Total income	42.3	51.5
Current transfers		
Central government	427.8	352.5
Other sectors	411.1	475.5
Total current transfers	838.9	828.0
Total	1,073.6	1,068.8
Debits		
Import of goods and services		
Import of goods	-1,024.3	-1,130.3
Import of services	-144.6	-171.8
Total import of goods and services	-1,168.9	-1,302.0
Income		
Compensation of employes	-6.5	-6.0
Investment income	-12.0	-15.6
Total income	-18.4	-21.5
Current transfers		
Central government	-64.0	-55.3
Other sectors	-103.7	-95.7
Total current transfers	-167.8	-150.9
Total	-1,355.1	-1,474.5
Balances		
Trade in goods and services		
Trade in goods	-945.3	-1,058.9
Trade in services	-31.2	-54.0
Trade in goods and services	-976.5	-1,112.8
Income		
Compensation of employes	20.4	21.0
Investment income	3.4	9.0
Total income	23.9	30.0
Current transfers		
Central government	363.8	297.2
Other transfers	307.4	379.9
Total current transfers	671.2	677.1
Total (Current balance)	-281.5	-405.8

Source: BPK (2006)

Table 3.

Trade Balance

(Outstanding amounts, end of period, in millions of EUR)

Description	2004	2005
Exports		
Live animals and animal products	...	0.5
Vegetable products	2.6	2.8
Animal or vegetable fats and oils - edible
Prepared foodstuffs, beverages and tobacco	3.8	4.6
Mineral products	2.4	3.2
Products of the chemical or allied industries	1.0	1.0
Plastics, rubber and articles thereof	3.7	0.9
Hides, skins, leather and articles thereof	5.9	6.1
Wood and articles of wood	0.4	0.4
Cellulosic material, paper and articles thereof	0.4	0.4
Textiles and textile articles	1.4	0.6
Footwear	0.1	0.1
Articles of stone, plaster, ceramic and glass	1.8	0.4
Pearls, precious, stones, metals, jewelry, etc.	0.1	0.2
Base metals and articles of base metal	19.7	23.8
Machinery, appliances, electrical equipment, etc	9.2	2.7
Transport means	2.0	0.9
Optical, medical and musical instruments	1.1	0.2
Arms and ammunition
Miscellaneous manufactured articles	0.7	0.3
Other	0.1	...
Total	56.5	48.9
Imports		
Live animals and animal products	52.4	54.2
Vegetable products	68.1	57.5
Animal or vegetable fats and oils - edible	7.3	11.1
Prepared foodstuffs, beverages and tobacco	165.4	164.8
Mineral products	173.1	212.3
Products of the chemical or allied industries	98.0	91.4
Plastics, rubber and articles thereof	42.5	51.0
Hides, skins, leather and articles thereof	1.0	1.5
Wood and articles of wood	29.9	30.7
Cellulosic material, paper and articles thereof	33.4	25.0
Textiles and textile articles	31.2	36.7
Footwear	10.4	11.3
Articles of stone, plaster, ceramic and glass	54.9	51.5
Pearls, precious, stones, metals, jewelry, etc.	0.3	0.3
Base metals and articles of base metal	77.5	90.7
Machinery, appliances, electrical equipment, etc	116.8	133.9
Transport means	50.2	110.3
Optical, medical and musical instruments	15.1	16.1
Arms and ammunition	0.5	0.2
Miscellaneous manufactured articles	35.4	29.6
Other
Total	1,063.2	1,180.0

Source: Statistical Office of Kosovo

Table 4.

Trade Balance (by commodity groups)

(Outstanding amounts, end of period, in millions of EUR)

Description	2004	2005
Balances		
Live animals and animal products	-52.4	-53.7
Vegetable products	-65.6	-54.7
Animal or vegetable fats and oils - edible	-7.3	-11.1
Prepared foodstuffs, beverages and tobacco	-161.6	-160.2
Mineral products	-170.6	-209.1
Products of the chemical or allied industries	-96.9	-90.4
Plastics, rubber and articles thereof	-38.8	-50.1
Hides, skins, leather and articles thereof	4.9	4.6
Wood and articles of wood	-29.5	-30.3
Cellulosic material, paper and articles thereof	-33.0	-24.7
Textiles and textile articles	-29.8	-36.2
Footwear	-10.2	-11.2
Articles of stone, plaster, ceramic and glass	-53.1	-51.1
Pearls, precious, stones, metals, jewelry, etc.	-0.1	-0.1
Base metals and articles of base metal	-57.7	-66.9
Machinery, appliances, electrical equipment, etc	-107.6	-131.2
Transport means	-48.2	-109.4
Optical, medical and musical instruments	-13.9	-15.9
Arms and ammunition	-0.5	-0.2
Miscellaneous manufactured articles	-34.7	-29.2
Other	0.1	...
Total	-1,006.7	-1,131.1

Source: Statistical Office of Kosovo

Note: Based on Basic Classification of Goods.

Table 5.

Adjustments to Trade in Goods on a Balance of Payments Basis

(Outstanding amounts, end of period, in millions of EUR)

Description	2004	2005
Exports		
Overseas trade statistics (f.o.b.)	56.5	48.9
Coverage adjustments		
Local consumption of goods by KFOR	22.5	22.5
Other adjustments ¹	0.4	0.0
Total coverage adjustments	22.9	22.5
Total	79.4	71.4
Imports		
Overseas trade statistics (c.i.f.)	1,063.2	1,180.0
of which from neighbor countries	330.7	401.3
Coverage adjustments		
Donor import ²	5.0	0.0
Electricity (transit and other adjustment for electricity)	3.4	1.2
Total coverage adjustments	8.4	1.2
Classification adjustments		
Freight	-36.6	-38.9
Insurance	-11.0	-11.7
Total classification adjustments	-47.6	-50.6
Other adjustments		
Goods for processing	0.0	0.0
Repairs on goods	1.0	0.1
Total other adjustments	1.0	0.1
Total	1,024.9	1,130.7

Source: BPK (2006)

1/ Based on data received by KEK;

2/ Excluded in the second half of 2004.

Table 6.

Services

(Outstanding amounts, end of period, in millions, of EUR)

Description	2004	2005
Credit		
Transport	24.0	24.2
Travel	26.8	26.4
Communications services	27.5	31.7
Construction services	-	-
Insurance services	6.6	7.1
Financial services	-	-
Computer and information services	-	-
Other business services	0.2	0.2
Personal, cultural, and recreational services	-	-
Government services, n.i.e.	28.1	28.1
Total	113.3	117.7
Debits		
Transport	(70.8)	(72.0)
Travel	(41.0)	(43.9)
Communications services	(15.3)	(24.0)
Construction services	(0.9)	(8.7)
Insurance services	(12.3)	(13.9)
Financial services	(0.2)	(0.2)
Computer and information services	(2.2)	(3.0)
Other business services	(1.7)	(5.9)
Personal, cultural, and recreational services	-	-
Government services, n.i.e.	-	-
Total	-144.3	-171.7
Balance		
Transport	-46.8	-47.8
Travel	-14.1	-17.5
Communications services	12.2	7.7
Construction services	-0.9	-8.7
Insurance services	-5.7	-6.8
Financial services	-0.2	-0.2
Computer and information services	-2.2	-3.0
Other business services	-1.5	-5.7
Personal, cultural, and recreational services	0.0	0.0
Government services, n.i.e.	28.1	28.1
Total	-31.0	-54.0

Source: BPK (2006)

Table 7.

Income

(Outstanding amounts, end of period, in millions of EUR)

Description	2004	2005
Credit		
Compensation of employees	26.9	27.0
Investment income	15.4	24.5
Total	42.3	51.5
Debit		
Compensation of employees	-6.5	-6.0
Investment income	-12.0	-15.6
Total	-18.4	-21.5
Balance	23.9	30.0

Source: BPK (2006)

Table 8.

Current transfers

(Outstanding amounts, end of period, in millions of EUR)

Description	2004	2005
Credit		
Central government	427.8	352.5
Other transfers	411.1	475.5
Total	838.9	828.0
Debits		
Central government	-64.0	-55.3
Other transfers	-103.7	-95.7
Total	-167.8	-150.9
Balance	671.2	677.1

Source: BPK (2006)

Table 9.

Financial Account (by Instrument)

(Outstanding amounts, end of period, in millions of EUR)

Description	2004	2005
Kosovos investment abroad (Kosovos assets = net debits)		
Direct investment abroad		
Equity capital	n/a	n/a
Reinvested earnings	n/a	n/a
Other capital transactions	n/a	n/a
Total direct investment abroad	n/a	n/a
Portfolio investment abroad		
Equity securities	0.0	0.0
Debt securities	116.6	6.2
Total portfolio investment abroad	116.6	6.2
Other Investments abroad (Kosovos assets = net debits)		
Trade credit	12.1	-0.8
Loans	11.7	-6.9
Currency and deposits	-326	-95
Other assets	0.0	0.0
Total other Investments abroad	-302.6	-103.1
Reserve assets		
Monetary gold	n/a	n/a
Special drawing rights	n/a	n/a
Reserve position in the Fund	n/a	n/a
Foreign Exchange	-0.4	25.8
Total reserve assets	-0.4	25.8
Total	-186.4	-71.1
Investments in Kosovo (Kosovos liabilities = net credits)		
Direct investment in Kosovo		
Equity capital	9.6	44.7
Reinvested earnings	8.0	14.1
Other capital transactions	0.0	0.0
Total direct investment in Kosovo	17.6	58.8
Portfolio investment in Kosovo		
Equity securities	n/a	n/a
Debt securities	n/a	n/a
Total portfolio investment abroad	n/a	n/a
Other Investments in Kosovo (Kosovos liabilities = net credits)		
Trade credit	84.6	110.1
Loans	9.0	10.8
Currency and deposits	-2	3
Other assets	0.0	0.0
Total other Investments abroad	91.2	124.3
Total	108.8	183.1
Net transactions (net credits less net debits)		
Direct investment		
Equity capital	9.6	44.7
Reinvested earnings	8.0	14.1
Other capital transactions	0.0	0.0
Total net direct investment	17.6	58.8
Portfolio investment in Kosovo		
Equity securities	0.0	0.0
Debt securities	-116.6	-6.2
Total net portfolio investment	-116.6	-6.2
Other Investments		
Trade credit	72.5	110.9
Loans	-2.7	17.7
Currency and deposits	323.9	98.8
Other assets	0.0	0.0
Total net portfolio investment	393.8	227.4
Reserve assets		
Monetary gold	n/a	n/a
Special drawing rights	n/a	n/a
Reserve position in the Fund	n/a	n/a
Foreign Exchange	0.4	-25.8
Total reserve assets	0.4	-25.8
Total	295.2	254.2

Source: BPK (2006)

Table 10.

Financial Account (by Sector)

(Outstanding amounts, end of period, in millions of EUR)

Description	2004	2005
Kosovos investment abroad (assets plus liabilities)¹		
By:		
Monetary authority (BPK)	89.8	-35.4
Othed Depository Corporation	-68.2	-2.8
Central government	-0.7	3.5
Other sectors	-44.6	-62.2
Total	-23.8	-96.9
Investment in Kosovo (assets plus liabilities)		
In:		
Monetary authority (BPK)	19.4	-14.5
Othed Depository Corporation	19.5	19.6
Central government	0.0	0.0
Other sectors	280.1	346.0
Total	318.9	351.0
Total Investment		
Monetary authority (BPK)	109.2	-49.9
Othed Depository Corporation	-48.8	16.7
Central government	-0.7	3.5
Other sectors	235.5	283.8
Total	295.2	254.1

Source: BPK (2006)

1/ Increase in assets and decrease in liabilities are recorded with minus sign, whereas decrease in assets and increase in liabilities are recorded with the plus sign.

